Q3 2020 Earnings Call

Company Participants

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

Other Participants

- Brian Meredith, Analyst
- Doug Young, Analyst
- Geoff Kwan, Analyst
- Jaeme Gloyn, Analyst
- John Aiken
- Mario Mendonca, Analyst
- Michael Phillips, Analyst
- Paul Holden, Analyst
- Tom MacKinnon

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Intact Financial Corporation Third Quarter 2020 Results Call. At this time, all participants are in a listen-only mode. After the speakers presentation, there will be a question-and-answer session. (Operator Instructions). Please be advised that today's conference is being recorded. (Operator Instructions).

I would now like to hand the conference over to one of your speakers for today, Ken Anderson, Senior Vice President, Investor Relations and Corporate Development. Please go ahead, Mr. Anderson.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Carl. Good morning, everyone, and thank you for joining the call today. A link to our live webcast and published information for this call is posted on our website at intactfc.com, under the Investors tab. As usual, before we start, please refer to Slide 2 for cautionary language regarding the use of forward-looking statements which form part of this morning's remarks, and Slide 3 for a note on the use of non-IFRS financial measures and important notes on adjustments, terms and definitions used in this presentation.

Our executives who are joining today from across the country in Toronto we have our CEO, Charles Brindamour; in Montreal are Louis Marcotte, CFO; Isabelle Girard, SVP of Personal Lines; and Patrick Barbeau, SVP of Claims. And joining from Calgary is Darren Godfrey, SVP of Commercial Lines.

We'll begin with prepared remarks, followed by the Q&A. With that I will turn the call to our CEO, Charles Brindamour.

Charles Brindamour {BIO 7012323 <GO>}

Well, good morning, everyone, and thank you very much for joining us today. The pace of the COVID-19 pandemic, as accelerated in the last few months across North America, and it continues to cause significant pain and hardship on society. We are thankful for the dedication of health care professionals and frontline workers, throughout this year. Businesses have an increasingly important role to play in protecting and supporting their communities through this crisis, especially if the second wave is more dramatic.

We entered the crisis in a position of strength which has enabled us to support our customers while protecting employees. To-date, we have provided CAD510 million of relief to over 1.2 million policyholders. In response to the changing environment our relief measures are evolving towards rate strategies based on our customers' changing risk profile and needs, accelerated deployment of our UBI offering to deliver savings to customers for safe driving habits and lower kilometers driven. Innovative product enhancements in personal property to support work from home, and continued support for the most vulnerable small businesses to our ongoing policy and rate adjustments as well as the recently announced a CAD50 million relief program to support approximately 100,000 customers in the small business area.

It is our strong performance over the years that has enabled us to provide substantial relief to our customers. Now let's turn to results. Yesterday evening we announced third quarter net operating income of CAD2.78 per share, an increase of 46% over Q3, 2019. This led to an operating ROE of 17%. Our resilient operations along with the tailwinds from our action plans over the years and benign weather delivered a strong results.

Topline growth was a healthy 8% in the quarter with Canada growing at 9% and the US at 3%. The overall combined ratio was strong at 87.1% with solid underwriting performance across personal lines and commercial lines. There were no direct COVID-19 provisions recorded in the quarter as we again have seen no evidence to warrant the change to our initial Q1 provision. In Canada, the combined ratio of 86% was strong, driven by underlying performance and the low level of CATs, while US commercial lines delivered a solid seasonal 94.5%.

Let's now look at our results by line of business, starting with Canada. In personal auto growth was strong at 8% as our relief measures have improved our competitive positioning leading to high retention and robust new business. The combined ratio was solid at 84.9% with the underlying loss ratio improving 9 points. The underlying improvement is driven by our profitability actions, changing mix, benign weather and reduced driving activity.

Driving activity itself has increased since last quarter, and stabilized slightly below pre-crisis levels. Overall, the fundamentals in personal auto are solid, and I expect this business to operate in the low end of the mid 90s range next year.

Looking at the industry rate momentum has been impacted by the crisis. However, with an industry combined ratio over 100% at Q2, we expect corrective measures to resume as claims frequency returns to historical level later.

In personal property, premiums grew a strong 10% driven by market conditions, unit growth and the GCNA acquisition. The combined ratio of 83.7% was driven by our profitability actions over time and benign weather conditions. Over the last decade we've more than doubled the size of this business, while better protecting Canadians from the risk of climate change. At the same time, we've transformed our offerings, advanced our pricing and risk selection and move deeper into the supply chain.

Personal property performance is in the right zone, and I'm confident this will continue. In commercial lines, premium grew 11% reflecting the GCNA acquisition. Growth has decelerated, as this segment is exposed to the economic slowdown. I know that SMEs in certain sectors are severely impacted by the crisis and the economic slowdown.

We are here to support our small business customers through this difficult time, and our relief measures are ongoing and evolving. The 89.4% combined ratio in commercial lines reflected strong underlying performance, in a low level of catastrophes. I expect this business to operate in the low 90s next year. While the hard market industry conditions in commercial P&C have returned we continue to temper our rate increases for the most vulnerable small business customers. In commercial auto, the hard market conditions remain tempered by the crisis.

Moving to our US commercial segment, premiums grew 3% with the GCNA acquisition adding 5 points. Lower volumes in lines impacted by the crisis such as ridesharing and entertainment have setting the strong organic growth in other lines. The underlying loss ratio improved 0.8 points[ph] [0:02:49.2], driven by our ongoing profitability actions.

The combined ratio at 94.5% including 3 points of seasonality was solid. This segment is positioned to hit our sustainable low 90s objective. The US commercial market is hardening and we expect it to continue.

