S&P Global
Market Intelligence

Intact Financial Corporation TSX:IFC

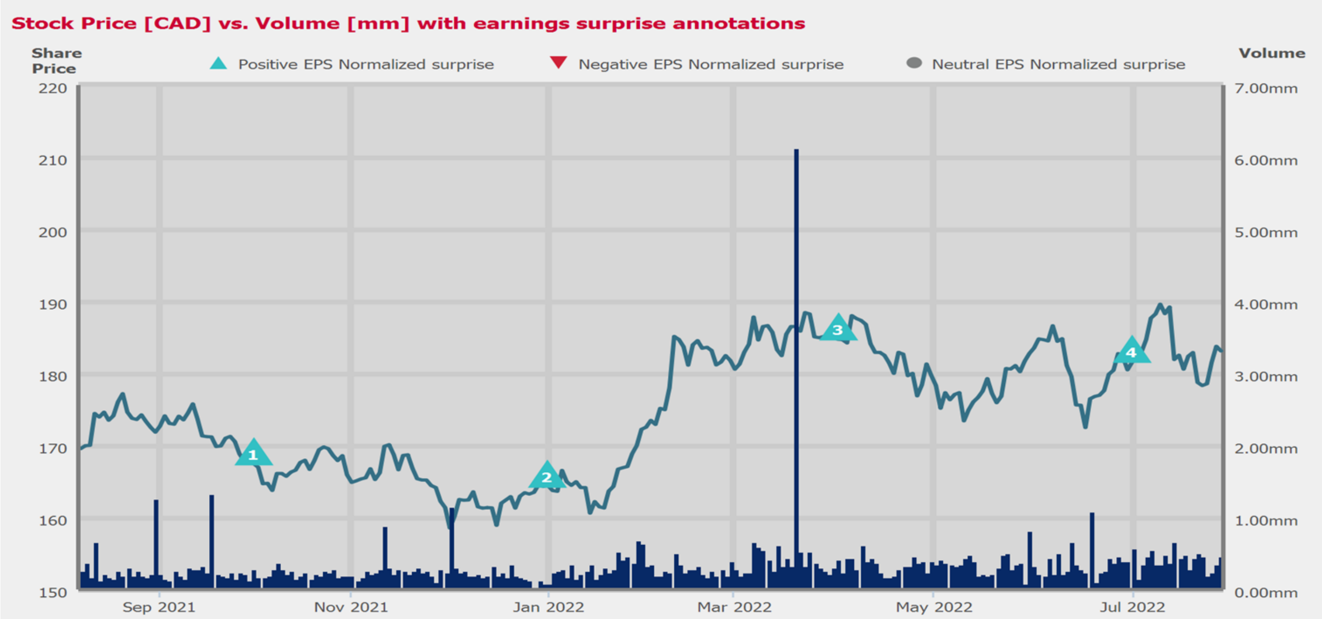
FQ2 2022 Earnings Call Transcripts

Friday, July 29, 2022 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.71	3.14	▲15.87	2.79	11.89	NA
Revenue (mm)	4897.20	4902.00	▲0.10	5064.67	19766.20	NA

Currency: CAD
Consensus as of Jul-29-2022 6:01 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	1.73	2.87	▲1 65.90 %
FQ4 2021	2.52	3.78	▲2 50.00 %
FQ1 2022	2.43	2.70	▲3 11.11 %
FQ2 2022	2.71	3.14	▲4 15.87 %

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Call Participants

EXECUTIVES

Charles J. G. Brindamour
CEO & Director

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Isabelle Girard
Senior Vice President of Personal Lines

Louis Marcotte
Executive VP & CFO

Patrick Barbeau
Executive VP & COO

Shubha Rahman Khan
Vice President of Investor Relations

ANALYSTS

Geoffrey Kwan
RBC Capital Markets, Research Division

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Mario Mendonca
TD Securities Equity Research

Michael Wayne Phillips
Morgan Stanley, Research Division

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Veritas Investment Research Corporation

Paul David Holden
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BMO Capital Markets Equity Research

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Intact Financial Corp. Q2 2022 Results Conference Call. [Operator Instructions] This call is being recorded today, Friday, July 29, 2022.

I would now like to turn the conference over to Shubha Khan, Vice President of Investor Relations. Please go ahead.

