Q3 2019 Earnings Call

Company Participants

- Alain Lessard, Senior Vice President, Commercial Lines
- Charles Brindamour, Chief Executive Officer
- Darren Godfrey, Senior Vice President, Personal Lines
- Ken Anderson, Deputy Senior Vice President, Investor Relations & Group Treasurer
- Louis Marcotte, Senior Vice President and Chief Financial Officer
- Patrick Barbeau, Senior Vice President, Claims
- Unidentified Speaker

Other Participants

- Doug Young, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- John Aiken, Analyst
- Mario Mendonca, Analyst
- Meny Grauman, Analyst
- Meyer Shields, Analyst
- Michael Phillips, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Intact Financial Corporation Third Quarter 2019 Results Conference Call. At this time, all participants are in a listen-only mode. (Operator Instructions). Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today. Ken Anderson, Deputy -- Senior Vice President, Investor Relations and Group Treasurer. Thank you. Please go ahead.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Cheryl [ph]. 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. Before we start, please refer to slide two for cautionary language regarding the use of forward-looking statements, which form part of this morning's remarks and slide three for a note on the use of non-IFRS financial measures. An important note some adjustments terms and definitions used in this presentation.

Joining me here in Toronto 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 will begin with prepared remarks, followed by Q&A. With that I will turn the call to our CEO, Charles Brindamour.

Charles Brindamour {BIO 7012323 <GO>}

Good morning, everyone. Thanks again and thank you for joining us today. Last night, we announced strong third quarter results with net operating income per share increasing 18% to $1.91. Our underwriting performance improved in both personal and commercial lines to deliver a strong combined ratio of 92.3% favorable market conditions continued in the third quarter with significant rate momentum across all our lines of business.

Top line growth accelerated to 11% with double-digit growth on both sides of the border. In Canada the hard market is not a surprise on the back of estimated industry ROE running below 4% in the 12 months to June 2019. We continue to outperform the industry ROE by over 800 basis points and we're exceeding our 500 basis points outperformance target, but our focus is firmly on returning operating ROE to the mid-teens.

So let's look in more detail at our results by line of business starting here in Canada. Personal auto premiums grew 12%, a significant step-up from the 6% we recorded in Q2 and 1% in Q1. Growth was again fueled by rate increases and was bolstered by a 2% increase in units in the quarter as our competitive position continue to evolve favorably. The combined ratio improved 5.6 points from Q3 last year to 93.4%, our best third quarter performance in auto for six years. The underlying performance was excellent on the back of lower frequency and substantial rate increases. Our actions in auto are working quite well.

Market conditions remain hard. The industry grew north of 8% in the first half of '19 and we saw further rate increases across the country in the third quarter. Our focus remains on portfolio quality and we're well positioned to capitalize on market conditions and continue to grow Personal auto at a mid '90s combined ratio moving forward.

Personal property premium growth also accelerated to 8% with rate increases and improving unit growth. The combined ratio of 89.1% included lower than expected CAT losses by close to 4 points of above average non-CAT weather losses. The actions we've taken over time in property have been successful. While we can anticipate some quarterly fluctuations, the fundamentals are strong and property is positioned for low-90s [ph] performance moving forward consistent with our five-year track record. The industry in this segment grew in excess of 6% in the first half of '19 and we expect growth to continue in this range in the coming year.

Looking at commercial lines in Canada, all segments contributed to the top line growth of 13% in the quarter, we saw a double-digit rate increases and continued strong new business and renewals. The combined ratio of 91.8% was solid despite lower than expected prior year development. The fundamentals in commercial lines are very good and rate increases are continuing to flow through the system. The industry outlook for Canadian commercial continues to improve and we expect the current hard market conditions to sustain upper single-digit to low double-digit industry growth over the next 12 months. We're positioned for growth and expect to run this business at our historical low-90s combined ratio moving forward.

Turning to US commercial. So premium growth in the third quarter was strong 10% on a constant currency basis with over 20% growth in the segments not undergoing profitability improvement. The combined ratio of 95.9% include some increased claims activity which reflects quarter-to-quarter fluctuations, which can be expected.

The year-to-date performance at 94.9% has been dragged by weak performance in lines under profit improvement. After a careful review of these businesses, effective July 1, we took the decision to exit the Healthcare segment, which represent approximately 5% of our annual premiums in the US. Pro forma, the year-to-date combined ratio in US commercial was 92.8% and keeps us on track to achieve our goal of sustainable low-90s performance by the end of 2020.

The US market is also evolving in our favor with hardening conditions now evident across a number of lines. We expect the US commercial industry to grow at a mid-single digit rate in the coming year and we expect strong growth to continue in the profitable segments of our portfolio.

Turning to strategy, while we've been successful in delivering on our financial objectives over the past decade, our aim is to deploy strategies to sustain this performance in the decade ahead. During the third quarter, we advanced meaningfully in my view. We deepened our presence in the supply chain with the acquisition of On Side Restoration, which closed on October 1. This was a big move to improve customer experience while capturing margins in a business, which helps customers get back on track.

In August, we also reached an agreement to acquire both The Guarantee Company of North America & Frank Cowan Company. With this transaction, we hit a number of strategic objectives. We bolster our Canadian leadership position, and add new products catering to high net-worth individuals, we enlarge our North American specialty platforms on both sides of the border and cement a top six position in the attractive short segment in North America.

With Frank Cowen Company, we acquire an MGA platform to manufacture and distribute specialty insurance products in Canada, which comes with a stable stream of distribution earnings. Frank Cowen also expands our presence into the public entity space in Canada, a specialty we already know well in the US. Most approvals have now been received and closing is on track for before year-end. Transition planning with The Guarantee and Frank Cowen teams is already well underway.

