Q1 2014 Earnings Call

Company Participants

- Alain Lessard
- Charles Brindamour
- Dennis Westfall
- Louis Marcotte
- Patrick Barbeau

Other Participants

- Brian R. Meredith
- Doug Young
- Geoffrey Kwan
- Mario C. Mendonca
- Paul Holden
- Tom MacKinnon

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Sharon and I'll be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. First Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. . Thank you.

Mr. Dennis Westfall, Vice President of Investor Relations, you may begin your conference.

Dennis Westfall {BIO 15155973 <GO>}

Thanks Sharon, and good morning, everyone. Thank you for joining us on the call today. A link to our live webcast and background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call.

Here with me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Patrick Barbeau, SVP of Personal Lines; and Alain Lessard, SVP of Commercial Lines; and Mathieu Lamy, Senior VP of Claims. We will start with formal remarks from Charles and Louis, followed by a Q&A session. The others will also be available to answer your questions during the Q&A.

With that, I would like to ask Charles to begin his remarks.

Charles Brindamour {BIO 7012323 <GO>}

All right. Thanks, Dennis, and good morning, everyone. Earlier today, we announced the first quarter net operating income of $129 million or $0.94 per share, down 8% from last year, excluding a non-recurring favorable tax item in 2013. For the second consecutive quarter, harsh winter took its toll on our underwriting performance. The first quarter of 2014 experienced much colder temperatures than the same period from year ago, both on average and in the number of days of extreme cold. The winter conditions led to $75 million of cat losses and a 14% increase in the frequency of claims in our auto businesses.

Over the past 12 months, our results have been impacted by close to $600 million of cat losses. Despite this, we've generated an operating ROE of 10%. Clearly, we're not satisfied with an ROE of 10% and we've been taking action. Progress from these actions is evident in our personal property results this quarter. Although, the business recorded 12 points of cat losses in Q1, it generated a combined ratio of 91.8%. This is a great result but we're not ready to declare victory on our goal to achieve a 10 point improvement in that line of business. Work continues to ensure we can meet our goal on a full year basis.

The industry has also started to move but as we were an early-mover, we continued to lose a couple of points of units in the first quarter, largely in line with our expectations. Despite moving faster than our competitors, we generated an underlying growth of 5.2% this quarter in property, which excludes the impact of converting two-year policies into one-year policies as we discussed last quarter.

Rate action should bring about two-thirds of our targeted improvement but rates are only one element of our plan. We recently began implementing meaningful product changes as well as offering customers the option to reduce premiums through prevention discount. The rise in losses these past few years has forced our peers to also announce profitability measures and begin taking underwriting actions, which should help with our retention in the latter part of the year.

I'm pleased to report that this line of business, which has lagged our outperformance in other lines, is now achieving a 2-point advantage versus the industry. We maintain our positive view towards personal auto, a line of business that generated a combined ratio of 97% in the first quarter as icy driving conditions led to an increase in the number of accidents. Overall, we're operating in an environment where competitors and regulators behave fairly rationally and costs have been generally stable in the recent past.

Turning to Ontario, the government's auto insurance costs and rate reduction strategy has been successful thus far at reducing filed rates by 5.7% across the market as a whole. Our process on reducing rates to customers by 5.3% on average began in early April. The government subsequently tabled legislation that would have brought further meaningful cost reductions to the industry. Unfortunately, the dissolution of Parliament has stalled the passing of this legislation.

We trust that it's very clear in fact for all parties that further rate reductions can only come in conjunction with meaningful cost reduction measures. In the current environment due to the cost reduction measures already implemented and our own proactive actions, we're comfortable with our margins in this market and will continue to pursue growth opportunities.

Our commercial P&C business was not immune to the effects of the winter seasons and reported a disappointing combined ratio of 105.6%. When I say disappointing because this line of business is priced to generate a combined ratio in the low-90%s on a full year basis. A meaningful portion of the claim cost in the quarter were weather-related including burst pipes and fires from severe cold as well as water damage from rapid thawing.

