Q4 2010 Earnings Call

Company Participants

- Charles Brindamour, President, CEO
- Dennis Westfall, Director of IR
- Mark Tullis, CFO
- Martin Beaulieu, SVP of Personal Lines

Other Participants

- Andre Hardy, Analyst
- Mario Mendonca, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Good morning. My name is Stephanie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corporation Fourth Quarter/full-year-end results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions)

Thank you. Dennis Westfall, Director of Investor Relations, you may begin your conference.

Dennis Westfall {BIO 15155973 <GO>}

Thank you, Stephanie. Good morning, everyone. A link to our live webcast and background information for the call is posted on our website at www.IntactFC.com under the Investor Relations tab.

As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call today.

Here with me today are Charles Brindamour, Chief Executive Officer; Mark Tullis, Chief Financial Officer; Martin Beaulieu, Senior Vice President, Personal Lines; and Byron Hindle, Senior Vice President, Commercial Lines. We will start with formal remarks from Charles and Mark, followed by a Q&A session. Martin and Byron will also be available to answer your questions during this Q&A session.

With that, I will ask Charles to begin his remarks.

Charles Brindamour {BIO 7012323 <GO>}

Thanks, Dennis. So this morning, we reported Fourth Quarter net operating income of CAD79 million, or CAD0.70 per share, down from the particularly strong CAD0.82 from a year ago. The early winter's impact on claims frequency and higher losses than expected from weather events in 2010 led to results below our expectations in our auto businesses, while strong results were reported in our other lines of business.

Overall, our combined ratio at 98%, up from last year's robust 94.6%, reflects higher catastrophe losses and lower favorable prior-year development. Looking at the current accident year, I am pleased to see an improvement in the loss ratio of 70 basis points versus the Fourth Quarter of 2009.

Net income for the quarter was CAD97.5 million, or CAD0.87 per share, up 7.4% from last year. We announced today that we are increasing our quarterly dividend by 8.8% to CAD0.37 per share, marking the sixth consecutive year that we've raised our dividend.

We also reported that we intended to renew our share buyback program once our current program expires. We believe that our strong financial position affords us the ability to return capital to shareholders, while retaining the flexibility to actively pursue broad opportunities in the market.

Our growth strategies continued to pay off, with a 4.8% increase in our premiums, despite our cautious approach to new business in Ontario auto and the cancellation of certain commercial group accounts in the prior year, which we've discussed a number of times last year. Our continued top-line growth reflects our organic growth initiatives, as well as improved industry pricing conditions, primarily in personal lines. For the full year, premiums rose 5.2%.

Overall, our underwriting performance and steady investment income resulted in an operating ROE of 13.2% in 2010 and GAAP ROE of close to 14%, notwithstanding our more than CAD800 million in excess capital. This is evidence that our strategies and action plans are working.

Moving on to our outlook for the P&C insurance industry in 2011, I would like to comment on growth, underwriting, as well as ROEs. 2010 has very much played out as we had anticipated for the industry. After nine months, the industry has recorded 5.3% premium growth in auto, driven by Ontario; 9.5% growth in personal property, in reaction to years of heavy water-related losses and more frequent and severe storms; and 3.3% income in commercial lines. We expect more of the same in 2011, which should translate into a growth rate for the industry in the mid-single-digit range.

From an underwriting perspective, again after nine months, the industry is tracking at about a 102% combined ratio. For 2011, we anticipate some improvement in personal lines, resulting from auto reforms in Ontario and continued premium increases in personal property, but do not foresee the industry earning an underwriting profit.

Finally, looking at the industry's return on equity, we do not expect improvement in the near term from the 7% level that it stood at through three quarters. Although underwriting income might improve slightly, we anticipate this would be offset by the negative impact on investment income from the low yield environment.

Looking specifically at Intact Financial, we believe that we are quite likely to outperform the industry's ROE by at least 500 basis points, which is our stated objective in 2011, given our current level of outperformance at 700 basis points for the ROE, our combined ratio advantage, our yield advantage and our significant capital management flexibility.

Specifically for Ontario, while the true effectiveness of the reforms will not be known for several months, initial signs are encouraging and consistent with the views expressed in the past few months. It is important to reiterate, however, that the reforms were not intended to address the degree of fraud that became apparent in the last year. That is why as a Company we are taking actions to fight fraud well beyond what the reforms were meant to accomplish.

