Q4 2016 Earnings Call

Company Participants

- Alain Lessard, Senior Vice President, Commercial Lines
- Charles Brindamour, Chief Executive Officer
- Darren Godfrey, Senior Vice President, Personal Lines
- Louis Marcotte, Chief Financial Officer & Senior Vice President, Finance
- Patrick Barbeau, Senior Vice President, Claims
- Samantha Cheung, Vice President-Investor Relations

Other Participants

- Brian Meredith, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- Kai Pan, Analyst
- Mario Mendonca, Analyst
- Meny Grauman, Analyst
- Meyer Shields, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Jodie and I will be your conference operator today. At this time, I would like to welcome everyone to Intact Financial Corporation's Fourth Quarter Results. All lines have been placed on mute to prevent any background noise. Thank you. Vice President of Investor Relations, Samantha Cheung, you may begin your conference.

Samantha Cheung {BIO 19462616 <GO>}

Thank you, and good morning, everyone. Thank you for joining the call today. A link to our live webcast and background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on this conference call. Joining me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Darren Godfrey, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We'll begin with our prepared remarks, followed by Q&A.

With that, I would like to turn the call to Charles to begin his remarks.

Charles Brindamour {BIO 7012323 <GO>}

Good morning, everyone, and thanks for joining us today. Earlier this morning, we announced fourth quarter net operating income of $1.58 per share, with strong results in both property lines; while personal auto saw weather and pool losses impact its performance. Our financial position is very strong with CAD 970 million of total excess capital, while our book value is up 7% to $42.72 over last year. Top line was up 3% in the fourth quarter despite us taking another early lead in pricing across all lines and provinces. On an annual basis, premiums grew 5% on the back of growth initiatives, including bolstering our brands, launching new product offerings, and making leaps on the digital front.

We see more of the same in 2017 from a growth point of view. While commercial lines were impacted by continued difficult conditions in the west, we benefited from the introduction of new sharing economy products, the expansion of our specialty lines division, and a favorable rate environment. We delivered a combined ratio of 92.5% in the quarter, thanks to very strong results in property. Personal auto results were disappointing with a combined ratio just above 100%. We experienced some choppiness in this segment in part because of industry pool and early onset of winter. Regardless of these factors, we find this performance unacceptable.

And as we said last quarter, we do not yet fully reflect the impact of rate increases in the pipeline, and the reforms implemented last year. Going forward, these benefits combined with our action plans in auto including more rates should bring significant improvements in 2017. Our operating return on equity was 12% in 2016 despite significant catastrophe losses. When comparing ourself to the industry as of the third quarter, we outperformed by a margin of 670 basis points on ROE above our target of 500 basis points. So let's now look at our fourth quarter results in a bit more detail.

So personal auto grew 3% on a combination of customer experience improvement and recent rate actions. The combined ratio deteriorated 4 points to 100.9% as we experienced higher frequency from early winter conditions, losses from industry pools, and lower prior-year development. We continue to address cost pressures in this segment with rate increases across the country. In Ontario, we raised rates another 4% effective this March on top of the 3% applied last September. This rate momentum combined with our claims action plans, tighter risk selection and continued benefits from reforms are expected to drive mid single-digit improvement as these actions are orient throughout the year.

When it comes to the industry outlook for personal auto, we continue to anticipate a rational competitive environment with low to mid single-digit growth in the coming 12 months as rate increases are implemented to address cost inflation. In personal prop, premiums grew 7% as new products and continued rate increases were deployed in favorable market conditions. Our profitability remained very strong with a combined ratio of 75.6% in Q4, and 91% for the full year after absorbing our country's costliest natural disaster on top of severe summer storms. With healthy top and bottom lines, this segment is very well positioned for 2017.

In terms of industry outlook for personal property, we see no change there. We expect recent weather events will prolong the firm market conditions with mid to upper single-digit growth over the next 12 months. In commercial P&C, difficult conditions in Western Canada, and robust rate actions taken in competitive markets led to a decline of 3% in premiums. That said, this business continues to deliver solid profitability with a combined ratio of 89.4% for the quarter despite catastrophes and fire-related losses well above last year's. On a full year basis, our combined ratio of 90.2% even with elevated catastrophes was in line with our low-90%s target.

Commercial auto premiums grew 8% in the quarter, mainly from our sharing economy products. Although the combined ratio of 101.9% was driven by prior year large losses, I'm encouraged by the underlying performance improvement, which improved by 5.2 points in the quarter as we continued to implement corrective rate actions. On a full year basis, our combined ratio was 94.6%, 4.4 points better than last year, another sign that we're on the right path to reach our low-90%s target in this segment. With respect to the outlook for commercial lines, markets remain competitive across Canada and particularly difficult in the west. Therefore, we expect low single-digit growth in the coming year.

In summary, overall, we delivered 92.5% combined ratio in the quarter, a decent result for a fourth quarter on the back of a very strong result in our property lines. Personal auto was a drag on our performance in Q4, clearly, but I'm confident that the actions we're taking will have a positive impact over the next few quarters. We're also making very good progress on several of our strategic initiatives. In distribution, for instance, we extended our direct-to-consumer business with the acquisition of our partnership with National Bank. Under the agreement, belairdirect will underwrite all policies distributed under the National Bank's brand, representing approximately $50 million in additional premiums or 0.5 points of growth.