To address these results, we'll continue to take rate action on the least profitable portions of the portfolio and leverage some of the same actions used to mitigate the impact of cats in our personal property business. When it comes to our outlook for the industry, we foresee low-single digit growth in personal auto as well as commercial lines and upper-single digit growth in personal property. We continue to expect the current hard market conditions in personal property to accelerate meaningfully for the foreseeable future. While we did not see significant acceleration in Q1, the commercial P&C market has shown distinct signs of firming in the past year. Rate increases on renewals across the portfolio were up by 4.5% in the first quarter versus 1.9% in Q1 of 2013. The low interest rate environment and elevated losses from catastrophes should support our growth outlook.

From a profitability perspective, we expect the industry's combined ratio to improve in 2014, given the unprecedented level of cats seen in 2013. Overall, we expect the industry's ROE to trend back towards its long term average of 10% this year. Looking specifically at Intact Financial, we believe we'll outperform the industry's ROE by at least 500 basis points.

In conclusion, we're energized by our prospects for 2014 and beyond and believe that the disciplined approach we take towards operating our business will continue to serve us well. I'm confident that we're well positioned to excel in the current environment aided by a strong capital position, which enables us to execute upon opportunities for profitable growth.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles. Today we announced first quarter net operating income per share of $0.94 with a combined ratio of 97.1% compared to 95.1% in Q1 of last year. The harsh winter season resulted in 4.3 points of catastrophe losses, four times higher than last year, and higher claims frequency which negatively impacted underlying loss ratios in personal auto and commercial lines.

Our disciplined approach to the business somewhat tempered our top-line, resulting in a 1% underlying growth rate for the quarter. This approach includes the continued reduction in our BC earthquake exposure and our actions to increase rates in the least profitable segments of our commercial portfolio. The top-line impact of these initiatives should decline in the coming months.

The combined ratio on personal property was 91.8% despite the difficult winter weather. Our actions to improve the performance of this line of business are clearly proving effective as we reported one of our best underlying loss ratios in the past six years despite the difficult winter. I believe we are well on our way to accomplishing our targeted improvement and have recently begun to roll-out the next wave of product changes.

Moving to auto, our underwriting performance in Q1 was negatively impacted by the extreme cold as a higher incidence of claims resulted in a combined ratio of 97% versus 94.1% a year ago. Favorable prior year claims development remained healthy at $61 million versus $71 million in Q1, 2013.

Our commercial P&C line of business experienced a challenging first quarter of the year both from the top line and bottom line perspective. I mentioned our actions to improve our profitability including reducing quake exposure and focusing on the least profitable segments of the portfolio. These actions contributed to a 3% decline in premiums in the quarter. Our $21 million underwriting loss reflected difficult winter conditions including $28 million of cat losses and an increase in both frequency and severity of claims.

Commercial auto premiums declined 2% from a year ago reflecting competitive market conditions and the impact of re-underwriting actions taken subsequent to Q1 2013. The combined ratio of 89.3% improved eight points from last year. Our expense ratio was 29.8% in the quarter was down from last year driven by lower variable commissions and compensation, both driven by weaker underwriting results. I'm pleased to report that we've achieved our after-tax synergies target of $100 million on the AXA acquisition and also essentially completed the systems decommissioning. This is an achievement that was made possible by thousands of dedicated employees and something of which we're all very proud.

We are also on track to decommission Jevco Systems throughout 2014 and have already reached a synergies run rate of $21 million. This is well in excess of our expectations when we announced the purchase two years ago.

Net investment income of $105 million was 9% higher than the year ago driven by higher dividends. Dividend income was helped by a higher than usual turnover in our dividend rollover strategy. We also received two dividends in the quarter from one of our holdings. Despite the elevated level of income in the quarter, we expect full year net investment income will remain relatively favorable in 2014 versus 2013.

