Q4 2017 Earnings Call

Company Participants

- 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 Barbea, Senior Vice President, Claims

Other Participants

- Brian Meredith, Analyst
- Doug Young, Analyst
- Geoffrey Kwan, Analyst
- Jaeme Gloyn, Analyst
- John Aiken, Analyst
- Kai Pan, Analyst
- Mario Mendonca, Analyst
- Meny Grauman, Analyst
- Meyer Shields, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

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

I will now turn the call over to your host, Mr. Ken Anderson, Vice President of Investor Relations and Treasurer. Please go ahead.

Ken Anderson {BIO 16846692 <GO>}

Thank you, Krista. Good morning, everyone and thank you for joining the call today. A link to our live webcast and published information for this call is posted on our website at intactfc.com under the investors tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on this conference call.

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 over to our CEO, Charles Brindamour.

Charles Brindamour {BIO 7012323 <GO>}

Good morning, everyone, and thank you for taking the time to join us today. Yesterday evening we announced fourth quarter net operating income of a CAD1.63 per share, driven by strong property and commercial results in Canada. For the full year, NOIPS increased 15% to CAD5.60, bringing the operating ROE to 13%. Results for the quarter include OneBeacon, which drove top line growth to 17%. Our Canadian businesses grew north of 1%, tempered by our rate actions, pretty much in all lines taken ahead of the market.

Our operations are demonstrating their resilience and proving the benefits of diversification. The overall combined ratio was 92.6%, with Canada at 91.9% and our US operations at 97.4%. Results in Canada were solid despite the impact of unusually severe winter weather, which began in late December and is still affecting many parts of the country.

Performance in personal property and commercial lines continues to be excellent and we see ongoing benefits from our rigorous expense management. Personal auto performance remains unsatisfactory and therefore is undergoing robust corrective measures.

We ended the year in a strong financial position with a total capital margin over CAD1.1 billion and debt to total cap at 23%. Book value per share grew 12% in 2018 to CAD48. When comparing ourselves to the industry, our combined ratio was better than the industry by 6 points at the end of the third quarter, driving an increase in our ROE outperformance to almost 600 basis points. We expect our ROE outperformance to widen further in the near to mid-term and remain above our long-term objective of 500 basis points.

So, let's look in more detail at our results by line of business. So, starting in Canada, personal auto growth was down 0.6% in the quarter, as our rate actions taken ahead of the market resulted in top line pressure as anticipated. We're very comfortable trading our top line to improve bottom line.

The combined ratio improved by 3.9 points over Q3, but at 101.2% was unsatisfactory even if adjusted for normal seasonality. Physical damage inflation remains the main driver of our current underperformance, but severe weather was also a factor this quarter. We estimate that the combined ratio run rate is in the upper 90s at the end of the year.

After more than 18 months of weakness in personal auto, it's fair to ask, are the actions paying off as anticipated? Our view is that the initiatives implemented have achieved what was intended. Indeed, we've meaningfully gained traction in rates adequacy, portfolio quality and claims frequency and severity trends related to bodily injury and physical injury or psychological injury.

However, cost pressures related to physical damage are more recent and that accelerated in the past few quarters. That's why we have meaningful additional rate increases in the pipeline across the country. We're also adding to our segmentation initiatives to continue to improve the portfolio quality and claims management initiatives focused on costs and the time taken for repairs are being ruled out.

We're executing with discipline on our action plan and remain committed to bringing personal auto's combined ratio back to the mid-90s. We're confident this is a short to mid-term issue and our actions should bring us back to our long-term track record of performance in this line. It's important to keep in mind, we've operated personal auto in the mid-90s for 7 of the last 10 years, and have averaged a combined ratio in the mid-90s over 5, 7 and 10 years. So, we'll keep at it until we get there.

When it comes to the outlook for auto, the industry continued to increase rates in the fourth quarter across the country. We also see expansion of the industry risk-sharing pools and double-digit growth in our non-standard auto business, supporting our view that the market is firming from coast-to-coast. We expect this environment will support our profitability improvement plan for sure and we see mid single-digit growth for the industry in the coming 12 months.

Historically, this kind of environment has translated into opportunities for Intact. In personal property, premiums grew by 4%, as rate increases continued to be deployed in favorable market conditions. The combined ratio for the quarter of just under 80% reflects excellent underlying performance. For the year, we delivered a combined ratio of 89% despite over 10 points of cat losses.

Our actions over time, I believe have been successful in this segment. We've delivered a combined ratio just under 89% on average over the past four years. Personal prop is performing and is positioned very well for the future. The industry outlook for personal property remains unchanged. Elevated natural disasters this year again support continued firm market conditions, with mid single-digit growth expected over the next 12 months, as the industry continues to adjust changing weather patterns.

Looking to commercial lines in Canada, top line was up 2%, as we saw strong growth in specialty lines and early signs of improving momentum in commercial P&C. This segment continues to produce excellent results, with a combined ratio of 87.4% for the quarter and 86.5% for the year.

Our pricing and segmentation actions are paying off, and this business is positioned for a sustainable low-90s or better combined ratio moving forward. In terms of outlooks for commercial in Canada, even though competitive, we see clear signs of improvement and we expect low to mid-single digit industry growth in 2018.

Turning now to our expansion into US commercial and results for the quarter. So, premiums of 307 million bolstered our growth. On an organic basis, excluding discontinued lines, growth in this segment was 2%. The combined ratio at 97.4% represents a good starting base to deploy our profitability improvement plan and it is well underway.

Beyond the two lines of business that have been exited at closing, we're applying Intact's analysis and analytics, and segmentation expertise in select other lines. Our claims practices are gradually being deployed in the US. Synergies are being realized as projected, which we will cover in a minute. Our plan is on track to bring the US combined ratio to a low-90s level within 24 to 36 months and in the exercise, deliver mid-single digit run rate accretion to net operating income per share by the end of '19.

There is upside to come from expanding distribution for OneBeacon's profitable lines and from being able to serve new customers across borders, North and South. And on that front, we've already begun to leverage OneBeacon's industry-leading expertise in Canada, where we are now underwriting new entertainment and technology products.

Looking at the industry outlook in the US market conditions, since the transaction closed, are slightly better than anticipated, with early signs of upward pricing trends in certain lines. Overall, we expect low single-digit industry growth for US specialty in 2018.

Turning to strategy, we continue to accelerate our customer-driven transformation in Canada. We completed the rollout of telematics via mobile across the country, launched a simplified home quick quote tool and added an enhancement to Belairdirect's app. We also launched Canada's first commercial auto quick quote engine in December.