The financial merits of these transactions are also compelling in our view, with each delivering an IRR in excess of our 15% threshold. Together, we expect immediate NOIPS accretion increasing to mid-single digit within 24 months. So on conclusions, results in the quarter were strong and the fundamentals continue to improve in all lines of business. We're focused on portfolio quality, while taking advantage of the momentum we see in the current market. Our competitive position also continues to improve and with strong third quarter performance, we're on the path to return operating ROE to our historical mid-teens level.

We're now posting double-digit organic growth in improving market conditions. At the same time, we bolstered our earning power further with measured and strategic capital deployment. We're maintaining a strong balance sheet and stand ready to deploy capital should further opportunities arise. So, we're well positioned to exceed on our financial objectives to beat the industry ROE by over 500 basis points, every year and grow net operating income per share by 10% annually over time as we have in the past decade.

With that I will turn the call over to our CFO, Louis Marcotte.

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles, and good morning everyone. We delivered strong net operating earnings of $277 million in Q3, up 17% from last year, driven by premium growth, higher underwriting margins, improved distribution results and benign weather. Underwriting income was up 30% over last year to $198 million, driven by strong performance in Canada where we delivered a 91.8% combined ratio.

Net investment income grew 7% over last year to $146 million, driven by an increase in assets under management and marginal year-over-year yield improvement. We expect full year net investment income to increase by about 6%. Distribution EBITA and other income grew 37% to $56 million as hard market conditions are fueling higher broker commissions and better margins.

In addition, 2019 continues to be a strong year for broker M&A with a 25% increase in transactions completed year-to-date and a robust deal pipeline. We expect full-year 2019 distribution and other income to grow north of 20% versus 2018. I will provide further guidance on 2020 expectations during our Investor Day on November 19.

Let me provide some additional color on the underwriting results, beginning in Canada. Personal auto growth of 12% was fueled by written rate increases of 8% in hard markets. This should drive earned rate growth north of 7%, well into the second half of 2020. In addition, our competitive position in auto is improving as evidenced by return to unit growth for the first quarter in almost three years. Auto profitability was solid in the third quarter at 93.4% even after adding one point of favorable seasonality. Prior year development was muted in the quarter and we expect it to remain muted in the near term. Overall, with strong top line momentum and sustainable profitability, we are well positioned to drive profitable growth in auto moving forward.

In personal property, written premiums grew by 8% with rates up 5%. As expected, with auto unit growth accelerating, our bundled products are also bringing benefits to personal property. In this line of business, the combined ratio was strong at 89% as low cat levels were partially offset by non-cat weather and fire losses.

The Canadian expense ratio was low at 27.8% as we continue to manage expenses carefully and benefit from growing premiums. We expect the full year expense ratio to be in line with our year-to-date figures. Turning to US commercial, the underlying loss ratio of 58.1% deteriorated 1.1 [ph] points driven by large losses in a few businesses. This is not a concern as specialty lines profitability can fluctuate quarter to quarter. On the non-operating side, we incurred $44 million in pre-tax equity impairment charges this quarter. Such impairments do not impact our book value or capital levels as the assets are already mark-to-market.

A few words on our financial position in the financing of The Guarantee and Frank Cowen. Our balance sheet is very strong as we ended the quarter with a total capital margin of $1.1 billion and an MCT at 195% after repaying $250 million of medium term notes. This takes our debt-to-total capital ratio to 19.3% below our 20% target. Our Q3 capital position excludes any proceeds from the subscription receipt offering completed in August, which raised gross proceeds of $461 million for the financing of The Guarantee and Frank Cowen. The balance of the $1 billion price tag is expected to be financed with the combination of excess capital and bank borrowings.

Our debt-to-total capital ratio is expected to rise a couple of points above 20% at close and should be back to 20% in 2020, leaving us in good shape to capture future growth -- growth opportunities. A quick reminder on the value creation expected from the acquisition. We expect to shave [ph] 10 points from The Guarantee's three year average combined ratio of 98%. Over three years, we see four areas of improvement, better underwriting and data-driven risk selection, claims handling and supply chain practices, at least $20 million in expense savings and optimization of the reinsurance programs.

The Guarantee, Frank Cowen and On Side represent highly strategic, synergistic and financially attractive transactions for IFC. In aggregate, they are expected to deliver mid-single digit NOIPS accretion by 2021.

Before I conclude, there are two points I would like to cover on weather. Firstly, we're at the point in a year where we usually re-evaluate our view of annual cat losses. Our annual estimates reflect a longer-term view of trends as well as our premium base and acquisitions. Reflecting these factors, we are raising our annual cat expectations to $300 million per year. We continue to expect approximately 75% to impact personal lines and we would expect about one-third of the annual estimate in each of Q2 and Q3.

Secondly, the cost of the heavy wind and the rain storm last weekend in Central Canada is expected to slightly exceed the catastrophe level recorded in Q4, 2018. As usual, our troops are on the ground and are doing a great job to get our customers back on track fast.

In conclusion, top line is clearly showing a strong momentum and we have yet to see the full impact on earned premiums. Earnings are solid on both sides of the border with auto showing strong signs of sustainable profitability. Book value per share increased almost 3% in the quarter and we are on the path to return operating ROE to our historical mid-teens level, a good proof point is if we annualize the operating ROE in the third quarter, we are north of 15%. We are well positioned right now, both from a top line, profitability and balance sheet point of view, we stand ready to deploy capital as opportunities arise to add further value for our shareholders.

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

Ken Anderson {BIO 16846692 <GO>}

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

Questions And Answers

Operator

(Operator Instructions). The first question comes from John Aiken of Barclays. Please go ahead, your line is open.