On the digital front, we enhanced our telematics offering with the new mobile application that improves customer experience but also adds to our data collection capabilities. Now, speaking of data, we expanded our industry-leading data analytics capabilities with the launch of the data lab. The mission of the lab is to expand our competitive advantage by doubling down on our focus on artificial intelligence and machine learning, while expanding our massive proprietary (08:13) data sets with external data sources including those from Telematics. Our Claims team was busy as well with the launch of our Toronto Service Center in the fall. We now have three locations across Canada with the fourth in Montreal scheduled to open in April. Results so far are positive with higher customer satisfaction level, and an estimated 15% reduction in cycle times.

And finally, we continue to do well on the people front. We were named the platinum level Best Employer by Aon for second year in a row, and a Top Employer for Young People by Mediacorp. We believe that building engaged teams with a customer focused mindset and is key to maintaining our competitive advantage. So in conclusion, while Q4 results were below expectation, our overall performance for 2016 was solid in light of the elevated catastrophe losses. Our property lines performed well, our commercial auto is improving, and we've already introduced significant profitability measures to address our personal automobile business in the near term.

We expect growth momentum to continue in 2017 as we pursue our investments in customer experience and distribution. And finally, our balance sheet is solid with $970 million of total excess capital. So with that in mind, we increased our quarterly dividends by 10% to $0.64 per share, the 12th annual increase since our IPO. So I'm confident that our actions and discipline will continue to help us outperform the industry's ROE by 500 basis points, and grow net operating income per share by 10% per year over time.

On that, I'll turn the call over to our CFO, Louis Marcotte.

Louis Marcotte {BIO 18040440 <GO>}

Thank you, Charles. Good morning, everyone. For the fourth quarter, net operating income was $212 million driven by the strength of our property lines, stable investment income and growing distribution activities. The auto lines were a source of pressure on our underwriting results, though actions are underway to deliver material improvements in 2017. Our operating ROE was 12% despite 2.5 points from CAT losses above our expected run rate. We closed the year with $970 million of excess capital and our book value per share grew 7% from Q4 last year. Our combined ratio for the quarter was 92.5%, a 4 point increase compared to last year's stellar results.

We attribute the increase as follows; 3 points from weather driven frequency and CATs; 1 point from industry pool losses; 1 point from large losses in commercial property, mostly fire-related; and 1.5 points of expense savings. The remainder is prior-year development, which was a bit lower than last year but in line with historical levels. Our expense ratio improvement in the quarter was due to lower profit sharing commissions on the back of softer underwriting results and lower general expenses due to cost management. Our distribution income grew 9% in the quarter to $24 million and reached $111 million for the year in line with our latest guidance.

As we said on the last earnings call, we expect distribution income to grow north of 15% in 2017, with the usual seasonal variations. Our investment portfolio continues to deliver consistent investment income, $104 million in the quarter, slightly below last year as expected. Although average net investments increased 6% to $14 billion from operating cash flows and mark-to-market gains. This was offset by a lower reinvestment yield. We continue to expect investment income to decline marginally in dollar terms over the next 12 months.

Our Q4 non-operating results improved $47 million, thanks to realized gains on our common share portfolio, reflecting the rebound in equity markets. Rising interest rates led to unrealized losses on our fair value to P&L bond portfolio, which were largely offset by the favorable impact of a higher discount rate on our claims liabilities. Our effective tax rate was 23.7% in the quarter, 6 points higher than last year, due mainly to the reversal of a tax provision recorded in Q4 2015. In summary, we reported quarterly earnings per share of $1.27, 13% lower than last year, as our operating results declined mostly on the back of weather and pools, while our non-operating results improved materially as equity markets rebounded.

Finally, a few comments on our financial position. Our balance sheet remains very strong. Our MCT stands at 218%, 3 points higher than at the end of Q3, driven mainly by capital generated from operations and the phasing of new MCT guidelines. Our total excess capital amounted to $970 million at the end of the quarter, and our debt-to-total capital ratio was 19%. Our investment portfolio's unrealized gain position improved $11 million in the quarter to $269 million, driven by significant improvements in our common and preferred share positions, offset by unrealized losses on our AFS bond portfolio.

Our capital deployment strategy remains unchanged, prioritizing regular dividend increases, investing in growth opportunities, and using share buybacks as an additional capital management tool. This morning we announced a 10% dividend increase to $0.64 per share per quarter, our 12th consecutive annual increase. This represents a 12% annual growth rate since we IPO'ed in 2004. During the year, we deployed nearly $300 million of capital towards growth opportunities, including broker acquisitions, investment in ventures, and the acquisition of the partnership with National Bank. With this latest acquisition, combined with the integration of CDI acquired in 2015, belairdirect has materially grown its footprint and is capable of serving customers from coast-to-coast.

We believe consolidation of the P&C industry will continue, both in manufacturing and distribution, here and abroad. Our troops are experienced and ready to tackle opportunities as they arise, so is our balance sheet. On buy backs, we lost our program one year ago, and repurchased nearly 0.5 million shares for approximately $44 million at an average price of $88.54. While our priority is to invest in growth opportunities, we feel that buying back shares at times in the market price may not fully reflect intrinsic value is a responsible use of our capital. Therefore, we plan to renew the normal course issuer bid upon our expire related this week. This renewal does not signal any change in our perception of the opportunities for market consolidation.