On the people front, we were recognized by Aon for the third year running as one of Canada's Best Employers, the key objectives we've set for ourselves. Building engaged teams with a customer-driven mindset is a core pillar of our strategy and we're committed to an employee promise, which attracts and retains top talent and experts. I want to take a moment to thank all our people for their contribution to our success across our lands. So in conclusion, '17 was a landmark year for IFC as we expanded our reach in the US. I'm pleased with the underlying performance and continued momentum in personal property and commercial lines. Personal auto, we are taking the actions necessary to bring the combined ratio back to the mid-90s and the ROE closer to 15%. Our US franchise is off to a solid start. This opens up a significant growth pipeline for our business and adds to our already diversified operation. IFC's financial position is strong and we're gaining momentum. And with that in mind, we're increasing our quarterly dividend by 9% to CAD0.70 per quarter. This is the 13th consecutive annual dividend increase since our IPO.

I'm confident that the strategies we have in place, together with our various actions and discipline position us well. We aim to deliver on our financial objectives to outperform the industry ROE by at least 500 basis points every year, and grow our net operating income per share by 10% per year over time.

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

Louis Marcotte {BIO 18040440 <GO>}

Thanks, Charles, and good morning, everyone. We reported solid earning numbers this morning, with fourth quarter net operating income being up 11% to 236 million, and net income up 36% to 232 million. These results were driven by the strong overall results in Canada, the addition of OneBeacon's earnings and solid growth in distribution income. The US tax reform and favorable capital markets also provided support to our results.

On a per share basis, after considering shares issued to acquire OneBeacon, net earnings grew 26% to a CAD1.60 for the quarter, taking full-year earnings per share to 5.75, an increase of 45% over 2016. Our ROE rose from 10% to 13% year-on-year, while the book value per share grew 3% from the end of Q3 and 12% year-over-year.

From a top line point of view, the addition of OneBeacon drove our Q4 growth to 17%, a substantial increase to our premium base and a meaningful diversification. The overall combined ratio in Q4 was 92.6%, including OneBeacon's 97.4%. These are solid results on both sides of the border, particularly while both personal auto and OneBeacon are still undergoing profitability improvement plans.

Let me provide some additional color on our Canadian results. In auto, the combined ratio remains elevated, but our actions are bearing fruit. We were pleased to see favorable prior year developments in the quarter, earned rates up 5.2% and written rates up 5.3%. Despite this progress, the underlying loss ratio remains above our expectations, mainly due to the higher prices for parts and the time needed to replace them. We will continue taking actions to bring our combined ratio progressively towards a mid-90s target.

Our actions to manage our overall expenses has also been successful. The 2017 expense ratio declined 1.8 points, driven by lower variable cost and rigorous expense management. 0.5 point of that improvement is structural and should continue in 2018.

Our distribution income grew 17% in the quarter to CAD28 million, bringing full-year distribution income to 132 million, an increase of 19%. This just reflects the benefit of capital deployed in distribution and our continued focus on margin expansion. We expect distribution income to grow by 10% in 2018.

On the US side, the underlying performance was healthy with a 56% loss ratio. We recorded unfavorable prior year development of 4.6%. About half of the prior year development represents our 20% share of losses ceded to the adverse development cover. The remainder reflects the impact of discounted -- discounting those ceded losses. As a reminder, the adverse development covers 80% of all losses for accident years 2016 and prior, up to a maximum of USD250 million. We used approximately USD25 million in Q4.

Charles talked earlier about our profitability improvement plans to bring the combined ratio to the low-90s in 24 to 36 months, and achieve mid single-digit NOIPS accretion by 2019. These are well underway. Our Q4 results already include approximately USD1 million of realized synergies. However, the actions taken to date will deliver USD9 million in synergies on an annual run rate basis. We expect to double the run rate by the end of 2018, leaving us in good position to reach our CAD25 million target within two years.

As of January 1, 2018, our seasoned investment management team has taken over the OneBeacon investment portfolio. They are now working to optimize the asset mix, taking risk, regulation, tax and capital factors into account. We don't expect significant changes to the overall asset mix.

Net investment income was up 17 million in the quarter, mainly due to the addition of the OneBeacon portfolio. Excluding OneBeacon, 2017 net investment income was unchanged year-over-year as expected. We estimate 2018 investment income to increase by about 8% or 9% over full-year 2017, after reflecting the addition of OneBeacon and the use of excess capital to fund the acquisition.

At the very end of 2017, the US enacted its tax reform legislation, which led us to recognize a non-operating tax benefit of CAD27 million, or CAD0.19 per share relating to the remeasurement of net deferred tax liabilities of OneBeacon. Going forward, the tax reform will have a negligible impact on our results. On one hand, we will benefit from the lower tax rate and a faster recovery of tax losses. On the other hand, OneBeacon's intercompany reinsurance agreements become ineffective.

Now, looking at capital in our balance sheet. We ended the year in a strong financial position with a total capital margin in excess of CAD1.1 billion. In Canada, our MCT was 205%, 4 points higher than at the end of Q3. And in the US, the RBC regulatory capital stood at 459%, well above minimum required levels. Our debt-to-total capital ratio was down to 23% at year end, ahead of schedule. We are well on track to get to our 20% target in 2019.

With a strong balance sheet and confidence in our outlook for growth and profitability, we raise our quarterly dividend by 9% to CAD0.70 per share. This represents a 12% annual dividend growth rate since our IPO in 2004.

In closing, 2017 was a milestone year as we deployed capital in the US, expanding into a new market to secure new growth pipelines for many years to come. With the diversity of our underwriting businesses, investment portfolio and distribution assets, we have built a highly resilient platform with significant growth potential. With our strong financial position, we're in good position to participate in consolidation opportunities as they arise, particularly in Canada where we are ready to act at any time.

We look forward to 2018 and beyond with increasing confidence in our ability to execute on our financial objectives, to outperform the industry ROE by 500 points and grow operating income per share by 10% over time.

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

Ken Anderson {BIO 16846692 <GO>}

Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourself to two questions. If there is time at the end, you can re-queue for a follow-up. So Krista, we're now ready to take questions.

Questions And Answers

Operator

Certainly. (Operator Instructions) Your first question comes from the line of Kai Pan from Morgan Stanley. Please go ahead. Your line is open.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you, and good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning, Pan.

Q - Kai Pan {BIO 18669701 <GO>}

My first question on the personal auto side. And if you roll back 12 months from now and at that time, you said, so you're taking actions and expect the combined ratio to improve in 2017. Now 12 months later, some of the actions actually have shown some results, but new loss cost trend is just popping up. So, I just wonder, can you talk a little bit more about your ability to anticipate that the loss cost trend were changes, make sure you are ahead of the curve rather than keep chasing the curve, and what give you confidence, you can bring back to mid-90s and how long will you take?

