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Q1 2021 Earnings Call

Company Participants

- Charles Brindamour, Director & Chief Executive Officer
- Darren Godfrey, Senior Vice President, Commercial Lines
- Isabelle Girard, Senior Vice President, Personal Lines
- Ken Anderson, Senior Vice President, Investor Relations & Corporate Development
- Louis Marcotte, Senior Vice President & Chief Financial Officer
- Patrick Barbeau, Senior Vice President, Claims

Other Participants

- Brian Meredith, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- Lemar Persaud, Analyst
- Mario Mendonca, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Intact Financial Corp. Q1 2021 Results Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Ken Anderson, Senior Vice President, Investor Relations and Corporate Development. Thank you. Please go ahead.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Mike. Good morning, everyone, and thank you for joining the call today. A link to our live webcast and published information for this call is posted on our website at intactfc.com under the Investors tab.

As usual, before we start, please refer to Slide 2 for cautionary language regarding the use of forward-looking statements, which form part of this morning's remarks and Slide 3 for a note on the use of non-IFRS financial measures and important notes on adjustments, terms and definitions used in this presentation.

Our executives are, again, joining us from across the country. In Toronto, we have our CEO, Charles Brindamour; with me here in Montreal are Louis Marcotte, CFO; Isabelle Girard, SVP of Personal Lines; and Patrick Barbeau, SVP of Claims; and from Calgary, we're joined by Darren Godfrey, SVP of Commercial Lines. We'll begin with prepared remarks, followed by Q&A.

With that, I'll turn the call to our CEO, Charles Brindamour.

Charles Brindamour {BIO 7012323 <GO>}

Thanks, Ken, and good morning, everyone. Thanks for joining us.

For over a year now, our people, customers and society have faced incredible challenges, and we're thankful to healthcare professionals and frontline workers, who supported all of us throughout the pandemic. And while the vaccine now gives us hope that we'll see some return to normalcy in the second half of the year, it's really important that businesses continue to protect and support their employees and the communities where they operate.

In March, we introduced a new relief program for our personal auto customers in recognition of the continued lockdown. This CAD75 million of additional relief complements our existing and ongoing measures to protect and support customers most impacted by the pandemic and brings the total amount of relief to over CAD600 million. We're committed to be there for customers in both good and bad times and our ability to provide meaningful relief is enabled by our track record of outperformance.

Now let's turn to results. Last night, we announced first quarter net operating income per share of CAD2.40, a 49% increase over Q1 last year driven by strong underwriting and distribution performance. Top line growth of 1% was tampered by 3 point of relief and 3 points from exiting BC and one large contract. The overall combined ratio was 89.3% with strong performances on both sides of the border. In Canada, the combined ratio of 88.2% was driven by continued strength in underlying performance and benign weather offset by 4.6 points of relief. In the US, the combined ratio of 96.3% included 7.6 points of cats related to the severe and unusual winter storm in Texas.

Our underwriting and pricing discipline, along with our strategic focus on growing distribution earnings led to 570 basis points of ROE outperformance last year, again surpassing our 500-point objective. In Canada, we beat the industry combined ratio by 5 points with broad-based outperformance in auto, property and commercial lines. In the US, our focus on profitable segments meant we beat our benchmarks combined ratio by 4.5 points. We seek to outperform not just an average, but everywhere we play.

Let's now look at our results by line of business, starting in Canada. In personal auto, premiums declined 8% year-over-year. Excluding the additional relief and the BC auto exit, growth was about 3%. The combined ratio of 93.4% was in line with our expectations, given the 9.3-point impact from customer relief. Overall, our personal auto business is really solid, and I expect it to deliver at the low end of our targeted mid 90s range this year. Looking at the industry, insurers have prudently slowed rate increases to reflect the reduced driving activity, while competition remains consistent. Given the weak industry performance over the past three years, we expect corrective measures to resume as driving activity returns to historical levels.

In personal property, premiums grew 6% driven by firm market conditions and modest unit growth. The combined ratio at 77.4% in the quarter was very strong and was helped by benign weather and favorable PYD. With the actions we've taken over time, I do expect this segment to continue to operate sub 95% every year, even in bad cat years.

In commercial lines, premiums grew 5% reflecting hard market conditions and strong new business. When we adjust for the loss of one large contract, Q1 growth was approximately 10%. The 90.1% combined ratio was solid, reflecting strong rate actions in the ongoing hard market. The Q1 combined ratio included 2 points of earned relief from 2020, which offset the higher than expected favorable PYD in the quarter. Our commercial lines business is performing very well, and I expect this segment to deliver low 90s or better going forward.

Moving to our US commercial lines business, premiums grew a solid 6% in the quarter driven by the continued hard market conditions and the benefits from recent tuck-in acquisitions. When we adjust for timing change from Q1 to Q2 for a few large renewals, growth is actually closer to 11%. The combined ratio of 96.3% was solid, considering the elevated cat activity I mentioned earlier. This business is positioned to deliver sustainable low 90s performance as we remain focused on portfolio quality and capturing rates in the current hard market.

