Q1 2019 Earnings Call

Company Participants

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

Other Participants

- Brenna Phelan, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- John Aiken, Analyst
- Mario Mendonca, Analyst
- Meny Grauman, Analyst
- Michael Phillips, Analyst
- Paul Holden, Analyst
- Sean Reitenbach, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Good morning. My name is Cheryl, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corporation Q1 2019 Results. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will a question-and-answer session. [Operator Instructions]

Mr. Ken Anderson, Vice President of Investor Relations and Treasurer, you may begin your conference.

Ken Anderson {BIO 16846692 <GO>}

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

Before we start, please refer to Slide 2 regarding these 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, an important note on terms and definitions used in this presentation.

Joining me here in Toronto today are Charles Brindamour, CEO; Louis Marcotte, CFO; Darren Godfrey, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We will begin with prepared remarks, followed by Q&A.

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

Charles Brindamour {BIO 7012323 <GO>}

All right, Ken. Good morning, everyone, and thank you for joining us today. Last night we announced first-quarter net operating income of CAD0.73 per share after reflecting approximately CAD0.87 impact from unusually severe winter weather. Our thoughts are very much with our customers who have been impacted by the winter weather as well as the recent flooding in eastern Canada. Our teams are working hard to get customers back on track.

The overall combined ratio was 101.5% reflecting the severe winter conditions in Canada and solid U.S. commercial performance of 94%. While weather led to disappointing results, underlying performance improved, particularly in auto where our profitability actions continue to pay off. Hardening market conditions are driving significant rate momentum across all our businesses.

Top line grew 6% with strength on both sides of the border. Our Canadian business grew 5%, led by double-digit growth in commercial lines and rate increases across all lines. In the U.S., premiums grew 7% on a constant currency basis with new business, strong retention, and rate increases. In Canada, hardening market conditions are no surprise given the 102% industry combined ratio in 2018. IFC's underwriting, pricing, and expense discipline led us to outperform the industry by over 8 points on combined ratio last year. This drove an increase in our ROE outperformance to almost 900 basis points, a historical high. We expect to remain well ahead of our long term objective of 500 basis points, both in the near and the mid-term.

Let's look in more detail at our results by line of business, starting right here in Canada. Personal auto premiums grew 1%, the first quarter of positive growth in almost two years, driven by rate increases and slowing unit declines as our competitive position continues to improve. Premium growth has been improving month to month at an accelerating pace and portfolio quality remains strong. The combined ratio of 101.9% included approximately 6 points of elevated weather-related claims, approximately double the expected seasonal pattern for first quarter. Underlying performance, though, improved 5.3 points from last year as our action plan continued to deliver with higher rates and lower claims frequency and severity.

Personal auto industry combined ratio in 2018 were north of 100% and, in our view, unsustainable. We expect the difficult winter conditions will harden the market further and lead to mid to upper single-digit industry growth in 2019. I'm confident, the actions we've taken in auto over the past couple of years, coupled with strong rate momentum in a hardening market, position us to sustain a mid-90% performance going forward.

In personal property, premiums grew 4%. Rate increases and favorable market conditions were tempered by mild unit declines due to our actions in auto. The combined ratio of 99.8% included over 14 points of tax. The actions we've taken over time in this line of business and property have been successful in my view. We expect this line to run at low-90s or better over time, consistent with our five-year track record. The outlook in property also remains favorable. The industry grew over 5% in 2018 and we expect mid to single-digit growth this year as the severe winter weather should lead to further firming of market conditions.

Looking to commercial lines in Canada. All segments contributed to the top line growth of 13% in the quarter. We saw mid to upper single-digit rate increases in hard market conditions as well as strong new business flows. The combined ratio of 106.7% was very elevated due to the severe winter weather and unfavorable prior year development on a few large files. However, underlying results also improved in this segment. The fundamentals remain solid and rate increases are flowing through the system at an accelerated pace. The industry outlook for Canadian commercial continues to improve and we expect the current hard market conditions to drive upper single digit to low double digit industry growth in 2019. This environment is very supportive of our rate and segmentation actions. We're positioned for strong growth and expect to run this business at our historical low-90s combined ratio moving forward.

Turning now to results for our U.S. commercial segments, which contributed CAD0.17 to NOIPS in the quarter. Premiums grew 7% on a constant currency basis with low double-digit growth in profitable segments of the business. The combined ratio improved 1.3 points to 94%. 18 months past closing, I'm pleased with the progress on U.S. commercial. We continue to improve underperforming segments with pricing actions while claims process and internalization initiatives continue to gain traction. We remain on track towards our goal of a sustainable low-90s combined ratio by the end of 2020. We expect the U.S. commercial industry to grow at the low to mid-single-digit rate in 2019 and while the pricing environment remains competitive, we expect modest upward pricing trends to remain. We'll continue to selectively grow new business, including new products in segments of the portfolio that are performing well.

Turning to strategy, our core tech renewals are now largely built and continue to be implemented across the country. With good progress on the infrastructure, we're now deploying customer experience enhancements at an accelerating rate across lines of business and distribution channels. Earlier this year, customers began to have the ability to use their mobile phones to start a claim right at the site of the accident, loading picture of the damage to speed up the claims process. Throughout the product lifecycle, options for digital interaction are delivering at a faster, simpler experience, while at the same time generating useful data for AI. We expect improvements in customer experience, pricing, and productivity to accelerate as we continue to add to the over 40 AI models currently in production.