For the industry, we estimate that the combined ratio is still well north of 110% and that premiums remain inadequate. As such, the level of approved rate changes for the industry announced earlier this year is a positive sign, but does not fully address the inadequacy in the system. Outside Ontario, the profitability of our auto businesses is strong and conditions remain relatively stable.

Pricing conditions in commercial lines remain soft, although we've benefited from firmer prices in the past year in a number of segments where we operate. Empirical evidence in the quarter continues to highlight that our focused approach is paying off in our commercial P&C business. We were able to grow our units 2.5%, in conjunction with putting through over 3% higher rates, while our reported top-line growth was more than 5%, if we exclude the impact of the canceled group that I referred to earlier.

In conclusion, 2010 marked a successful year for the Company, as our strategies and action plans continued to pay off. We grew our top line by more than 5%, improved our combined ratio by more than 3 points to 95.4% and increased our net operating income per share by almost 50%.

From a capital perspective, we ended the year with a strong balance sheet, despite having returned CAD0.5 billion to shareholders in the forms of dividends and share repurchases.

Looking ahead, we are excited about our prospects for 2011 and beyond, and believe that our disciplined underwriting and robust capital levels place us in a strong position to benefit from the environment in which we compete.

With that, I will now turn the call over to our CFO, Mark Tullis.

Mark Tullis {BIO 4180270 <GO>}

Thanks, Charles. Fourth-quarter underwriting performance was healthy, but below the particularly strong results of a year ago. The combined ratio at 98% exceeded last year's 94.6%, with a more normal seasonal weather pattern, compared to the unusually good weather last year.

Prior-year development was favorable at 5.3% of opening reserves, but less than last year, which included a CAD22 million release related to minor injury cap reforms. Top-line growth was solid at 4.8%, while earned premium growth reached 5.3%.

Slide nine shows results by line of business. In personal auto, top-line growth slowed from 6% in the Third Quarter to 4% as we adopt a cautious approach to new business while we make sure that the Ontario auto reforms and our auto action plans unfold as expected. We are also focused on managing and combating the ongoing issue of fraud.

Our disciplined approach to the Ontario auto market has led to a loss ratio outperformance versus the industry, which accelerated from 6 points in 2009 to 14 points in the first nine months of 2010. Renewals in the coming quarter will benefit from rate increases already in the system, and units should benefit as competitors raise rates.

Of note, underwriting results in Ontario were 5 points improved versus the prior year. Overall, the personal auto underwriting loss in the quarter is due mostly to Cats, as well as to the impact on claims frequency from the early winter driving season. Excluding the impact of Cats in prior-year development, the current-year loss ratio improved 0.8%.

Let me provide more detail on the level and nature of our catastrophe losses in the quarters. We are typically quite accurate in estimating the impact of weather events. However, this year, there were a couple of prior-period storms where I believe we could have done a better job, and where, with the benefit of a few months of hindsight, it is clear that we underestimated the impact of these storms.

One in particular, the rain storm that hit Ontario and Quebec from September 29 through October 1, was unique in that it overlapped two quarters. In total, the Cat losses in the quarter and for the full year fall into what I would consider a normal level, but 2010 again illustrated the lumpy nature in which they tend to occur.

In personal property, top-line growth continues to reflect low-double-digit premium increases, partly offset by a small drop in units. We increased segmentation initiatives in the past 12 months, and are comfortable losing unprofitable business. In fact, retention is best for the most profitable customers.

The 91.7% combined ratio was strong, but trailed last year's unusually strong 87.8%. We estimate the impact of our home insurance action plan to be roughly 13 points of combined ratio compared to the initial target of a 10; to 15-point improvement through mid-2011. While we believe the improvements already in place would get us to the top end of this range, we maintain focus, including rate increases, product changes and claims management.

Commercial auto reported solid results in the quarter, both from a top-line and bottom-line perspective. Premiums rose 5.8% and unit growth was particularly strong at 7.4%. The combined ratio of 93.9% was solid, but above last year's very low 70.4%.

Commercial P&C premiums increased 3.6%. While market conditions remain very competitive for new business, retention rates are solid, despite 3% rate increases at renewal. Underwriting income of CAD12.1 million was much improved from last year's loss of CAD7.4 million, as the combined ratio improved 10 points to 93.8%.