Turning to RSA, we are nearing the June 1 closing date, and we're ready to hit the ground running. The areas of focus for us are building the best team, integrating the business and creating value. And we look forward to welcoming the RSA folks into the Intact family in three weeks. The teams are collaborating really well, as we work together to put the final touches on the integration and transition plans. We're also finalizing our leadership structure, with the name to further strengthen our bench, elevate top talent and operate with the best team in the insurance business. On integration and value creation, our teams have performed detailed bottom-up planning to ensure we can immediately begin to deliver on our strategic and financial objectives.

In Canada, we have a proven playbook for the integration and that's where we expect to capture three quarters of the added value. In the UK and International business, we're zoning in on the opportunities to leverage our core capabilities and RSA's scale to build outperformance over the coming few years. In specialty lines, we're well advanced on mapping out how we'll best leverage the enhanced distribution and global platforms will allow following the close. So overall, we're well positioned to hit our net operating income per share accretion targets, which have us reaching high single-digit in the first year and increasing to upper teens within 36 months. The deal will generate an IRR well north of 15%, our stated objective. In North America, we're continuing to invest in our business to drive outperformance and to build earnings momentum. One strategic area of focus is growing our stream of distribution earnings.

Over the past five years, distribution EBITDA has grown by 17% per year on average. And we expect to generate well over CAD300 million this year. Our brokerage BrokerLink has more than doubled its business since 2015, thanks to both solid organic and active of pursuit inorganic growth. With ambitious goals on winning new business and a healthy acquisition pipeline, I see a lot of opportunity for the BrokerLink team. In the MGA space Frank Cowan Company, which we've rebranded recently to Intact Public Entities is performing well and we're putting underwriting capacity behind it. We'll continue to leverage our investments in distribution to expand our North American footprint in specialty lines. Overall, our distribution EBITDA generated 170 basis points of ROE outperformance last year, and we're continuing to build scale in this unique competitive advantage.

Our customer-driven digital strategy is helping us engage with our customers like never before, while also leveraging data to bolster outperformance. Digital adoption accelerated significantly since the start of the pandemic. We've increased the number of customers using our Client Center up by north of 60% year-over-year. In the broker channel, adoption has more than doubled. And while our direct business is three out of four customers now actively engaged digitally with us. As customers adopt our tools and the experiences we provide, we see benefits on both the claims side with over 40% of reprisals now done virtually and on the telematics side. As we continue to gain scale on the digital front, it certainly further expands our ability to leverage data and AI, working with our 370 strong Data Lab to further our outperformance.

So in conclusion, we started 2021 with a lot of momentum across the business. NOIPS is up 49%. Book value is up 20% year-over-year, and we produced a 19% operating ROE over the last 12 months. Our teams are very engaged delivering an outstanding customer experience every day and working hard to ensure that we hit the ground running when the RSA deal closes.

We know it's been tough for everyone, including our employees. But we're starting to see light at the end of the tunnel, and we're quite optimistic about the months to come. So a big thank to our employees for really stepping up and pulling through. And to our RSA colleagues, we look forward to welcoming you and to working together to strengthen our outperformance further. Over the past decade, we've compounded NOIPS at over 10% a year and beat the industry ROE by 680 basis points on average yearly. With strong momentum in our business, a robust game plan to capture the benefits from the highly strategic RSA transaction, I think we're well positioned to continue to drive well into the future.

And with that, I'll turn the call over to our CFO, Mr. Louis Marcotte.

Louis Marcotte {BIO 18040440 <GO>}

Thank you, Mr. Brindamour. Good morning, everyone.

While the pandemic has had a severe impact on people and communities coast to coast, I'm pleased to see the progressive return to normal has started. We remain committed to supporting our customers, brokers and employees throughout these difficult times. With this in mind, an additional relief program was launched in personal auto to assist customers who need it most and to reflect the temporary change in driving habits. The cost of the new relief program was estimated at CAD75 million and impacted IFC's top line by 3 points. The relief was entirely written and earned during the quarter and any amount claimed in excess of the CAD75 million recorded in Q1 will be reported in Q2. We expect any amount to be fairly modest.

Let's now turn to our Q1 operating results. First quarter net operating income per share of CAD2.40 was up 49% from last year on the back of strong underwriting and distribution performances. Underwriting income grew 87% over Q1 last year with strong performances across the business. The quarter was characterized by strong underlying loss ratios, thanks to our continuing profitability actions, benign weather and strong prior year development.

Net earned premium in the quarter were down 0.3% due to the impact of CAD157 million or roughly 6 points. Our premium relief earned in the quarter, including the CAD75 million discussed earlier, both of which offset the impact of the reduced driving activity. With regards to prior year development, we expect Q1 to be a bit more volatile than other quarters due to its proximity to prior year, but we maintain our long-term expectation that prior year development will be favorable and in the 1% to 3% range. In the short term, given the strong start in 2021, we should finish the year at the upper end of this range.

Net investment income of CAD141 million was stable compared to prior quarters, but was CAD9 million lower than in Q1 2020, as the crisis led to lower interest rates and dividend cuts. For the remaining quarters of 2021 and excluding the impact of RSA, we expect quarterly investment income to be comparable to Q1 2021.

Distribution EBITDA and other income grew a solid 41% in the quarter driven by strong underwriting results, profit sharing commissions and accretive acquisitions. On the back of these results, we are raising our full year distribution EBITDA growth expectations to mid to upper teens. RSA will have a positive impact on distribution income. However, this will only begin in 2022.