Q - John Aiken {BIO 6329080 <GO>}

Good morning. Just wanted to get a little more color on the US commercial operations. We've seen some pressure on the contribution of the last couple of quarters and on a year-over-year basis. Was hoping that you could talk about what's happening on the net earned premiums because that's been flattish over the last couple of periods and also you talked about higher claims impacting the combined ratio, but my understanding is with the healthcare being pulled out, it actually looks like the impact on the quarter was a little bit more damaging than just the two points, if you give us some color around what was happening on those higher claims, I'd appreciate it.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. The performance of the US operation 9 months in is around 94.9% that's including healthcare. I think if we strip out healthcare, we're at 92.8% and well on our way in my mind towards low-90s combined ratio performance by the end of 2020. There is fluctuation from quarter to quarter. It's, a business, that is specialty in -- as a number of segments, but overall, not no big issues there. As far as I'm concerned, I think we're on track. I think, there is a number of lines that are under profitability improvement and there's good progress being made there and I think in healthcare we didn't see a way to low-90s performance in the mid-term and we've decided to move away from it. I'll ask Alain to give a bit of perspective on the healthcare decision and the US performance in general.

A - Alain Lessard {BIO 17592535 <GO>}

So maybe just a bit of context on healthcare decision. That's a line of business unit that was already undergoing some forms of correction when we bought OneBeacon two years ago. So, fundamentally the plan was to really exit long-term care, large facility and everything. And when we look at that at the time we really felt that we were able to bring the line of business in the low-90s. I would say 20 months in the plan, it became clear that the action needed would be a lot more than what we were doing right now and I would think -- and we were seeing changes in the health care environment.

Our plan was really to focus on in the out risk [ph] classes, single physician, outpatient care facility, small one. And what we're seeing is a lot of physician are leaving private practice joining larger organization. Hospital are pushing acute care treatment into small medical facility for outpatient. So all of a sudden, those were picking up, larger exposure that are normally in hospital and we were shrinking the portfolio because of all the action we were thinking. We're not a large player in that field. So looking at all of that results that needed more action, portfolio that was getting smaller and the structural changing happening it became probably clearer for us that the best option we had was to really sell the renewal right. Okay. And basically exit the business unit, and that's what we did in September.

Maybe a comment on the net earned premium for the quarter. When you compare the quarter 2019 to 2018, you see flat, but that's because in 2019 there is no healthcare and in 2018, healthcare was included. So the net earned premium is really picking up on the growth we're seeing.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And the other point I would make about net earned premium is that in specialty lines, not all products are yearly products that are evenly earned through month. But if you compare quarters to quarter, you see that Q1 over Q1 was 3.14% [ph] to 3.53% [ph] Q2 over Q2 was 3.40% [ph] to 3.43% [ph] and Q3 over Q3 is flat. And if you go back in 2017, you see a progression as well. Despite I think exited healthcare

A - Louis Marcotte {BIO 18040440 <GO>}

I would echo Tom's comments about the volatility of the results, like quarter to quarter, they can fluctuate for large losses and everything. I think the more relevant number is the pro forma number excluding healthcare of 92.8%. I think that's a better view of where we are in terms of profitability. To give you the comparable number for the full year 2018 [ph]. It was 93.3%. So I think we're taking the actions that are necessary to bring us in the low-90s.

Q - John Aiken {BIO 6329080 <GO>}

All right. Thanks, (inaudible). Thank you. Yeah, I think just one further one follow-on question if I may. And not going into specifics, but are there any other lines that are under profitability improvement that may be under review in the future to exit.

A - Charles Brindamour {BIO 7012323 <GO>}

So I mean we have three lines under review at the moment and the work that's being done in each of those three lines by the business unit leaders running those three lines is in my view impressive and taking advantage of the market in which we operate. And I have great faith that these lines will be back in the low-90s performance in the near to mid-term. So, no, the answer is no.

Q - John Aiken {BIO 6329080 <GO>}

Great, thank you. I'll re-queue.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

The next question comes from Geoff Kwan of RBC Capital Markets. Please go ahead your line is open.

A - Charles Brindamour {BIO 7012323 <GO>}

Good Morning, Jeff.

Operator

Geoff Kwan. Your line is open.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

My first question was, there has been a little bit more chatter in NBC about potentially looking at some point moving to more of a no-fault system like what's in Ontario and I'm just wondering from your perspective from Intact's perspective if we didn't have ICBC in existence, is there one province is kind of set up that you think is better for you?

A - Charles Brindamour {BIO 7012323 <GO>}

So the best solution to BC is to have the private competitive marketplace and whether you have a no-fault product or a tort product, in my mind you would get better outcome for BC drivers there is absolutely no doubt in my mind there. I think that the -- a no-fault product for both car repairs and bodily injury can be a very effective product provided that it's not overly rich so as to invite third parties to take advantage of the richness of the product and so I think no-faults have very good characteristics provided that the coverage offered to drivers is one that's commensurate with the actual need of the drivers, as opposed to being overly generous as we have seen historically in Ontario.

And I think that some of the reforms that are in the pipelines are ones where governments across the land or trying to take abuse out of the system and really right side or right-size the coverage that's being provided and increase care for drivers. So I think both systems can work in my mind, and have proven to work in a number of provinces in Canada. I don't think no-fault is a panacea to automobile insurance issues. It's a calibrated one could get the job done, but far more important than my view is choice and private competition.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay, thanks for that. And just on the On Side acquisition, I know it's obviously like a reasonably small acquisition, but is this a sort of thing that -- that you might -- we might see a bit more evolution in terms of a little bit more vertical integration and then also to the extent that On Side's other insurance customers leave. I'm assuming that would get factored in, with the kind of the two-year payout that you've structured for the transaction?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So I think on the, on your vertical integration question. If you look at it from a strategic point of view, over 10 years we've outperformed the industry ROE by 650 basis points, a third of that came from leveraging our size in claims a big portion of that strategy is about getting customers back on track ourselves to the greatest extent possible. It means in practice that we're managing ourselves 99% of claims as opposed to using third parties. We have a preferred provider network where more than two-thirds of our repairs both in home and in cars are done.