Our financial position at the end of Q1 was strong with $670 million in excess capital and a debt to total capital ratio of 18.4%, below our target of 20%. Our MCT improved to 213%. Keep in mind that Q1 typically sees a favorable seasonality impact while our earnings in the quarter and improved capital markets also contributed to the 10 point improvement from year-end.

We intend to maintain a robust capital position given the potential growth opportunities we see in manufacturing and in distribution. I believe that Intact continues to add sustainable competitive advantages due to our disciplined approach and quality operations. We have been innovative in our actions to improve profitability and grow the business as evidenced in our traction with the home improvement plan and the launch of UBI. With $670 million in excess capital to support our business decisions, I am happy about the range of options available to us.

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

Dennis Westfall {BIO 15155973 <GO>}

Thanks, Louis. Sharon, we're now ready to take questions.

Q&A

Operator

. Your first question comes from Geoff Kwan from RBC Capital Markets. Your line is open.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

I just had two questions for you. Just first off is, Charles, you were talking about Ontario auto and the election. I guess is the way to maybe think about it is with the election and then eventual hopeful implementation of cost reduction measures, not much of an impact in 2014, maybe a bit of a slight negative impact in 2015 to the extent these cost reduction measures are delayed a bit?

A - Charles Brindamour {BIO 7012323 <GO>}

Let me ask Patrick Barbeau, SVP of Personal Lines to give his perspective on it.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. The response so far has been quite efficient in containing costs. We have seen the cost reduction measures implemented in February are now in place. The new Bill 171 that passed second reading just prior to the General Ontario election was stalled would further reduce cost by few points. So all of that are good signs that government is wanting to align cost reduction measures or rate reduction with cost reduction measures. So it's very positive sign for us, in fact also on top of it the fact that all parties largely supported the elements part of the bill is also a very positive for us. So really, the only dark side is, those additional cost reduction measures are probably postponed now because of this election (14:32).

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I think that's right, Patrick. And I think given all the parties stance on Bill 171, I mean, our expectation is that once the elections are done, we'll see this bill back early in the fall. So clearly this delay there is a cost to 2014, thought not clear to me, it will be cost to 2015 and that's not clear to me that further cost reduction measures that folks were thinking about will not necessarily take place. I think on the contrary and we don't want to speculate on the outcome of the elections, but we certainly look at the range of options here and I think that there is many options that are as good if not better as the current setup.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. And the second question I had was with the pricing changes that you've been making in terms of price increases changing to the product features, is it too early to say, or are you seeing changes in terms of client behavior as they come up for renewal on their policies?

A - Charles Brindamour {BIO 7012323 <GO>}

Patrick?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. On residential, yeah, we've seen a bit of people – our prevention discount has just been launched. So this is one way that customers can act by being active on the prevention side. So we are seeing a little bit of that, we are seeing also client increasing their deductibles to try to alleviate the rate increases. So those are the two main parts that we have started to observe.

A - Charles Brindamour {BIO 7012323 <GO>}

Geoff, was your question for prop or for automobile insurance?

Q - Geoffrey Kwan {BIO 7413168 <GO>}

More so around the property side?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, okay. So I think that's exactly right. And I think if you get down to understand the top-line, we said that the top-line was up 5.2% and personal property rates are up obviously closer to 10% at this stage. Units are down a couple of points as I've mentioned in my remarks. So reconciling factor here other than some insured is what we call it change in mix. And change in mix is essentially this behavioral change that you are talking about and that's the examples that Patrick gave are exactly that and that's had an impact on the growth of mid-single digit range which has nothing to do with the bottom line but everything to do with customers' decision in terms of options.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay.

A - Charles Brindamour {BIO 7012323 <GO>}

We're quite pleased with what we're seeing in prop at this stage.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thank you.