The severe winter highlights why we've been longtime advocates of climate change adaptation. Our investment in the Intact Center for Climate Change Adaptation at the University of Waterloo is leading to strengthened building codes and flood standards, as well as education for consumers on how to protect their homes. Recently, we also announced funding for 16 organizations to explore concrete solutions for managing climate change from coast to coast. Our goal is to help lessen the impacts of climate change on our communities and make Canada one of the most climate-resilient countries in the world.

In conclusion, while results have been disappointing, fundamentals are solid and improving in all lines of business. We're not satisfied with the 12% operating ROE, not satisfied. The business is already priced to run at a mid-teens ROE, but we're not taking any chances. We expect to take advantage of the substantial rate momentum we see in the current market condition and we'll continue our segmentation and claims initiative. We're committed to returning to our historical mid-teen ROE level and we will not relent until we are there. With the strategies we have in place, the depth of the talent in our workforce, we expect to continue to deliver on our financial objectives to outperform the industry ROE by at least 500 basis points and grow our net operating income per share by 10% per year over time.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. Good morning, everyone. A difficult winter saw storms across Ontario and Quebec, in late February, bring damaging wind gusts, freezing rain, and blizzard conditions. In early March, we saw dramatic temperature changes leading to rapid snow melt and water infiltration. These severe events led to significant property damage, including a record number of roof collapses. Prolonged periods of intense cold, combined with freezing rain, also resulted in an elevated number of auto collisions. The severe weather drove CAD95 million of cat losses and $70 million of non-cat weather losses above seasonal expectations for Q1, for a total of $165 million pre-tax. This represented approximately 8 points on the Canada combined ratio as disclosed in our press release on April 8. While severe weather hurt our performance in Q1, the underlying underwriting results in Canada improved 3.2 points year-over-year, driven by personal auto.

In the U.S., positive momentum continued at OneBeacon, which posted a solid 94% combined ratio, contributing CAD21 million to underwriting income, an increase of 40% over last year. Despite the adverse weather, we delivered net operating income of CAD113 million with strong growth in investment income, distribution earnings and the U.S. commercial. Net investment income rose 12% to CAD140 million, reflecting the benefits from portfolio optimization and reinvestment in higher yields which began late Q1 last year. We still expect full year net investment income to grow by approximately 5% in 2019.

Distribution EBITA grew 20% to CAD36 million, driven by commission growth and margin improvements. Distribution results are now entirely presented on a pre-interest, pretax basis which is consistent with industry practice and how we manage performance. This change has no impact on net operating income and we still expect mid-single digit growth in distribution EBITA in 2019. On the tax front, there are two items to note. Firstly, operating taxes in the quarter included a one-time tax benefit of CAD17 million related to a tax legislation change for farm insurance. Secondly, non-operating earnings include a non-taxable gain of CAD72 million related to a distribution transaction which drove earnings per share up 56% in Q1 to CAD1.06.

Now let me provide some additional color on our underwriting results beginning with Canada. In auto, at the end of Q1, our written rates were up 10%, while earned rates rose 7%, which means earned rates should grow at about 8% for the remainder of 2019. This is really positive for our auto business. In terms of weather, we experienced approximately 6 points of impact from elevated adverse weather in the quarter, a level similar to last year and roughly 3 points worse than the expected Q1 seasonality for auto. When we look past the weather, our underlying performance in auto has improved over 5 points compared to last year, driven by our profitability actions. We continue to see lower claims frequency and severity, further evidence that our actions are paying off. Prior year claims development was unfavorable by 2.2 points, driven mainly by short tail physical damage claims from late 2018. To conclude on auto, we've got good rate momentum, while market conditions are hardening. As the underlying profitability continues to improve, we are gaining confidence in the opportunities in this line of business.

In personal property, weather is the story for the quarter. The fundamentals remain strong and market conditions remain favorable to rate increases. In commercial lines, the combined ratio of 106.7% was elevated due to roughly 10 points of weather losses above our expectations. Favorable prior year claims development was 4 points lower than last year due to development on some large prior year files, mostly in specialty lines. These large losses are within our range of expectations and we don't view them as a concerning trend. In terms of rates, the average return rate increase was 6% in Q1 and we expect to reach 10% by the end of Q2.

On expenses, in 2018, we outperformed the Canadian industry by 3 points in the broker channel and by close to 8 points in the direct channel. In Q1 2019, the Canadian expense ratio of 28.1% improved almost 1 point from last year with improvements across all lines. We have been able to keep expenses low while investing in technology, focused on improving customer experience. For the full year, we expect the expense ratio to be roughly in line with 2018.

Turning to U.S. commercial, the combined ratio improved 1.3 points to 94%. Underlying performance improved 3.6 points, driven by profitability actions in some lines and solid performances in others. In fact, if I look at the 10 lines that are not undergoing a profitability improvement plan, the portfolio grew north of 10% at a combined ratio in the mid-80%. While we still have work to do to achieve a sustainable combined ratio in the low-90%, we are very pleased with progress in U.S. commercial.

Now looking at our balance sheet, we ended the quarter in a very strong financial position with a total capital margin of CAD1.4 billion and MCT at 198%. Our debt-to-total capital ratio was 21.5% and we're on track to reach our 20% by the end of the year. Book value per share increased 3% since year-end, driven by the strong rebound in equity markets and the decline in interest rates since year-end. This reversed the losses from Q4 and improved our unrealized gain position by

CAD250 million after tax or CAD1.80 per share. In terms of weather activity so far in Q2, cat losses are estimated at CAD65 million. This is still within Q2 expectations.