We're 70% of the defense work of our customers is done by our legal team of close to 400 people. We've developed few years back, a number of service centers in automobile insurance so and now our perspective is that when it comes to home repairs, what is very clear is that when we look at what customers are telling us. The restoration process is the area where there is the biggest upside from a customer experience point of view. The other key observation there is that there is a big capacity issue because the level of natural disasters has increased over time. So we see a couple of things, one, a big opportunity to improve customer experience in in-home restoration and two, a big opportunity to build the business in a space we know that's relevant to our core manufacturing business where there is a big capacity problem at the moment.

And so, should one expect to see more of that? I'd say, absolutely. Certainly in home restoration. And again, the more we can get involved in helping customers get back on track with a second to none experience the more we'll do. I'll ask Patrick to give additional color I recognize, I sort of covered key points, but go ahead, Patrick.

A - Patrick Barbeau {BIO 18476397 <GO>}

Well, first, I think you're right on the point. Maybe additional comments. You were referring to other clients of On Side, so far, it's going well. All the improvements we're making by putting the two operations together to design better process for clients, it's not only for our own clients, it's as for all of On Side clients. There is a lack of capacity in the market and we, I think, with On Side would bring additional capacity, so we don't expect -- and we're happy to continue to service through On Side, all of their customers.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I mean it's one of our objective to make sure that on side is the biggest and best restoration company in the country and that is to the benefits, not only of Intact's customers but every other customers of On Side, and that's very important to us.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay, great. Thank you.

Operator

Your next question is from Meny Grauman of Cormark Securities, please go ahead, your line is open.

Q - Meny Grauman {BIO 15238080 <GO>}

Hi, good morning. Question on the guidance on cat losses. And if you could just give more detail in terms of what new information went into expanding that guidance. Is there, is there a new data that you have available? Is it based on just the more recent history that you're seeing, trends increase?

A - Charles Brindamour {BIO 7012323 <GO>}

I'll ask Patrick to give his perspective because he is the one managing the cats.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah, we -- outlook at those trends on the -- in the short term, that can fluctuate obviously from one quarter to the other even on one year to the next. But, we look at each cats and we estimate return periods, we look at an extended period of time, five years to 10 years and we'll make models based on that, I would say that the increase from 275 to 300 [ph] reflect some of that. But mostly the organic growth and the new acquisition.

Q - Meny Grauman {BIO 15238080 <GO>}

Yeah that's helpful. And then just another question, just in terms of the high net worth market in Canada. So one of the rationale for the recent, the recent acquisition. I'm just wondering how do you define high net worth and how does this change your market share in that vertical?

A - Charles Brindamour {BIO 7012323 <GO>}

So we are not really in that vertical, quite frankly, and we've defined our appetite based on historically. Anyways, it's based on the size of your house, and how much your house would cost to reconstruct and past $2 million to $3 million, we really think that this is how to -- out of the expertise and the platform that we've built already and so anything above that is how we would define that segment. It is a rudimentary definition of the segment, but it's only a tier 1 [ph] and we will build when we close the transaction, a unit that'll be entirely focused on that segment with dedicated appraisal process, dedicated claim support, yet benefiting from our data, our pricing and risk selection, our claims expertise and our scale and we're looking forward to tap into what we think is a market that is under-served today. Darren, anything you want to add?

A - Darren Godfrey {BIO 19791482 <GO>}

No, I think that's it. I mean I think we are positioning ourselves to be a meaningful player in that space and as Charles says, there's not a lot of players currently in that space and we're ready to tackle that space and be a leading player in the high net worth just as we are in the retail market as well.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. As we chose historically not to play in that space because we felt we couldn't provide a second to none experience. Now, I think we're much closer to be able to do that and we'll put our energy into getting there in the near term.

Q - Meny Grauman {BIO 15238080 <GO>}

And how big is that market in terms of premiums?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So there is a wide range of estimate as to how big that market is and it is a low single-digit billion dollar market.

Q - Meny Grauman {BIO 15238080 <GO>}

Thank you.

Operator

Your next question comes from Doug Young of Desjardins Capital Markets. Please go ahead, your line is open.

Q - Doug Young {BIO 5640851 <GO>}

Good morning. Just first question on the prior year reserve development 0.4%, well below what you target 1% to 3%. I think it looks like there has been some pressure in the commercial side and just hoping to get a little bit more detail on that.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes it is. Doug, a little bit below 1%, which is at the lower end of the range and I think we've said in the current interest rate environment. One should expect us to be in the near term at the lower end of that range and indeed 0.4% below that. So you're right, there is a caution on our part in automobile insurance. We've signaled that before. And you're right that in commercial lines, there has been a bit less PYD and there has been historically. I'll ask Alain to share his perspective on that.

A - Alain Lessard {BIO 17592535 <GO>}

Okay. So what happened in the quarter is, as we took a basically a bit more prudent and stance on some of commercial auto and trucking accident year which led us to revise ultimate loss ratio by one point. It's very a minor adjustment on some accident year commercial auto and trucking, which in total in the quarter amounted for about four points. When you look at it on a yearly basis what happen is mostly, what's affecting the PYD is a bit lower catastrophe, a bit more large losses in the PYD which can be very much fluctuation and lumpy and roughly about a point that's coming from the last quarter reserve review and I would say this is really getting a bit more conservative on some of the accident year being a bit more prudent. So nothing major there, but it's, that's it.