Shubha Rahman Khan
Vice President of Investor Relations

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

As usual, before we start, please refer to Slide 2 for cautionary language regarding the use of forward-looking statements, which form part of this morning's remarks, and Slide 3 for a note on the use of non-GAAP financial measures and important notes on adjustments, terms and definitions used in this presentation.

With me today, we have our CEO, Charles Brindamour; our CFO, Louis Marcotte; Isabelle Girard, our Senior Vice President of Personal Lines; Patrick Barbeau, Executive Vice President and Chief Operating Officer; Darren Godfrey, Executive Vice President, Global Specialty Lines; and Ken Anderson, Executive Vice President and CFO, UK&I. We will begin with prepared remarks followed by Q&A.

With that, I will turn the call to Charles.

Charles J. G. Brindamour
CEO & Director

Thanks, Shubha. Good morning, everyone, and thank you for joining us today. We delivered strong second quarter results despite higher-than-expected catastrophe losses and cost pressures. This is thanks to the actions we've taken over time as well as our disciplined underwriting and deep claims expertise.

That being said, we're aware of the impact that the challenging environment is having on our customers. We understand that providing them with the second to none experience is particularly important in these times. And we work really hard to be there for our customers despite labor and supply chain disruption. And in fact, our people know that we exist to help people and businesses do well in good times and be resilient in bad times and they understand that nothing should stand in the way of being true to that purpose.

Yesterday evening, we announced second quarter net operating income per share of $3.14. Top line growth of 36% this quarter was driven by the contribution from RSA as well as organic growth of 4%. The overall combined ratio was 90.7% with low 90s underwriting performance across all segments.

Let's look at each of our lines of business, starting with Canada. In personal auto, premiums increased 28% year-over-year, mostly driven by RSA. Organic growth remained relatively muted at 1% as units were under pressure, given our cautious stance on rate. We expect this pressure to be temporary as the market is actually catching up and gradually reflecting headwinds in its prices. This is no surprise though that the combined ratio is very strong at 89.8%, despite 8% inflation on claims costs and higher driving activity.

Inflation this quarter continues to be driven by global supply chain disruption leading to higher market values of used cars, repair costs and thefts. We've been anticipating these trends and proactively managing them for some time now.

First, there is a high degree of caution already embedded in our reserves for both short and long tail claims. It's true of past years as well as for the current year. That's why I look at the underlying performance of this line very much including the development from prior years. A proof point of discussion is the strong level of prior year development at close to 5 points.

It certainly helps that we don't see cost increases on 40% of our claims that are not physical damage in nature. Certainly, past product reforms on accident benefits and bodily injury continue to help provide stability in personal auto.

Second in auto, rates have been moving higher as the portion of relief provided true rates during the pandemic has been rolled back. Note that unlike many of our competitors, a large portion of our relief was provided as one-time rebates. Further rate increases to deal with inflation were deployed also earlier this year. And at the same time, the gradual shift of the car pool to newer car models is automatically reflected in our pricing, which is yielding additional premium over and above our rate increases.

So in aggregate, written rates and insured values generated close to 4 points in Q2. And based on what's approved to date and embedded in upcoming renewals, I expect that to increase to close to 9 points by Q4. That alone anticipates, and in my view, covers prospective inflation and driving activity.

That being said, our game plan in auto is not only pricing driven; equally important is how we manage claims and our supply chain. Our capabilities on this front have generated 1/3 of our ROE advantage and really helped mitigate inflation. In particular, our reliance on our service centers and our Rely Network has been important in addition to our parts purchasing activities.

We also clearly benefited from our salvage disposals as an increasingly important source of income as the cost cuts of parts and scrap metal increased. But as cost pressures have persisted, we've been taking additional actions in claims. For instance, we've deployed machine learning applications to the front lines to make smarter decisions between repairing and declaring total losses. And we're also seeing more volume through our growing number of dedicated service centers, which provide courtesy car fleets and lower repair costs.

And so with the actions we've taken so far, I expect our personal auto business to run at a sub-95 combined ratio in the next 12 months. And looking at the industry, the environment is evolving largely as we anticipated. We see rate increases climbing to the mid-single-digit range in the near term for the industry.

In personal property, premiums grew 28%. In addition to the RSA acquisition, this was driven by 5 points of organic growth in firm market conditions. The combined ratio of 97.6% included 16 points of cat. Weather and inflation are continuing to support a firm market. While we've been seeing sustained increased cost in materials for a of years, this remains well captured by rate momentum and indexation. This business is very well positioned to continue to deliver strong performance, consistent with the past few years.