Looking at a few areas in more detail. In personal auto, the combined ratio of 93.4% was strong despite a 9.3-point impact from current and prior year earned relief. Prior year development improved 1.5 points, half of which was due to pools.

On expenses, the overall Canadian expense ratio of 31.7% increased 2.4 points from Q1 last year. Half of the increase was driven by the impact of relief measures on net earned premiums, with the balance coming from higher variable commissions consistent with the strong profitability in the quarter. The overall US expense ratio of 40.2% was largely in line with our expectations, reflecting the business mix and seasonality of our operations.

IFC's earnings per share for the quarter of CAD3.51 were significantly above last year, thanks to the strong operating results and the non-operating gains recorded in the quarter. Included in these gains are CAD273 million pretax from a Ventures investment that went public in February. The investment is now accounted for in the same way as our other publicly traded equity investments and is held as available for sales. As such, any unrealized gains or losses are captured in AOCI and book value.

Moving to the balance sheet. We ended the quarter in a strong financial position, with a total capital margin of CAD3 billion and all financing for the RSA acquisition fully secured. This includes the CAD250 million of subordinated hybrid notes issued on March 31 of this year. Our book value per share increased 20% year-over-year to CAD62.19 on March 31, reflecting strong operating performance and mark-to-market investment gains, following the market rebound over the past year.

Let me now provide a few comments on the RSA deal, as we continue to drive towards a June 1 close. First, from a value creation standpoint, we expect immediate NOIPS accretion for the first month following close. This will come from a combination of adding RSA's existing earnings to ours as of June 1 and a small share of the synergies we expect to generate over time. Our visibility on the expense synergies is improving steadily, as we approach closing, in viewing further confidence that we will deliver on them as planned. These synergies still do not consider loss ratio improvements driven by the benefits of our data and analytics advantage. Our Q2 results will include one month of RSA's operating earnings, which we will report in aggregate in our Corporate and Other segment. Both underwriting and investment income, net of financing costs, will be included in our pretax operating results. This will include the results of UK&I, Canada and Denmark.

From a balance sheet point of view, at close, we will consolidate RSA's entire balance sheet for the perimeters we are acquiring. Our investment portfolio will grow by some CAD15 billion, following close and reach a total of CAD35 billion. As usual, following an acquisition, the yield on the invested assets acquired will be reset and the investment income going forward will be consistent with current yields. We expect the acquisition will generate approximately CAD100 million of additional investment income prior to any asset mix for the seven months in 2021.

From a book value point of view, our November subscription receipts offering of CAD4.5 billion will be converted into common shares and added to our book value upon close. When combined with the impact of the purchase price accounting and deducting financing fees, we expect the book value to grow by some CAD4.6 billion and the share count by 33 million shares. Consequently, our book value per share will grow by approximately 25% on close, that's roughly 50% higher than where we were a year ago.

The financing of the transaction is entirely secured, and we continue to expect our leverage ratio to be below 26% at close and return to 20% within 36 months. We will undertake to optimize the capital structure of the group, including the replacement of acquired RSA debt where appropriate. Starting in Q3 and going forward, RSA's underwriting results for Canada will be reported in the Canadian business within each of our existing lines of business. The underwriting results for UK&I, will be reported under a new segment with personal and commercial lines granularity. We will continue to report separately on our US commercial segment and the result of Denmark will also be reported separately.

In summary, we will pick up additional earnings from June 1 and for seven months in 2021. Synergies are expected to be generated immediately and accumulate gradually over three years, reaching a run rate of CAD250 million pretax. We continue to expect high-single digit accretion for the first 12 months, seven months of which will impact 2021. Accretion should reach upper teens within 36 months. After completing the transaction, the operating ROE will be lower than current levels as the NOIPS accretion in year one is lower than the book value per share accretion. As we get closer to year three, we expect the operating ROE to be running at our mid-teens historical average, as synergies fully kick in and we see upper teens NOIPS accretion in our results. With an IRR well north of 15%, solid earnings accretion and a price below book value, the financial merits of the transaction are compelling.

The truth is in the pudding, with 75% of the transaction's value creation coming from Canada, we will lean on our successful track record of Canadian integration to deliver on our targets. In the UK&I segment, Scott Egan and team have been improving the performance over the past 24 months and this momentum continued in the first quarter of 2021. We are looking forward to joining forces with Scott's team and supporting their efforts to build a solid outperforming business in the UK&I market.

The addition of RSA to our strong operations is highly strategic and transformational. Our teams are already hard at work to ensure we deliver on our expectations and now the real work begins. With the help of our new colleagues at RSA, we can create a tremendous amount of value for all stakeholders. Finally, the acquisition positions us well to continue delivering on our financial objectives of growing NOIPS at 10% annually over time and bidding industry ROE by 500 basis points annually.

With that, I'll turn the call back to Ken.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourselves to two questions per person. If there's time at the end, you can certainly re-queue for a follow-up. Mike, we're ready to take questions now.

Questions And Answers

Operator

(Operator Instructions) Your first question comes from Jaeme Gloyn from National Bank.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah. Thanks, and good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Jaeme.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

My first question is actually on some of the guidance, Louis, that you just provided around investment income. And I just want to make sure I heard it correctly that net investment income coming from the RSA transaction would be about CAD100 million for the seven months in 2021. And if I heard that correctly, I guess that suggests quite a bit of a step down in the yield earned on those assets more than what I was actually anticipating. So is there anything that you're looking at doing and to potentially improve that yield and drive that investment income higher?