On the investment side, we generated about CAD73 million in net interest and dividend income. We expect this level of investment income to continue in the near term as growth in invested assets is likely to continue to be largely offset by the impact of the low yield environment. The continued market improvement positively impacted our AOCI balance, but also generated a loss on embedded derivatives. Book value per share increased 10% from a year earlier to CAD27.37 per share.

We ended the year in a strong financial position, with approximately CAD800 million in excess capital. Debt-to-total-capital at 13.9% remains below the target ratio of 20%. Because of our strong financial position and the quality of our earnings, we continue to return value to shareholders through an 8.8% dividend increase, as well as the renewal of our normal course issuer bid.

With over CAD1 billion in excess capital and additional debt capacity, we have plenty of room to return capital to shareholders while retaining the financial flexibility to pursue strategic growth opportunities.

Before closing, I would like to touch on capital requirements. In December, OSFI released a discussion paper on revisions to the MCT. OSFI had previously announced that the impact would be neutral to industry capital levels, and we were surprised that the discussion paper as currently drafted would lower aggregate industry MCT by 14percentage points, and a little less than that for Intact.

We have provided impact to OSFI on what we view as this most conservative outcome. It is too early to say how this process will end. However, we see no change in our plans or strategy as a result.

In summary, Intact remains well-positioned through its continued focus on operational excellence. We will continue to leverage our strengths and to take advantage of opportunities in the market.

With that, I will now turn the call back to Dennis.

Dennis Westfall {BIO 15155973 <GO>}

Thanks, Mark. Stephanie, we are now ready to take questions.

Questions And Answers

Operator

(Operator Instructions) Andre Hardy, RBC Capital Markets.

Q - Andre Hardy

Thank you. I have three questions. The first, on the quarter, what would the combined ratio have been if the Company didn't have to adjust reserves for storms that happened earlier this year -- so in 2010 calendar year?

Secondly, can you comment on the timing of implementing a shareholder rights plan, and what triggered that thought process?

And thirdly, Mark, related to your closing remarks on capital, one of the issues is that anything with a long duration will have a higher capital requirement. Can you comment as to whether perpetual prefs are still an attractive investment with higher capital requirements potentially?

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks for your question. I think Mark will take one and three, and I will take the one in the middle.

A - Mark Tullis {BIO 4180270 <GO>}

In my remarks, when I talked about the adjustments due to prior storms, what I really was talking about was not from prior years but from prior quarters. In the stat supplement, we've added something new this quarter, where we break down Cats by line of business and we actually show how much of the Cat is due to prior years.

There was what I would consider a fairly small Cat adjustment due to prior years, sort of in the CAD1 million sort of range. But about half of the incurred Cats this quarter, I would consider more accurately reflected to prior quarters.

So the sort of things I talked about in the -- if you look at the CAD27 million of Cats, about half of that, I would say, you could view as having maybe been more accurately reflected in prior quarters, as opposed to this particular quarter. And the net result is about 2% to 3% higher -- better combined ratio.

Q - Andre Hardy

Okay. That's helpful.

A - Mark Tullis {BIO 4180270 <GO>}

On the last one, let me make one other comment on the -- and one reason this is -- we say things like until this settles, it is sort of unclear what the results will be. There's the required capital levels and what we consider as excess capital is a function of many things, including, for example, rating agency requirements.

And the rating agencies have their own formulas. Many of the rating agencies already reflect duration of assets. So it is not a one-for-one thing, that if OSFI changes a formula, it would have a one-for-one impact on our particular situation. Because it depends, for example, on how the rating agencies react, if at all.

But clearly, one of the -- for our particular business, which tends to be short-term, one of the things we do look at is the extent to which perpetual prefs, which do have long durations, would impact the capital requirements. And obviously, it changes the relative attractiveness if -- depending upon where the OSFI rule ends up.

Q - Andre Hardy

And does it change it enough that the Company might incur some realized losses that today are unrealized as a result of these new capital rules?

A - Mark Tullis {BIO 4180270 <GO>}

I would say it would reduce the relative attractiveness. It doesn't necessarily follow that it would make them completely unattractive, and --.