In conclusion, with strong underlying results in property lines, we continue to focus our efforts on improving results in personal auto with our usual discipline and energy. We believe the actions we are taking in our auto lines, combined with the strength of our property lines will drive improved results over the next 12 months. Our earnings have proven the resilience to adversity during the year, thanks to the strength of our insurance operations across the country, the contribution of our distribution and investment activities, and our investments in growth, innovation and technology. With these advantages in mind, we are looking forward to 2017.

With that, I'll return the call back to Samantha.

Samantha Cheung {BIO 19462616 <GO>}

Thank you, Louis. Jodie, please open the line for questions. In order to give everyone a chance to participate, kindly limit your questions to two per person, and time permitting, you may log in a follow-up. Thank you.

Q&A

Operator

Your first question comes from the line of Geoff Kwan of RBC Capital Markets. Your line is open.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi there. I know this is more of a short-term-type question, but as I'm thinking about Q1 results, can you kind of talk about what you're seeing across kind of maybe, even just kind of general comment, because I think from a weather perspective, at least out here in Vancouver, the weather has been pretty brutal, unless you like to speed skating on the side street. In Toronto, though, I think it's been relatively mild. Calgary, I think, it's been a little bit mixed. But just wanted to get any comments you have on what you're seeing so far this quarter.

A - Charles Brindamour {BIO 7012323 <GO>}

So in fact, being the lead sponsor of the national speed skating team, we do like to speed skate on side street, but prudently. Patrick who's sort of overseeing our Claims – well, not sort of, he's overseeing our Claims operation, can give you maybe a perspective on the level of activity we've seen so far in the quarter.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. So in January, we've seen, as any January, some variations in weather but no big events so far. We've had a few ice storms; we've seen some in Atlantic, a good example yesterday here in Toronto. But none of those events, single events have reached what we consider a CAT.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

A - Patrick Barbeau {BIO 18476397 <GO>}

But it has had some impact on general frequency, but nothing unusual for January.

A - Charles Brindamour {BIO 7012323 <GO>}

No. Nothing of concern there, and I think service is pretty good as well. So no important concerns on our part there.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. And just my other question was, you had I think was about $19 million in restructuring-ish related costs. Can you just maybe provide a little bit of color – because you also mentioned some expense management initiatives, maybe some color as to what you're doing on that front and kind of some color around the size of the booking in Q4?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Geoff, we're really focused in terms of building an advantage when it comes to segmentation and claims management. It's been our big focus. We don't talk about expense as much, but there's a fair bit of focus inside to run the operation as lean as we can, and constantly sort of challenge ourselves on the status quo. And I think there's been a fair bit of that in the past few months. I'll ask Louis to give you a perspective. So we do outperform meaningfully from a combined ratio, and from an ROE point of view. And if you dig in the numbers, and particularly by channel, and for the broker suite of the business, as well as the direct business, the thing you'll notice is we also outperform on expenses meaningfully in each of the channel. And I think that's the way to look at this because of mix-related issues. That being said, Louis, why don't you give us some color on some of the moves we've made to remain agile and effective as a shop?

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. Thanks for the introduction, Charles, on this topic. So we are continuously managing expenses, of course. And as part of our usual process, we did take a few actions back in the fall, and essentially driven that streamlining some of the management structures in-house. So we did take some action that led to a bit of a restructuring costs. It's in the $10 million, $13 million range, and that's what you see in the non-operating results, Geoffrey. So that was booked in Q4, executed in Q4, and we'll have a slight positive impact in 2017.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Great. Thank you very much.

Operator

Your next question comes from the line of Kai Pan of Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you and good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Kai.

Q - Kai Pan {BIO 18669701 <GO>}

So first question on personal auto, in recent year, you've seen some U.S. players basically reporting higher frequency and some high severity. I just wonder, from your perspective, do you see any underlying trends, what's your assumption on the loss cost trend going forward, and what pricing have you taken or planning to take in? And when do you expect the margin will see meaningful improvement? How soon will we see that?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. If you take a full-year perspective, Kai, the frequency in personal automobile is down 0.4%. So, there's not meaningful pressure on that front. If you look at the severity for the full year, it's up close to 2%, and we've been talking about general inflation starting in 2015 across the land, which has led to us firming up our view on the past, as well as taking rate actions. I'll ask Darren to give a bit of flavor on the full-year perspective in automobile insurance. Then I'll ask him to give you a sense of what's in the pipeline in terms of improving what we think is not a good performance in that line, and sort of fine line of improvements. And probably worthwhile hearing Patrick as well on some of the things we're doing in claims because when we look at performance, pricing and rate level is one thing, segmentation is something else, risk selection is another part of it, claims prevention and so on. So Darren, why don't you give us a sort of 2016 perspective?

A - Darren Godfrey {BIO 19791482 <GO>}

Sure. Thanks, Charles. So as Charles mentioned from a frequency standpoint down slightly in the year versus the prior year. Obviously, as we saw in Q4, we get a bit of noise from quarter-to-quarter. So literally, essentially the increase we saw in frequency in Q4 was totally weather driven. So other quarters obviously, we've seen a favorable impact from a weather standpoint relative to the year-on-year quarter. So frequency, relatively flat, but we still see, as Charles mentioned, the 2 points in severity. So there still is a little bit of inflation within the system, and varies very much from coast-to-coast. We've taken and we mentioned, obviously on the Q3 call in terms of some of the actions we're taking from a rate standpoint, we are continuing to push further on that front. We received approval, as Charles mentioned in his opening remarks, for further increases in Ontario.