In Commercial Lines, premiums grew 42%, which included 7 points of organic growth. The combined ratio improved by 4 points to 86% as we continued to take advantage of the hard market here in Canada. Rate increases continue to be above loss cost trends. We expect market conditions to remain favorable due to a combination of elevated cat losses and inflation pressures. Overall, our Commercial Lines business is well placed to sustain low 90s or better performance.

Moving now to our UK&I business, which delivered a combined ratio of [91.3%]. In Personal Lines, the combined ratio was a strong 88.3%, which partly reflected a revised estimate of prior quarter cat losses. Normalized for this and seasonality, the combined ratio was firmly in the mid-90s range despite cost pressures. With a focus on bottom line performance, we've maintained pricing discipline in a competitive market that continues to adjust to reforms introduced at the start of the year, and we expect inflation will support rate increases over time in the UK.

In Commercial Lines, the combined ratio of 93.6% included nearly 8 points of tax, twice our expectations for the quarter. The business is performing very well otherwise, with cost pressures being offset through our pricing actions and hard market conditions. At the same time, we're continuing to optimize our footprint prioritizing the more profitable regions and specialty businesses. Overall, the UK&I business is performing better than expected after 1 year, but we remain really focused on actions to drive sustainable outperformance over time.

Our U.S. commercial business grew 14% in the second quarter, driven by our focus on expanding profitable lines and for market conditions. The combined ratio of 91.1% reflected solid rate increases, improvements in risk selection, claims actions and strong execution of our profitability improvement plan.

As a result of our continued focus on portfolio quality and given the compelling market fundamentals, we're well placed to deliver sustainable low 90s performance or better in this business.

Turning to the RSA acquisition, which closed about a year ago, I'm pleased to see that the integration is very much on track. In Canada, policy conversion in the broker channel is nearing completion and almost 85% of Personal Lines broker policies as well as Commercial Lines small business and fleet policies have converted to Intact systems so far.

We also closed on the sale of RSA's Middle East business for close to book value on July 7. The transaction underscores the progress we've made in optimizing our UK&I footprint since we acquired RSA a year ago.

In addition to the integration, we executed on several other initiatives during the quarter. Just to name a few in Canada, for example, we launched a digital reporting tool for customers to file property claims through our e-mobile app. Approximately 1 in 5 of our claimants have used the tool since launch reducing claims cycle time and improving experience.

On the distribution side, BrokerLink delivered in the quarter a record of acquisitions completing 10 transactions across the country, representing close to $200 million premiums. In the U.S., we bolstered our global specialty lines platform with the acquisition of Highland, an MGA focused on providing builders' risk insurance. The transaction expands our portfolio of owned distribution assets and supports our strategy of growing profitable verticals as we build a leading specialty lines platform.

Over the past 5 years, we've compounded net operating income per share at 20% a year and exceeded the industry ROE by close to 700 basis points. At the halfway mark of 2022, I continue to see a lot of strength across our business. We are delivering low 90s underwriting performance despite ongoing cost pressures as well as solid growth led by Commercial Lines.

With a robust balance sheet, disciplined underwriting, industry-leading claims management and the RSA integration firmly on track, we're really well positioned to grow our net operating income per share by 10% per year over time and outperform the industry ROE by at least 500 basis points every year.

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

Louis Marcotte
Executive VP & CFO

Thanks, Charles, and good morning, everyone. I'm pleased to report strong results again this quarter despite all the turbulence going on around us. All segments delivered combined ratios in the low 90s. We saw solid growth in investment and distribution income and strong accretion from RSA.

Gains on the sale of Denmark and on our equity portfolio led to an 85% earnings per share growth year-over-year and ROE in the high teens. Underwriting results were solid with an overall combined ratio of 90.7% but 4 points higher than last year's stellar performance, largely explained by significantly higher cat losses.

Year-to-date cat losses are $430 million compared with our annual guidance of $600 million. We can't predict how weather will behave in the future, but we believe it is reasonable to expect 1/2 of our annual guidance to hit our results in the second half of the year.

Favorable prior year development remained healthy at 3.8%, broadly consistent with last year and with our short-term expectations. This should not come as a surprise as we have repeatedly stated that we have been prudent in reserving and that our balance sheet was strong. We are seeing the benefits this year as our past decisions bear fruit and contribute to solid underwriting results. We remain prudent in establishing current year reserves, particularly in personal auto, given changing driving patterns and supply chain challenges.