On the strategic front, our teams haven't missed a beat, advancing our long-term roadmap. Expanding our leadership position in Canada is front and center, and we've made significant progress. First, our customer experience is second to none. We reached a significant milestone in belairdirect with three out of four customers digitally engage with us.

Our mobile apps continue to lead across Canada with the belairdirect and Intact Insurance taking the two top spots in the app store, in the insurance category. And as the economies of reopen our digital engagements across our claims, apps and UBI have all remain at record levels.

Second BrokerLink recently surpassed 2 billion of premiums as it continues to grow organically, and through acquisitions. The growth story isn't done, as we've set a new premium target of CAD3 billion for BrokerLink. And finally, the integration of GCNA is progressing really well. And we're on pace to meet our financial objective on this transaction. Building a leading specialty lines players another one of our main strategic pillars, and our execution is continuing.

In September we acquired International Bond & Marine leader in the US Customs bond market. This stuck-in was in line with our strategy of finding opportunities where we can leverage our manufacturing capacity, gain deep expertise in specialty markets and capture an ongoing growing stream of distribution earnings.

In October we brought together our Canadian and US specialty platforms under a single brand, Intact Insurance Specialty Solutions. This is an important step as we build a world-class specialty platform. There is significant growth potential in this business, through organic and inorganic opportunities as we drive towards our objective of CAD6 billion of premiums running in the low 90s.

Finally, we have reinforced our commitment to be a best employer and support our employees through this difficult time. We've ramped up training and awareness around mental health issues, enhanced our diversity and inclusion strategy and invested more in learning and development. These initiatives have helped drive an all time high employee engagement across our organization as measured in September. As well for 2020 we're recognized again as a Best Employer in both Canada and the US.

Our outperformance mindset is what sets us apart from our competitors, and drives us to deliver on our promise to customers to support our communities, to transform our competitive advantages, and to build a world-class insurer.

In conclusion, we've made significant progress on our strategy, while delivering strong results. We ended the quarter with the robust capital margin, ready to manage potential shocks and invest in strategic opportunities that will come. Our book value is up 10% year-over-year and we're delivering a mid-teens operating ROE. Our employees have made this outperformance possible, and I want to thank them for their continued focus and hard work.

We've the best team, our business is very resilient and we're very well positioned to surpass, our financial objectives in the years ahead.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles, and good morning, everyone. The crisis continues to have an impact on society and we remain committed to supporting our customers, brokers, and employees throughout these uncertain times. With this in mind, we recently launched a CAD50 million targeted relief program for our small business customers, bringing our total relief to CAD510 million and covering over 1.2 million customers.

These new targeted measures will be entirely written and earned in Q4 2020 in Canada commercial lines. During the third quarter. The relief measures impacted our written premiums by 5 points, and our net earned premiums by 1 point. The unearned portion of the relief measures will impact net earned premiums in future quarters, offsetting the impact of reduced frequency.

At the end of Q3, the incurred losses related to COVID were less than CAD40 million, with more than 85% of reported claims already paid and closed. We are therefore, confident that our provision for both COVID related direct losses and bad debt remain adequate.

Moving to results. We delivered strong net operating results of CAD411 million up close to 50% versus last year driven by strong underwriting and distribution performances. Underwriting income grew 86% over last year driven by our profitability actions and benign weather combined with higher earned premiums. This was partially offset by our continued relief measures.

Net investment income of CAD143 million was down 2% compared to last year. This was mainly due to lower reinvestment yields, partially offset by higher invested assets from the GCNA acquisition. All else being equal, we expect net investment income for Q4 to be similar to Q3, reflecting lower yields. Distribution EBITDA and other income grew 45% in the quarter driven by underwriting profitability, organic and inorganic growth including divisions of FCC and on-side, as well as disciplined expense management. On a year-to-date basis, distribution income grew 24%, above our earlier expectations. When including Q4 earnings we expect full-year growth to be around 20%.

Now let me provide some additional detail on the underwriting results, beginning with Canada. Our action plans and our improved competitive positioning in auto led to solid results as units grew 6 points in the quarter and profitability was at 84.9%. The improvement was driven by a combination of better weather conditions, our profitability actions, lower driving activity offset by release measures.

With regards to our decision to exit the BC auto market, this will have a negligible impact on our underwriting performance. In personal property, organic growth was largely fueled by unit growth and a high retention ratio. The combined ratio improved 5 points mainly driven by our profitability action and mild weather. Conversely, the expense ratio increased 2.1 points, driven by higher variable commissions due to strong underwriting performance.

In our Canadian commercial lines, we saw premium growth of 11% in Q3, mostly driven by GCNA. The combined ratio of 89.4% reflected a solid improvement of 2.4 points in the underlying performance mainly driven by lower claims frequency in our profitability actions. The Canadian expense ratio of 29.8% for the quarter increased 2 points from last year. This was mainly driven by higher variable commissions due to continued improvements in our underwriting performance. We expect the full year expense ratio to be in line with our year-to-date figures.

Turning to US commercial. Keep in mind when looking at our Q3 results in US that there are 3 points or 4 points of unfavorable seasonality. Having said that, the underlying loss ratio of 57.3% in the quarter improved 0.8 points, which was largely driven by our profitability actions including migrating to a more profitable business mix. Despite the high level of CAT activity we've seen across the US landscape, none of these events generated losses that met our own CAT threshold. It has however impacted non-CAT losses in the quarter.

The US expense ratio of 39.2% was 0.8 points higher than last year, mainly due to the addition of GCNA's surety business. We expect the full year expense ratio in the US to be slightly lower than our year-to-date figures. Our operating performance led to an operating ROE, are close to 17%. In terms of our performance, we've generated 690 bps during the first half of 2020, well above our objective of 500 bps.