A - Louis Marcotte {BIO 18040440 <GO>}

So Jaeme, it's a good question, and I'm happy you're raising it. So as you know, and this was my point about the fact that we have to reset basically the book yield to current yield at the time of acquisition. So what happens is their book yield right now is higher than the reinvestment yields and when we take over the balance sheet, we need to reset those yields to the current yields. And then the investment income will be based on current yields. So that's a step down from what they're earning now. Now it's on their balance sheet, and they're seeing there is a what they call a pull to par impact that they are impacted with. We net this out and then we start fresh from the date of acquisition at current yields. And those again are lower than their book yield. So that is really what happens from the acquisition. All our modeling has been based on that. So it's not a surprise to us, but certainly wanted to flag this as you guys are modeling for the future.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. And follow-up on that is just related to their average life. Is there an opportunity to more quickly roll that portfolio into higher yielding assets based on our maturity that might be lower than the current Intact book?

A - Louis Marcotte {BIO 18040440 <GO>}

So the work is being done right now to optimize the asset mix and the position. I think there is a strong feeling it was very well managed already. We are in the UK environment with their own rate environment. So the numbers I gave there were prior to making asset mix changes. So we are looking into those. I don't think you'll see a massive change in the asset mix. But there will be a bit of shift, particularly in that market towards a bit more equities, because they're right now in a fairly conservative portfolio structure.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay, great. And then my second question is just around unit growth in personal lines. I think they're down in personal auto on the BC exit and then personal property slowdown probably related to just the GCNA acquisition last year. Can you just talk about how you're feeling about unit growth in personal lines and how that looks and into the rest of the year based on some of the moving parts with COVID and pricing and competitiveness?

A - Charles Brindamour {BIO 7012323 <GO>}

Jaeme, we're feeling good about our position in the marketplace, and we do expect momentum on that front. I would say, unit wise, you're probably talking about low-single digit and maybe Isabelle, I don't know if you want to add any color. We're comfortable growing in this environment. We're comfortable with our price position, and we're out there in the market trying to grow the business.

Isabelle?

A - Isabelle Girard {BIO 21256467 <GO>}

Yeah. No, you're totally right, Charles. I would just add that as you mentioned in auto, BC has an impact on units on the underlying growth removing the BC impact is quite consistent with what we saw in Q4. And on the same front for the property piece, you're also right that GCNA impact is not there anymore in Q1. So the underlying growth also is very strong in Q1 and for both of those lines, the mid-single digit, the number is what we're looking for the quarters to come.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Great. Thank you.

Operator

Your next question comes from Geoff Kwan from RBC Capital Markets.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi, good morning. My first question was on RSA. For the countries that you'll now be operating in, just wanted to get a sense of do you need more time to assess your strategy of either improving them or pursuing alternatives? And if you do need some more time like how much time might that be doing that exercise?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think we're pretty clear about what needs to take place in 2021, Geoff. From the perspective that for most markets we are putting the final touches of how outperformance will be built, and I think there is a couple of areas where we're exploring strategic alternatives at the moment. And as such, our game plan is pretty clear. Then I think the second round of questions comes later in 2022, which is as we gain traction in building outperformance and can we get outperformance in the mid term, that's the second round of question, but at this stage, there's couple of areas where we're exploring strategic alternatives in other markets. We're focused on building outperformance, and I feel pretty good about the plans that we have in place at the moment. I think we'll be ready to hit the ground running in three weeks from now.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay, perfect. And just my other question was on the auto side. Can you talk about with the telematics data that you've got kind of relative to pre-pandemic levels? What it looked like in Q1 and then what you've seen so far in Q2?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. Isabelle, do you want to share a bit of color on telematics observation?

A - Isabelle Girard {BIO 21256467 <GO>}

Yes. So as we saw in 2020 in the fall, we saw driving that has returned progressively as the economies were reopening. But entering into 2021 and with the second and now third wave of the government restrictions, we saw some variation across the regions. But what we observed in Q1 2021 was that the driving reduced a little bit, again, but not to the extent that we saw in the spring 2020 for sure. And so that's why, as a result, we decided to announce the new relief program in March. So as we are today, we're still seeing driving being below historical level. But as I said, not to the extent that we saw when the crisis started in April 2020.

A - Charles Brindamour {BIO 7012323 <GO>}

Geoff, we're in the low-teens range as of this week. If you look at this week versus pre-pandemic, you're in the 13-ish sort of range, less driving than pre-pandemic. So nowhere near the levels we saw in the spring of 2020.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Got it. Great, thank you.

Operator

Your next question comes from Brian Meredith from UBS.

Q - Brian Meredith {BIO 3108204 <GO>}

Yeah. Thanks. A couple of questions here for you. So I'm just curious, a lot of discussion this quarter down in the US with respect to pricing in commercial lines and just the level of rates cut to decelerate and also some lines of business approaching rate adequacy. I'm just curious, you didn't change your outlook with respect to commercial lines in your commentary. Maybe you can give a little color on what you're seeing, what your expectations are, are we getting some rate adequacy in some lines and should we see that rates start to moderate some?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Darren, do you want to take first crack at that question, and then I'll provide additional color?