To give you a sense of the rate momentum that we have currently within the portfolio, and I'll quote some January 2017 numbers here. We had a 3.9% rate increase in the month of January, just going. And this compares to a written, and I should say, that's a written rate increase. This compares to a written rate increase in Q4 impacting our result of 2.2%, and an earned rate increase of just 1% in Q4. So this illustrates the current rate momentum that is building within the portfolio in 2017. Now, in addition to that, as I mentioned, we have rate increases coming in Ontario, and we also have a number of other rate increases that have been currently filed with the many rates approval authorities across the country.

So when we look at the rate momentum that's building, obviously, there is a little bit of a lag between the written and the earned, and that will narrow through 2017. So in combined with the rate increases, the segmentation, and advancements in UBI, et cetera, together with the Claims' action plan, obviously we'll continue to see impact and benefits from the Ontario reform, also into 2017. Now, we're confident that even though we may see a little bit of choppiness early in the year, we're confident that we'll see improvement in our results in the mid single-digit range in 2017. We'll see a little bit of choppiness as our action plan is already baked in towards the second half of the year.

A - Charles Brindamour {BIO 7012323 <GO>}

And just in rates, we expect to earn a good 4 points, just in rates. And so there's more action taking place, maybe a good opportunity to us, Patrick, to give us a very brief window into what's in the pipeline in Claims.

A - Patrick Barbeau {BIO 18476397 <GO>}

Sure. So the claims action plan that we've started to build over, I would say, the past six months with some actions already in place in March coming 2017 is expected to produce also another 2 points roughly of improvements on the bottom line for personal auto specifically. It involves four main themes; the first one is tighter indemnity control. This is enabled by our new national IT platform, so better controls within the system on a national basis to reduce indemnity. The second one is accelerated leverage of our data analytics in the field of subrogation, fraud detection and supply chain management.

There's quite a few initiatives there that will also help us reduce our cost. And then we have specific action plan by coverage for longer tail lines (26:17) injury. We are increasing staffing to address some of the trends we're seeing specifically in Alberta that involves higher, more surveillance and more proactive settlements of claims early on in the process. And finally, on accident benefit, it involves a lot around the management of our Rely Network. We see good benefits from a cost perspective when our clients elect to go through our Health Rely and this we have additional initiatives up on that front as well for big arrears.

Q - Kai Pan {BIO 18669701 <GO>}

Okay. That's great, very comprehensive. Then my follow-up question is on the industry pool. Because this fees is probably less of your control. I just wonder, will that getting worse before you get in there or (27:10) basically there continue to be a point of drag on your combined ratio in 2017?

A - Alain Lessard {BIO 17592535 <GO>}

So I mean, from a pool standpoint, maybe a little background, there's two elements of the pool. There's one element, which is the facility association. Now SI (27:28) as we like to refer to it is the market of last choice for the industry. We assumed back from the Facility Association our market share proportion of underwriting performance. The other element of pools is what we call the risk-sharing pools. So this is where the industry and individual companies, it's a mechanism whereby we have the ability to seed underpriced risks, what we deem to be underpriced risks to this industry pool, and then we assume back a proportion of the total pool.

Now, those two pools do represent a very small portion of the total industries. So not too sure we could sort of say that they reflective of overall performance. Now, we definitely do see noise in the pools from quarter-to-quarter, as you've seen in our results over the last few years. We will have some quarters like this quarter in Q4 where we've had some unfavorable development. We've seen other quarters where we're seeing significant favorable development. The pools themselves operate, and we get quarterly updates from their actuary with updated reserve valuation. So that obviously can generate some of the noise. Sometimes there's a timing mismatch between maybe where we may recognize something from a PYD or a current action year development standpoint, there may be a timing mismatch for the pools as well. So we don't see that the pools is for the longer-term drag, but definitely from quarter-to-quarter, we will see definitely noise in 2017 just like we saw in 2016 and prior years as well.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think in the fourth quarter, the drag was 3 points roughly when you put current accident year prior year from pools. Only year-to-date in personal auto, it's 0.07%. And I think Q4 was probably a function of a good pool performance in Q4 last year versus a not so good pool performance this year. Not are really worried about the pools being a meaningful drag like we experienced in the quarter for the full year next year, but there might be some choppiness there.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Well, thank you so much for all the answers.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

Your next question comes from the line of Meny Grauman, Cormark Securities. Your line is open.

Q - Meny Grauman {BIO 15238080 <GO>}

Hi. Good morning. Just going back to personal auto, just a broader question in terms of when you see a quarter like we saw in Q4, what gives you confidence that you are taking the right steps to adjust those problems? I guess, another way to ask it is, could you say that maybe the measures are not strong enough, and so how do you gauge that? I know it's probably an art and a science together, but I'm just wondering what your perspective is on that.

A - Charles Brindamour {BIO 7012323 <GO>}

Well, I think that – I'll take this one, Darren. At a high level, how do I comfort myself that we're being proactive enough, and I would say that, I look at what's in the pipeline in three different buckets at a high level. The first bucket is what we're doing in terms of pricing, risk selection, claims, improvements, and so on. And I think that's what Darren and Patrick have talked about. And these are things that are baked in the system. I think the fact that there's four points of earned rates, that's easy to execute upon. I mean, you put it in the machine, it goes out and then you manage your retention basically. The claims piece is not as easy to execute upon. But there's a fair bit of things in the pipeline and the claims guys are really good at executing. So on that first angle, which is what we do, there's more than mid single-digit worth of meat in the system. So that's point number one.