In conclusion, despite a challenging winter, the fundamentals of our businesses remain strong on both sides of the border. In Canada, the results from our auto action plan and hardening market conditions in all lines are adding momentum. In the U.S., we're making steady progress at OneBeacon and executing well with strong top-line growth and improving underwriting performance. Our capital position remains strong and we are ready to capitalize on growth opportunities that arise in manufacturing or distribution across North America. With a talented team, robust operating platforms, and solid fundamentals, I'm confident we can continue to meet our financial objectives and deliver increased value to our shareholders.

With that, I'll turn it back to Ken.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourself to two questions per person. If there is time at the end, you can re-queue for follow-ups.

So, Cheryl, we are now ready to take questions.

Questions And Answers

Operator

[Operator Instructions] Our first question comes from Tom MacKinnon from BMO Capital.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Just a question with respect to the PYD in personal auto that you got. I think you mentioned that you didn't see -- you had lower claim frequency and lower claim severity, yet in terms of PYD you had -- it was higher and I think it was -- you mentioned short tail physical damage claims from late 2018. What can you do to convince us that this wasn't related to any kind of claims inflation or inflation of kind of physical damage and that this was more of a one-time thing? And I've got a follow-up.

A - Charles Brindamour {BIO 7012323 <GO>}

It is indeed a puzzling question and I will ask Patrick to give you his perspective on it.

A - Patrick Barbeau {BIO 18476397 <GO>}

So the main driver of the unfavorable PYD on personal auto in Q1 is actually, as you said, physical damage, so short tail claims that were reported late in Q4, closed in Q1. We saw a mix of those claims that is slightly different than anticipated and that showed a higher average severity. This is something that can happen from time to time from one month to the other, but when this flow happens between December and January, it shows into the PYD instead of in the underlying. But we do not see a trend in this because when we look at all the physical damage claims that we closed in Q1, the severity on those is flat Canada-wide year-over-year. And in fact, when you look at the total severity in auto, including long tail and physical damage, it's the third quarter in a row where the average severity is down year-over-year. So, for those reasons, this was more a timing and a slightly different mix between claims reported late in the year, closed in early 2019.

A - Charles Brindamour {BIO 7012323 <GO>}

So I think, overall, this was a surprise to us, Tom. No doubt about that. It is a question of mix or mix of claims as opposed to general inflationary trend across all trends -- across all claims on average.

A - Patrick Barbeau {BIO 18476397 <GO>}

I could maybe add that this is not to say that there is no inflation in the cost of parts like this. This is still happening, we see it. But the actions we've taken in risk segmentation and in claims has actually tamed down this cost pressure over the past few quarters.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I've been actually very pleased with how much impact the claims team was able to butt or break the neck of that inflationary trend in physical damage. But clearly, there is still inflation in the system when it comes to PYD and seems to do nothing about it. That materializes but the claims team and then the actions we've taken in pricing clearly are driving the underlying improvement we're seeing. Next question, Tom?

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. And the follow-up was just with respect to the CAD65 million in cats that you see so far in the second quarter and that it was in line with second quarter expectations. Just remind me, I think are you still at CAD275 million just for annual cats and with generally half of those in the third quarter and the rest kind of evenly distributed throughout the year or throughout the rest -- or throughout the other three quarters?

A - Charles Brindamour {BIO 7012323 <GO>}

So with regards to the CAD65 million, there's a lot of focus on the floods and the storms in the month of April. And I guess what we're seeing is that it looks like CAD65 million one month into the quarter, it's within the envelope of the quarter. If it's materially different not because of those floods but because of additional natural disaster by the end of the quarter, we will let investors know as we normally do. But so far it is within the envelope. With regards to the cat guidance per se, Patrick being our general on the front line when it comes to natural disaster, he is best positioned to take that question.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. So as you see, our cat guidance is at CAD275 million on a full-year basis. Q3, in general, is the most busy quarter, representing close to 50% of the total. And overall we guide at around 75% of that CAD275 million affecting personal lines. We review those projections on a very regular basis like at least once a year with the debt at the end of Q4, confirm the CAD275 million. And we don't want to necessarily react too quickly on a few months or even a few quarters, given some of the events we've been facing have written periods that are longer than just a few years. That being said, we have seen a higher frequency of weather events in the recent past, not necessarily more severe, but definitely more wind storms, rainstorms, and winter storms.

So, for sure, we'll review it at the end of Q2 again to make sure we reflect that new pattern, but also the change in the portfolio, so the mix of business, the growth in the different line. And if that changes the number, we'll be in a position to communicate it on a forward-looking basis when we release the Q2 numbers. But in the meantime we're -- as we mentioned, we're taking advantage of the right momentum in the market to take as much as we can and focus on reaching the mid-teen ROE all-in including weather impact. Just important maybe as a final note to say that, when you look at personal properties, 75% personal lines, a good chunk of it is personal prop and over the last five years this business has run very steadily at 90% or so while absorbing between 7 points and 12 points of cats every year.

A - Charles Brindamour {BIO 7012323 <GO>}

And just to highlight what Patrick is saying, in terms of rate flowing through the system at the moment, what the market sort of allows us to do, we're seeing close to 7% written rates in the first quarter all lines combined and our view is, there will be a pickup in the amount of rate we'll be able to drive at the written level in the coming months, probably a little more than what we would have thought six months ago. And so, yes, there's weather, there's a bit of noise. Should we change our mind on cat loading and so on, I'm pretty confident that there's room to act on rates very quickly, if not already, in the current market environment.