Operator

Your next question comes from Tom MacKinnon from BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

A couple of questions. Did you talk about the commercial premium rate hikes you've been getting in the quarter? Was that 4.5% in this quarter? Is that the average...

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And that was...

A - Charles Brindamour {BIO 7012323 <GO>}

From 6.9% a year ago.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And maybe you can talk a little about what is happening in personal auto outside of Ontario? What's that environment like? What's the pricing like? We certainly do talk a lot about Ontario auto, but maybe you can talk about outside Ontario auto, and in what regions you are getting some price firming in there, and what is the environment like there?

A - Charles Brindamour {BIO 7012323 <GO>}

Tom that's the refreshing question. We feel like we've been talking Ontario for the past three years now. So I'll let Patrick give you sort of an overview there about our automobile market.

A - Patrick Barbeau {BIO 18476397 <GO>}

Overall, I get the main area where we're seeing firming conditions on price for personal auto is Alberta, we are increasing our rates by 5%. The industry gives us well (18:43) the loss ratio of 2013, it was demanding it. In Quebec, this is fairly stable and a slight increase also in Atlantic. So overall, when you combine that with minus 5% in Ontario, rates are fairly stable (19:03).

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, no exactly right. When we look at the first quarter average rate change in personal automobile business, it's about 1.5% on a direct return basis.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Positive 1.5%?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, positive 1.5% driven by some of the things that Patrick has talked about. Clearly, this will change direction as the rate reductions in Ontario take place. But as we've mentioned before, I think we're pretty comfortable with our margins there.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And can you just remind us what percentage of your premiums earned are from auto split between Ontario and outside of Ontario?

A - Charles Brindamour {BIO 7012323 <GO>}

So, I think the automobile portfolio, I stand to be corrected here, but is – 46%, 47% of our overall portfolio and automobile and Ontario is about half of that roughly.

Q - Tom MacKinnon {BIO 2430137 <GO>}

This is personal (20:07) excludes commercial, does it?

A - Charles Brindamour {BIO 7012323 <GO>}

That excludes commercial. Yeah.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thanks very much.

Operator

Your first question comes from Paul Holden from CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Guys, I'm going to start with a less refreshing question and then I'm going to go back to Ontario auto. Charles, it seems like the message I'm getting for you is there is not room for rates to decrease further today based on announced cost reductions, but for the industry we are still 2 points away from the August 2014 objective. Is that how I should be reading it? Are we not going to reach the 8 point objective?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, I don't want say that, Paul. I think that there is still a portion of the industry that has not filed. Again, I think at this stage, if you look at the first wave which was announced in early January, if you look at the second wave that was announced in April, what is it, Patrick, 70% of the industry?

A - Patrick Barbeau {BIO 18476397 <GO>}

Close to 80%

A - Charles Brindamour {BIO 7012323 <GO>}

Close to 80% that has filed. So you still have the 20% of the industry that might move the needle a bit. But I think as far as we're concerned and in discussion with various stakeholders that are involved in that process other than our competitors obviously. It's pretty clear that there is no room to pressurize the industry at this stage. And I think that we've said that all along with a combined ratio at the industry level close to 100% in the past year or two, make people to get it. And corrective measures are being taken at the industry level. You can see that in the number of companies. These are signs of capacity tightening. And I think that the government and – or the prior one anyways and the regulator clearly get that. They understand very well the dynamics of the market and I think availability is objective number one. So I think that's where we stand. I don't know what Patrick, what you think.

Q - Paul Holden {BIO 6328596 <GO>}

And then maybe moving on to personal property, you mentioned that competitors are starting to move on rate, and I guess product action more similar to what you've done. Should we expect customer attrition in the next couple of quarters to be roughly in line with what we saw in Q1?

A - Charles Brindamour {BIO 7012323 <GO>}

I will let Patrick take a stab at this.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yes. I think we should see similar levels in the coming two quarters even if some of our major competitors are starting to take rates and take actions on the product and underwriting side. Some of our recent actions are not yet fully reflected in our results. So we think you should leave us to project the same kind of retention for the coming quarters which were very satisfactory.