The second lever is reforms. So part of the issue now is there have been reforms in the past few years, meaningful reforms in the spring, in Ontario, further reforms in June. And we have yet to see the full benefits of those, though we're very confident about the quality and the nature of these reforms, and there might be more this year. How much is that actually worth, I'm not sure, but I know it's worth something. And part of it we've reflected in pricing earlier in June to work with the government, to reflect the impact of what we think is pretty good work on their part. So that's the second bucket that gives me confidence that inflation will be in check in part in Ontario for sure.

And I think the third bucket – and this is a much tougher one to asses, is the fact that our teams in the field are dealing with many changes at the same time, are becoming more efficient, are processing claims faster. And that is also to a certain extent reflected in the numbers, which gives me a fair bit of confidence that between the actions we're taking, the impact of the reforms and the fact that our folks in the field are probably processing claims faster, and that might point to some deterioration, which is in fact, process-driven as opposed to ultimate cost-driven, I think, it gives me a reasonable degree of confidence that we will see mid single-digit improvement in 2017.

It's important to keep in mind in all of this that personal automobile is a long-duration product, and that it is a regulated environment. And that there's a lag between the data set you can use to price the product, and the moment at which the product is actually consumed, that is when the claims is paid. That in itself in personal automobile is a source of uncertainty and it's certainly from quarter-to-quarter. It's not surprising to see some noise. Now, the better you are at identifying trends, segmenting the business, the more aggressive you are at taking action and being ahead of the market, the more you outperform. That's what we've done in the past 20 years here at Intact, and I think these past few months and the coming year will be very much about that. And we try to over-execute on what we control, and beat our competitors in the exercise.

Q - Meny Grauman {BIO 15238080 <GO>}

And then just to clarify, you talked about the timing in the previous question, but sort of, I guess, an important time mark for you would be sort of the middle of the year. If you were to see a lack of progress in the middle of the year, that would be a time where you would reappraise the situation and not earlier. Is that a fair assessment of how did you look at the timing?

A - Charles Brindamour {BIO 7012323 <GO>}

We do that every week, to be honest with you. I mean, we monitor the progress in the field. We monitor the progress in claims. And we reassess weekly, at the latest, on a monthly basis. This is how we run the business. I think there might be some choppiness in Q1. There might be some choppiness in Q2, but the execution will be monitored very closely on a weekly basis. And there are a number of things that are given, like rates for instance, it's just running in the system. And I think Darren's point, which is, when you compare the earned of 1% (35:47) in Q4, the written of little more than 2% in Q4, and when you look in January with the series of rate increases, the written is close to 4%, I mean, this is just happening. So we reassess frequently, I think, for sure when we hit June, I'm hoping that those things are well ingrained and upgrade in momentum.

Q - Meny Grauman {BIO 15238080 <GO>}

Thank you.

Operator

Your next question comes from the line of Tom MacKinnon, BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks very much. Two questions. One, I think you talked about a reversal of the tax accrual in the quarter. I wondered if you can quantify that what that was, and if this – what we should see the tax rate, which I think the operating tax rate, which I think was 23% in the quarter, what we should see at that going forward, because it's a little bit higher than what we've trended at. Then I have a follow up.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. In fact, the reversal occurred in 2015 (36:54) comparative. So we have a big jump from 2015 to 2016, and that's because we had reversed a provision in 2015.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. I misunderstood. And then my second – so do you think the 23% tax rate we're seeing on operating basis right now seems to be...

A - Louis Marcotte {BIO 18040440 <GO>}

No. That's a bit high. I would say there's probably a point to 1.5 point here that is quarterly fluctuations. So I would not expect that to trend going forward. I'd be much more in the 21.5% by 22% range on an ongoing basis.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And then, I really think this pool stuff was causing a lot of noise in the quarter year. Just looking at it, what it was in the fourth quarter – of 2015 it was only $6 million and all over 2015 there was $6 million loss in pools. And then the fourth quarter of 2016, we had a $24 million loss from pools, and that was half of the entire 2016 loss. I think, really this noise from the tax and the pools really caused a lot of the maybe some of the confusion in the quarter. I'm wondering if you can help us model what pools should be going out. You've got $48 million for 2016, and as I said $6 million for 2015. How should we think about that going forward, because obviously this is causing some volatility, and it's not really necessarily attributable, Charles, to your business.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. No. Fair enough, and I think the pool would look at their provisions and their financials maybe on a different frequency than we run our own business. I think, Tom, next week is the Investors Day. And you know what, I will commit to sort of provide better guidance at the Investors Day. We'll devote the specific question on it. And give us a week to sort of think about 2017 in that regard, which is not something we have spent a lot of time on. I think we totally understand, 2016 I think we're comfortable with the overall provisioning of the pool at the end of 2016, but we'll spend a bit of time and take a perspective view of the pool and put that on the table at the Investor's Day. Does that work for you?

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. That's good. Thanks.

Operator

Your next question comes from the line of Mario Mendonca, TD Securities. Your line is open.

Q - Mario Mendonca {BIO 2450557 <GO>}

Good morning, Charles. Could you just put a fine point on this guidance you're offering on personal auto? You're saying that the improvement could be mid single-digits in 2017 relative to 2016. I think that's the way I've interpreted it. So if I'm going to use the current your claims ratio in 2016, about 76.6%, I think I'm close to what the actual number is. Are you suggesting that could be 500 basis points lower in 2017 full year?