Operator

Our next question comes from John Aiken from Barclays.

Q - John Aiken {BIO 6329080 <GO>}

Would you mind expanding upon the information you gave us on your acquisition in India? Can you let us know what the amount you invested in and what percentage stake you've taken?

A - Charles Brindamour {BIO 7012323 <GO>}

This investment was done in the context of our venture strategy. As you know, when we think about transforming our organization, we have -- 90% of our investments are in transforming our current operation and then the remaining 10% of our investment would be geared towards research or venture. The investments we have done in this automobile insurance disruptor, in the context of India, is in the context of venture. This is an opportunity for us to learn about the market, but more importantly about how this group called Acko top-notch company is actually intending to grow and disrupt in the context of the marketplace. Louis, color you want to add there?

A - Louis Marcotte {BIO 18040440 <GO>}

Quantum is in the CAD10 million-ish and it's a small minority stake, so it's treated really as a venture and it's an observation post for India.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. We're keen on learning from these guys, solid track record, one should not conclude a desire for massive capital deployment outside of our North American sort of growth path.

Q - John Aiken {BIO 6329080 <GO>}

No, understood. How complementary is this to the investment that you made in Brazil?

A - Charles Brindamour {BIO 7012323 <GO>}

It is, from a strategic point of view, pretty much in line with our strategic thought process in Brazil. Big unsophisticated fast growth market where we take a minority stake in a disruptor in the marketplace. Brazil is primarily distribution. These guys are both distribution and manufacturing, so that's the difference. But it is the same strategic thought that you can observe here between Brazil and India.

Operator

Our next question comes from Brenna Phelan of Raymond James.

Q - Brenna Phelan {BIO 20108118 <GO>}

So I was wondering, could you just give us an overview of your key takeaways from the Ontario budget proposals for personal auto reform, what you think where there's opportunity and maybe where you perceive some pressure, and how you're responding and working with the regulators, if at all?

A - Charles Brindamour {BIO 7012323 <GO>}

I think it was the last quarter or the quarter before, and one of the question was, what do you expect of the new government in Ontario. And my position at the time was to say, I think these guys will want to make it better for Ontarians and for Ontario drivers. And at the time we said cutting red tape, getting fraud out of the system, and making sure that insurance companies will compete as aggressively as possible for the business of protecting Ontarians. And I think what you've seen in the budget that was released last month or a few weeks back is exactly that. And so, overall, we think this is a step in the right direction for Ontarians. It makes sense, it's commonsense set of proposals. And I will let Darren give his perspective on what that means and maybe Patrick will want to add a perspective from claims, if needed. But, Darren, go ahead.

A - Darren Godfrey {BIO 19791482 <GO>}

Clearly, the Ford government has well laid out the blueprint for changes to the auto insurance system over the coming years in its first budget. I mean, it contemplates a number of measures that will streamline access to care, increase choice, and make the market more competitive as Charles said. But more specifically, the budget contemplates changes to the accident benefits coverage, bringing more transparency, reforming the assessment process, and improving treatment for common injuries. It also highlights reform around rate regulation as well, eliminating red tape, enabling us to offer more discounts and options for customers. And also I think importantly, enabling full electronic communication with consumers, including electronic pink slips. So that's a good step in that direction as well.

With respect to timing, Brenna, it's a little early to speculate on both the timing of the reforms and also the impact. We understand that the government does want to take steps towards a more sustainable product and that we can expect those reforms to be implemented in phases over a period of time that is still yet to be determined. So as Charles said, we very much view the budget very favorably and Ontario drivers will greatly benefit from the changes announced in the budget itself.

A - Charles Brindamour {BIO 7012323 <GO>}

Patrick, anything -- you want to add any color?

A - Patrick Barbeau {BIO 18476397 <GO>}

Maybe just one, from a claims perspective, we like the approach of focusing in the accident benefit area about care, not cash. This is as a principle something we support and I think will be good for both Ontarians and this product. We don't have all the details on how this will apply yet, but this is going in the right direction too from a claims perspective.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And so being an Ontario driver, I like what I'm seeing and as an organization, we will support the government to make this in place in the marketplace as quickly as possible.

Q - Brenna Phelan {BIO 20108118 <GO>}

And just a quick follow-up there on the ability to potentially use credit scoring for pricing the premiums. Is this something that you think you have a good model in place already that would allow you to move right in there?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. I think that -- I think the general theme, you got to pick out of that is that what makes sense in Ontario is that people are charged the best price for their profile and their behavior and how they drive broadly. That's why we are big fans of telematics. Clearly, financial stability is a highly predictive factor of how people drive and take care of their assets. And this is one that we have been studying and used where it's allowed for over 20 years..

Q - Brenna Phelan {BIO 20108118 <GO>}

And then if I could, just one more. In the U.S. specialty business, the adverse PYD in the quarter, is that related to similar types of issues to the Q4 PYD or different issues?

A - Charles Brindamour {BIO 7012323 <GO>}

You want to take this, Louis?