Now looking at our balance sheet. We ended the quarter in a strong financial position with a total capital margin of CAD1.9 billion and debt-to-total capital ratio of 21.2%. We remain on track to reach our 20% target over the next six to 12 months. We also have CAD500 million of cash at the holding company and our CAD750 million credit facility is entirely undrawn. Our book value per share increased 4% since June 30 to CAD56.22 million, thanks to solid earnings and favorable capital markets.

Before concluding, I'd like to draw your attention to the risk of an impairment loss of CAD96 million pre-tax in Q4, related to the equities that have not yet rebounded from the pre-crisis levels. This may change due to market fluctuations. But as a reminder, the impairment will not impact our capital position nor our book value per share.

Overall, we have maintained a position of strength throughout this crisis, and that has allowed us to continue to support over one million customers coast-to-coast. We are well positioned right now, both from a profitability and a balance sheet perspective, while the fundamentals of our business remains solid on both sides of the border. We stand ready to deploy capital as our opportunities arise during these uncertain times to add further value for our shareholders.

With that I will turn the call back to Ken.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would kindly ask you to limit yourselves to two questions per person. At this time at the end you can certainly requeue for follow-ups.

So, Carl, we're now ready to take questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Jaeme Gloyn from National Bank Financial. Please go ahead.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah. Thanks, and good morning.

A - Louis Marcotte {BIO 18040440 <GO>}

Good morning, Jaeme.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

I just wanted to dig into the M&A picture first off. And can you just really reiterate what you're seeing in terms of opportunities nice tuck-in with IB&M, but looking at the excess capital of CAD300 million to CAD500 million and then the credit line facility as well at your disposal. How is this part of the picture evolving?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, thanks for your question. Jaeme, yeah, the acquisition in the US which you just pointed to IB&M is very consistent with the strategy we've laid out to build a distribution footprint in the US to really helped scale up some of our operations in this case, our surety operation expand our reach and at the same time build our distribution earnings stream which as you've seen is very healthy and growing.

Now, your question is bigger than that, Jaeme I recognize and our thesis is very much intact 15 points to 20 points of market share here in Canada will change hands. In the coming years we think that with an industry running in the single-digit ROE range with the dislocation that is taking place, globally, and the pressure that COVID it's putting on institutions here and abroad we think that -- this is a good environment in the coming months, coming years for consolidation to take place. That's the first point. And as you know, expanding our position in Canada is our number one priority when it comes to capital deployment.

Second point, I would make Jaeme is that, there is a fair bit of activity at the distribution level in Canada as well. The joint venture we have with the number of brokers and then BrokerLink also very healthy deal pipeline, and we're really bulking up and helping a number of players, including BrokerLink to consolidate the space.

And again you can see the distribution income, earning stream here being a reflection of that activity. Clearly if you move south of the border, when you look at the performance of our US platform now known as Intact Insurance Specialty Solutions, you see that this is really operating in the zone that we were looking for before deploying capital that is low 90s, and if you take season into account that's very much where the business operates now.

We would look to deploy capital in that space, but we need to find a target that bulks up the strategy that we're focused on in the US, but I see an opportunity to consolidate a portion of that market as well. So I would say in aggregate, I think we are in a very healthy environment to advance our consolidation and acquisition strategy. And we think that there are opportunities to leverage our skills at integrating and creating outperformance on a bigger base.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Thank you for that. And second question, just digging into the US operations. Organic growth was down 3%, sorry 2% I guess, year-over-year in this quarter primarily on the rideshare and entertainment businesses. Can you talk about the organic growth outlook for the other lines were even those lines as well as we head in the Q4? And then in the 2021, what you're seeing in terms of unit growth and rate growth in the US?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So I think, high level the market in the US is hard, broadly speaking and when I look at our own business, and I leave aside the noise that COVID as related to them in terms of business activity, I see it as an upper single digit growth story, quite frankly. We've seen throughout the year, Jaeme that most of the lines of business that are not under profitability improvement plan are growing in the teens.

The lines of business that are under profitability improvement plan have been shrinking. I see that work diminishing next year because there's been so much heavy lifting that's been done by our teams that are trying to improve performance that all in we view 2021 for the US base as upper single digit sort of performance, a combination of rates tapping into the hard market, and then some unit growth as well.

But very healthy organic growth profile there. I don't know, I see Darren is nodding in Calgary. Darren do you want to add a bit of color?

A - Darren Godfrey {BIO 19791482 <GO>}

No, I think the only thing I would add to this show is you're right in terms of Q3, obviously some of the COVID sort of economic sectors you can think of sharing economy, and you can think about entertainment for example, where we saw some top-line pressure as expected. If we somewhat look at the other lines of business we are in the upper single close to double-digit range growth in the US on those other lines of business.

So again and a very consistent with what we would expect moving forward into '21 as well.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Thank you.

Operator

Our next question comes from Michael Phillips from Morgan Stanley. Please go ahead.

Q - Michael Phillips {BIO 21023048 <GO>}

Hey, thanks, good morning everybody. I guess first question is on a lot of talk on digital and in personal auto on UBI. I guess, how much of that do you think does the UBI uptick is more temporary because the times ran versus a longer-term trend that you think should sustain once we get out of the COVID crisis?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, I don't think it's temporary. I think that it is a trend. Clearly, there has been a jump during COVID. But, Michael, we've been very proactive for the past four years to build a massive telematics or UBI program and we're clearly you know, in the current context where it makes eminent sense for people to embrace that technology have been pushing this as a product that is really good for customers.