A - Charles Brindamour {BIO 7012323 <GO>}

I don't anticipate meaningful realized losses at all, in fact, on that front. And I would like to point out, Andre, that our exposure to fixed rate perps is roughly a third lower at the end of this year than it was at the end of last year.

Q - Andre Hardy

Okay.

A - Charles Brindamour {BIO 7012323 <GO>}

The second question, the shareholders' rights plan, I think -- first of all, let me say that you shouldn't read anything into that, other than when the Group sold its shares in 2009, I think there is a number of things we had to tackle as part of that look that -- what it meant to be an independent company. Did a fair bit of analysis on that, had lots of discussions with the Board.

Felt that this shareholders' rights plan is good for shareholders from the point of view that it gives you more time to assess proposals when proposals come in. And therefore, decided to go ahead with it and will present it to the shareholders at the upcoming annual general meeting. Nothing to read into this, beyond just updating our toolbox here.

Q - Andre Hardy

So the timing was not triggered by a third party?

A - Charles Brindamour {BIO 7012323 <GO>}

No.

Q - Andre Hardy

Thank you very much.

Operator

Paul Holden, CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Hi. Good morning. A question for you regarding distribution. In particular, regarding the Desjardins acquisition of Western Financial and how that may or may not impact the way you distribute product in Western Canada.

A - Charles Brindamour {BIO 7012323 <GO>}

We have a multichannel distribution strategy, Paul, which includes Intact Insurance, which distributes to brokers, which includes BrokerLink, which is a broker that we actually manage ourselves and own 100%, which is meant to grow at the speed of a direct writer, which also includes in the Alberta marketplace a business called Grey Power, which is 100% owned by ourselves. So when I look at our toolbox in the Alberta marketplace and in the West, we really have a fulsome, multichannel distribution strategy.

The reason why we have this strategy is twofold. First of all, because consumers change, their demands change, their approach changes, and we want to make sure we can distribute our product through a number of channels. The other reason why we have a multichannel distribution strategy is because we expect that over time, new entrants will come into the marketplace and that the landscape will change, and that is why we are a team, in advancing that strategy.

So the change -- or the acquisition of Western Financial Group in Alberta at the high level will not change the strategy that we are currently pursuing, because it is because of things like that, actually, that we are developing our multichannel distribution strategy.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. So it won't necessarily change the way you've approached the direct market in, say, Alberta -- selling insurance through a direct channel?

A - Charles Brindamour {BIO 7012323 <GO>}

Well we have Grey Power in Alberta, who sells product to people that have been driving 25 years or more. And we have BrokerLink, who is developing rapidly in that marketplace through advertising and through the web. And I think as the market evolves, we certainly will calibrate our distribution strategy to be best-equipped to deal with new entrants. But this acquisition is not changing our strategy much, no.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Then maybe a somewhat related question in terms of consolidation in the brokerage community. Is that something you are still pursuing through Canada BrokerLink, and how robust do you think the opportunities are there?

A - Charles Brindamour {BIO 7012323 <GO>}

That is a good question. The focus when we talk to investors is of course about large manufacturing opportunities. But BrokerLink has been developing pretty quickly. And just to give you an example, BrokerLink in the Fourth Quarter actually closed an important transaction which will bring more than CAD95 million of direct written premium to BrokerLink -- not necessarily to Intact Insurance, but to BrokerLink -- which grows that business unit by close to 25%.

That is an example of the fact that there are consolidation opportunities in distribution, and clearly, BrokerLink is one of the players with strong financial backing. So it is in the cards to grow that business like that.

However, I want to point out that our core strategy with BrokerLink is to build a strong organic growth machine, with a strong footprint, a strong technology platform and an ability to generate response through marketing, similar to what direct writers could do. And I think we've talked about that at the Investors Day. I talked at the Investors Day about a desire on our part to participate in distribution consolidation, and clearly, that is what BrokerLink has been doing.

I also would like to point out that, as you know, we have equity participation or partnerships with a number of other brokers, from coast to coast, and we tend to line up with very strong entrepreneurs who want to grow their business, and we will keep doing that by supporting these guys through financing and equity participation.

It is very clear to us that in personal lines distribution, scale is very important. We repeat that to brokers as often as we can. Because in personal lines, to compete effectively in the future, one has to be able to invest in technology, one has to be able to invest in response, and that is clearly what we're doing with our own business units, and we want to help brokers keep doing that.