A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. Absolutely. Thanks for the question, Brian. When we look our Q1, right another very, very strong quarter, very much consistent with prior quarters. Our rate increase in Q1 came at 8.7% to be precise. Now we now accident portfolio, which is pretty competitive given the profitable performance of that portfolio. So ex accident, we are pushing close to 11% in the quarter. So really, really strong momentum. Now obviously within that 11%, there is quite a range as you could imagine. But in fact 8 of our 11 business units were up sequentially quarter-on-quarter and 6 of them were at all-time cycle highs. So really, really strong momentum across many of those different lines. It was hard market environment you can think about, the auto environment, pricing D&O, excess property, marine umbrella, all of those are in clear hard market conditions with rates close to mid teens. So we don't see any change in momentum and obviously, as you could expect, those rates are well in excess of our loss cost trends. So very much like the market conditions that we see right now in the US, and we don't see any sign at this point of any slowdown.

A - Charles Brindamour {BIO 7012323 <GO>}

Brian, I would add to your question, we track pricing adequacy at very high frequency at Intact. It's one of the core governance elements of how we run the business. Everybody needs to stand on their own when it comes to price adequacy and when we don't have price adequacy, we press the break pedal. We just don't go along with the market then. That's why there is some dislocation in growth amongst the business units. My view today is that the vast majority of the book is at or above adequacy. So no concern there and the lines of business we're trying to improve, three of them are also writing new business at adequate prices and beyond.

My observation on momentum and trajectory would say that the rate increases, as Darren just mentioned, are very healthy, they're above inflation, market remains tight, but if you take a two-year perspective, and we talk in terms of derivatives, the second derivative here, which is the acceleration in rate change built up from early 2019 right until December-ish 2020 and now it's flattened. So the second derivative has reduced, but the rate increases have not. They're actually flattened and flat in the sort of 10-ish range and pretty healthy and the market is I think pretty tight still. So good environment for us to grow. I think the run rate of the US business is very healthy and same thing on this side of the border as well.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you. And then second question, curious on the personal auto book frequency obviously remains very, very favorable. You can see that in your results. If you look out here over the next, let's call it, 12 months, what are your views with respect to claim severity trends, particularly the physical damage side given potential labor cost increases, commodity prices up, those types of things? And how do you factor that into your pricing algorithms?

A - Charles Brindamour {BIO 7012323 <GO>}

Why don't we ask Patrick, who oversees claims and has the best pulse on inflation to first start his perspective on inflation, then we'll ask Isabelle to give us a perspective of how is her thinking about that in relationship with our pricing strategy. So Patrick, why don't you pick it up?

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A - Patrick Barbeau {BIO 18476397 <GO>}

Sure. So on auto in claims cost, we haven't observed an acceleration of inflation even recent months. However, it is a sustained pressure that we've talked about over the past four, five years that's coming from more technology in cars that creates an inflation in the cost of parts and it makes the repair process more complex to perform. That was central to our action plans and pricing, risk selection and claims over the past three years. So we have a good view on that rate. It is, when you look at auto PDs, so the replacement of cars and repair of cars, there is a yearly or annual inflation rate and severity in the mid-single digit range that we've seen, but that's nothing new, it's been sustained over the past few years, and we have a good sight on it. We're very close between the claims and pricing team of Isabelle to identify these trends reflected in the pricing.

A - Charles Brindamour {BIO 7012323 <GO>}

I think the other point I would add, Brian, before we ask Isabelle to share her perspective on pricing, is the area where there's been some inflation over the past six, seven years is on the liability side of things, and you've seen us starting in 2016, taking bold actions from a pricing, risk selection, claims, supply chain management to tame that trend, which I think we've had, but this has been a pressure point. And as we look at the current COVID environment on long tail lines, in other words lines that are subject to liability exposure, an excellent benefit exposure, we've taken a really cautious stance in reflecting the impact of the reduced driving to ensure that it doesn't come with meaningful increases in severity for various reasons. We're not really observing that now, but learning from the inflation in liability, we're taking a fairly cautious stance at this stage.

Let's talk about pricing, Isabelle, for a moment.

A - Isabelle Girard {BIO 21256467 <GO>}

Yeah. So on the pricing side, as Patrick mentioned, we're working very closely with the claims team and making sure that in our overall profitability assessment of our book, we reflect the projected trends we think will have in terms of inflation in cost and that's exactly why in the past we've put some measure and action plan around our pricing to make sure we will cover those inflation. So as we are sitting today, we have tempered our rate and momentum because of the temporary reduction in driving. But as soon as we see that the level of driving is picking up, we'll get back to our rating strategy and making sure that will cover for the inflation in cost we project.

A - Charles Brindamour {BIO 7012323 <GO>}

So the severity inflation, which we've observed for a number of years, Brian, is fully baked in in our rate position and our rates adequacy. We're temporary reflecting drop in frequency, but we've done that in a way where we can revert back to pre-COVID rate levels without too many obstacles as driving returns back to normal, and I think our stance on severity has been quite cautious.

Q - Brian Meredith {BIO 3108204 <GO>}

Great, thank you.