Q - Paul Holden {BIO 6328596 <GO>}

Right. And then once we hit Q4, you probably rolled over most of the portfolio and competitor actions will be more reflected, so less attrition once we hit Q4? (23:37)

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I think that's the likely scenario, Paul, if I can give an industry perspective. First half 2013 industry's top-line in personal prop was up 5%, second half 2013 industry's top-line growth in personal prop was up 7.2%, clearly a sign – when we say upper-single digit, an accelerating and hardening market and commercial lines in our outlook. You see the trajectory, I mean, 2 points over a six-month period is actually quite something. And it's not just rates, I think, our competitors behaving fairly rationally are taking action on the product side as well. There is a time lag and I think we've talked about that with investors in the past six to nine months. People were concerned about retention and quite frankly this is turning out as we anticipated. I think product changes will kick in, in April or additional product changes will kick in April. I think we'll see how that goes. But then the industry will catch up as well. So I think we feel pretty good about where we are and what we see in the market.

Q - Paul Holden {BIO 6328596 <GO>}

Right. A couple of questions on telematics, and not necessarily based on your experience so far. I guess the first question is, how are the brokers you are dealing with responding to the marketing push with respect to telematics? Are there any kind of incentives you are providing to the brokers to market this product?

A - Charles Brindamour {BIO 7012323 <GO>}

There is no incentives per se in the two provinces. Firstly, our UBI initiative now has been launched in Quebec and Ontario in both channels. On the broker side, in Quebec, which has been a few months we're seeing good uptake from our brokers, very good signs but no incentive. I think the main incentive is UBI is the powerful business development tool for new business and this is what's driving the behaviors of our brokers so far.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah and we think thank UBI is a great customer-driven option and our brokers have customers interest at heart and when that fits, they go for it and we're surprised about the uptake so far – so far, so good.

Q - Paul Holden {BIO 6328596 <GO>}

Is there any kind of data you can provide us behind the uptake in Quebec? Or is it still too early?

A - Charles Brindamour {BIO 7012323 <GO>}

Patrick, you might give a brief indication.

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah, it's easier for a moment to measure on our direct channel side, so it's a good uptake there, close to 30% of our new business is entering in the product. Overall, we have enrolled more than 6,000 clients at this point.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. So that is quite good uptake in the direct channel. And then maybe you can give us a little more commentary or sense around the initial profit drag I would expect from watching this program. There is going to be start-up costs associated with technology as well as marketing. So is there any kind of idea you can give us regarding profitability over the first couple of years?

A - Patrick Barbeau {BIO 18476397 <GO>}

Most of the cost of this program is variable, so it's not mainly start-up, it's - it has the technology. So it's linked with the volume we receive. So we don't see a big drag on the profitability coming from UBI because of the structure of (27:20).

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I would add Paul, that if you look at the marketing strategy, when you try to make the phone ring or people click, you use new ideas, new product and I think we tabled on UBI's, the idea or the product, as opposed to necessarily overly heavy load of additional marketing to sell UBI. I mean it was part of the envelope (27:55) that we have every year to make the phone ring, so to speak, so not a drag there for sure. That's not to say that we won't increase marketing in the near term. I think it's important to keep in mind, it's early but the experience we find is actually pretty slick now and offer all sorts of upside from a customer experience point of view. So as we think through how we can improve the customer experience, we might invest more in marketing, but so far no change compared to what we've done in the past.

Q - Paul Holden {BIO 6328596 <GO>}

Okay, thank you for your time.

Operator

Your next question comes from Brian Meredith from UBS. Your line is open.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Brian.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Good. I guess, the first one just on the commercial P&C business, you said you are taking 4.5% rate. How does that compare to what loss trend is in that business, is 4.5% enough given you get an underlying, (28:53) even with the adverse weather?