Q - Paul Holden {BIO 6328596 <GO>}

Final question, one of the other parts of your growth strategy is potentially expanding outside of Canada. I realize that is going to take time. But is there any update you can provide us with since the last time you spoke about it?

A - Charles Brindamour {BIO 7012323 <GO>}

No. I think -- just one thing to put things in context. When I talk about our growth strategy, I've outlined in the past what would pay off in the short-, mid; and long-term. And I've talked about the need to invest now to build a long-term pipeline. This is what the strategy is all about.

I would say that we spent a fair bit of time last year doing research in terms of where the opportunities could be. We have identified a number of opportunities which we are studying at the moment, but not prepared to give specifics this morning.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. Thanks for your time.

Operator

Mario Mendonca, Canaccord Genuity.

Q - Mario Mendonca {BIO 2450557 <GO>}

Charles, the improvement in your personal property, the claims ratio, excluding development and Cats, certainly, it has improved a lot if you look at it over the last, say, 12 months or so. But the improvement -- it is becoming clear that the improvement is starting to moderate, as you've essentially successfully implemented all those strategies.

When you think -- when we look going forward -- first of all, is that a fair statement, that the improvement is moderating? Then secondly, have you exhausted all the options you have available to you to take that claims ratio down? Or is there more that you probably could announce at a later date?

A - Charles Brindamour {BIO 7012323 <GO>}

Let me pass this one along to Martin Beaulieu, Mario.

A - Martin Beaulieu {BIO 15316652 <GO>}

Clearly, 2010 is a good year for the industry and for ourselves in personal property. I see the pressure though continuing to build on that line of business, as the trends and costs, mostly due to water losses and also weather-related losses, is not going away. So we've had a good First Quarter in terms of weather, but I think it is not the end of it.

So we are foreseeing that the market conditions will remain hard for 18 to 24 months still. And we have middle of the range of our 10 to 15 points improvement plan achieved. But we are not letting the ball drop on this, so we are continuing to invest in prevention claims and product changes, such that we would maintain a focus on the combined ratio. We don't expect, though, that the combined ratio itself will go much lower than it is right now.

Q - Mario Mendonca {BIO 2450557 <GO>}

So you would feel like you have accomplished -- you'd feel successful in this endeavor if you were to maintain things at current levels?

A - Charles Brindamour {BIO 7012323 <GO>}

I think that a fair statement -- I would say, Mario, if you look at -- first of all, when Martin says middle of the range 10 to 15, he is referring, I think, to 12, 13 points at the moment.

I think if you look at 2010, we have improved our combined ratio by about 13 points over that period. You have seen the improvement in that line of business moderate a little bit. And the question is, is there much left in the pipeline. I would say if you look at the direct written premium, this -- the rates in the direct written premium in the Fourth Quarter were up 7%. I don't think there is 7% inflation in the system at the moment. So clearly, from my perspective, there is still some room there. Certainly not at the pace we've seen in the past year, but I am hoping for marginal improvement.

The other thing, as Martin is referring to, is that we still have initiatives in claims, we still have supply chain management initiatives that will support our performance in home insurance in the coming period.

Q - Mario Mendonca {BIO 2450557 <GO>}

Thank you for that. A question perhaps for Mark. While this call has been going on, I've been trying to look at the yield you disclosed, the dividend interest yield, and just compare it to any external metric, whether it is like a five-year -- Canada five-years or 10-year yields. And you can see some relationships, but nothing -- not as strong as I would have expected.

With rates -- and I acknowledge more on the US moving higher, not so much in Canada -- is there anything you might point us to to help us understand how quickly that yield would change in relation to the broad interest rate environment?

A - Mark Tullis {BIO 4180270 <GO>}

So I think a couple of things. The yield curve in the US has tilted more so than the one in Canada. And as you know, we invest 100% Canadian. So unless there is similar yield curve movement in Canada, we wouldn't be as affected by much.

The other thing is the average duration of our bonds is fairly short. So changes in what -- I believe what has mostly happened in the yield curve is the very long-term bonds have gone way up, and there has been less movement in the sort of short to mid bonds. So I would say unless there is an increase in the five-year rate, I wouldn't see our bonds being impacted that much.