Operator

Your next question comes from Tom MacKinnon from BMO Capital Markets.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thanks very much, good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

A question really on the favorable prior year development. Just one quarter ago, you said that although you held the 1% to 3% over the long run guidance, you said in the near term, you expect to be at the low end of the range. And then one quarter later, you reported some pretty good favorable prior year development. So how should we be thinking about what happened in this quarter? To what extent could it continue? And it seems to me that -- are you suggesting you may be running more at the midpoint of that level in the long run as opposed to the low end of that level in the long run? And then how should we be thinking about favorable development with respect to the RSA book of business as well? Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think very good observation, Tom, and I think we pointed to the bottom end of the range last year in relationship with the fact that with a lower interest rate environment, your provision for adverse deviation is as a result reflective of that and as such in a low interest rate environment, you should expect to be at the lower end of the range. Now all sorts of conditions can drive where you sit in the range. I'll give Louis Marcotte maybe an opportunity to share his perspective on PYD going forward.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. Thanks, Charles. So firstly, we know that Q1 is typically a bit more volatile than other quarters because it is very closer to the prior year. So there is not much time between the prior year and the actual quarter to elapse and to absorb the changes, that is typical. In this Q1, we identified, I would say, three factors that led to a stronger PYD. Firstly, we saw that prior year cats develop more favorably than we anticipated, so that impacted favorably. Generally speaking, the lower claims activity that we've observed, I would say, over the past year since the crisis started is also a factor here. Just having a lower claims volume has enabled a bit more favorable development to gather steam now. And then the last element was what I mentioned in my remarks, the pools have also had a positive impact in the personal auto. So those were, I would say, the three main drivers in Q1.

We have maintained our guidance, our long-term guidance from 1% to 3%. And I have noted in my remarks that given the strength of the start of this year, obviously for 2021, it's reasonable to assume that we may finish at the upper end of that. Of course, we are -- it's a COVID environment, there is uncertainty, and we've been cautious in the reserving. So as time passes, we're hopeful that that will have a upward momentum on PYD. But we've had a couple of years where it was tougher and before sort of hinting towards a permanent shift in the expectations, I think we're cautious here, and we'll see the quarters develop as they come around here. But I think we're in a good stance here both Canada and the US, and we'll monitor as the quarters pass.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And so that guidance -- sorry, on the RSA book, if you could continue with that. Is that guide related to the RSA book as well?

A - Louis Marcotte {BIO 18040440 <GO>}

No, not at all, sorry. So my comments do not relate to the RSA book and the expectation is fairly muted on development on the RSA book itself.

A - Charles Brindamour {BIO 7012323 <GO>}

So I think on bottom line, Q1 tends to have a bit more PYD than previous quarter, sitting where we sit today, looking at the environment in which we operate and the position we've taken on reserves, we think we'll be at the upper end of the range for a number of months, for a number of quarter, that's the first point.

With regards to RSA, we have a bottom-up view of where their reserves stand and what we'll do upon closing as we'll make sure that these reserves are brought to a level that's consistent with the IFC conservatism. I will say and so obviously hard work on that started a long time ago because that's the first place we start, and we'll make adjustments as a result upon closing. As a result, this should not really change the view of our ongoing -- there might be noise in the near term, but nothing major and this shouldn't change our long-term guidance on PYD because we'll manage the claims ourselves, and we'll make sure upon closing that reserves are at a level that is consistent by line of business, by province, by country that are consistent with our standards. On top of that, we're in the process of buying protection for the past so to make sure that we're not held back in terms of generating outperformance because of the past. So feel pretty good about where we are, we'll provide more clarity once we own the business.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks very much. And just you spoke fairly positively about what you're seeing with respect to the US commercial lines. With respect to Canadian commercial lines, we've had I guess to what extent has any of this lockdown or economic downturn impacted the Canadian commercial business? And what do you see in terms of I think you're talking upper-single digit premium growth and hard markets continuing. Is this accelerating at all? And would it change as we kind of moved out of lockdowns here?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I'll ask Darren to share his perspective on the market. And I'll give you a bit of color in terms of the COVID implications. Go ahead, Darren.

A - Darren Godfrey {BIO 19791482 <GO>}

Yeah. Thanks, Tom. I think as we referenced in the remarks, obviously, there was an impact of a loss of a single contract in the quarter that was worth about 5 points from a growth standpoint. So our run rate is more in the 10% range at the moment. That's very consistent with what we've seen in past quarters as well, obviously, ex GCNA.

When I look at the rate environment today or even just the general market conditions today, it still is a very hard market. Rate momentum is continuing, capacity remains very tight. We've not seen any form of you new underwriting capacity enter into the market, obviously, we saw orbit leave Canada last year. None of that has returned. So the operating environment is very, very consistent at the moment compared to, I would say, where we were at the start of the pandemic.

From a rate standpoint, we're very much still upper-single digit. Obviously, we're been very protective in terms of vulnerable customers. Obviously, as you can remember, back in Q4 with our relief program that we put in place for small business, vulnerable customers were watching and very much protecting the renewals for those particular customers because that's the right thing to do. But outside of that, rate momentum very much continues very much varies obviously by not only on class of business, but also profitability of risk as well and our level of rate execution at the desk level is exceptionally strong right now in addition to obviously managing quality, which is, as we've talked about in the past, is really critical during this market cycle as well too. So all in all, Tom, I would say, a very, very favorable market conditions, which I would suspect will continue for a little bit here.