A - Charles Brindamour {BIO 7012323 <GO>}

Okay. Good. So, I think -- Kai, let me just take this one. 18 months ago, in the third quarter of '16, the results in automobile insurance took a turn in a direction we didn't like. And at that time, this was primarily driven by bodily injury as well as accident benefit. Part of it was reporting of larger claims from years 2013-2014, so late reporting, which when you add to our forecasting mechanism, changed our view of the trend at that time.

So, when we realized that this was the case, Kai, we, of course, were very transparent with investors. But at the same time said, hey, we're seeing this happening, new claims in large part and we're changing our view of that environment, not only are we reserving for it but we're pricing for it. And at that time in late '16, we started to roll out, laid actions across the lands pretty much, underwriting actions across the lands as well as claims action across the land.

And when I look at the earned rate in the system, when I look at our multivariate scores that track the prospective profitability of the business, I mean, there is lot of traction that has taken place. And I would say, when I look at the cost curve, when it comes to psychological damages and bodily injury, we clearly have seen inflation in that front and restored in large part, the profitability of those coverages, per se.

What happened though over that period is that, in Q4 '17 or in Q4 '16, I should say, we've noticed in the Ontario market, an increase in total losses for vehicle, which later in '17, so this was a -- I would say, could have been a blip. But soon in early '17, after noticing that total losses in the Ontario marketplace were up, put in place an action plan in claims in particular to try to tame total losses. And what happened in '17 throughout Q1, Q2, picking up in Q3 is we've seen physical damage beyond Ontario. The cost of repairs go up across the land basically.

So, you need a quarter or two to figure out whether it is something that is changing or whether it's just a blip. And when we realize that there was pressure in PD, basically launched a PD-oriented action plan which includes rates, which includes claims action, risk selection actions and so on. And that's why, Kai, we have said last quarter that, while we've made a lot of progress to improve the performance, the emergence of trends in PD which was months old, quite frankly are largely driven by cost of repairs, largely driven by technology, has driven a whole new set of actions.

When I stack the actions we've taken in '16 as well as in '17 with what's in the pipeline now, we're saying, hey, we are getting back to our long-term track record this year. It is sort of what we're shooting for, but we'll keep at it until we've tamed that trend. The other thing that I think is important to point out is that, it should be easier to keep physical damage under control from a pricing point of view than it is to keep bodily injury and accident benefit under control, which, I think we've gained a lot of traction on that front.

So, look, this might be a bumpy ride, but we're not going to let go until we're back to our long-term track record in personal auto. So, I don't think there -- when I look back and I can tell you, we look back and think about how we could have avoided some of these bumps.

It's not like there have been trends building up, for which we have the information sitting in front of us for many months, quite frankly. And I would say that, if you look at our top line in personal automobile where we have basically -- look at Q4 again, shrunk our customer count by 1.7%. I mean, we're basically off-cycle when it comes to the markets read. So, I think if those trends are solid and real, we are at least 18 months ahead of the pack, which in my mind translate -- and has translated over my career, for sure, in meaningful growth opportunities, both organic and inorganic when the industry wakes up to these trends. And I think, looking at the markets from coast-of-coast, we're feeling that the industry is picking up.

So imperfect answer, but that's sort of my view of things at this stage. And when I look at our profitability indicators, I'm seeing meaningful traction but this might be a bumpy road. It might be appropriate, Kai, to ask Darren to give you a perspective on what's in the pipeline and what's coming in '18 in terms of action and we may be we want to do the same thing with Patrick because claims is playing a meaningful role in my mind in improving those trends and that might give you a more fulsome perspective on what's in the pipeline. So, Darren?

A - Darren Godfrey {BIO 19791482 <GO>}

Thanks, Charles. So, as Charles indicated, our current run rate sits in the upper-90s. So, I think it's important to recognize that Q4 obviously is a tough quarter from a seasonality standpoint. So, when we normalize and look at our action plans over 2017 in terms of where we sit today, we're in the upper-90s. So, that really is our starting point in terms of our movement down towards mid-90s.

When we look at the actions that will flow through the portfolio in 2018, the vast majority are actually coming from actions that we took in 2017. So, whether it be in terms of rate increases we continue to earn, claims actions, underwriting actions, risk selection, et cetera, a vast majority of the impact of '18 actually is coming from '17, which is already flowing through.

Obviously, as we indicated, PD is where the concern is. So, we're augmenting our actions there. Just to look at some additional color there, in the quarter itself, as Louis mentioned, earned rates were up 5.3% in the quarter. So, there continues to be strong momentum. Written rates were also up as well.

As Charles indicated, when we look at our prospective quality measures, we're looking at an extra 1 to 2 points of improvement coming in terms of improvements of quality of the portfolio. So, we have lot of actions currently in play with a lot of strong momentum, but obviously, the focus remains on the trends around PD. That's where we will continue to focus our efforts, and obviously, Patrick in the claims team as well.

In terms of additional rate actions in 2018, we are expecting a further 5% increase in rates in 2018. So, this clearly will also give good momentum into 2019 as well. With respect to our 2018 plans for rate increases, we've already received approval for additional rate increases already to-date in 2018, and we have a number of further filings currently with regulators for approval and we'll continue to evaluate and apply for further rate increases as necessary and as per our plans in the remaining months and quarters of 2018. So, when we look at where our starting point is, all of our actions flowing from '17, additional actions in '18, we are confident that we expect the combined ratio to be back in mid-90s run rate by the end of 2018.

A - Charles Brindamour {BIO 7012323 <GO>}

Patrick?

A - Patrick Barbea {BIO 18476397 <GO>}

Yeah. Well, as Charles, you alluded to, the drivers of the cost pressure on auto physical damage is really on the severity side. So, with -- it's coming from cars being more sophisticated because of technology. This translates into -- parts are more costly, the repairs is more complex and take more time. So from a claims perspective, there is quite a few things we can do about it and we have started the actions in 2017 and continue to focus on that and we're focusing on three pillars -- our actions on three pillars. The first one is better tools deployed to our claims frontline.

Q - Kai Pan {BIO 18669701 <GO>}

I said you already answered the question.

A - Patrick Barbea {BIO 18476397 <GO>}

Pardon? Sorry. Okay. I continue.

A - Charles Brindamour {BIO 7012323 <GO>}

Keep going, Patrick.