You know, we have a fairly significant amount of our investment income from shares, so dividend yields obviously have an impact as well. I think the comments I made at the beginning, during my prepared remarks, that in the short term I don't see much change in investment income is -- whatever -- relatively small changes in the yields are more or less offset by the relative changes in the amount of investments.

A - Charles Brindamour {BIO 7012323 <GO>}

I would like to add, Mario, that we are certainly not pricing for higher yield at the moment --

Q - Mario Mendonca {BIO 2450557 <GO>}

I understand.

A - Charles Brindamour {BIO 7012323 <GO>}

-- when it comes to the product.

Q - Mario Mendonca {BIO 2450557 <GO>}

And Mark, the short term means what -- 12 to 18 months?

A - Mark Tullis {BIO 4180270 <GO>}

Yes, during the coming year.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. Then a final question. Going back to the preferreds for a moment, or any fixed income securities, to the extent that these are securities issued by the banks -- and take into consideration what we learned from OSFI not long ago -- there could be some -- the banks could certainly be motivated to buy back or call these preferreds.

And I'm not referring to any innovative Tier 1 capital, where there could be an early call. I'm just suggesting that -- could Intact benefit in terms of the value of some of these preferred shares or any other securities issued by banks, to the extent that the banks truly are motivated to buy these back earlier? Are you seeing any kind of lift as a result of that OSFI announcement?

A - Charles Brindamour {BIO 7012323 <GO>}

That's one possible scenario Mario. I think when we look at what we are doing here, we are looking at that as one possible outcome, versus other outcomes, where prefs could become less attractive, back to your original question in terms of capital requirement. And we are trying to weigh all of that information in terms of assessing what is the optimal fixed rate perpetual position here. But it is definitely one scenario, indeed.

Q - Mario Mendonca {BIO 2450557 <GO>}

Thanks.

Operator

Tom McKinnon, BMO Capital Markets.

Q - Tom MacKinnon {BIO 2430137 <GO>}

A question about your comments about the P&C industry, talking about despite the potential combined ratio improvements, don't expect the industry to earn an underwriting profit in the next 12 months.

Well the industry combined ratio, as you said, is around 101 or 102. So under that scenario, it doesn't look like you are talking about much improvement in the industry combined ratio. And so why don't you think, given the fact that you are seeing some pricing improvements overall, how come you do not expect to see an industry combined ratio improvement? Then do you expect to see a combined ratio improvement for Intact, and why would Intact expect to have any combined ratio improvement over and above what the industry would?

A - Charles Brindamour {BIO 7012323 <GO>}

Let me talk about the industry, because I don't -- when we talk about Intact, we are basically saying that we are pretty confident we will outperform the industry's ROE by at least the objective we have been pretty consistently stating over time.

Q - Tom MacKinnon {BIO 2430137 <GO>}

I'm just talking about combined ratio here, more than ROE, right?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, I know. Let me talk about the combined. So at the end of September, it is indeed 102. I anticipate, all else being equal, mild improvements in the combined ratio of the industry, based on the outlook. I think there are a couple of factors that I would like to put in perspective for the industry.

The first one is that, overall -- and I think we've said it in 2010 -- 2010's First Quarter was pretty good. And in fact, if you look at the seasonality on page 11 of our MD&A, you see that for us -- and I would suspect that compares for the industry -- from a seasonality point of view, the First Quarter was at 98% of the year, while the average -- the six-year average First Quarter combined ratio relativity was about 101. So I think that is one source of caution, Tom, that I am bringing for the industry.

The second source of caution that I am -- that was implied in my remarks there is that when you look at the reserve development patterns of the industry, it has been much closer to 1% to 2% -- or 1% historically, while in the recent years, '08 and '09 at least, the industry's favorable reserve development has been in the 3.5% to 5.5% range. I personally don't see that continuing for the industry.

And you might say we are getting into some details, but this is what is bringing my caution in relationship with the industry's combined ratio improving by more than 2 points. I would be -- it's possible. I would be surprised.

When it comes to Intact Financial, definitely the First Quarter of 2010 was very strong because of the weather -- in part because of the weather; in part because of our action plan. So I think that comment applies. I think that from a favorable reserve development point of view, I do think we are in a better position than the industry, if I just look at the historical standard.

Third of all, I think that while the industry is catching up slowly on pricing, I do think that our action plan, which has paid off in terms of combined ratio expansion in 2010, will continue to pay off in 2011.