The reason why I don't see this coming down is because of the fact that the telematics offer is actually evolving a fair bit, and what you'll see at Intact and belairdirect in early 2021, is a broad range of value-added services that will be provided as part of our telematics offerings, will not just be about how well and how much to drive and what it means for your price. It will be about your driving experience and what Intact or belairdirect can do for you. And we will clearly tap on these new features as we enter into 2021 to make sure that the trend goes up.

You'll also see that the marketing game plan will very much back up this notion. We have a big lead in telematics and we want to make sure that we accelerate that lead going into 2021, and as I said it is in touch with times and what people are going through in terms of changing habits. And so, we're quite bullish about what telematics can do for our business. And we'll press the accelerator in the coming months.

Q - Michael Phillips {BIO 21023048 <GO>}

Okay. Thanks, Charles. I guess, second question shifting gears on your decision to combine the Canadian operations and US under kind of one roof, on the specialty operations there under one roof. Was that more of a marketing play to do so? Or are there maybe expected synergies that can come from doing it?

A - Charles Brindamour {BIO 7012323 <GO>}

You know, the synergies in my mind are independent of the brand. I think we have acquired the business in the US, and Mike Miller and team have done a phenomenal job in my mind to really connect our value offering, and specialty lines in Canada with our value offering in the US. And I think we've also established very strong cross-border capabilities and in a number of segments like entertainment, marine, surety, et cetera, we truly have a North American offerings. So, it just makes sense at this stage to operate under one brand and a brand that is distinct for specialty lines as we embark on the second leg of our growth in specialty lines, where we see a ton of opportunities, you know in that segment broadly speaking.

So it was more, you know people ask me when we did the acquisition, how about the brand? And I said brand as they two. Well, this is they two. It's just the normal continuation. But from an expense and synergy point of view we really have achieved what we wanted to achieve with the US platform. And I don't know Louis, if you want to add some color on that point? The branding exercise was not done with a major expense blend line.

A - Louis Marcotte {BIO 18040440 <GO>}

No, I would agree with you, Charles. Here, the most of the synergies were extracted early on. I would say, maybe there is still a bit more to be done on the claims side internalization and process, but and that you're seeing flow through quarterly as we improve the results, but the pure synergies were achieved, I will say probably in the first 18 months, 24 months of the transaction.

Q - Michael Phillips {BIO 21023048 <GO>}

Okay. Thank you, guys. Congrats on the quarter, and all the best. I appreciate it.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

Our next question comes from Geoff Kwan from RBC Capital Markets. Please go ahead.

Q - Geoff Kwan {BIO 7413168 <GO>}

Hi, good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Geoff.

Q - Geoff Kwan {BIO 7413168 <GO>}

Yeah. I have a question on personal auto pricing. Just wondering where you see yourselves versus peers.? Do you think there is still more room that they need to catch up to you on pricing? Just trying to understand is like, if we see further rate increases from them that could help here policies enforce growth in DPW growth?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, Geoff. This is sort of the question at the moment quite frankly because the team, and I were surprised by the strength of our growth in Q3. And in fact, I think there was everybody is surprised by the speed of our growth in personal automobile in Q3. Relief was largely in line with what we had guided before, but clearly the new business flow is very strong and then the retention is at an all-time high. And that's clearly a sign that the industry is catching up to some of the heavy lifting, we've been doing over the past three years. And we're entering, and I think this period where growth comes at the healthier clip, now that we're in the zone, we were aiming for.

And we're very happy to grow in this sort of environment. I'll ask Isabelle maybe she wants to provide a bit of color in terms of competitive positioning without sharing all the tricks with our competitors who always listen to those earnings call.

A - Isabelle Girard {BIO 21256467 <GO>}

Thanks, Charles. No, I think, to add to what you just said, I think the fact that we were fighting cost inflation in automobile for already a long period of time. We're already entering 2020 in a position of strength and the relief measures we have put in place have brought our competitive positioning in a very good spot. And now as Charles mention, that's part of why we saw a good growth in Q3.

So new business levels are robust and that is to be expect to continue a bit in Q4. Further, of course, there is still moving pieces. But we think our competitive positioning is very good as we speak.

Q - Geoff Kwan {BIO 7413168 <GO>}

Okay. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. I think one of the nuance that Isabelle has just made, Geoff is that we launched a big relief effort in late March. Now we stepped up the relief effort in automobile and it was needs based and risk base and I think what we've done in the second part of the summer is basically reflected a portion of the relief that we want to provide customers in our rate position, and it's clearly the response is very strong. So we're quite pleased with that.

Q - Geoff Kwan {BIO 7413168 <GO>}

Okay, perfect. And just my second question was I know it's a really small part of the business, but staying on personal auto the decision to pull out of the BC market. I'm just curious whether or not it was something to happen, maybe it did before we made the decision or after if there's been any discussions, with the government because obviously this is effectively reducing competition?

And then what would you need to see for you to contemplate reentering the BC market, if you were to do it at some point in the future?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And you're right that it's not a big part of the portfolio, and Louis will give you a bit of perspective on what it means from a topline point of view. But look, Geoff, I mean we've been at it for 20 plus years. And as you know you're trying to compete on a small part of the marketplace against the monopoly we subsidizes one part with the other has made it very difficult, and it's one of the areas of the organization, probably the only area of the organization we're hope was part of the strategy. And I'd say in the last year we lost hope there, yet I think what would be needed, and we've gotten the capabilities to serve the marketplace extremely well in BC. We are fully equipped to run. I think the way to go, in BC is to open up competition across the board basically and compete against the platform in place now, but to compete in a small part of the market, which the monopoly is subsidizing is just unpinable[ph][0:00:25.7] from a strategic point of view. We thought people were sort of eventually, realize that the best thing for drivers in British Columbia, would be to open up competition. We just don't see that happening at this stage.