Q - Doug Young {BIO 5640851 <GO>}

What caused you to be more conservative. I mean this is long haul trucking, I would imagine. And is this stuff that's going across the border? Just curious.

A - Alain Lessard {BIO 17592535 <GO>}

I think we were looking at different methodology. Our -- we were seeing a bit more claim activity on the trucking side on some aspect there and when you look at the ultimate, you're always faced with a range. Okay. So our range -- we were pretty much in the middle of the range. I think right now we would be in my qualification bidding being a bit higher in the range, closer to the higher point.

A - Charles Brindamour {BIO 7012323 <GO>}

It's an assessment of one segment of commercial auto done in one quarter and I think that there is not an emergence of a trend there. I don't think.

Q - Doug Young {BIO 5640851 <GO>}

That makes sense. And then second, just personal property looked like there was elevated by a lot. I mean your combined ratio was good, but it looked like there was elevated fire losses. I think there was a similar issue last quarter, is there an issue here, just hoping to get a little more detail. Thanks.

A - Darren Godfrey {BIO 19791482 <GO>}

Doug. I mean we continue to watch the fire side and you rightly point out, we've highlighted that in past quarters, our position today continues to be like last quarter, it's a lot of noise. When I look at fire, sort of province to province, some are up, some are down and it's fluctuating from quarter to quarter. So, we don't see an underlying trend. We've done an underwriting review of many of our large losses. We don't have any concerns right now from a underwriting standard viewpoint. This was not a frequency issue in the quarter itself more just some movements on the severity side, so again, watching very, very closely, but no underlying trend that concerns us at this point in time.

A - Charles Brindamour {BIO 7012323 <GO>}

I think in the quarter. Doug, if you strip the cats, this line is running at about 85% [ph] and there, there's. We think four points of non-cat weather in there beyond historical average. So it gives you a bit of visibility on the level at which this line is priced.

Q - Doug Young {BIO 5640851 <GO>}

That's helpful. Thank you.

Operator

Your next question comes from Michael Phillips of Morgan Stanley. Please go ahead, your line is open.

Q - Michael Phillips {BIO 21023048 <GO>}

Thank you and good morning. I guess a follow-up on that last question on reserves. So a quarter after you took the auto reserve charge anything three months later that makes you think that maybe overshot that last quarter and then I guess drilling down kind of, can you talk about what you're seeing in the personal auto loss trends.

A - Charles Brindamour {BIO 7012323 <GO>}

Three months in what we've seen is certainly an environment that gives us very good comfort in terms of where we closed Q2 as we'd all seen. When I look at the trends in personal automobile, I mean the main trend in my mind is the fact that frequency is down fair bit. I mean, it's down year-to-date 5.3% in personal auto. It's down in the quarter a couple of points. And you're seeing on the other side of the ledger rates at about 8% clip. Now there is a mix change and one should not subtract or add those two things to figure out where the combined ratio is going. But the big trends in my mind is that the frequency keeps coming down and partly driven, if not, largely driven by the actions we've taken and we're in environment, we're in the upper single-digit rate increase, Darren?

A - Darren Godfrey {BIO 19791482 <GO>}

I think the only thing I would add to that Charles, is our paid activity continues to be relatively benign as well. So that's another important point that we're watching very closely.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, I think we've highlighted. That's a great point Darren. We've highlighted that in Q2. The paid is very steady. It's in the past two years, it's been -- our caution was driven by the case activity and I would say that three months in, we're seeing actually better activity on that front as well. And the paid remain stable.

Q - Michael Phillips {BIO 21023048 <GO>}

Okay. No. Thank you That's helpful. I guess, sticking with personal lines in general. Anything else that would drive the expense ratio improvements from here. Besides increases in your own premium?

A - Charles Brindamour {BIO 7012323 <GO>}

I'll let Louis share his perspective on the trajectory of the expense ratio, when and where we stack against the market maybe.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. Thank you. So, as you know, we manage the expenses globally for all lines of business and they are benefiting now from the premium growth, certainly that's a positive impact. When we manage those expenses, we're careful to hold back as much as we can trying to leverage productivity improvements and then reinvest on the other side in technology, in AI, and other initiatives that we want to pursue actively. When we look at ourselves and compared to our peers in the industry, we clearly are successful at this. We are outperforming on the broker side of the business by three points on the expense ratio.

And when I look at the direct business, we're actually outperforming the industry in the 700 basis points to 800 basis points. So we're successful there. And then if you add the premium growth to that, that's even improving the ratio itself. So it's on both sides. It's premium growth plus managing the expenses that has driven this-- the low expense ratio in the quarter. And we're going to keep pounding on managing the expenses in the same way going forward. Future premium growth will just make it a bit better.

A - Charles Brindamour {BIO 7012323 <GO>}

I think there are, there are a number of powerful structural trends that that we're focused on. And here, all the progress we're making in distribution is a separate source of distribution earnings, we need to recognize that. I think it will be above $200 million next year or this year. If you look at our core manufacturing expense ratio, in the broker channel, the expenses we control is less than 8% and we're continually trying to improve that performance, but in fact, insurance was very efficient operation.

On the distribution on the direct side of things, there is a big drive there to drive our expense ratio meaningfully below what it was historically. We've made really good progress on that point. This should help overall our expense ratio in aggregate. And then across all operations both brokers and direct we're deploying new platforms, which should help us make us more efficient over time.

Q - Michael Phillips {BIO 21023048 <GO>}

Okay, great, thank you for the color, appreciate it.