I would rather stick to my statement that I feel pretty confident we will outperform the industry's ROE by more than our stated objective.

Q - Tom MacKinnon {BIO 2430137 <GO>}

But you don't have an objective in terms of how you would outperform the industry combined?

A - Charles Brindamour {BIO 7012323 <GO>}

No.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And the reason for putting in comments about what is happening in the industry, is that because, in part, your results would have to be related to the industry's -- the movements in the industry? Is that what you are trying to flag here?

A - Charles Brindamour {BIO 7012323 <GO>}

Well what I am trying to flag is to give some context for my view on the industry's ROE. And that is why we talk about the various components of the industry. But as you know, we've been very cautious since becoming a public company of being too specific about our own performance per elements of the P&L. I think that is the right approach, and I intend to stick to that.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Then one quick follow-up, maybe Mark. On the operating earnings that you've put in there, was the tax rate somewhere around 18% on the operating earnings? And what should we be looking -- should we be looking at something closer to 20% going forward?

A - Mark Tullis {BIO 4180270 <GO>}

Yes, from memory, so there was a decrease of about 2% vis-a-vis last year. And we actually -- there is a reconciliation in the financial statements. I think it is Note 9 or something like that. But just a couple of (cough).

There was a reduction in the statutory rate, which is the base rate of about 1.5 points this year. So some of the reduction year-over-year, the biggest driver was basically the reduction in base tax rates. And as you know, a few years ago, there was a reduction put in place that is scheduled to reduce a little bit more over the next couple of years. So I would see a little more reduction in the base rate.

But the big thing that drives the movement generally from year to year or quarter to quarter is the proportion which is represented by dividend income. This particular quarter, quarter-over-quarter, the big driver was the reduction in the statutory tax rates. And that is -- we would consider that a permanent reduction, unless, of course, they change the tax regime again.

Q - Tom MacKinnon {BIO 2430137 <GO>}

So what should we be looking at more like -- on an operating basis? Closer to something under 20% going forward -- possibly under 20%?

A - Mark Tullis {BIO 4180270 <GO>}

You know, the way I look at it -- because I don't look at it as operating; I look at it as dividends and then everything else. And again, it is -- yes, I guess you can expect a little bit of increase -- or a little bit of decrease over from where it is this year going forward. But the statutory rate should reduce slightly next year.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks for that.

Operator

(Operator Instructions) Andre Hardy, RBC Capital Markets.

Q - Andre Hardy

Just two cost-related questions. The first, if you look at page four of your supp pack, you had an increase in commissions-related expenses, even though the claims costs also increased. And I was always under the impression that some of the commissions are based on profitability, and there is often a bit of an offset where if the profitability deteriorates, commissions tend to go down. So if you can help me understand what happened, that would be helpful.

And the second one on costs relates to fraud prevention. Have you put in place the people and the systems that you need -- presumably it is more people -- to prevent fraud? And if not, how much more cost should we expect the Company to incur?

A - Charles Brindamour {BIO 7012323 <GO>}

Why don't you start, Mark, with commissions? And I will take the fraud question.

A - Mark Tullis {BIO 4180270 <GO>}

Sure. So you are right about the -- I would say other things being equal, the commissions do tend to go up when the profitability goes up. There are reasons in the short run you can have apparent dislocation, if you look at it in total.

One is the profit scheme changes. It is different in every province, and it tends to be either two-year or three-year averages. The other thing is differing profitability between direct business and the brokerage businesses. So if you have a quarter where the brokerage business does relatively better than the direct, and then you're looking at total profitability numbers, the premium could do different. If you have situations where one province does better than another, you can have diff --.

So it is tough to look in total and draw a conclusion, other than over the long term.

A - Charles Brindamour {BIO 7012323 <GO>}

But I think the most important driver here -- and I think your observation is very good, Andre -- is driven by the fact that there has been a divergence in the last year between the direct performance and the brokerage performance. That is what explains this observation.

A - Mark Tullis {BIO 4180270 <GO>}

I think on the fraud thing, we've got people in place, and this is part of the cost of doing business and I wouldn't expect a meaningful bottom line that you would see from that.