A - Patrick Barbea {BIO 18476397 <GO>}

So, I was saying, the first pillar is better tools that we deployed through the claims front line staff so that we take smarter decisions around the repair process and early on. Examples of that are faster determination, if the car would be repairable or if it has to be declared total loss. By doing so, we reduce the cycle time and eliminate cases where we need to tow the car more than once. Another example is enhanced body shop booking tool, to guide our clients towards the best shops depending on the types of car and the types of repair that needs to be performed. So that's the first pillar.

The second one is tighter controls around the process itself, around the estimation, around the repair process and around parts ordering, working closely with our reliant network. And finally, beside the actual repair, there is other cost involved in physical damage. I'm talking about rental costs, towing fees, storage and service fees, and we have adjusted many of our processes and continue to do so to minimize the cost there. There are significant savings that can be done on that front as well.

A - Charles Brindamour {BIO 7012323 <GO>}

Good. Thank you. So, hopefully that (Multiple Speakers) long answer.

Q - Kai Pan {BIO 18669701 <GO>}

That's plenty and very appreciate that. My second question on OneBeacon, if I may switch to that. Is that -- if you strip out the reserved charges for the quarter and the underlying is actually running at around 93%. That has been the case for the fourth quarter -- third quarter as well at OneBeacon. So, you're making improvement actions over there. You are really actually at low-90s, I would say, between low-90 and mid-90s. So, why would it take another two or three years to get there?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I think that there are segments in the portfolio that need work and we want to be smart about how we go about improving those segments. There are segments in the portfolio that have had stellar performance and clearly, that's been the case in Q4 and we want to grow those segments. But we're new to this market, we're cautious, we love the new team that has joined Intact with Mike Miller and his team. And I think we want to make sure that we improve the performance of all the lines that we've chosen to focus on and that we give growth momentum to those lines who are already operating sub-90s.

But our game plan, Kai, is, risk segmentation is one thing and focus on the number of lines that have been operating around 100%. But we have improvements we want to bring from a claims point of view and that will take 24, 36 months. And the other thing is synergies, which is also part of our plan. But clearly, exiting a number of lines, two lines that were under-performing and that we didn't have much hope of bringing to the low-90s really helps the starting point. There's no doubt about that. But I don't think we're there yet.

Q - Kai Pan {BIO 18669701 <GO>}

Thank you very much.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

Your next question comes from the line of Tom MacKinnon from BMO Capital. Please go ahead. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thanks very much. A question for Charles, and then a follow-up. Distribution income, I think you guys had guided to being up above 15% in 2017. It looks like it's up more than that nicely in the fourth quarter, up closer to 19% in 2017. What's driving that and how should we look at distribution income going forward?

A - Louis Marcotte {BIO 18040440 <GO>}

So, go ahead, Charles.

A - Charles Brindamour {BIO 7012323 <GO>}

I'll ask Louis to comment on the performance and then we'll talk strategy after. Go ahead.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. So, I think we guided to north of 15% for this year, came in at 19%. So, we're happy with those results. It's a combination of investments we've done in the past in the brokerage network, capital deployed in that stream and as well as working on the margins for the brokers. So, it's really those two elements that drove this year's results. And our view is for next year, we expect the income to grow 10% off the 2017 actual results.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And why did it slowdown?

A - Louis Marcotte {BIO 18040440 <GO>}

Well, actually, it's interesting. It really follows EBITDA capital deployment. So, you will have seen a bump in 2015, capital deployment hitting us -- 2016, I am sorry. And then it scales down a bit in 2017. So the growth will follow the investments we've done in the past. Yeah.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay.

A - Charles Brindamour {BIO 7012323 <GO>}

So, Tom, I think the way I think about growing our distribution business at this stage, there is obviously consolidation and therefore, capital deployment, which remains pretty healthy. It's hard to predict where that will finish because we do it deal-by-deal, when it kind of make sense to us. But we are all out on this front and have no intentions to let go of that activity.

And then, I think the area of upside is that, we've now reached the size in distribution, both with BrokerLink and brokers where we have joint partnership, where we can crank up the organic growth of these businesses. And so in 2018, there'll be not only the consolidation activity you've seen in the past, but greater focus on organic growth in distribution as well. And so, I have a pretty optimistic view of the growth of these distribution operations in the coming period. And I think that the margins are very strong and stable in that segment, and a number of initiatives to expand those margins there as well.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks. And then a follow-up question is really just with respect to net investment income. And if we look at slide 11 of your slideshow, Louis, would the net investment income earned in the fourth quarter be kind of representative of a reasonably good run rate now that you've got OneBeacon?

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah. So, I would take care of seasonality and what I've guided to in my remarks was really, if you take the actual fiscal 2017 net investment income of 432 million and add 8% -- 8%, 9%, that would be my best estimate for the 2018 investment income.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Because annualizing the 121 million is 484 million, which is more like 12% growth. So, is there something in the 121 million that you're not expecting to continue?

A - Louis Marcotte {BIO 18040440 <GO>}

So, there's some seasonality in our investment income. So, we have dividends that may come in one quarter over the other. So, I'm always careful on the quarterly dividend income, and that's why our guidance annually is a bit, I would say, more reliable.

A - Charles Brindamour {BIO 7012323 <GO>}

And Tom --

Q - Tom MacKinnon {BIO 2430137 <GO>}

How does the rising rate environment here help? I mean the book yields, I assume on the OneBeacon portfolio was a little bit less but your book yields went up quarter-over-quarter.

A - Louis Marcotte {BIO 18040440 <GO>}

Yes. So, that estimates that guidance we're giving for next year, would not imply any future rate increases. We do expect a bit of upside from extending the duration of the portfolio on the OneBeacon side. That will be helpful. But we haven't taken any upside from the potential yield rising. Now, you remember, we talked about this at the Investor Day last year, 100 basis points yield rise represents about 20 million of investment income but the accrual were a three-year period roughly. So initially, it's a small impact, and then it grows to 20 million over a three-year period. So it's really in the first year of the rate rise though the impact is limited.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And is that a 100 basis point rise in a five-year?

A - Louis Marcotte {BIO 18040440 <GO>}

Yes. That's where we are building.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks.

A - Charles Brindamour {BIO 7012323 <GO>}

And Tom, we'll spent time on that at the Investors Day in March where I think, Wern, our Head of Investments will talk about that. Given the addition of OneBeacon, as Louis was pointing out, it gives -- it affords interesting opportunities to better manage our portfolio and the asset mix. And we will put the spotlight on that and we'll be [ph] crisper about our guidance for '18 on the investment side.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you.

Operator

Your next question comes from the line of John Aiken from Barclays. Please go ahead. Your line is open.