A - Charles Brindamour {BIO 7012323 <GO>}

Pretty much, yes.

Q - Mario Mendonca {BIO 2450557 <GO>}

That's significant, because that would take us back to the levels that we saw, say in 2012 and 2013, which are pretty good years. So you're saying you can reverse pretty much everything, the deterioration we've seen throughout 2015 and 2016, in one year?

A - Charles Brindamour {BIO 7012323 <GO>}

I think we're certainly have lots in the pipeline, Mario, that I feel will create some momentum throughout 2017.

Q - Mario Mendonca {BIO 2450557 <GO>}

That's helpful. The reason I want to clarify, just it seemed like a big commitment to take it down back to what we saw in 2012 and 2013, and I appreciate that a lot of it could be pool related. It just seem like a big statement, and I wanted to clarify. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. I think there are CATs and things of that nature that took place, but I think we're closing the year with a 100% combined ratio. This is far from the level at which we operate that business, and we think there is mid single-digit improvement, all else being equal.

Q - Mario Mendonca {BIO 2450557 <GO>}

I think, given your track record, it's important to take these things very seriously. That's why I'm clarifying them. Thank you.

Operator

Your next question comes from the line of Jaeme Gloyn of National Bank Financial. Your line is open.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah. Good morning. First question is related to the uptick in volumes that we've seen over the past couple of months here. I'm just wondering given your forecast that investment income is going to continue to decline into 2017 modestly. If rates were to stay flat, where would the inflection point be for investment income to start picking up given the maturing bonds reinvested at a higher yield?

A - Louis Marcotte {BIO 18040440 <GO>}

So at this point, we see it, as I said, moderately decreasing. What we've estimated, it would take probably a 35 bps, 30 bps increase for us to have that investment income stable. So we need that level of points to bring it to stability. In terms of inflection point, I assume you're talking about time?

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yes.

A - Louis Marcotte {BIO 18040440 <GO>}

And given the turnover of the portfolio, we're probably in the, I'll say, north of more than 12 months. Probably, at least, I would say, nine to 12 months out.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. And so just to confirm then, it would be 35 basis points from where we are today or from the, I guess, the average yield of 2016? Or what would be the base for that?

A - Louis Marcotte {BIO 18040440 <GO>}

End of 2016, where we closed 2016.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Where we closed 2016. Okay. And just a quick question on the National Bank and Sun Life relationship. How will that be broken down by line, I guess? Could you give any – a little bit more color around with that relationship is going to bring in terms of the $50 million in premiums written?

A - Charles Brindamour {BIO 7012323 <GO>}

So this was a 50/50 partnership. And so the 50 is incremental premium we're picking up by taking over that partnership. It's white label agreement. belairdirect is running the business through National Bank, it's through of Sun Life. I think the Sun Life sort of a smaller, in fact much smaller impact than this acquisition. It is of course a personal lines deal, and weighted towards personal automobile, 60% to 70% personal auto, the rest personal property. And it's Québec only in the case of National Bank. We love the business in Québec, and so for us to strengthen and better position in Québec was strategically really good, and we'd like to work with National Bank. They're a good people.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. And this commenced I guess in 2017 or is it due to commence soon?

A - Charles Brindamour {BIO 7012323 <GO>}

December was the closing.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. Great. Thank you.

Operator

Your next question comes from the line of Paul Holden, CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. So first question is related to commercial P&C, so we saw a bit of a downtick in premiums written year-over-year, as you highlighted that related to Western Canada. Wondering how we should be thinking about that business in terms of premiums written for 2017 given some of those macro factors versus some of the initiatives you're doing in specialty lines?

A - Charles Brindamour {BIO 7012323 <GO>}

Go ahead, Alain.

A - Alain Lessard {BIO 17592535 <GO>}

Okay. Well, when we look at the growth or the minus 2.9% in the quarter, like we said, some of that is driven – there's a bit of timing issue but very small, 0.3%. We've got some action coming up from profitability action where segmentation and risk selection has led to about 25% of the explanation for the reduction there, which is about 0.7 point. And the economic drag – and I think that's the part that's probably the most difficult to predict or see where it's going, the economic drag in the quarter is probably in the 40% to 50%, explaining that reduction in growth. And we see the same thing at the industry level.

When we compare, like the industry, our performance compared to the industry, we don't have the Q4 result but we have our experience at the end of Q3. At the end of Q3, we were reducing by 1%, but the industry at the same period of it was reducing by 2.3%. And in both cases if that was the biggest drag was really coming from economic condition in Western Canada. Our view when we look at it, and we look at it combining commercial auto and commercial P&C together, is really to see that going forward this will operate at a very low single-digit growth in 2017.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. And then my second question would be related to belair. So you've invested a lot in new technology, invested a lot in advertising over the last of couple years, particularly targeted at the Ontario market. So just looking for an update on, I guess, realized growth, and then also growth appetite for the year ahead.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think the last two years in the direct channel with a number of acquisitions, the brand being deployed from coast-to-coast, we've just finished the integration of CDI, Canadian Direct Insurance, which improved our position in Alberta. We feel pretty good about the level of that platform and its performance, like it's doing really well. The growth in 2016 in the direct channel was 11% and 7% if you were to exclude the impact of CDI. So for me, a business that's doing well from a combined ratio point of view with that growth profile, I think that's pretty good. And quite frankly, I've been happily surprised by how well these guys have established the brand in the new markets they're in. And I've been happily surprised by how much response we've had from customers to the new digital innovation we've launched, new quick quotes and various service platforms where the response has been stronger than what I anticipated.