A - Charles Brindamour {BIO 7012323 <GO>}

Alain, do you want take this?

A - Alain Lessard {BIO 21962461 <GO>}

Yes. Our overall plan to improve profitability on the commercial lines include what you're talking about the rates 4.5 points increase in the first quarter, that's up from 3.8% in the last quarter of 2013 and well above last year's. And we expect those rates to continue throughout the year. We also, as a part of our plans aspect to manage a lot on the flood and SBU. These have been implemented higher deductible on flood without any rate change. We're reviewing our SBU also rates coming up in the second quarter. And on top of it the management of our earthquake exposure in BC where we exited some of the worst, I would say, or the most difficult to reinsured part of the business basically condo booking BC also will bring improvement to the profitability.

We think that all of those aspects combined will basically give us and lead us to operate in the low-90%s. Basically we see that excluding catastrophe, we are running right now on a 94% combined ratio for the last, let's say, five quarters and even lower than that if we take on more year, and basically there is a little bit of seasonality in looking at those result. So we are quite confident that the impact of the 4.5% rate increase combined with the action on the earthquake exposure and flood are in fact bringing us back to low-90%s.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. I think if you look at the underlying current year loss ratio over a number of years, clearly sort of rate action that we're taking is enough. I think if you look at how prior years impacts that picture, you see a very healthy level and certainly not less than what it was a few years back. I think, as Alain is saying, when you look at the commercial P&C performance, cats and large losses are the issue. And so for me the answer is really dependent on our ability to tame the impact of cats. Hence our recognition of what is the new level of cats going forward in that line of business. We think that 4.5% is enough at this stage and particular in combination with the measures that Alain is talking about. But this is up for debate. I must admit that I personally after five or six quarters of what I would call bad results in commercial lines, whether it's large losses in cats, we're on high alert on those two points. So actions are being taken. And if we feel that there is a new normal there and the actions don't tame completely the new normal, we will crank it up.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Great. And then are you seeing any impact yet, Charles, of some of the acquisitions, like the Travelers acquisition and the State Farm acquisition yet in the marketplace?

A - Charles Brindamour {BIO 7012323 <GO>}

So there is a Personal Lines side to this, not personal. And there is a Commercial Lines side to this. I think so State Farm is not closed. So we don't see anything concrete at this stage but just to outline there, they're really good operators. And when this deal closes, I'm sure their behavior will be rational and good for the market. But no clear signs in the short-term because the deal has not closed. I think Travelers rational folks disciplined and we understand that there is work being done at the moment to improve the performance of the Dominion which I think come to market and it's consistent with my comment earlier in my remarks that competitors behave fairly rationally. Does it change the market dynamic dramatically? Not at this stage, but the sort of moves that we're seeing certainly makes sense to us. Patrick, I don't know - or Alain, do you guys have anything to add on that?

A - Patrick Barbeau {BIO 18476397 <GO>}

I'd say on the Dominion and Travelers, they are still not integrated, they have their issue (33:52) integrating the two organization. And for commercial lines, Dominion was roughly about 5% of the Ontario market, it was not a big player. So it's not enough to change the dynamics, okay.

Q - Brian R. Meredith {BIO 3108204 <GO>}

Okay, great. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Okay.

Operator

Your next question comes from Doug Young from Desjardins Capital. Your line is open.

A - Charles Brindamour {BIO 7012323 <GO>}

(34:13). Hi, Doug.

Q - Doug Young {BIO 5640851 <GO>}

I won't comment on State Farm. So first question, Charles, to you I guess, is that I know in the past you've mentioned, and I hate to bring up Ontario auto, but it is a big topic.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, don't worry about it.