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. So I would not camp it in the same issues here. So, we're seeing a slight level of PYD in the U.S. I would say most of it is covered by the adverse development because it dates from 2016 and before. So there's the portion that we retained, the famous 20% that is ours which will drive some of that. And this is the majority of what's left over. I would say here it is focused on some lines of business that are essentially going under profitability improvement plans and is really to the past. So in our minds, although, there is a bit of noise quarter to quarter, it still relates to businesses that were either improving or exited and therefore it's not something that we expect to carry a long time in the future. But I think it's not necessarily quarter-to-quarter the same reasons, but the focus is on the leftovers of pre-2016 and some of the very specific lines that I think were fundamentally out of.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I would say, high level, our perspective of the lines that are doing really well and our perspective on the lines that are not doing well that have either been exited or are under profitability improvement is reinforced by where we see PYD taking place.

Operator

Our next question comes from Paul Holden from CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

So I will ask two questions. First on personal auto. Want to get a sense of longevity -- potential longevity behind this firm rate cycle. And the context in which I ask is, Charles, you had mentioned that both severity and frequency have flat-lined now. So given those trends, do you expect you will continue to be able to reprice higher?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. The rate change in auto today, the written rate change in auto today is approaching 10%, okay. That's what is going through the system at the moment and we'll get earned over the next 18 months, 18 to 24 months. So there's a fair bit of juice in the system at this time. Timelines are regulated. Some provinces are regulated, others are not regulated. We think the industry is -- overall the industry ROE is about 3%. Automobile insurance is running above 100%. People are catching up. We're seeing it very clearly in the top line sequentially throughout Q1 into April, but there's a fair bit of room left for the industry to move in the coming year or 2. And so we will find the right balance between growth and margin in that context. But clearly, a hardening market like what we're observing in automobile insurance with tightening capacity is a very good market for us to operate in, given where we're sitting today. Darren?

A - Darren Godfrey {BIO 19791482 <GO>}

No, I think that's exactly right, Charles. I mean, we do see a pivot in our growth profile as well. Obviously, you have seen the announcements in Ontario in particular of the rate changes in Q4 which were obviously quite significant. We talked about that on the last call. We started to see our competitive position improve towards the tail end of Q1. And so our growth profile will definitely change come March. And then that has continued now into the early months of Q2 as well. Obviously, you have seen the Q1 rate changes that were announced -- or again in Ontario. Most of those rate changes are effective in the latter part of Q2. So we expect to see solid top line momentum and in fact, in the early part of Q2, we see top-line growth for both auto and property which obviously follows very much on the auto in the mid-single-digit range. So we do see the market pivot and I know it's one month and it's not yet a trend, but we don't see that abating in the short term, given the momentum that we see within the industry around rate.

A - Charles Brindamour {BIO 7012323 <GO>}

I think, Daren, it's probably fair to say that we've got this rate momentum now. What we've observed in the past, say, a couple of months is the rate shrinkage in units has actually started to break meaningfully and probably sitting here today, faster than what we thought because you'll recall, on previous calls, we said we expect the growth profile of the organization to change dramatically, in particular, in the second half of the year. And I would say, what we're observing in the past few weeks towards the end of Q1 is certainly more in line with what we would have expected maybe in Q3 and Q4.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. And then the second question is just a follow-up on the PYD at OneBeacon. I mean, Louis, I think you sort of refer to them as leftovers. Like, when do you think the situation with these leftovers pre-2016 business will be completely cleaned up? Like, does that take another year, another two years, maybe just some context and a reminder on how much reinsurance coverage you have remaining as well?

A - Charles Brindamour {BIO 7012323 <GO>}

Questions for you, Louis.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. So, keep in mind, the duration here of the liabilities is less than three years. I would say the payment on the liabilities at the time of acquisition have come down by more than half. So the risk is reducing at a fairly fast clip. In terms of usage, we have plenty of capacity left there. I would say, we've used probably just a little over half of the entire capacity so far. So there's still capacity left to absorb some headwinds if it shows up, but I would say, the risk is declining rapidly as time passes, given the nature and then the duration of these liabilities.

Operator

Our next question comes from Michael Phillips from Morgan Stanley.

Q - Michael Phillips {BIO 21023048 <GO>}

So I want to talk here on the positive momentum in rates and what goes on weather. I guess, I want to get a sense of what else -- and you are committed to the 15% teen ROE even including the weather. So what else can you do, I guess, longer term so that you're not as much at the whims of the cycle with rates so that you can stay committed to that 15% no matter what the industry cycle is doing? What else besides rates can you consider? And I'm sorry, I say that because it seems like a lot of the answer is, yes, rates are good and I know that's going to help us, but ex rates what else can you do, because weather is not going to go away?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, agreed. Weather is not going to go away. So is your question, what can you do to tame the weather or what can you do to remain around 15%?

Q - Michael Phillips {BIO 21023048 <GO>}

Yeah, not what can you do to tame the weather. What can you do as a solution to what seems to be kind of a common problem of severe weather every quarter besides fall in the cycle of rates?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Fair enough. I think that, overall, Michael, if you look at our strategy, our strategy is to generate 500 basis points of ROE outperformance every year. And the reason why we've chosen at least 500 basis points minimum is because our cycle in the industry, sometimes the cycle are supply driven, but often in our industry, the supply is cost driven and weather is part of that. Inflation in automobile insurance is also part of that. And in periods where the industry's performance drops, we tend to expand our ROE outperformance and clearly today 900 basis points shows how much leverage we have to not follow the industry and its cycle completely. We are far more stable than the industry. At a trough of the industry where the ROE is 2.8%, our operating ROE is 12%-ish.