Operator

Your next question comes from Paul Holden of CIBC. Please go ahead, your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning. Wanted to ask you a question regarding the potential longevity of this firm rate cycle and you've commented that you expect it to continue for another 12 months and are benchmark to a 10% ROE. So I guess my questions are, where do you think. Cost inflation is running across the lines of business and how much rate would it take for the industry to get to roughly about 10% ROE?

A - Charles Brindamour {BIO 7012323 <GO>}

So that's across all lines of business?

Q - Paul Holden {BIO 6328596 <GO>}

If you can, let's not -- yeah,

A - Charles Brindamour {BIO 7012323 <GO>}

It's a hard one. You know what, it's a good one. We'll think about it, come back on it at the Investors Day.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Good. Second question would be a number of US commercial lines insurers have talked about loss pressure from litigation and settlement, wondering how you're thinking about that risk. And if you're seeing similar pressure, I guess specifically in the US business. But maybe commercial just more broadly as well.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So I think that many people talk about inflation in liability in the recent past and quite frankly, this is surprising to us because we have been focused on inflation in liability in Canada for many years, but in particular in the last three years to four years where we've shared with investors that there was a fair bit of pressure coming from the fact that psychological damage, concussions, PTSD and chronic pain was sort of invoked far more often than before and as a result, drove liability inflation.

We've also talked about the fact that there has been over the past, make it three, four years, greater representation of lawyers on file. So that inflation is not new and one we've been fighting for many years. In the US, look, we've been exposed to the US now for two and a half years and it was very clear to us that inflation in casualty was an issue before we actually make the acquisition. That's why we've taken a number of measures to protect ourselves. That's why we have gone out of lines of business that we felt from a casualty point of view had an exposure that was really difficult to price and that's why a big portion of our policies are actually claims made which reduce the tail that is exposed to liability and as you know, we bought protection also for the past in the relationship with inflation.

So yes, there is inflation. I'm surprised that's talked about now as something new because we think it's been percolating in the system for many years and very much reflected in the actions we've been taking over time. It could help sustain if this sort of recognition that there is inflation in liability drives a harder markets, then we're all for it.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. Okay, thank you for your answers.

Operator

Your next question comes from Jaeme Gloyn of National Bank Financial. Please go ahead, your line is open.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah. Thank you. First question is just related to the strong premium growth that we're seeing and how that's expected to impact the underwriting leveraging the business, do you see room for that to expand and to what level do you think that could expand to within the next 12 months?

A - Louis Marcotte {BIO 18040440 <GO>}

Listen, we at this point I don't see that expanding significantly. We're running at the an underwriting leverage of 1.5 [ph] roughly. I don't see that expanding meaningfully. We're careful that we -- our capital position is strong and able to absorb the growth but not necessarily a significant increment in the leverage itself.

A - Charles Brindamour {BIO 7012323 <GO>}

And the way I think about leverage is really relationship. If you, if you think about how leveraged and evolve over time. Naturally, the relationship between the speed at which you're growing, the earnings you're generating, which help your book value grow and I think that what we're aiming for in terms of ROE is above the speed at which we're growing as an organization. Of course, we're paying dividend in the exercise, but we feel like the capital generation of the organization can sustain the growth we're seeing in the top line. The other thing is, a big chunk of it is rate-driven.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay, thank you. And second question, it's kind of on the ROE topic. Charles, you've talked previously about starting work on Monday morning with an 8% ROE from non-insurance operations essentially, given the growth in distribution. Is there a shift in strategy? Or is there a sort of a underwritten strategy to increase that 8% through distribution and at what level do you think would be reasonable to think about?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, that's a good question. There is not a shift in strategy, but there are side benefits to our strategy and I'll let Louis give his perspective on that.

A - Louis Marcotte {BIO 18040440 <GO>}

So, thanks for the question. As you point out, it's 8% Monday morning as we start the week. And I think the view here is to get that 15% [ph] or mid-teens ROE more stable. We'd like to push that 8%, we would be aiming to take it as high as 10% overall. And so there are sources of earnings that we can add to the investment to the distribution to increase that Monday morning ROE. I think those are initiatives, we'd like to take. And so it is, you may say unwritten but it's clearly in our thought process to strengthen the base of the ROE.

A - Charles Brindamour {BIO 7012323 <GO>}

I wouldn't call this a shift in strategy. I think we, we've said that we would build a very strong distribution platform. The benefit is that you generate stable earnings growth. The reason why we're scaling up our distribution is to make sure that we've got scale and distribution to invest in response in technology, put our product in front of Canadians in as many ways as possible. And our view is scaling up distribution is the best way to fight disruption. And when you look at the earnings stream we're building in home restoration it is countercyclical to the insurance product in property, but our objective there is really to make sure that we raise the bar in terms of the customer experience that we're providing, tapped into a market that has capacity issue. And yes, add to a stable stream of earnings, but it's part of a broader strategy.

Operator

Your next question comes from Tom MacKinnon of BMO Capital Markets. Please go ahead.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Thanks very much. Good morning. Just a couple of questions here. With respect to distribution income, I think Louis, you said you would expect it to be growing north of 20 [ph]. I assume that's organically because you are adding Frank Cowen to this going forward. That's the first question just got a couple of follow-ups.

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah. So my north of 20 was for full year 2019. Just to give a sense of where we finished the year. I have not yet commented on 2020. We're keeping that for Investor Day. And the transaction has not closed yet as you know. We're expecting that to happen in Q4. Before the end of the year. So we'll pick it up next year.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thanks. I think there was some comments about (inaudible) growth north of 7% in the second half of 2020. Was that with respect to a particular line or was that for overall?

A - Louis Marcotte {BIO 18040440 <GO>}

That's just with respect to personal auto.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Is there any commentary you can give on what you're looking for, like organically for the entire company then -- in this regard?