Q - John Aiken {BIO 6329080 <GO>}

Good morning. Was a little surprised to see the prior year developments in OneBeacon's being so stark right after you closed. Can you give us a little more color as to what factors were underpinning that, and then how do you address any concerns about the level of reserves on a go-forward basis?

A - Louis Marcotte {BIO 18040440 <GO>}

So, thanks for the question. The Q4 activity really related to a couple of large losses that the company incurred. As you said, we closed the balance sheet on September 28th with our best estimates. But there were some activity in the quarter that forced us to pick up some unfavorable development. So it's really a couple of losses, a significant one that we've picked up and that we could not -- that was not -- the information was not available before hand to reserve for, so it's really the development of those cases that has triggered the adverse development.

A - Charles Brindamour {BIO 7012323 <GO>}

Plus risk margin build-up as well. And so, I think if you look forward, the adverse development cover is pretty good shield against any meaningful adverse development in the coming periods, so not a big source of concern there.

Q - John Aiken {BIO 6329080 <GO>}

No, understood. We can see that in the quarter, obviously with the 25 million that Louis referenced. And then my second question if I may, do you guys see the issues that are occurring in personal auto, potentially spurring on additional consolidation opportunities within the industry?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. If I go back 15, 20 years, if you wait too much to take action in automobile insurance, it can be painful for an extended period of time. And I think there's two things that happens. One is that if you're comfortable with your rate position, which we largely are, your appetite to grow organically and your ability to grow organically is pretty solid. There is more business that comes to you than you actually want. So, that's good.

And then, I mean, a number of players are heavy concentrated in auto. Our personal automobile portfolio was only 36% of our business, we have to keep that in mind. But we have a number of competitors who are in the 60%, 70%, 80% of their portfolio, highly concentrated in Ontario.

One has to keep in mind that we insure one out of three vehicles in Quebec, were tilted towards Quebec, which is a short-tail physical damage province, which has been fairly profitable over time. But I think overall, those periods of pressure in automobile insurance have been catalyst for change in the industry and we remain opportunistic in that context but cautious with regards to automobile insurance.

Q - John Aiken {BIO 6329080 <GO>}

Great. Thanks, Charles. I'll re-queue.

A - Charles Brindamour {BIO 7012323 <GO>}

Thanks.

Operator

Your next question comes from the line of Brian Meredith from UBS. Please go ahead. Your line is open.

Q - Brian Meredith {BIO 3108204 <GO>}

Yes. Thank you. Charles, I'm just curious, I think you all mentioned that you have gotten the approved rate increases your need for 2018. Is that true for Ontario also? And on that context, do you anticipate any push back because the election is coming up in '18 and trying to achieve rate adequacy in Ontario?

A - Charles Brindamour {BIO 7012323 <GO>}

I think, in Ontario, it's true for one business unit and there is one business unit that is still under discussion. I think that our track record in '17 on that front is very good, our relationships are excellent. And this is fact-based, so I'm not overly concerned by those approvals that are not yet in. But the bulk of what we need across the land is pretty much in the bag at this stage. So, that is point number one.

Point number two, when it comes to elections, I think, automobile insurance is not at the top of the list yet, of issues that Ontarians are concerned about. This might become political and it's, in part, why when we started to notice that there were performance issues in the third quarter of '16, we raised to get increases across the land before having 100% understanding of what was pushing the trend. Because we know that, when capacity is an issue, it can get political, whether there's an election or not.

And then getting rates becomes a little bit difficult. It's not yet an issue in the marketplace. We're seeing signs of tightening, but we're not seeing availability issues. And it really gets political, Brian, when you have availability issues. When you are forced to be insured by the residual markets, which are far more expensive, so then you get into capacity issues, affordability issues and so on. We're not in that stage. It's not to say that it won't get political, but I wouldn't say that there is a red light on that at this stage.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. And then just curious, so down south of the border here, we've seen some big improvements in claims frequency trends in auto insurance for the last couple of quarters, which really helped drive profitability for industry. I'm curious, what are you seeing up in Canada from a claims frequency perspective?

A - Charles Brindamour {BIO 7012323 <GO>}

Claims frequency is flat. And claims frequency, if you leave weather aside, has been flat -- largely flat for the past -- a couple of years. And so we're not seeing improvements in frequency but overall, fairly stable. So the whole distracted driving theme that everybody is talking about, of course, is real, but we're not seeing an increase in frequency. And indeed in the US, we're now starting to see for a few months, improvements in frequency. Patrick, I don't know if you want to add anything there.

A - Patrick Barbea {BIO 18476397 <GO>}

No, that's really through the variations that we've seen over the past two, three years on frequency and auto in Canada has really been linked to variations in weather.

Q - Brian Meredith {BIO 3108204 <GO>}

Yeah.

A - Patrick Barbea {BIO 18476397 <GO>}

When we neutralize for that, it's been flat and then really our focus is more on severity. The trends is on the severity side with the cost of parts. There might be a few factors. We hear about distracted driving, but at the same time, cars are being safer. And for us at least, the net of the two is pretty much flat.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And we've got a pretty substantial telematics base that we will work with and there is no clear clues coming out of there at this stage.

Q - Brian Meredith {BIO 3108204 <GO>}

Great. Thank you.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

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

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

A - Charles Brindamour {BIO 7012323 <GO>}

Good morning.

Q - Paul Holden {BIO 6328596 <GO>}

So, I want to try to quantify the cost inflation that's coming through on personal auto. So the way I look at is, you realized 5 points of rate in Q4. But underlying current year loss ratio was up 3 point. So, that would suggest to me cost inflation is running high single digits. Is that a fair way to look at it and then, what would your expectation for cost inflation be going forward over the next two or three years?

A - Louis Marcotte {BIO 18040440 <GO>}

Yeah. I think when you're looking at the rates there, Paul, what we also have in play is a little bit of a mix change happening as well, too, within the portfolio. So, when we talk a little bit about sort of quality metrics and so forth, that's one of the things that we look for. So, obviously, less new business, lower average premium. Because of that, the way the retention curve is working relative to a higher rate increases.

So, we obviously look to and we receive approvals on rate increases. We don't always realize those because of the mix change. Now, those mix changes though have associated quality metrics associated with them as well, too. So, if you don't realize the rate, you can gain it obviously in the quality, which is what we're seeing as well, too.