And what are we doing? Well, there's three buckets that we're managing to generate ROE outperformance and to build a capability to generate more than 500 basis points. One is data and segmentation and in data and segmentation, price is just one thing. This is where investments in AI and finding new variables and finding better ways to combine variables compared to our peers is a huge area of investment for us in part to make sure that if historically this generated a couple of points, we are trying to push the outperformance we're getting in that segments or true segmentation past our historical track record. Second bucket of ROE outperformance comes from claims. Claims has been a generator of about 300 basis points of ROE outperformance. Patrick and team either by leveraging digital or by going deeper into physical world and in-sourcing much of what we do is trying to beat the 300 basis points we've generated historically. And the third bucket is capital and investment management, which has been a big contributor.

The other thing we've been doing in the past 5 years to really bolster the ROE of the organization is our investments in distribution which are far more stable than the personal lines insurance business. And between investment and distribution income, today when you come to work there is roughly 8% to 9% of ROE points baked in. Then the work of underwriting, pricing and claims start. I think the -- furthermore the capital deployment in the U.S., which is in the context of our book of business is far less sensitive to weather line of business, in my mind, is a way to deemphasize the impact of weather on the organization over time.

So there is a question of how we write the business. Pricing and claims, there is a question of bolstering other parts of the business like distribution as well as commercial lines. Then specifically, in home insurance per se, which is the most sensitive part of the portfolio, there is a whole range of things we've done over time to improve the performance of that segment at least on a yearly basis. Quarterly, it swings a fair bit, but I'll let Darren just give you a couple of minutes on what we've done in home insurance and what we were able to do in terms of track record.

A - Darren Godfrey {BIO 19791482 <GO>}

No, absolutely. So I think if you look historically, property was an area of concern for us many, many years ago. So we implemented actions plans around pricing, product and claims. One of the major chances was around water and the way we mange water from a product standpoint, how it responds in different severe weather events and so forth. So when you look in the last 5 years, 4 of those 5 years have been under a 90% combined with an average of less than 90%. So -- and I would say that -- and that is during a period of elevated weather level. So the product itself is very much in a sustainable environment. Today, even though we would say it's sustainable, we continue to drive rate as well. In the quarter, we drove just over 4 points of written rate as well too, together with inflationary increases in the product as well too. So both of those are well beyond the trends that we see within the portfolio. So the product is, as I said, very, very well positioned from a sustainability standpoint, but it really was due to a lot of that hard work that we did a number of years ago around rates, but more importantly, around product improvement as well.

A - Charles Brindamour {BIO 7012323 <GO>}

I don't know if you want to go...

Operator

Our next question comes from Mario Mendonca, TD Securities.

Q - Mario Mendonca {BIO 2450557 <GO>}

Could we just flip over to Alberta for a moment? It's fairly clear that Alberta is not going through the best time. I'm referring specifically to personal auto now. Could you talk about like what do you see in that market and the potential for Alberta to sort of upset this improvement you're seeing generally?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. No, absolutely. I think, Mario, we've been on the liability inflation file in Alberta with the government since 2013. We have taken almost 20 points of rate a while back in Alberta.

A - Darren Godfrey {BIO 19791482 <GO>}

30 points in the last 36 months.

A - Charles Brindamour {BIO 7012323 <GO>}

30 points in the last 36 months. And, Darren, our SVP, Personal Lines is based in Alberta, so why don't I give you provide -- let you provide the local flavor.

A - Darren Godfrey {BIO 19791482 <GO>}

I mean, you're right, Mario. I mean, obviously, we have that level of political intervention from the prior government. We welcome the changing government. They are acutely aware of the issues facing Alberta drivers and they've clearly articulated a focus on red tape, focus on reducing regulation, a focus on creating a competitive sustainable marketplace, not just from an order standpoint, but just more from a philosophical standpoint. So we welcome that clearly. As we communicated I think last call or the call before, in order to remove the cap because there is, not for us, but there is for the industry inadequacy in writing in the industry, product reform will be required to bridge some of that gap. So we're ready to assist the government in that regard and we have a number of ideas that could help in that regard.

So clearly the focus is creating a sustainable marketplace. We see, even though, auto is not their number one priority, they understand the issues and we look forward to working with them. As we said, from an IFC standpoint, we have been going at this for a good three years now. Well ahead of the industry, our gap to the industry is significant. And that reflects all the action that we've done in the last sort of 36 months. Clearly, that impacted and hurt us from a top line standpoint. That was a strategic decision that we were comfortable to make. But we're well-positioned now. We see the market moving as well too from a capacity standpoint. And we're well positioned in that regard and we see our growth profile improving slightly in Alberta as well too. But I would say, we welcome the new government. We look forward to working with them. They understand our issues and we're hopeful that Alberta drivers will see a competitive market moving forward.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. No, I mean, important to just bear in mind that a couple of things. First of all, Alberta has been running in the mid to low 90% overall as a province and our outperformance in automobile insurance in Alberta is about 10 points. So the question is, how do you create sustainability in inflation in Alberta. If you leave physical damage aside, which compares from province to province, we've beaten that horse before, no pun intended. The issue in Alberta is inflation related to minor injury. There was a very tight definition of what a minor injury was which prevented one to seek pain and suffering rewards. That definition was put in place in 2003 or 2004. Sustained constitutional challenges over time and was eroded in 2012-2013 by letting chronic pain broadly to be used to pierce this gap. The solution for the current government is very simple and it's tried and true, which is to slightly amend that definition to exclude chronic pain for what is a minor injury and that would alleviate much of the pressure that exists in the marketplace. So if this government is pragmatic, there is a practical solution for them that is fairly easy to act upon.