So I think that this is a business unit that is growing north of mid single-digits. I think that the CDI impact certainly won't be there in 2017, but this is enough for a single-digit growing business. That being said, we're thrilled by the progress we're making in Intact Insurance and the progress we're making in BrokerLink, like BrokerLink now is approaching $1.2 billion, the margins are very strong, you're seeing the distribution profit of $114 million pre-tax at the end of 2016. Keep in mind, this is a new business generation machine that feeds Intact Insurance. And the growth in our broker distribution business, Intact Insurance, is also quite good, and we're prepared to support that growth – as much growth as we can in Intact Insurance because these guys are doing well. I mean Intact Insurance has grown close to 4% in 2016, which is faster than the industry. And I think when I look back at the year, certainly, would have loved to have made bigger acquisition, but from an organic growth point-of-view, we've grown close twice the speed of the industry. So when you are close to 20% of the market and you outperform from an ROE point of view by 670-basis point, if you can grow organically, almost twice as fast as the industry, it's good place to be regardless of the distribution channel you're in. That's sort of how we look at the world.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Thanks for that. And hopefully at the end of 2017, the message will be a little bit different on the big acquisition (50:40) or glad we did a big acquisition in 2017. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think that the message we want to have at the end of 2017 is about personal automobile performance.

Operator

Your next question comes from the line of Brian Meredith, UBS. Your line is open.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thank you. Charles, the first question here, I noticed that your language with respect to your outlook on commercial price environment is changed. You took out the commentary about firming market or firm market. If you can give us a little color behind why you believe that you're now going to see a firm market?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think, as I mentioned earlier, we've been four years worth of rate increases, generated 13% rate increases in what was a firming market to a firm market, to a market that has been still competitive throughout with pocket square, where we could take – or meaningful pockets where we could take action. I'll let Alain give you a bit of color on that market. And Brian, I think it's important to understand that we're in the small to mid space, and a meaningful presence in specialty lines that is doing quite well. So why don't you, Alain?

A - Alain Lessard {BIO 17592535 <GO>}

Yes. So if I look at where we see what we see in the market, a little bit like Charles explained, the market was competitive. But we saw throughout the year lots of pockets on places where type of risk, where we saw rate increase, more underwriting action, selection from our competitors. This is still continuing. But at the same time I would say that by the end of the year, this was happening to probably a lower extent than the beginning of the year. Throughout the year, we've continued to basically increase rate. And in fact, when I looked at the rate increase in the fourth quarter, it's about 3% that we've passed through on the renewals. And yet, at the same time, our retention has almost not dipped. We saw a small dip in the last quarter of less than 0.5 point. And that's part of what we're doing on both the segmentation and the selection and some corrective measure ourselves on pockets of the risk. So that is what we think the market remains competitive. It's still open to some rate increase, but maybe a little bit less. On our case, we're continuing to pass the 3% rate increase. Our aim is to continue to protect our margin and improve our portfolio. And basically, if I look at what's happening right now, we're going to be earning the rate level of what we'll be earning in the next 18 months, we'll to continue to rise.

Q - Brian Meredith {BIO 3108204 <GO>}

Right.

A - Charles Brindamour {BIO 7012323 <GO>}

I think, Brian, just to put things in perspective, when I look at our retention in December, it's 89.3%. It is a little bit lower than what it was a year before. The industry is still in the rate increase environment. I think there are indices that point to that. But I think we're just being cautious with the words we use. We like what we see in the market. There's always people who do crazy things, and that's fine, that's part of how one outperforms. But at the end of the day, we're focused on growing earnings and we will see rate increases go through the system even though the performance is getting pretty good. I think the industry's performance in commercial lines is not great.

A - Alain Lessard {BIO 17592535 <GO>}

Yes.

A - Charles Brindamour {BIO 7012323 <GO>}

And I think that's important to keep that in mind, Brian. So do you want to comment maybe, Alain, on the industry?

A - Alain Lessard {BIO 17592535 <GO>}

Well, the industry, 2016 was really affected...

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Just nine months, but...

A - Alain Lessard {BIO 17592535 <GO>}

Yeah. We have just nine months, but we outperformed in fact the industry on a loss ratio basis by 15 points. So that would put basically the industry results north of 105%, 106%. That's fairly affected by Fort McMurray, but there is not really – this will continue as a pressure point on the industry to continue to have some rate increase.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. So I guess, Brian, I sort of use that as a key data point to say this is not a soft environment by any means. If anything that people look at their performance closely, you could expect the industry to take a firmer view. But because we've seen the retention dip a little bit we're sort of cautious with our language. In the meantime, you'll see rate increases go through your system.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thanks. And then my next question, Charles just curious, in the past you've kind of mentioned that a possible area of acquisition would be small commercial in the U.S. Given the changes we've seen in the administration and kind of the political climate here in the U.S. and some of the things that the administration has talked about doing the economic growth et cetera, et cetera, has that changed at all kind of your views with respect to that type of an acquisition?