When we look at trends -- relative to trends, we talk a lot about timing on AB and the BI side, which we're comfortable with. On the PD, we are in sort of the upper single digit sort of range from a PD standpoint. Now, obviously, a lot of our action is around taming that trend. I think we'll expect to see some form of severity pressure moving forward, but obviously, not to the same extent that we're seeing right now. And that will be very much driven by not just what we're doing from a rate segments -- segmentation, risk selection standpoint, but obviously, what Patrick is looking like to doing and has claims actions in play right now.

So, PD obviously is only a portion of the total coverage. So, in totality, we are looking at sort of the 3% to 4% range from a trend standpoint. We do get the benefit of drift as well, too, which is around where the vehicle fleet is becoming -- is younger obviously, as people buy new vehicles. So, we actually get a little bit of lift in premium from that phenomenon as well, too. So, we're in the sort of 2 points to 3 points net of premium trend range moving forward.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. That's helpful. Thank you. And then my follow-on question to that would then be, your expectation to raise rates by roughly 5% in 2018, the way I would look at that is, that would sort of catch you up to roughly where you want to be. But I'm not sure it will get you ahead of the curve for future cost inflation at 2 points to 3 points you just identified. So, my assumption is, you are going to have take 5 plus another 2 to 3 to really maintain the margins you want in that mid-90 level. Is that fair?

A - Charles Brindamour {BIO 7012323 <GO>}

No, Paul. I think this is where risk selection, underwriting and claims make the difference. And so if I look at the prospective indicators that we calculate per customer across a number of markets, if I look at the Ontario market and the Alberta market where we've taken the more action, there is -- just in terms of risk selection and mix improvement, 2 points to 3 points more than rates in terms of prospective profitability indication, if you follow what I'm saying.

Q - Paul Holden {BIO 6328596 <GO>}

Yeah.

A - Charles Brindamour {BIO 7012323 <GO>}

And so that is risk selection driven, primarily mix driven. I mean, just the fact that our new business has shrunk meaningfully in relationship with the in-force. That in itself should be a source of profitability and it is non-negligible because new business tend to have a loss ratio that is almost 20 points higher than mature business. So, when that mix shifts, you should see a profitability improvement, let alone all the other risk selection measures.

So, when I look at our action plans, I think we're earning 2 points, 3 points of quality improvement beyond the actions we have in claims. That's the first point. And therefore, I don't think we need 2 points, 3 points more rates to get to where we want to get. And therefore, that's -- I think why one needs an action plan that goes beyond rates.

Q - Paul Holden {BIO 6328596 <GO>}

Understand. And then if I could just sneak one more and it would be related to OneBeacon and the US tax reform. Maybe you can talk about some of the offsets to that tax that will be applied for captive reinsurance premiums.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So, two questions. We're not going to answer, just kidding. I will ask Louis to take this one.

A - Louis Marcotte {BIO 18040440 <GO>}

Sure. So, I mentioned negligible impact overall, two offsets. So, the rate reduction is positive to the income in US. The fact that we will have more income in the US enables us to recover taxes faster, the tax loss that we have available.

On the other hand, OneBeacon was a Bermuda-domiciled Company, had a reinsurance, an internal reinsurance structure and that has to be unwound because it becomes ineffective following the tax reform. So, that's a negative offset by the lower rate, brings us basically to a flat outcome.

Q - Paul Holden {BIO 6328596 <GO>}

Great. Thank you.

Operator

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

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Yeah. Thanks. Good morning. First question is just around some of the claims initiatives. You spoke about tighter control on processes around estimation, repair, parts ordering. Can you just elaborate on what you can actually do to ensure that you're getting, I guess, a more precise process on that front?

A - Patrick Barbea {BIO 18476397 <GO>}

Yes. I'll give you a few examples. When we look at the technology, not all models and makes are using the same technology. We see body shops that are getting more specialized in some types of repairs than others. And when you can deploy to the front line, clear indications on where to guide our clients, to get their car repaired depending on the model, depending on the type of accident, you get significant savings.

That has evolved over time. When a few years ago, the body shops were more generalist. You could -- you had body shops that were performing better than others from that perspective. It's still the case, but not necessarily flat across all types of repairs. So, that is one.

The other one that I briefly mentioned, but I could elaborate is there is a lot of cost in physical damage that are outside the actual repairs. So, we're talking rentals, towing. So, when you are able to be more efficient in the repair process itself, you save significant portions of the cost under rentals, what we call cycle time. And we've seen already, especially with the actions we've taken in Ontario that started earlier than the other regions, we've seen a couple days of savings on the rental side that are helping us and this will be -- will continue across Canada with our other actions.

The last one, I could maybe comment a bit more, the tighter controls on estimates. This new technology involves new processes of repair. There are scanning involved that requires different equipment and by elevating our understanding of all those processes, when we look at the estimates made by our body shops and by our people in the field, we can guide them better and save cost in the estimate itself even before we start the repair. So, those are three areas that are already deployed and we continue to refine them across the land.

A - Charles Brindamour {BIO 7012323 <GO>}

And I think that, if you look at the service center strategy, where we have deployed a number of service centers across the land, part of the objective there is to improve the customer experience when they bring their car to the garage or in our case, service center. But we then are in a position to actually select where we send the car based on performance broadly and then expertise, as Patrick, has played out.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. Thanks. And my next question is on the growth in the distribution. I spoke about focus on organic growth. Can you quantify what the contribution of organic growth in 2017 of that 19%? And then how does that compare to the 10% growth outlook in 2017? And what are some of the initiatives that you can do to help organic growth of the brokers and BrokerLink?

A - Charles Brindamour {BIO 7012323 <GO>}

So, with regards to the 19% growth, organic growth in '17 would have been in the low single digit for our own channels, in part because Intact Insurance is an important product of these distributors, and we've chosen to put ourselves in a less competitive position because of what we were seeing in automobile insurance. And therefore, our distributors were under pressure from that point of view.

I think that what needs to happen is better leverage of brands and greater investments in the brand, but certainly better leverage of the Intact brand and then the use of technology. I think that we have made meaningful progress in leveraging online distribution. We changed the structure of the organization late in '17 to really be able to crank up our digital arm and obviously, our broker partners would be key beneficiaries of greater focus on online distribution.

So, these are just two examples of areas of opportunities for organic growth. And I think, when you look at a distributor that has options on the shelves, that is massive, that can invest in technology and brand. You have a platform that over time should be able to deliver organic growth well north of mid-single digit. We're not there and we're saying we need to focus on that in '18.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. So the 10% would be another low single-digit type organic growth with acquisitions making up the balance?

A - Louis Marcotte {BIO 18040440 <GO>}

Yes, I would say so.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. And if I could just sneak one more in on the new business loss ratio, 20 points higher than mature business. Have you noticed any changes or evolution in that delta given what we've seen in the PD inflation?