A - Charles Brindamour {BIO 7012323 <GO>}

Well the work that they'll do, I certainly expect a loss ratio improvement. But I would not anticipate meaningful cost pressure as a result of that. We have put as -- we've talked about 40 people in place earlier this summer. And we beefed up a bit in the fall, invested in technology. But nothing that will move the needle from an expense point of view in the coming period.

Q - Andre Hardy

And your expectation is you would save more than what you've put in, presumably?

A - Charles Brindamour {BIO 7012323 <GO>}

Definitely.

Q - Andre Hardy

Thank you.

Operator

Mario Mendonca, Canaccord Genuity.

Q - Mario Mendonca {BIO 2450557 <GO>}

Just a couple of quick follow-up questions then on personal auto. If you look at the change in direct written premium per insured risk in personal auto, over last few quarters, that number has been a fairly strong number, 5%, 7%-ish. In this quarter, it kind of sinks back to low single digits, the way we've seen in the past. Is there anything you can point us to that would help understand why that would sink this quarter?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. I mean, the main reason is that we have slowed down marketing and advertising in the fall in the GTA, basically. As reforms unfold, I think we want to make sure that we want to give more credibility to the initial signs that we are seeing.

As I've said, I think the reform is sort of turning out as we anticipated, but it will take some time to assess. And we have been cautious in terms of putting ourselves out there from an advertising point of view. And this is, I think, one of the drivers in terms of why the unit growth has suffered in Q4.

And you know what? I do expect, Mario, that for the coming three to six months, we will have a bit of pressure as a result of slower advertising activity in the GTA.

Q - Mario Mendonca {BIO 2450557 <GO>}

I see what you are talking about from a units perspective, but the direct written premium per written insured risk, also the year-over-year growth there, we are not seeing what we saw in the past. I would've expected the pricing increases to still be in the system and take that higher.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. Well let me talk to that specifically. I think that one of the elements that we've observed -- and I've talked about that a number of times before -- but in personal lines, when you look at the mix, you recall the notion of average size of account.

So this is not rate-driven, because from a rate point of view, we are seeing, as I mentioned earlier, close to 7% in personal prop, close to 3% in automobile insurance. But the mix in personal prop is down 3.6%. So what it means is that we insure more condos, more tenants and smaller houses.

Then we are seeing a mix shift of about 2.7% in automobile insurance. And I don't know, Martin, if you want to comment on that. But I suspect this is one of the drivers of the question that you are asking, as well.

A - Martin Beaulieu {BIO 15316652 <GO>}

No, but that is exactly the mix that does that then. And on top of more condos and tenants, I think even in the home insurance. The premiums that -- the way we have restructured our pricing algorithms, we are driving away more of those -- we increase the price more, and they tend to be in the higher-premium band.

Q - Mario Mendonca {BIO 2450557 <GO>}

I was referring more specifically to personal auto. Is there -- there's a mix element there as well that would --?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes.

A - Mark Tullis {BIO 4180270 <GO>}

2.7%.

A - Martin Beaulieu {BIO 15316652 <GO>}

And for the year, it was more in the just below 1%, so --.

Q - Mario Mendonca {BIO 2450557 <GO>}

The mix in personal auto.

A - Martin Beaulieu {BIO 15316652 <GO>}

Yes. That's right.

Q - Mario Mendonca {BIO 2450557 <GO>}

So just less -- cars that are less expensive.

A - Charles Brindamour {BIO 7012323 <GO>}

Well it goes beyond that. If you look at the young driver growth we would have, for instance, in the direct writing operation, if you slow down the speed at which you grow your direct writing operation, in theory, the average age goes up a little bit. And as a result, your mix goes down a little bit in that.

But Mario, I think that I'm giving you one example of what might drive mix. There are a number of other examples, such as provincial mix as well. The speed at which you grow in the provinces, where the average premium is lower -- so we are now talking outside Ontario -- would have been greater in relative terms this year. So that would be another driver.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. Thanks for your help.

Operator

There are no further questions at this time.

A - Dennis Westfall {BIO 15155973 <GO>}

Thank you, everyone, for participating. The webcast will be archived on our website for one year. The telephone reply will be available at 1 p.m. today until Wednesday, February 16. The replay number is 1-800-642-1687. The pass code is 33110678. A transcript will also be made available on our website.

Please note that our First Quarter results for 2011 will be released on May 4. That concludes our conference call. Thank you. And have a good day.

Operator

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