Q - Doug Young {BIO 5640851 <GO>}

I know in the past you mentioned how you think that it is going to be margin neutral with all of the changes. I don't know if I am reading into this, but it seems like you have talked in the slide deck about, you think you will be able to protect your profit. There is no mention of it still being margin neutral. So I'm just wondering do you still think net-net with all the changes coming down the pipe, it is margin neutral? And that is my first question.

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, Patrick do you want to comment there?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah, definitely we would continue, we still have the same view on profit margin neutral with our rate changes that are coming in April given the cost reduction measures that are already implemented since February and some of the other internal measures we discussed in the last quarters.

Q - Doug Young {BIO 5640851 <GO>}

Yeah.

A - Patrick Barbeau {BIO 18476397 <GO>}

A few item change (35:15).

A - Charles Brindamour {BIO 7012323 <GO>}

Absolutely not, I think when we expressed our view at the first quarter, the measures were approved essentially by regulators and our own measures were in the pipeline. So that's in our mind sort of pretty solid.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And then I wanted to go to the commercial. You talk about 4.5% increase. That's on the renewals, and you've given us the data in terms of year-over-year and sequential, is that across your entire book?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes, 4.5% is a global picture of how rates increase across the whole commercial portfolio. I will let Alain to give a little bit of flavor there.

A - Alain Lessard {BIO 21962461 <GO>}

That's 4.5% on renewal and that's for the whole book, but it's not distributed evenly on every policy, like we've mentioned we have a segment that approach to rate increase at renewals and we're in fact targeting much more 25% of the book, the least profitable part of the book where we're seeing rate increase in average close to double-digit. But even within that segment rate increase will go up to 15% or 17% depending on the region or the characteristic of the accounts. So we're seeing those translate when we look at it average on the whole book of basically 4.5% on renewal. And on the new business if you look at new business to new business rate increase Q1 2014 over Q1 2013, we are seeing something around 8% on the new business side.

Q - Doug Young {BIO 5640851 <GO>}

And is there much differential between pricing on a new business versus a renewal, or is that basic basically pretty tight?

A - Charles Brindamour {BIO 7012323 <GO>}

I would say on average probably not that much, okay. It varies account by account, it varies on the different situation. But overall, I would say it's pretty close.

Q - Doug Young {BIO 5640851 <GO>}

Okay. And then just had a question about frequency because you've itemized your prior year reserve developments. (37:39) wrapped around that around the cat losses. But I think you've also disclosed that the increase in frequency of losses came – the frequency of losses increased in the quarter. And that is not really necessarily broken out as a separate item. But it is probably fairly important. So can you give us a sense, or can you quantify what you think the frequency trends were in the quarter from a combined ratio, or a loss perspective or anything? Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, Doug are you talking commercial P&C or all lines or...

Q - Doug Young {BIO 5640851 <GO>}

I think all lines, commercial P&C was hit particularly hard, but I mean all lines in general?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So if you look at automobile lines of business, frequency quarter-over-quarter was up 14% in personal auto and 11% in commercial auto largely because of the same reasons. And here you have to understand winter conditions certainly our take on it. If you look at commercial lines, frequency was up mid-single digit in commercial P&C, not commercial auto. In automobile, severity was down. But in commercial P&C, on top of the frequency increase, severity was up. It's very different profile of losses than in automobile lines of business. And I don't know Alain, if you want to comment on commercial P&C frequency.

A - Alain Lessard {BIO 21962461 <GO>}

Yes. Like we mentioned, the severity was up. Basically we saw more fires during the first quarter and most fire are mostly in apartment buildings and everything where we have a lot more heating that was required during the first quarter due to cold winter situation. We also saw from pipes bursting, mostly sprinkler pipes or anything and these created some water damage that can be also affecting the severity size there because they can be large, when you burst huge sprinkler pipe you affect the larger element of building or the content. So there is, that's what's affected mostly the severity in commercial P&C during the first quarter, all related to what we saw to a longer and colder winter situation.

A - Charles Brindamour {BIO 7012323 <GO>}

Did we answer your question and Doug or...