A - Charles Brindamour {BIO 7012323 <GO>}

So I would say, Tom, the biggest difference between the environment in which we operate and the post pandemic environment is the lines of business where there are gaps, inadequacy that are subject to lockdown at the moment. There is not much rate activity going there because we feel this is not the right time to do that. Once we return to normalcy, we'll make sure that the segments that are most vulnerable rate increase will resume, that's the main difference, I think.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks so much for that.

A - Charles Brindamour {BIO 7012323 <GO>}

Okay.

Operator

Your next question comes from Lemar Persaud from Cormark Securities.

Q - Lemar Persaud {BIO 20750088 <GO>}

Thanks. I just wanted to revisit the distribution EBITDA and the revised guidance from 10% last quarter to the mid to upper teens. Maybe you can touch on what's changed over the course of the past quarter to drive this increased optimism? And then secondly, I think I heard Louis mentioned that RSA won't add to distribution EBITDA until 2022. Maybe you can explain why that's the case? Thanks.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. Thanks for the question. So on the growth here, so we have to keep in mind that we're comparing Q1 this year to Q1 last year, which was a start of pandemic, and I would say you would expect all the brokers to hold back on their expectations for variable commissions. So that was true last year in Q1, given the uncertainty. We're now far into the -- well, a year to the crisis. Things have stabilized and you'll remember for the second half of the last year, the business was growing at a very healthy pace and of course the brokers were benefiting from increased margins and variable commissions.

So the gap year-over-year is really driven by a different view, we're today in a much better position and the confidence in earning the variable commissions is higher and therefore flows through the earnings. So it's a combination of additional organic growth from last year, impacting the Q1 results this year and then the additional earnings. So when we look the solid start of Q1, and we look at what's left for the year, the impact of our view of profitability for the year plus the adding growth has led us to increase our expectations and our guidance towards the mid to upper teens this year. So that's really what changed in our mind.

Then the second part of the question for RSA, so we don't expect a huge change to distribution income and I'm careful there might be a bit more distribution income, but it's not incremental to what is already reported by RSA. It might just shift geography because they don't have a distribution line in their reports. So it will come in our distribution, but may come out of another line, so it's neutral. Where we do see some clear upside, example is in the onsite business, which we expect to serve more customers going forward in the onsite operations. But that is not, I would say, not going to happen until next year, so the benefits will start kicking in, I would say, in 2022. You won't see a lot of it in 2021, that was really why I pointed to 2022.

Q - Lemar Persaud {BIO 20750088 <GO>}

Okay, thanks. And then, just another question, just on the relief programs. Should we assume that the remainder of the unearned relief from the 2020 programs will come through similar to what we saw in Q1? So we'll see some come through in Q2, a smaller amount in Q3, and then we're done heading into Q4. Is that the right way to think about it?

A - Louis Marcotte {BIO 18040440 <GO>}

It is.

Q - Lemar Persaud {BIO 20750088 <GO>}

Okay, thanks.

A - Louis Marcotte {BIO 18040440 <GO>}

As long as you take what's left, the big chunk of it is in Q2, I would say, probably comparable to what we had in Q1, a bit lower, but that would happen in Q2, then Q3 a small portion and Q4 is almost nothing.

Q - Lemar Persaud {BIO 20750088 <GO>}

Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

And to be clear, the CAD75 million was written and earned top and bottom line in Q1.

Q - Lemar Persaud {BIO 20750088 <GO>}

Got it.

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah. So you really have to go back to the 2020 unearned portion of it was earned in Q1 and the remainder will be earned in the next few quarters. But the 2021 new relief is already earned.

Q - Lemar Persaud {BIO 20750088 <GO>}

Okay, thanks.

Operator

(Operator Instructions) Your next question comes from Mario Mendonca from TD Securities.

Q - Mario Mendonca {BIO 2450557 <GO>}

Good morning. Can you go, Charles and Louis, right back to that point, the earned premium, net earned premium Q1 2021 relative to Q1 2020? It was down only about CAD46 million. Now I guess, I would have expected a little more than that given the in quarter premium relief and then the unearned from the previous year, from 2020. Can you help me sort of reconcile the difference? Is the difference just essentially other pricing increases, growth in units? Like what bridges the gap between those two?

A - Charles Brindamour {BIO 7012323 <GO>}

Isabelle, do you want to take this? It is, in fact, units, earned rates and a bit of a drift. In other words, increase in the value of the car pool. But Isabelle, do you want to give some color on that?

A - Isabelle Girard {BIO 21256467 <GO>}

Yeah. Sure. So you're exactly right, Charles. I think it's in combination of, yes net earned premium in 2021 bit impacted by relief, but we're still getting momentum from the past rate increases we had in the pipeline early in 2020 that our hurting throughout the year. So that's creating momentum, plus unit growth and also increase in value of the new cars for example. So that's also a positive impact on net earned. So that's why the overall impact is not that different or that big in terms of comparing 2021 to 2020.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. So looking --

A - Charles Brindamour {BIO 7012323 <GO>}

To put things in perspective, Mario, the increase in the value of the car pool in the quarter earned is 1.8% and the average rate change earned in the quarter is 2.9% might not be 100%, but I think it's as precise as you'll get it on these calls, and then you chose some units on top of that.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. I think that gets me there. So looking at next quarter, the 4.5% decline we saw net earned premium in Q1, presumably, it should be a little less than that because, you mean you've essentially recognized most of that in quarter or the one month release. So is that a fair statement? It should be a lot less than the 4.5%.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes.