And we've got so many growth opportunities now on the platform that we've decided to redirect our efforts we're private markets operate effectively and where we can give customers the best deal we can.

Q - Geoff Kwan {BIO 7413168 <GO>}

Okay. Thank you.

Operator

Our next question comes from John Aiken from Barclays. Please go ahead.

Q - John Aiken {BIO 21267604 <GO>}

Good morning. Clearly, I appreciate all the guidance that you gave us for the fourth quarter. Just wanted to talk about the distribution EBITDA for a moment. Can you remind me about the seasonality expected in Q4 given the expected drop-off in the fourth quarter from the third quarter based on your 20% growth target?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, so I guess historically it's probably in the 24%, 25% or quarter of the earnings in the fourth quarter. So, that would be historical. Having said that, it fluctuates a bit based on when the brokers will record some CPC, and so we have to be careful with the variations. And the guidance, I provided earlier was really meant to say there is 46% growth in Q3, don't -- well let's not carry this over into Q4, because that's not what it -- how it's going to work.

So this is what we're trying to sort of clarify, in giving the overall year guidance, if you want. So I'd be careful. Normally, I would say you would expect to have a light Q1, a heavy Q2 and then the other half of earning spread between Q3 and Q4, but it does vary a bit and I want it to be specific enough so that you have the right idea of what Q4 will look like in terms of what we expect.

Q - John Aiken {BIO 21267604 <GO>}

Fantastic. Thank you. And then in terms of the personal auto claims ratio, obviously we saw a step back in the quarter because of the number of kilometers driven, but are we seeing the increase in the claims ratio? Is that actually commensurate within the amount of kilometers driven of course, ex the impact accounts?

A - Charles Brindamour {BIO 7012323 <GO>}

Isabelle may be, you want to? I think in the context of Canada, it's always better to compare quarter, one year from the next because there are seasonal patterns here. Isabelle why don't you explain high level the underlying improvement in personal auto? And how it's largely breaks down? And then we'll give you a perspective on what driving as shown throughout the summer right until today. Isabelle?

A - Isabelle Girard {BIO 21256467 <GO>}

Yeah, sure. So in terms of looking at the improvement in the underlying loss ratio in Q3 versus the same period last year, where we think about 9 points of improvement and we estimate that three quarters of this improvement is coming from our actions. So mainly rate action, risk selection actions and claims actions we have taken in the past. So, and that the remaining quarter would be explained by the benign cost environment that were hidden[ph][0:01:03.5] due to the pandemic, net of the relief we gave and different mix of claims.

So that's what we see in our improvement versus last year. In terms of driving what I can say is that since April as we said last quarter, driving is returning progressively since then and at an increasing pace, that's why (inaudible) [0:01:30.7] I would say a bit by province as governments were either re-opening the economies or I think new restriction at different points in time, but since the summer we're still seeing the driving level increasing.

I would say that as we speak today we're still below normal levels in terms of driving. And in terms of frequency at the driving as increasing we saw that frequency[ph][0:02:00.0] also increasing at the same time. And since the end of the summer frequency has stabilized as well below normal levels. So that's what we see today.

A - Charles Brindamour {BIO 7012323 <GO>}

But driving is now sitting here within 10% of what it's been historically, basically severity is up a bit, but driving is roughly within 10% now fluctuating across the land.

Q - John Aiken {BIO 21267604 <GO>}

Thank you. I'll requeue.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks.

Operator

Our next question comes from Brian Meredith from UBS. Please go ahead.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thanks. Charles, I'm just curious, you know, you've talked about it is a little bit, but I was a little surprised as the outlook with respect to personal auto direct premium written growth for the fourth quarter, just kind of mid to high single digits. I would have thought without any premium relief coming through, it could be double-digits. Maybe a little color around that?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. Isabelle, do you want to provide a bit of perspective there?

A - Isabelle Girard {BIO 21256467 <GO>}

Yeah, sure. So as we explained a bit earlier our Q2 growth at 8% including the impact of relief was really driven by our improved competitive positioning and driven in part by high retention and robust new business.

So that's why, as we are sitting here today, our best guidance for our Q4 growth would be mid-to-single, mid to high single-digit for Q4, knowing that we have -- moving, we've moved from our relief program to rate strategies. And as I said, I expect that, us and other peers may continue to move as well. So, that's why our guidance is aligned with the growth we saw in Q3.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you. So competition has picked up, I guess what you're saying?

A - Isabelle Girard {BIO 21256467 <GO>}

I guess is reacting to inflation as we do.

Q - Brian Meredith {BIO 3108204 <GO>}

Got you, got you. And then, Charles, I'm just curious, your guidance with respect to the personal auto combined ratio next year kind of the low end of the mid to low '90s as you're talking about. Is that contemplating some normalcy in the claims frequency environment?

A - Charles Brindamour {BIO 7012323 <GO>}

No, I think that we are expecting that we'll be a bit in the low in 2021 from the driving and frequency point of view. And we do expect it return to normal driving level that is bridging the small gap, we're seeing now by year-end. And to a certain extent that is reflected in our temporary price position which were equipped to reverse should driving returned back to normal, but when I look at the overall cost environment at the moment and some of the work that we've been doing, which is flowing through our performance in mix and quality of portfolio, we think we'll be at the low end of the mid 90s sort of range for the foreseeable future.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Okay.