A - Charles Brindamour {BIO 7012323 <GO>}

No. I think that we're in this for the long run, and we feel that this is an environment where we can bring something to the table, given we have close to a 25% market share in that space in Canada, and outperform at least our Canadian competitors. We are not well positioned to help Canadian businesses who do business in the U.S. for sure, but I think the opportunity set in the U.S. is significant. We've studied that for a long time, and what's happening in the near term in the U.S. is not changing our view of the opportunity there.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. Could you make it actually even a better opportunity from your perspective?

A - Charles Brindamour {BIO 7012323 <GO>}

We could, indeed. Yeah.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. Thank you.

Operator

Your next question comes from the line of Meyer Shields, KBW. Your line is open.

Q - Meyer Shields {BIO 4281064 <GO>}

Great. Thanks. Good morning. One quick question. I don't know if Louis wants to address this next week, but what's the pricing flexibility on the industry pools?

A - Charles Brindamour {BIO 7012323 <GO>}

So there is two different setup. One is what we call the risk-sharing pool, which is companies feeding (57:35) some of their own risks in the pool. That's all done at the company's filed rates. So your question really applies to what we call the Facility Association, which is a separate insurance company. We actually manage half of it, roughly, on behalf of the industry, and we receive a fee to manage that unit. And there, the facility in most jurisdictions would have to file rates the same way an insurance company would. But regulators understand that the facility has to have the highest rate in the market because it's the market of last resort. If the facility didn't have the highest rate in the market, you'd end up with lots of risks in the facility, and that would be bad market dynamics. So I would say, in general, there is reasonable flexibility. Patrick, who's running claims, you're involved on the board of the Facility Association, maybe you want to give a perspective.

A - Patrick Barbeau {BIO 18476397 <GO>}

Well, you're absolutely right, Charles, on the FA which is, what we call, the last resort. It's to ensure availability of auto insurance for everyone. So it's really, the idea is not for it to compete with private insurers. So it's always the highest rate in the market. And it's based on filing. There is not in our jurisdictions that we can fully reflect maybe what would be normal cost of capital and the rates, but beside that small margin globally we filed, the FA filed full indications. And that's not the source longer term, I would say, of the last because we fight for it. It's more – the pools though is each insurer ceding the risk that they believe they were not able to have enough rates. So the portion of their (59:40) on that overall it is deficient. But on the other hand, when we count pools, we also are exceeding ourselves, our worst risk in there is benefit from that. So overall we'll come back as you see Charles next week with probably more details. But I don't expect long term the total of those two things to be significantly (01:00:03).

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Exactly. Okay. Thank you, Patrick.

Q - Meyer Shields {BIO 4281064 <GO>}

That's very helpful. My second question. I guess, if you look at the full year personal property results from the perspective of – I guess, underlying attritional non-catastrophe weather losses in major catastrophes. Can you talk about how those compared to expectations broadly?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. So personal prop closing the year at 91% with Fort Mc in there, I would say, is probably slightly better than what we would have expected. And we would not have expected Fort Mc. I think we've talked about the fact that we want to position ourselves to do well and good in bad times. And I've told investors, for us that sub-95% in bad times. So when you look at 91% and Fort Mac in there, plus a decent load of CAT, I think that this is better than what we had anticipated. Maybe you want to give some more color, Darren, because while I say that we're still moving the needle from a rate and risk selection point of view in that line of business.

A - Darren Godfrey {BIO 19791482 <GO>}

No. Absolutely Charles. So when we look at Q4, I mean, top line was up 7.5% in the quarter. And there is some (01:01:37) about 3 points of rate. But we are also still growing units as well, close to 5 points of unit growth. So that's the line of business that, yes, we have taken some strong action in the past both in terms of rate but also in terms of product. But we're continuing to grow and really outgrow the industry within that line of business as well. We have taken further action in particular targeted segments. We have taken a little bit of further action in Alberta with respect to hail and our coverage around hail, again, following another tough summer from a hail storm standpoint. So we're continuing to grow our margins in targeted segments where we feel that we need to create maybe further sustainability in terms of the product.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Exactly. And I think – look, the reality is with personal automobile performance being subpar as far as we're concerned, we're not in the mindset of letting margins go to grow in other lines of business, even though those other lines of business are good. I mean, this is the practical reality of running an insurance company, at least like ours.

Q - Meyer Shields {BIO 4281064 <GO>}

No. I completely understand. Thank you very much.

Operator

You have a follow up question from the line of Kai Pan of Morgan Stanley. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you for fitting me in. Just a clear follow up on the PYD commentary in your management discussion and analysis. You said fourth quarter PYD of 3 points is in line with your long-term expectation, for the full year was about 5 points, that's remain consistent with long term historical levels. So are you expecting 3 points or 5 points going forward?

A - Charles Brindamour {BIO 7012323 <GO>}

We've talked about 3 to 4 points. Every time this question has been asked, I think in the past few years, I said this is how you want to look at the future even though it's been 5 points, 6 points, 7 points in the past few years. I think 3 to 4 points is the right way to think about that.

Q - Kai Pan {BIO 18669701 <GO>}

Great. Well, thank you for the clarification.

Operator

There are no further questions at this time. I'll turn the call back over to the presenters.

A - Samantha Cheung {BIO 19462616 <GO>}

Thank you all for your participation today. Following this call, the telephone replay will be available for one week, while the webcast will be archived on our website for one year. A transcript will also be available on our website in the quarterly financial archive.

I should also note that we will host an Investor Day one week from today in Toronto, on February 15. Please let me know if you would like to attend. As well, we will host our Q1 2017 earnings call and AGM on May 3. Thanks again and this concludes our call for today.