A - Louis Marcotte {BIO 18040440 <GO>}

Not really, no.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Okay. Thanks.

Operator

Your next question comes from the line of Meny Grauman from Cormark Securities. Please go ahead. Your line is open.

Q - Meny Grauman {BIO 15238080 <GO>}

Hi. Good afternoon. You talked about Ontario politics, but just a follow-up. Curious about your interpretation of the document that was published in early December, the Fair Auto Insurance Plan and when you read that, what were the implications that you understood for your business in particular?

A - Charles Brindamour {BIO 7012323 <GO>}

So the Fair Auto Insurance Plan that you're referring to, I think is a string of recommendations to improve the product in Ontario, which we very much support. It makes a whole lot of sense to move away from cash settlement awards care [ph] to establish more rigorous assessment network.

I'll let Patrick give his perspective on this, but we view this as positive. I think it's important to keep in mind that our action plan and our view on where the performance is going is not dependent on future reforms or any expectations that government will bring a specific contribution to this issue. I do think that with regards to psychological injuries and accident benefits, government can contribute if they choose to, but our action plan certainly does not depend on them.

A - Patrick Barbea {BIO 18476397 <GO>}

Fully agree. There were quite a few reforms in Ontario addressing those kinds of injuries in the past few years. The most recent ones in June are starting already to show signs that they will be producing the impact we're expecting, especially the catastrophic impairment definition. This new Fair Auto Insurance Plan is following recommendations that were part of the Marshall Report, in which we participated and commenting with industry. So, those changes are also, in my view positive and we will continue to contain the costs around -- especially the costs that are around the litigation.

So, having clear treatment plan and assessment centers being created. The next steps are, there will be a panel in the coming weeks or months before the election, created to the -- for the enactment and to guide the enactment of those changes. But overall, everything that has been put on paper seems to be positive.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And I think, to Brian's earlier question, given there is an action and given this report was put on the table recently, I mean, the hopes of seeing anything on that front before the election, I think is very small as far as I'm concerned.

And therefore, we're not counting on this, but we think this is a great report and that any government should really look at it for inspiration in terms of what else to bring to the market to improve affordability of the products in Ontario.

Q - Meny Grauman {BIO 15238080 <GO>}

Thank you.

Operator

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

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Hi. Good morning. My first question is, I know it's a small part of your business, but there has been some news out here on ICBC with financial issues. Some of the changes that were announced yesterday and then you've also got the new Liberal leader talking about maybe re-investigating whether or not we need to open it up to competition you share. I just wanted your thoughts on the developments that we've had out in BC?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah, I think that this is something we look at with interest. I think one of the key ingredients of what was put on the table by -- in BC in the past few days has been the introduction of a cap on pain and suffering award for minor injury. We think this is a great idea. This is what the private markets have done 18 or 16 years ago.

So, it's good that BC sees this as a solution. We're operating in BC. We have a platform in BC. We're cautious in that marketplace. But I think that there is no doubt in my mind that competition, all else being equal would put far more options on the table for BC consumers.

And if you look at automobile insurance, where companies produce billions of different price points, if you have 5, 10, 15 companies or even 20 companies like it is in private markets, the odds of finding a better deal if you are a consumer are very, very high. And I think that people would be advised to introduce competition, in particular in a period where there is lot of pressure. So, I think, this -- not counting on that, obviously, but we have a platform there. We will remain open to opportunities. And it's clear that competition gives far more options and room for better deals for drivers.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Thanks. Just my second question is, in your MD&A, you made reference to upcoming legalization of cannabis and that there is going to potentially be some impacts for various lines of your business. Wondering if you can maybe give some of your thoughts as to how that will impact? How you look underwrite and price that business that would be impacted.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. Darren?

A - Darren Godfrey {BIO 19791482 <GO>}

Yes. I mean, obviously, we're watching very closely in terms of some of the experience coming out of the US, where we actually have seen some pressure from a frequency standpoint. So to the extent that we start to see potential pressure around the rate of car accidents and so forth, we will be -- we can move relatively quickly on that.

We're very active in terms of -- with IBC and talking with governments around the policing and so forth of cannabis usage and bringing a lot of parallels, obviously back to use of alcohol relative to driving as well, too.

So, trying to put a lot of pressure on -- in terms of -- to ensure that level enforcement is there relative to cannabis use, like it is around the use of alcohol. But it's the fire, obviously that we are watching very, very closely.

Q - Geoffrey Kwan {BIO 7413168 <GO>}

Okay. Thank you.

Operator

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

Q - Mario Mendonca {BIO 2450557 <GO>}

Good afternoon. I'll try to be quick. Louis, the 25 million you referred to on OneBeacon, is that your estimate of the gross PYD, taking into account -- adding back the reinsurance?

A - Louis Marcotte {BIO 18040440 <GO>}

That's right.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay.

A - Louis Marcotte {BIO 18040440 <GO>}

That's what -- those are the losses that we incurred in ceded and then, take 20% of that as being our share.

Q - Mario Mendonca {BIO 2450557 <GO>}

I understand. So, there is still potential for some kind of recovery. Do I have the right that -- because there is clearly more than 4 points. You are at 4.6, but to get to 25, it clearly wouldn't be 4.6, it would be more like 2%. So, what is that amount that can be recovered once you hit your attachment point?

A - Louis Marcotte {BIO 18040440 <GO>}

So, let me be clear. The 4.6 here, half of it is our share, that's same as 20%. And the other half is basically the risk margin, plus the impact of discounting the ceded losses. And so that explains basically the other half, and this discounting is a big share because the time at which we will recover those ceded losses is further out in the future, once we've begun paying or exceeding the attachment point.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. I think I misunderstood than originally. So, that is time value of money discounting, not some other forms of discount?

A - Louis Marcotte {BIO 18040440 <GO>}

Absolutely .

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. That's understood.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. And then going back to personal auto really quickly, the -- is there a change in your outlook? Because I was always under the impression that you are expected to get to the mid-90s in 2018, not at the end of 2018. Am I putting too fine a point in? Was it always sort of the end of 2018?

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. That's sort of how we view it, Mario. I think we're aiming to earn all these improvements to be solidly there by the end of the year. It might be a bumpy ride as we get there, but it is -- you have to think about it as earned in the last part of '18. That's our view today.

Q - Mario Mendonca {BIO 2450557 <GO>}

But has that view changed or is that always been your view?

A - Charles Brindamour {BIO 7012323 <GO>}

It has changed last quarter when we talked about it, but I think it's largely been our view. I think if we changed our view, we'd be pretty clear about it.