Operator

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

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks very much. Good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

I've heard retention mentioned more on this call than normal and I get the impression that some of the premium relief measures are helping with retention, if you can clarify that. Is that strictly in personal auto? And what's going to happen, maybe you can put some metrics around retention as well, just to show how much it has improved? And what's going to happen when some of these relief measures kind of wear off? Do you think the retention has been change at all? And have you experienced, what's retention like outside of personal auto and personal property? Or maybe in commercial where you given some hard pressed industries and some relief as well. And I have a follow up. Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, Tom will ask Isabelle and Darren to share a perspective on what they see in their respective lines of business, but I would say from my own point of view historical high across the board in terms of retention. And I think it is a function of tight market capacity in both auto as well as commercial lines. And the heavy lifting we've been doing for three years which is also slowly eroding from a competitive disadvantage point of view, and all of this is paying up. But why don't we kick it off with Darren in commercial lines, and then we'll go to Isabelle.

A - Darren Godfrey {BIO 19791482 <GO>}

Tom, so as you would expect, I mean obviously there are different sectors within the portfolio experiencing different profiles given the economic realities of the crisis today. So when you think about more on the more vulnerable customer side. So you can think about hospitality and retail. We do see a little bit of pressure there from a cancellation standpoint. Not material, but definitely there is a little bit of pressure there.

On other segments of the portfolio, which are not as impacted by the economics we see either flat or slightly improved retention. So again it's very much depend upon sort of where we're at sort of an economic cycle standpoint. New business levels are starting to pick up as well too. It's a reflection of I think capacity challenges within the marketplace. Obviously we've been very cautious and prudent relative to quality, but definitely, I think the growth profile is changing a little bit, but again, it's difficult to make broad brush comments because it is very much sector by sector that we're watching very, very carefully.

Obviously, I mean obviously you saw the announcement around our relief program there to further support our most vulnerable P&C customers there 100,000 customers coast-to-coast. So we believe that will help as well, but again were monitoring wise too in particular and modulating rates as we need to, based on the crisis as it unfolds.

A - Charles Brindamour {BIO 7012323 <GO>}

But Tom maybe if I put some numbers on that. Darren, correct me if I'm wrong, but historically in commercial lines, you would be in the upper 80s in terms of retention in units. That is in units I'm talking about. And if you look at September for instance, here in the 91% range. So a couple of points of retention change like this is very good, because we know that the more loyal/mature business as always better business in terms of loss ratio performance. So a nice pick up in commercial lines. Let's look at personal lines. Isabelle?

A - Isabelle Girard {BIO 21256467 <GO>}

Yes. So as you mentioned, part of the various form of relief we have provided was in the rate tempering or rate increases at renewal and that's because in retention to increase accordingly. So in both lines, I would say. So in personal auto as of example a bit like Charles when he was mentioning in commercial, we were running in the upper 80s and low 90s retention ratios in units. And in Q3, we saw as an example, the retention ratio increasing close to 94%. So meaning that we're keeping 94% of our clients at renewals. So that's one of the highest point we saw in retention in the last 24 months to 36 months. So that contributed to the growth we saw in Q2 in personal lines in general.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, and I would Isabelle what you say 24 months to 36 months, I would go so far as to say probably 20 years. 93%, 94% combined retention in personal automobile is extremely high, and we are seeing very strong retention in both channels. So we're quite pleased with that. And in fact if you look at what most people expected from a topline point of view in auto and what we expected versus what actually happened, I'd say 40% of the spread in expectations was driven by retention. 40% of the spread then was driven by new business generation. So very pleased with that.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thanks. And then the second question has to do with disruptors. We just saw another one kind of come out here IPO recently Root, Lemonade, and companies aren't necessarily in Canada, but they are potential disruptors to what extent maybe Amazon or Facebook might come into that play as well. I mean they have -- they social media to market that, I guess I just assume that some sort that the distribution edge. And can they replicate your pricing and segmentation edge as well? What are you doing to the 10 year you've space against these potential disruptors? Is it simply just by trying to change mix, or maybe you can discuss some of the points around that?

A - Charles Brindamour {BIO 7012323 <GO>}

Sure. I think Tom, we've been focused on disruption for 10 years, I would say. We've been far more focused on preparing for disruption than competing with our existing competitors quite frankly. And you know for disruption to actually take effect you need in our book two things, you need better design, and you need better value for money.

And so if you've got both then you can promoted at scale, you've got a good shot at potentially disrupting. So, if you look at the agenda that we've presented to investors over the past decade, you'll see that there has been a lot of focus on the digital tools, the role of our design lab and the customer experience broadly speaking.

You'll have seen that we are dramatically changing the experience in the direct channel, through our insurance simplified project and you've seen in the direct channel big drop in the expense ratio to make sure that we can compete on affordability or just value for money, if somebody came in to do things dramatically differently. You've seen us invest aggressively in our brands, both Intact Insurance and belairdirect who are two leading insurance brands in the country.

And the other thing you've seen, Tom is a big focus on creating optionality in distribution. You've seen us build Intact Insurance then bring Intact Insurance online even though we distribute to brokers, you've seen the build up of belairdirect then you've seen us build a massive personal lines distribution platform with multi-options which also provides a ton of optionality.

So that is on the sale, distribution and customer relationship side of things. The other edge, that is very significant is the product we actually delivering, by that I mean claims. Our perspective when it comes to disruption that the work we're doing to get our customers back on track in the physical world is quite differentiating. And so it is depreciating from a cost point of view, and it is differentiating from an experience point of view.

So, the whole in-sourcing of the supply chain process and taking in charge, the experiences, we see a differentiator with often how people see the claims process as a financial transaction. We don't see the claims process as a financial transaction. We see the claims process as getting our customers back on track and we've built quite a force there.