Q - Mario Mendonca {BIO 2450557 <GO>}

I understand that. And then just real quickly, how important is Alberta and personal auto? What proportion of your total direct written premium really would relate to Alberta in personal auto?

A - Charles Brindamour {BIO 7012323 <GO>}

15%-ish.

Operator

Our next question comes from Geoffrey Kwan from RBC Capital Markets.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Louis, you mentioned to CAD65 million estimate for cat expectations. Ballpark, I guess, based on what you know right now, like how much of that would be taken out by some of the flooding we've seen in Central and Eastern Canada?

A - Louis Marcotte {BIO 18040440 <GO>}

So, I guess, I'll pass it back to Patrick on that front, of the CAD65 million.

A - Charles Brindamour {BIO 7012323 <GO>}

What portion is flood?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. Well, in dollars...

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, just so we're clear. Your question is what portion of the CAD65 million is flood?

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Well, I'm just -- we've obviously seen the flooding in Central and Eastern Canada up to CAD65 million, then you expect like how much of that has already been, let's call it, taken up?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. So the heavy rain that we've seen in April is because of the floods, but also many water infiltrations from roofs and foundations that are spread throughout Quebec. There were some flooded areas also in Ontario and New Brunswick. That event in itself is the main one when we look at overall in April. And in terms of counts of claims, it's about two-thirds that are water infiltration and a third that are linked to floods and sewer backup type of claims. There was one small freezing rain event that adds up into the overall CAD65 million that we discussed. I don't know if that answers the question.

A - Charles Brindamour {BIO 7012323 <GO>}

And I think, Geoff, what's important to understand is, the CAD65 million is our view of the ultimate. It's not the case incurred to date. It's our view of the ultimate. We have sophisticated models that basically develop based on the number of calls and the speed at which we get them and the nature of the claim and the peril that projects the ultimate number, we are pretty clear about severity. And that's where the CAD65 million is coming from.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. All our exposures with [indiscernible] capacity have been mapped as well as all the reported claims so far and combined with prior experience with similar events, we think our estimate at this point of the ultimate cost is very precise.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

And so if I'm just thinking about this on the annual cat loss assumption you guys have, you have like a CAD65 million-ish from this event based on what you know right now and for what might be a typical Q2? Are you comfortable I guess on what it might imply? Obviously, it's a crystal ball in terms of this question, but your comment is that CAD65 million is in line with what you would typically expect in a bigger picture of an entire Q2 period in terms of cat losses. Is that understanding it correctly?

A - Patrick Barbeau {BIO 18476397 <GO>}

It's well above what we'd expect in April, but it's well within what we would expect in Q2. And what happens in May and June, we don't know.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Right. Okay. And just the other question I had was, in BC, we --- I know it's a smaller market for you on the auto side, but just was kind of curious with the changes that were implemented out here, I guess, a month ago, has there been any kind of other impacts to the comprehensive side of the market that impacted how you think about the business in BC?

A - Charles Brindamour {BIO 7012323 <GO>}

Darren?

A - Darren Godfrey {BIO 19791482 <GO>}

No, not at this point in time and obviously we're watching very closely in terms of the moves that ICBC is taking. We're careful in terms of the way we're positioning ourselves, the way we're marketing. I think what is important to highlight for Bel Air in particular in BC, heavy use of telematics and our UBI program which obviously ICBC does not have. So we believe that that's an advantage for us, but we don't see a material change in the environment at this particular point in time. But we're watching very, very closely.

Operator

And our next question comes from Meny Grauman from Cormark.

Q - Meny Grauman {BIO 15238080 <GO>}

Just following up on that discussion of the Q2 guidance of CAD65 million, it just seems like that's quite a bit better than what one would have expected just given the headlines and maybe if I can also reference the experience, last time we saw significant flooding in 2013. So I'm just wondering, is this a case of the headlines just aren't necessarily reflective of the reality on the ground or is it more company-specific? Would you kind of pat yourself on the back in terms of changes you've made since the 2013 flooding and it's really the guidance is really driven by more the kind of underwriting changes that you've made and the kind of geo-coding that you use? Curious to hear what your perspective is on that.

A - Charles Brindamour {BIO 7012323 <GO>}

It's clear we've learned a lot in the past 15 years and have made a number of changes to make sure that we're better than we were when we faced large floods. I'll let Darren give a bit of a perspective and maybe Patrick wants to add a claims perspective, because claims is also part of the question.

A - Darren Godfrey {BIO 19791482 <GO>}

You're right, Charles. In terms of the, obviously, the Calgary floods, the Toronto floods back in 2013, clearly greater clarity was required in the product post those events. So that led to a lot of the product changes that we made, better simplification of our wording, greater clarity between sewer backup, what is not sewer backup, but it also enabled us to enhance the coverage around overland water as well too. So I think the important thing of note in particular for Quebec and that's probably why you see the number being a little bit lower than expectation. It very much is a sub-limit based product based on zones. So limits are not very rarely exposed for flood coverage. Clearly Quebec, like the rest of the country, only about 90% of our product base or our consumer base have the opportunity to purchase the product as well. So clearly the highest of highest at risk. There is no coverage from a flood standpoint and we see that happening a little bit in this particular event. But the thing about Quebec, as I said, is the use of sub-limits and very much has controlled the quantum in this particular event. I don't know, Patrick, if you want...