A - Isabelle Girard {BIO 21256467 <GO>}

Yes.

Q - Mario Mendonca {BIO 2450557 <GO>}

Great. So let me just get to my final question then. And this is one that I've kind of been struggling with when this all came down with the pandemic. In Q2 2020, just simply looking at underlying claims, so ignoring anything to do with prior year development and anything to do with cat, not that were a lot, what I noticed is that the year-over-year, the underlying claims declined substantially in Q2 2020, a little bit in Q3, and this is all on a year-over-year basis. And the underlying claims remain low, so it's exactly what you highlighted that we haven't seen a return. What is confusing to me, however, is you talk about driving being down, I think at one point you talked about maybe 30%, 40% this quarter maybe 13%, but we're not seeing that kind of a decline in claims. So I imagine very much like my first question, there's a lot more going on here. Can you help me understand then why the actual underlying claims are not dropping as much as, say, driving is dropping?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, there's a number of factors, Mario, and one would be the relief that we have provided, which obviously is reflected in the underlying loss ratio. I think the other one, Mario, is that the sudden drop -- meaningful drop in frequency was really just in Q2, then it increased from there. Third, for long tail lines, Mario, as I mentioned in Brian's earlier question, we're taking a fairly cautious stance in terms of what we will see because we think there might be upward pressure in severity and as a result, we've reflected that in how we've reserved the current -- the accident year 2020 and 2021. And therefore, that will tame a portion of the reduced driving that you would see in accident. Then I would say these are high level, the main factors that would explain why you're not seeing such a drop and relief being a big ticket item in that equation, you said any additional color you want to provide there, I assume, you were looking at underlying loss ratios, right?

Q - Mario Mendonca {BIO 2450557 <GO>}

No. In fact I was talking about underlying claims ignoring anything to do with ratios. Just the dollar amount. I wanted to see if that track some of the commentary you were offering. So I'm not talking about the ratio.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Then I think -- go ahead Isabelle.

A - Isabelle Girard {BIO 21256467 <GO>}

No. I would just maybe add that as well, on the short tail lines, we saw a bit of an increase in severity due to the mix up claims as well since the type of driving was different during the crisis. So I think that's also something that influence the level of claims you see.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. I guess, I think the answer is mostly severity, and that's what I'm just trying to understand because it does sound like severity has changed because there is such a difference between just the basic change in underlying claims relative to the amount of driving we're seeing. So I felt like there is something else happening here that I didn't understand. I think the answer might be severity or you come up with a better answer to come out of it?

A - Charles Brindamour {BIO 7012323 <GO>}

But I think a key point, Mario, was the point I made. If you think about the losses in automobile insurance business, ballpark 65-ish is bodily injury and liability and 35-ish, some would say, 70-30 depending on the province in which you operate the rest, so a third of it, say, is repairing the cars. What you see in the results and the impact of the drop in frequency is far more pronounced in short tail lines and it's far less pronounced in long tail lines. And why, because long tail lines, R&D long tail and as a result, we take a cautious stance until we see what severity will do. I wouldn't conclude other than the severity that Patrick has talked about, that there is plenty of inflation in the system at this stage, I think more so we're being careful as we think about bodily injury and liability.

Q - Mario Mendonca {BIO 2450557 <GO>}

Yeah. I think that goes a long way toward explaining the difference as well. Thank you for that.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Operator

That was our last question. At this time, I will turn the call back over to the presenters.

A - Ken Anderson {BIO 16846692 <GO>}

Thank you very much. And maybe before closing, I will turn it over to Charles, just for a brief word on the recent leadership changes.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, indeed. Thanks a lot, Ken.

You've seen this week that we've announced retirement of Mathieu Lamy, a leader at Intact that many of you have met in the course of Investors Day and so on, you've seen at the same time that Mathieu will be succeeded by Patrick Barbeau, also a leader that you have seen and heard every quarter for many years. Let me first say that Mathieu has been a pillar for Intact. One of my key partner in building Intact. He is respected across the organization. He knows the business, cold, shrewd, fast, he defines what hands on actually is, made a big difference for us. Mathieu will remain as Vice Chairman on a part-time basis and will help us continue succeed in technology, innovation, as well as in security.

Patrick has been exposed to, as well a tremendous leader, a very well respected in the organization also knows the business, cold as overseeing in fact, done a lot of pricing himself, overseeing personal lines, overseeing claims, drove a big portion of the claims strategy and has been exposed to both distribution channels, used to oversee marketing in the direct channel and I'm very confident in Patrick's ability to step up. So I want to congratulate Mathieu and thank him for quite an impact he's had on the organization and congratulate Patrick on his new role.

And on that, thanks a lot for your attention. Ken, I don't know if you want to close this.

A - Ken Anderson {BIO 16846692 <GO>}

Yes. Thanks, Charles. So following the call, a telephone replay will be available for one week and the webcast will be archived on our website for one year. The transcript will also be available on the website in the Financial Reports & Filings section. Just to note, we'll be hosting our Virtual Annual Meeting of Shareholders shortly after this call at 1:00 PM Eastern today, and you may join that meeting via live webcast from our website. Lastly, second quarter 2021 results are scheduled to be released after market close on Tuesday, July 27. So thank you again. And this concludes today's call.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.