The last point I would make Tom is the importance of data in the disruptive process and as you know you could say we're a data shop. We've been harvesting our own structured data sets for decades. We're tapping into unstructured data sets. We're tapping into external datasets. Telematics is a great example of a massive program that we have built and it's all backed up by a huge team of machine learning experts in our data lab, few 100 people in addition to the data experts that we have in the rest of the organization.

And so when you stack all that together, I would say, we're paranoid of course that's our makeup, but we're quite equipped to face distribution. And the last point I would make, in terms of optionality as you've seen in the past three, four years a lot of emphasis on commercial lines, specialty lines and opening up a big pipeline of growth in that segment to make sure that should there be growth pressure in personal lines in part because of disruption or change in how people move we've got big pipelines of growth outside as well.

I don't think we -- there is a dependency on that, but our strategy is one of plenty of optionality.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks so much for the color.

A - Charles Brindamour {BIO 7012323 <GO>}

Pleasure.

Operator

Our next question comes from Mario Mendonca from TD Securities. Please go ahead.

Q - Mario Mendonca {BIO 2450557 <GO>}

Good morning, everyone. First on, I want to clarify some guidance you've already offered. I think you said that, you'd expect mid to high single-digit growth in direct written premium personal auto in Q4. Did I hear that correctly?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. You did.

Q - Mario Mendonca {BIO 2450557 <GO>}

Yeah. Thank you. And can you offer anything about 2021? Because presumably the premium relief will continue throughout. Would I be correct in saying the entire year, at least the first half of the year?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I think that's fair, Mario. I would -- I'd be inclined to think about 2021 in the mid-single digit range. The thing you need to keep in mind is that the exit of BC will be, I think a pointing that. Louis, can you confirm? (Multiple Speakers) Yeah. So look, Mario we've been surprised by the pick up, so to speak, in the last 2, 3 months. So we're thinking about auto with BC in the mid single digit range in 2021, but subject to adapting to the environment that's our best guess at this stage.

Q - Mario Mendonca {BIO 2450557 <GO>}

And that's despite the premium relief?

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah, that's all in.

Q - Mario Mendonca {BIO 2450557 <GO>}

So let me, how do we think this through? I've been in the notion that at some point the frequency would increase or return to normal. The premium relief will still be in place and it could result in some lumpy quarters. I think that was the word you used to describe this earlier on in the process. Is that no longer your view? Is it fair to say now the premium relief is being matched up with a gradual increase in frequency there is nothing really abrupt happening here that could cause lumpy quarters?

A - Louis Marcotte {BIO 18040440 <GO>}

We don't see abruptness. I think what we see Mario is running the business, of course taking seasonality into account at this stage at the low end of the mid 90s. But we don't expect too much lumpiness as a result of relief at this stage. Isabelle you want to add any color to Mario's question?

A - Isabelle Girard {BIO 21256467 <GO>}

No, I think you're right, Charles. The only color I would love is that we also have an increased momentum going on. So, even if we have relief that will behind throughout Q4 and 2021 will serve as a earned increased momentum on top of the benign cost environment we are operating in.

So I think that's why we are believing that we'll be able to operate at the lower end of the mid-90 range in personal auto.

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah. Keep in mind, Mario, there was a lot of heavy lifting done pre-COVID here that is still earning through the system.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. Thank you.

Operator

Our next question comes from Paul Holden from CIBC. Please go ahead.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. So, first question I want to ask is regarding the distribution EBITDA. So the guidance for the year is helpful. I'm wondering if you can help us with those contingent commissions. How much of that added to growth in 2020? And what I'm really trying to get to hear is for 2021, the growth is likely going to be a little bit below normal because of that. And that's what I'm really trying to solve for? So anything you can help us on contingent commissions or otherwise would be appreciated.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, that's I think profit sharing indeed, but Louis why don't you take that for Paul?

A - Louis Marcotte {BIO 18040440 <GO>}

Sure, Paul. So let's unpack year-to-date, as one example. Here we're around 23%, 24% growth. About 10% is our existing broker plant. What we would consider organic growth and that would include the impact of CPC. Then you have about 5 points, which is the result of M&A. So the inorganic impact on BrokerLink and our other brokers. And then the remainder would be the impact of adding On Side and FCC.

So that's roughly the three main components that we expect. Going into next year the pace will slow, but it's still expected to be a fairly healthy growth pace, and this would be -- the sharing here of course On Side and FCC will become organic, I would say. Here the M&A impact is probably similar to what we've had year-to-date. So mid-single digit area. And then we do expect a higher contribution from On Side and FCC next year, that will juice up with the growth. And that's simply accelerating the earnings mostly at the On Side side into 2021.

So I would say next year an expectation probably year slightly above 10%, and split between organic, a bit of a M&A, and then top up with the On Side and FCC.

Q - Paul Holden {BIO 6328596 <GO>}

Perfect. That's very helpful. Second question, is related to net investment income, obviously seeing some pressure on refinancing rates. I guess the question is, are there any shifts you're that are taking place in the investment portfolio to offset reinvestment pressure either actions taken to-date or things you're contemplating over the next 12 months?

A - Charles Brindamour {BIO 7012323 <GO>}

I don't expect a major shift in the portfolio. These are, I'd say tweaks here and there. In the portfolio we're very cautious, as you know. And there is some pressure clearly. Going one way we're seeing a bit of erosion on the other side the growth in assets. So to some extent they offset each other and help us sort of (inaudible) [0:02:48.7] the pressure here, but you would not expect us to take -- you should not expect us to take massive moves here in terms of our asset mix or investment style to chase higher yields. We do on the margin, but it's not a huge changes, and it doesn't move the risk envelope very much.

Q - Paul Holden {BIO 6328596 <GO>}

Got it.