Q - Doug Young {BIO 5640851 <GO>}

You gave a good flavor to it. I may come back. It is probably maybe little too technical for the call. I may come back on a few other ones. That is fine. That is all for me, thank you very much.

A - Charles Brindamour {BIO 7012323 <GO>}

In automobile, Patrick, do you want to comment on what it means in loss ratio terms maybe or combined ratio terms this frequency increase?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah. As you've said 14% frequency increase is combined with the reduction of about seven points in severity for auto. When you add on top of that, about two points increase in average earned premium that leads to an underlying rate loss ratio that's improved when you're improving the prior (41:03) development by about six or how is it, by four points.

Q - Doug Young {BIO 5640851 <GO>}

Four points?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah.

Q - Doug Young {BIO 5640851 <GO>}

So I think clearly frequency was the drag in the quarter. Everything else pointed in the right direction?

A - Patrick Barbeau {BIO 18476397 <GO>}

Yeah.

Operator

. Your next question comes from Mario Mendonca from TD Securities. Your line is open.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Charles, first on capital. It's been a little while since the capital level has been this strong entity specifically. Are buy backs still in the tool kit for you because we haven't seen it in some time?

A - Charles Brindamour {BIO 7012323 <GO>}

So listen, the buyback actually expires on 12th of May and we have not been active since last year. And we do not intend to renew the buyback for now. So we've always said we would execute the buyback if we intended to. At this point in time, given what we see in the market, we do not intend to renew.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

When you say – what you see in the market?

A - Charles Brindamour {BIO 7012323 <GO>}

The opportunities. I think if you look at manufacturing, acquisition opportunities, if you look at distribution, acquisition opportunities, there is a fair bit going on at the moment on both front. And if you recall the tool box when we think about excess capital, we first tried to reinvest your capital in good growth opportunities that will meet your hurdle. Make sure of course you increase your dividend which we've done before and then you move to buyback at this stage, we look at the opportunity set and we're pretty pumped actually about what's going on in the market and that's where we stand. And I think when we intend to actually use the buyback then we'll reinitiate it, but just to leave a buyback open for the sake of it is not how we think about capital management.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Okay. And then if we can go to the AFS gains this quarter, $67 million, I am not sure I follow how the derivatives generated that gain, and was there anything special I think you refer to equity strategies? Anything special you can describe there?

A - Charles Brindamour {BIO 7012323 <GO>}

Listen, I guess the uptick there was really driven by the equity markets in Q1. So we were - the market is up on the interest side, the interest rates were down which combined with the uptick in equity markets provided gains. So we gained essentially on those two drivers. There was no abnormal activity on that front.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

The derivative gains? Anything you can refer to there?

A - Charles Brindamour {BIO 7012323 <GO>}

Well, we were a bit extended on duration at the early part of the quarter with the rate decreases that drove a bit of derivative gains and we reduced the duration at the end of the quarter. So a bit of it was driven by the fact that the rates declined and we were a bit long on the duration at the beginning of the quarter and that helped and generated those derivative gains.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

When you say duration you are referring to...

A - Charles Brindamour {BIO 7012323 <GO>}

Fixed income.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

But not supporting your contract liabilities, but your surplus?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes.

Q - Mario C. Mendonca {BIO 2450557 <GO>}

Okay. Thank you very much.

Operator

We have no further questions at this time. I'll turn the call over to the presenters.

A - Dennis Westfall {BIO 15155973 <GO>}

Thank you everyone for participating today. The webcast will be archived on our website for one year. A telephone replay will be available at 2:00 p.m. today until Wednesday, May 14 and a transcript will be made available on our website. Please note that our Annual & Special Meeting of Shareholders will be held at 2:00 p.m. Pacific Time today at the Pan Pacific Hotel in Vancouver while our second quarter results for 2014 will be released on July 30. That concludes our conference call for today. Thank you and have a great day.

Operator

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