A - Charles Brindamour {BIO 7012323 <GO>}

So if we look at all lines of business combined in Canada, so bear in mind, I won't make a US commercial point, but the best data point I would offer on that is, we are writing right now our return rate change is 7.4% at the moment. Across all lines of business in Q3. So, from that point of view, that's the kind of level one should expect will be earned in '20.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So at the personal lines, I think it's north of 7% and overall it seems to be north of 7% then, and is there any reason why in the, you mentioned in the second half. Would it be lighter than that in the first half?

A - Louis Marcotte {BIO 18040440 <GO>}

I think the comment was, it would extend all the way through the second half. So when that necessary that well (inaudible).

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thank you. In corporate, there is a negative 15 [ph]. There is an expense of 15, it seems to be at least twice which you kind of run at, is there anything funny that happened in the quarter with respect to this other expense that you have in corporate?

A - Louis Marcotte {BIO 18040440 <GO>}

I wouldn't call it funny, I would say two non-recurring items both less than $5 million bucks that just happened to happen here. So I wouldn't read too much into that. These are non-recurring items essentially that hit our results in Q3. But I would I would take -- this can be lumpy in during the year and I would look on a year-to-date basis as a better reference.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, that's it, thanks.

Operator

Your next question comes from Meyer Shields of KBW. Please go ahead, your line is open.

Q - Meyer Shields {BIO 4281064 <GO>}

Great, thank you. I wanted to go back to healthcare just because I'm a little confused. You talked about the issues that are impeding the improvement to a low-90s. Those issues like with the physicians joining bigger practices those sound like issues in terms of premiums as opposed to losses, am I reading that correctly?

A - Patrick Barbeau {BIO 18476397 <GO>}

I think that way you have to read it as -- all the plan on the healthcare to bring it back to the low-90s was to exit really exposed class going into (inaudible) classes which means out of patient care facility, small physician situation and all of that. And what's happening in the structural healthcare system in the US is these tend to a bit does appear there is less and less private practice physician, they're moving into larger organization and hospital are sending acute care patient to outpatient facility.

So all of a sudden those facilities that were basically very small classes that really low exposure are now are picking up hospital type exposure. So we felt that this was a bit -- the market we were going after was a bit shrinking, disappearing and that made it very difficult for us to get that line of business back to the low-90s and would have cost a lot of volume. So we were getting smaller and smaller and smaller, so at some point you have to figure out that, it makes more sense to sell the renewal right and get out of the business completely.

A - Charles Brindamour {BIO 7012323 <GO>}

Our view is, exposure was changing in the facilities which we thought were low risk basically and so difficult to think that we could run that business in the low-90s and liability associated with those facilities is really hard to price for.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay, that's helpful. Thank you so much. Second question, and I don't know if it's related, but there was about $15 million of ceded adverse development. Was that healthcare-related. And can you let us know how much limit remains on the OneBeacon ADC.

A - Louis Marcotte {BIO 18040440 <GO>}

So I guess we have never provided the exact figures on the ADC. What we're saying is there is plenty of room on the ADC at this point in time, particularly as we're further into the transaction. So there is nothing specific to add to that. I think the view is there is still quite a bit of room on that.

A - Charles Brindamour {BIO 7012323 <GO>}

But it is fair to say though that the bulk of the ADC usage to date is driven by the exited lines.

A - Louis Marcotte {BIO 18040440 <GO>}

Absolutely, absolutely.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That is fantastic. I thank you so much.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

Your next question comes from Mario Mendonca of TD Securities. Please go ahead, your line is open.

Q - Mario Mendonca {BIO 2450557 <GO>}

Louis, just a quick clarification, you said that distribution income would be up about 20% full year '19 versus '18 now some of the growth we've seen this year has been pretty strong. It's possible that I'm not looking at the restated numbers. So when you offer the 20% one over the other. I think you're doing this is off of some restatements in 2018?

A - Louis Marcotte {BIO 18040440 <GO>}

Well, because of the, there was, reclassification. Let me just pull out the right number here. Because we moved from the EBITA [ph] remember we moved [ph] some of the earnings [ph] in the past to the EBITA, all right. And you're right. So let's just go to the right number. In the end just a sec. Do you have another question, Mario. I'll pick up the number.

Q - Mario Mendonca {BIO 2450557 <GO>}

It's not a huge number. I just. Clearly, you're talking about 2019. And I think if you could just clarify when you can either now or another time that you're talking on restated numbers. And then maybe a more general question. The performances here has obviously been very good. And it is interesting to see that every segment is delivering -- is exhibiting hard market conditions. So where I'm going with this, Charles, is, I mean the last time something like this was true was industry ROE, above 10%? Do you recall? And I don't mean specifically in personal, I mean, just generally and what are the conditions that cause something like this to eventually -- what upsets such a great market? What sort of conditions would drive a change?

A - Charles Brindamour {BIO 7012323 <GO>}

So to find similar conditions Mario, you want to go back in 2002, 2003 where the industry ROE dipped, I recall, to 2.7%. Number that's stuck with me and you're sitting today in a market that is sub-4% whether you look at the first half of '19 or '18 and you're in an environment where the industry, who is heavily invested in fixed income securities has a duration of three years is sort of seeing not only underwriting pressure from the past. That's being corrected. But it's coming at the same time as there is a headwind on the investment side of things for the industry. And so, in my view, you have good 12 months to 18 months. Pretty comfortable thing that of industry, trying to get out of what is a pretty tough profitability situation.

And so I think there is, there is a lot of digestion taking place at the industry level where the momentum is still good, it's not dissipating at this stage and the asset side comment that I'm making is one that gives me a certain amount of comfort that that there is more of it left in the system here, and so what could upset that? Because it is tough across all lines of business, the odds of upsetting the momentum we're seeing in my mind are fairly small.