Q - Mario Mendonca {BIO 2450557 <GO>}

Okay. Then finally, and I know this is an imperfect way of looking at it. But I often look at your direct written premiums on personal auto divided by the written insured -- number of written insured risks, and try to use that as a gauge for pricing increases. And again, I know it's not perfect, but that's only up 1% year over year. Is there something else that's keeping that number from showing the significant price increases you're putting in place?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes. So, there is a mix change, which is -- the earned mix change in the quarter was 4%, going the other way. I mean, that's essentially the reconciling item, Mario. So, where is this mix change coming from? Well, you've got, for instance, the fact that there is less new business in relationship with the overall portfolio coming and the fact that the areas that are unprofitable have a higher average premium and our success where we're hitting hard is obviously much less, plus a number of other risk selection strategies that we have in place. And I think, our view is that this mix change on top of the rate change is not diluting premium. It should expand profitability, if your risk selection strategy is a good one.

Q - Mario Mendonca {BIO 2450557 <GO>}

So, would I be right in saying that, on a mix-neutral basis, that ratio I play around with would be up above 4%?

A - Charles Brindamour {BIO 7012323 <GO>}

Yes.

Q - Mario Mendonca {BIO 2450557 <GO>}

Got it. Thank you.

Operator

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

Q - Doug Young {BIO 5640851 <GO>}

Good afternoon. Just back to personal auto, Charles, I think historically, you said you expected 3 points to 4 points improvement just from rate increases as that earns through 2018. Is that changed? And I'm just wondering what level of cost inflation you're baking into that assumption?

And then the second part of the auto question is just, there was a mention of -- you are able to direct clients to certain body shops as a way to save costs. I thought that's something that Intact had already been doing. I will leave it there.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. So, we are earning 5 points of rates today and we are writing 5 points of rates and there are few more rate increases coming in '18. So, both the earned and the written in '18 will be above 3 points to 4 points. It should be at least 5 points, sitting here today. With regards to body shop, indeed, it is something that we've been doing historically. Patrick, maybe you want to comment on that?

A - Patrick Barbea {BIO 18476397 <GO>}

Yeah. The difference, Doug, is in the -- up to sometime in 2017, our models to guide clients towards body shop are to offer our best -- our Rely Network was based on proximity, service and overall performance of the shop, which is still part of the model.

But with 300,000 car repairs that we do across the land at Intact, so that's 25,000 a month. It's a huge database on which we have all the details on the parts ordering, the process performed and we started to data-mine all of that data in much more detail starting last year and implement those specifics into our tools. So, we don't only taking into account the overall performance of the shop, but also the types of repairs, the makes and models of cars to guide them to the most performing shops.

A - Charles Brindamour {BIO 7012323 <GO>}

Yeah. And Doug, I think if you look at the history here, so we put in place those preferred provider networks, I don't know, 15 years ago, something like that. Where today about 60% of automobile repairs, 66% would be in the preferred provider network called the Rely Network and then in home insurance, we are around 70% roughly. And so initially, historically, we encouraged our clients to go to the Rely Network. That was the first phase of pitching the network.

Then over time, we made sure that within the network, we directed customers where quality was the highest, and then we've introduced the notion of availability and proximity, so that we would shrink the cycle time. And I think, we're taking this process now up a notch further, taking into account the physical damage trends that we're seeing in, and a number of the elements that Patrick has been talking about. So yes, we've been at it for a long time. Our thought process has evolved. And I think as I said, the service centers, which we've rolled out in the past two years, I think is the ultimate sort of supply chain, not the ultimate, but certainly a good step forward in terms of supply chain management in that regard.

Q - Doug Young {BIO 5640851 <GO>}

And Charles, just on the 5 points of earned rates, when I think of how that rolls through the combined ratio, are you assuming cost inflation stays where it is today? Are you assuming within that there is some benefit you're getting on the claim side?

A - Charles Brindamour {BIO 7012323 <GO>}

We're not -- I shouldn't say that beside, Patrick, but we're not baking in, in our view of what we need in rates, major improvements in claims, right. Because this is operationally far more difficult to drive than increasing your rates, for instance, or changing your risk selection mechanism. We'll act on it. I'm pretty comfortable we'll get the benefits, but we're not pricing for that.

Q - Doug Young {BIO 5640851 <GO>}

Good. Thank you very much.

A - Charles Brindamour {BIO 7012323 <GO>}

Thank you.

Operator

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

Q - Meyer Shields {BIO 4281064 <GO>}

Great. Thank you very much. Good afternoon. So, two quick questions. First, if I understand correctly, the mid-90s combined ratio for auto by the end of next year assumes a lower than normal level of new business and the associated penalty. How long will it take until you can be at the mid-90s with -- I guess, whatever normalized level of new business is? Is that another year?

A - Charles Brindamour {BIO 7012323 <GO>}

No, I think that we're seeing a market tightening. We think that this will normalize likely in the latter part of the year. And therefore, we're not really counting on less new business to achieve the target that we have laid out. I have highlighted this -- I have highlighted this as one reason why the mix to Mario's earlier question, was down 4%. It's not baked in as a sustainable strategy because we would shrink to glory if that was the case.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. That's helpful and better than I thought. Second question. So the -- what sort of the adverse development in OneBeacon this quarter was the discounts associated with the recoverables. Does that mean that, going forward, if there is no change to growth reserves that the unwind of that discount will show up as positive reserve development in that segment?

A - Louis Marcotte {BIO 18040440 <GO>}

Yes. That's what we can expect. Yeah.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Is there anyway to quantifying that on a quarterly basis?

A - Louis Marcotte {BIO 18040440 <GO>}

At this point, I think I would say it's probably not very material and it's -- because it's over a long time. The duration of that ceded loss is fairly long. So, I don't think it would be very material quarterly.

Q - Meyer Shields {BIO 4281064 <GO>}

Okay. Thank you very much.

Operator

There are no more questions in the queue at this time. I will turn the call back over to the presenters for closing remarks.

A - Ken Anderson {BIO 16846692 <GO>}

Thank you all for joining us today. Following this call, a telephone replay will be available for one week and the webcast will be archived on our website for one year. The transcript will also be available on our website in the financial reports and filings archive. As Charles mentioned, we will be hosting an Investor Day on Monday, March 26, here in Toronto and registration will open later this week.

Lastly, our first quarter 2018 results are scheduled to be released after market close on Tuesday, May 8th, and our AGM is scheduled for Wednesday, May 9th. Thank you again, and this concludes our call for today.

Operator

Thank you for your participation. This does conclude today's call, and you may now disconnect.