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. I would agree. I think it's the combination of a couple of points. The product is simpler to apply, very clear what is sewer backup, what is flood, what is infiltrations and how it's covered into different parts of the contract. So that for claims makes it more straightforward and clearer for clients as well. The other piece is, what we've seen in the media was the extremes and sometimes it was affecting a few houses here and there. So I think when there's quite a few areas that are significantly impacted, but -- and the other thing is our geo-coding, our flood maps have improved over time with the different events that we've faced over the past 3, 4 years since we launched the product. So all of that contributed to maybe a number that is a bit lower than what others might see in the media. It's comparable if I look at Quebec only. It's a bit wider in [2019 to 7] than what we've seen in 2017 of spring, but not that different in terms of amount of claims and type of severity.

A - Charles Brindamour {BIO 7012323 <GO>}

So it's clear that this event is a major event and that impacts people in Quebec and Ontario as well as in New Brunswick. And having been in the field when those sorts of events happen, it's terrible for people going through that and our thoughts are with those people. I think that clearly, we have expanded the water coverage. As Patrick has said, we've been charging for that product. We've made the product simpler and clearer, but obviously, we cannot put our capital at risk in areas where flooding is a recurring event because then that's not insurance. This certainly brings important question from coast to coast on the importance of land use planning. This is becoming far more relevant and far more important a discussion where to research we're trying to help cities and the province and the Fed, make sure that we improve what we're doing from a land use planning point of view. And I would say the biggest surprise in what's just happening here in Central Canada and where our assessment of risk might have been off a bit is in the context of man-made dams that break. So that was not necessarily part of the plan and I would say what is pure flood cover was very much driven by the failure of man-made protection in a specific part of Quebec. Would you agree?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah, that was one of the -- for sure one of the significant area. There were a few others that were more expected I guess with the water levels. But, yeah, Sainte-Marthe-sur-le-Lac in Quebec was that exactly.

A - Charles Brindamour {BIO 7012323 <GO>}

So our thoughts are with people going through that at the moment. We have in claims 3,500 people across the land who are in the business of getting people back on track. We have people on the ground in the communities that are touched in particular in Sainte-Marthe-sur-le-Lac which has been touched heavily and we'll do our utmost to help people get back on track as quickly as possible.

A - Patrick Barbeau {BIO 18476397 <GO>}

Absolutely.

Operator

Our next question comes from Sean Reitenbach from KBW.

Q - Sean Reitenbach {BIO 20103487 <GO>}

Hi. With the improving specialty REIT market in general and especially in the U.S., how does IFC think about adding new specialty lines either to Intact Canada or the U.S. commercial business?

A - Charles Brindamour {BIO 7012323 <GO>}

So we have 14 business lines in the U.S. and in Canada, we have imported two business lines where we think we have very strong track record, deep expertise in the U.S. and we want to be -- we want to pace ourselves because we want to do it right. So now we've launched those two lines, gaining traction there and our thought process in the U.S. is to grow the 10 lines in which we're strong, scale up those lines of business, work with the business leaders in the lines where we have profitability issues to get them back on track so that we can invest in growing these businesses as fast as we can. But we like the footprint we have. We want to make it deeper, more scale and we'll gradually leverage the expertise in the U.S. on the Canadian platform. The other area beyond the two products that we brought here is, we've created North American teams in sectors like ocean marine, which we feel makes sense from a North American point of view, in sectors like surety. And so we're pacing ourselves, but we're gradually making sure that our product capability can be used across the North American platform. Alain, anything that you want to add?

A - Alain Lessard {BIO 17592535 <GO>}

Well, the only thing I would add is, on top of that, we're keeping the focus completely on bringing the combined ratio in the low-90%. That is really the focus and we don't want to be focused the team in everything and trying to go in all directions. That's why we're pacing ourself and we're always looking at what can be brought from north to south and from south to north, but really pacing it to keep sure that the focus is on the low-90%.

Q - Sean Reitenbach {BIO 20103487 <GO>}

And then in terms of these cross market opportunities that you referenced just now and then originally with the acquisition, are those performing as expected or is the focus really going to be driving growth in those after the combined ratio comes into line?

A - Charles Brindamour {BIO 7012323 <GO>}

I think the latter. The teams are in place for establishing relationship or gaining traction. It's not yet moving the needle as far as I'm concerned in terms of the scale of the operation. We're building capability and indeed the day one item is low combined ratio. The product capability is in place, but we give ourselves a few years to get the full traction.

Operator

And our next question comes from Jaeme Gloyn from National Bank Finance.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

I will save it for another day. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

And thank you very much. That concludes the questioning in the queue, I'll turn the call back to the presenters.

A - Ken Anderson {BIO 16846692 <GO>}

Thank you all for joining us today. Following this call, the telephone replay will be available for one week. The webcast will be archived on our website for one year. A transcript will also be available on the website in the financial report and filing section. Also, we'll be hosting our Annual Meeting of Shareholders at 11:30 a.m. this morning at the Art Gallery of Ontario here in Toronto. You may also join the meeting via live webcast from our website. Lastly, our second quarter 2019 results are scheduled to be released after market close on Tuesday July 30. Thank you again and this concludes the call for today.

Operator

Thank you very much for joining us today. Ladies and gentlemen, this does conclude our call. You may now disconnect.