A - Charles Brindamour {BIO 7012323 <GO>}

You know on the contrary I would say that we've taken a cautious position on the asset side of the house, early in the crisis to be able to defend against volatility but also to make sure that you know at all points in this crisis, we would be in a position to take advantage of opportunities. So reaching for yield and expanding the risk envelope has not been one bit our approach to-date.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you for that.

Operator

Our next question comes from Doug Young from Desjardins Capital Markets. Please go ahead.

Q - Doug Young {BIO 5640851 <GO>}

I get to say good afternoon. Two questions, here. And Charles I know I've asked

You this in the past, and it comes and goes. But given what I've read in The Globe and Mail, and I know that's maybe placed always go to, but are you at all worried in Canada about the commercial market becoming regulated? And has there been any discussion around that with the government or with the regulator?

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks, Doug. Look, I think the commercial lines market. No, I'm not worried that it becomes regulated from a pricing and product point of view, I think that, and the reason why I'm not overly worried about that is the fact that coming into this crisis the market was tight, meaning that the industry ROE was single-digit and commercial property was under, and commercial P&C was under pressure, right. It was liability inflation in the system.

And then the impact of natural disasters put a fair bit of pressure on property and there has been 10 years of sub-market in commercial property. Now people forget about that now, but there has been 10 years of soft market in commercial P&C.

Then COVID happens, and the investment income potential comes down. You get a fair bit of pressure on the claims side of things. Now we've reserved for all of this in Q1, and we're in good shape, but the industry is under -- has been under pressure as a result of claims. So clearly the capacity issues that existed in the first place have been exacerbated by COVID, and then you layer on top of that the demand that reinsurers have made. In terms of awarding and so on, you have to acknowledge that there are areas of the market where capacity is tight. With COVID there has been a number of class actions on long-term care facilities for instance. And then there is moral hazard of vacant buildings that is also an issue.

So long story Doug, but I think the nuance is important here. In the high-risk areas of the market. Take bars, restaurant, with heavy liquor liability this part of the market was largely served by foreign operators, and a number of them left and this has led to a capacity crunch only small -- very small portion of the market, because it's still very competitive in commercial lines. But a number of foreign operators left, and this has created a bit of tension.

Now, I don't think you bring capital back in the industry by regulating. The problem is capital is left, not people are doing extremely well in commercial lines. And I think that people understand this dynamic. That being said solutions need to be found. So we're leading a solution with the industry to ensure uninsurable risks and there is a number of mechanisms that are being put in place to address the issue here, but I don't think regulation will solve the problem.

It's not that people are overcharging. It's because capital has left the system. And I don't think scaring insurers is the way to bring back capital in the system. And that's my sort of analysis of the situation. We've been providing a ton of relief in commercial lines.

We're growing our commercial lines platform. We've frozen rates for vulnerable customers. We've just announced a CAD50 million relief program in that space and quite frankly the large leaders in the marketplace are stepping up at the moment. The issue is number of foreign operator in the high-risk base has left -- have left.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And so it doesn't sound like the regulators really breathing down your neck or there is that discussion going on. Like I get all your explanations, and it's absolutely logical. I think regulatory team logical, but it doesn't sound like that a real concern you're having right now.

A - Charles Brindamour {BIO 7012323 <GO>}

No, I think that there is a dialog and were capital has left the system we need to find solutions. And that's where the dialog is taking place. But, so the regulation won't sell the system, it will make it worse, if not far worse, if you want my opinion.

Q - Doug Young {BIO 5640851 <GO>}

And my second question is, my question I actually I just received, and it's the industry, I think you quoted the industry as having fine ratio is about 100% and ROE, so around 5%. It doesn't seem like that's really improved materially, despite some of the favorable headwind and that 2020 as provided and we're seeing some good results out of you and some of the others. Is there a certain segment of the market that's really performing absolutely horrendously and then certain segment of the market that's doing really, really well? And I am just surprised by that.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So I think there is two things, Doug. One of the things we've seen in the first half of 2020, which were we surprised yes or no. I don't know, but adverse development from the past in automobile insurance has been a problem and we've been at it since 2016, there's a lot of heavy lifting, you've seen us take a cautious stance in reserve, a few years back, I think that is taking place now at the industry level and as such, putting pressure on the overall performance in automobile insurance, even if you could expect the benign sort of cost environment.

Commercial lines performance overall, first half of 2020 has been very bad, at the industry level. So you know, depending on the province in which you operate, you see 105, 110-ish type performance in commercial lines and that's why you know, my view is, you've got a capacity issue, clearly an opportunity for us. And, but that is the nature of the market, and hence the industry's result. I expect things will get better this year, but there is a fair bit of digestion to do in this industry to return to historical levels of performance from an ROE point of view. And that's why our view, Doug, has been you know when we were asked before the crisis, how long will the hard market last, Darren had done a very good analysis last year to say, we think it will be 24 months.

And you know, this has been put on pause to a certain extent you know, depending on the line of business, but there's a lot of work left to do to improve the performance and the attractiveness of this industry, for say average players, gladly we've done that early on. And now I think the topline is benefiting and the bottom line is doing well, and that's how we operate as a firm, we've shown that in the past and trying to -- to win in this environment.

Operator

This concludes the Q&A portion of our call. And I would like to turn it back to Ken Anderson for final comments.

A - Ken Anderson {BIO 16846692 <GO>}

Thanks everyone for joining us today. 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 and filings archive. In closing, our fourth quarter 2020 results are scheduled to be released after market close, on Tuesday, February 9th. Thank you again. And this concludes the call for today.

Operator

Ladies and gentlemen, this does indeed conclude today's conference. Thank you once more, for participating. You may now disconnect.