Q - Mario Mendonca {BIO 2450557 <GO>}

But clearly an ROE approaching and I mean it sounds like pie in the sky now. But an ROE approaching 10% would be the sort of level where -- sort of hard market couldn't persist is that fair?

A - Charles Brindamour {BIO 7012323 <GO>}

I think it's fair. Yeah and we're not there.

Q - Mario Mendonca {BIO 2450557 <GO>}

Not even close. Maybe just a quick follow-up then. Do you see anything from a new entrant's perspective? Like any potential change in competition from [ph] new entrants and what do you feel like the regulators view on an issue like that is the concept of new entrants into this market?

A - Charles Brindamour {BIO 7012323 <GO>}

I think the regulators, I personally find are quite constructive. When it comes to new entrants, there are quite constructive. When it comes to us coming up with new products, stuff like UBI products that combine both personal and commercial lines we have found in most jurisdictions across the land in regulated line so automobile constructive regulators. So I think they'd be open to see -- even though it's super competitive, they are open to new forms of distribution, especially when consumers respond to it. And I think it's true of distribution. It's true of manufacturing.

Have we seen anything of substance taking place? Hard to say yes. Part of it might be driven by the fact that it's been an environment that was tough to navigate in the past few years, and it makes it harder for new entrants to find a niche. What we've seen, Mario, is-- what we think should take place is consolidation of distribution and we might not call that disruption, but a consolidation at the distribution level is certainly a powerful trend in the industry, one in which we play and lead.

And I think we'll prepare industry for disruption, because I think the vulnerability at the industry level is that you've got a bunch of sub-scale distributors who have a hard time investing in response and technology.

Q - Mario Mendonca {BIO 2450557 <GO>}

I see. One final just real detailed question that Louis might be best positioned for. The closing of The Guarantee acquisition, do you see any risk of this could spill into the new year, or are you confident this is by the end of the year.

A - Charles Brindamour {BIO 7012323 <GO>}

Mario. We have to get four approvals. We have three approvals and the Competition Bureau being part of the approvals, we've received to date with regards to our prudential regulator. I see. We've worked with them for many years on acquisition and the odds of having an issue, are very, very small as far as I'm concerned. So we're doing everything we can to close this ASAP. And I'd be very disappointed if it didn't close before year-end.

A - Unidentified Speaker

So we expect it full year next year. In fact, I will say (inaudible) was extremely helpful as well to get the file and to move it rapidly for an approval this year. So we're thankful there. Just on your first question, so all the numbers have been restated, you might remember, to EBITA [ph] numbers pure EBITA numbers for distribution. So the 20% I referred to is based on the EBITA figures that we've restated for the prior years. So if you look at 2018. Just to be clear, we reported 1.75 [ph] to which I would add 20% for the 2019 estimates.

Q - Mario Mendonca {BIO 2450557 <GO>}

I think I was, I may have been looking at numbers that weren't restated. I got it though. Thank you.

Operator

Your last question comes from Michael Phillips of Morgan Stanley. Please go ahead, your line is open.

Q - Michael Phillips {BIO 21023048 <GO>}

Thanks, just a real quick one. My own. Sorry, my own confusion on one more thing on the healthcare. It got moved into non-operating in July 1. You gave the year-to-date -- about two points. But was it in the 95 not [ph] in the third quarter.

A - Louis Marcotte {BIO 18040440 <GO>}

No. Nothing in the third quarter.

Q - Michael Phillips {BIO 21023048 <GO>}

All right, thank you very much.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you. And maybe before we close the conference. I want to take this opportunity to thank and Alain Lessard our SVP commercial lines who joined us from AXA in 2012, Alain has gave us a heads up, I don't know 18 months ago probably Alain, that you were considering retiring. And that will take place in the coming weeks. He has been an exceptional leader recognized for is depth in commercial lines, speed, as unwavering drive to improve performance. But more importantly for being very kind.

And I wanted to thank Alain because he has made a huge difference for us, for our platform both product, pricing, segmentation as well as technology. He of course will remain involved coaching, mentoring our leaders in commercial lines as well as assist us in our expansion in specialty line. In what I think as a long tradition of developing our succession internally, Darren Godfrey who you know very well will move to commercial lines to oversee our Canadian operations and continue to build on our outperformance there. Darren, tremendous track record in personal lines and claims and distribution. Led the personal auto improvement plan.

So bringing him in commercial lines is clearly a move that will help us deepen our commercial lines knowledge at the top of IFC and I want to thank Darren for taking up that challenge. Darren, will be succeeded by Isabelle Girard who drove a big portion of the personal automobile improvement plan you've seen in the past few years. Isabelle is -- many investors actually met is that well in the last year.

This was deliberate on our part as one of a good number of exceptional young leaders at IFC, and she will join the earnings call in 2020 and she'll have plenty of help because out of five people on the earning earnings call four people are or have been SVP personal line, so she should be fine. So I want to thank Alain for all his contribution and good luck to Darren and Isabelle.

On that. I'll turn the call back to Ken.

A - Ken Anderson {BIO 16846692 <GO>}

Okay. Thanks, Charles. So, thanks everyone for joining us today. 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 our website in the Financial Reports & Filings archive. Our fourth quarter 2019 results are scheduled to be released after market close on Tuesday, February 4.

Lastly, as already mentioned, we will be hosting our Investor Day on Tuesday, November 19, with presentations by senior executives, beginning at 9:00 AM Eastern. The event will also be accessible live via webcast and we invite you to visit our website for more details. And we look forward to welcoming you at that event. So that concludes our call for today.

Operator

Thank you for your participation, you may now disconnect.