Net investment income of $211 million increased by 37% in the quarter largely driven by the addition of RSA's investment portfolio and higher rates. We now expect investment income for the full year to reach $865 million, $25 million higher than in our prior guidance. Any further increases in interest rates from current levels would represent upside to our expectations.

Distribution earnings grew 19% year-over-year with our On Side home restoration business contributing strongly this quarter, thanks largely to additional work generated by recent elevated cat activity. This is a good example of the countercyclical nature of our restoration earnings. Looking forward, we expect distribution income to be in the region of $425 million for the year, up 17% from last year, reflecting continued momentum in the business.

Now let's look at our underwriting results in a little more detail, starting with Canada. In personal auto, the underlying loss ratio was up 9 points, driven by increases in frequency and severity. That being said, the overall combined ratio remained strong at just below 90%, reflecting the actions we've taken, including prudent reserving.

While this tends to penalize our current accident year results, we see an offset in higher prior year development levels, which in aggregate, enables us to deliver solid underwriting results. When taken with our other actions, this gives us confidence in our ability to deliver a sub-90 combined ratio in personal auto despite the market environment.

In personal property, the combined ratio of 97.6% included 16 points of cat losses, 4 points higher than expected. Non-cat weather-related claims were also elevated and higher than last year, partially offset by lower commissions. Our personal property business is well positioned to absorb inflation and weather events.

In Commercial Lines, the combined ratio was very strong at 86% as we continue to see the benefit of rates being earned as well as other profitability actions taken over time. Favorable prior year development was very healthy, but around 3 points lower than last year. Such volatility is not unexpected quarter-to-quarter as the development of prior year large claims will be lumpier than in other lines.

The overall expense ratio in Canada improved by almost 4 points, largely driven by lower variable commissions across all lines of business relative to the elevated levels of the last 2 years. This is tempering the impact of higher frequency and/or severity in all lines.

Turning to the UK&I. We delivered another solid quarter despite a challenging environment. Personal Lines operating performance was strong with a combined ratio of 88.3%, which included around 3 points of net benefit from revised estimates of the Q1 windstorms. Excluding this item, the 91% combined ratio reflects the favorable seasonality of Q2 for this line of business.

Given the prevailing conditions in the U.K. personal lines market, I expect the second half of the year to be more challenging with results likely to be in the upper 90s range. Our limited exposure to U.K. motor, which represents only 1% of IFC premiums is certainly helpful in this regard.

In Commercial Lines, the combined ratio of 93.6% reflects elevated weather-related cat losses in our specialty lines, partly offset by strong prior year development and lower expenses. We continue to execute on our outperformance strategy, but a 92% combined ratio for the first half of the year is broadly in line with expectations.

In our U.S. business, the combined ratio was 91.1%, reflecting solid underlying performance, offset in part by 2 non-weather cat events. The operating result also benefited from our exit of public entities, but the entire portfolio is also benefiting from our focus on pricing discipline, risk selection, claims internalization and prudent reserving.

A quick word on global specialty lines. When combining our half year results in Canada, U.S., U.K. and Europe, we have reached $2.8 billion in premiums written, grew at 15% and a combined ratio of 85%. There is no doubt that building this platform further will be a huge contributor to our growth and outperformance objectives.

It's already been 1 year since we closed the RSA acquisition, and I'm delighted with the progress we have made against our strategic and financial objectives. We delivered 15% earnings accretion, which is well above the high single-digit target we have set for ourselves at this stage.

Our annualized run rate synergies increased $50 million in the quarter to $175 million, of which approximately $75 million were earned in the first 6 months of the year. Projected accretion after 3 years is nearing a 20% run rate, and I have strong confidence in achieving this. The transaction's IRR is north of 20% ahead of initial estimates, thanks to stronger earnings from RSA and the sale of Denmark.

Moving now to our balance sheet. It's been a challenging quarter for capital markets with a combination of interest rate hikes and drops in equity markets. While our investment portfolio suffered mark-to-market losses, this was partly mitigated by higher discounting on our claims reserves. Overall, our financial position has remained strong with a total capital margin at the end of Q2 of $2.5 billion, broadly unchanged from last quarter.

Book value per share is up 4% from last year and down 2% from last quarter, a fairly minimal decline thanks to strong earnings offsetting the impact of volatile capital markets. As we mentioned last quarter, we used the majority of the proceeds from the sale of Codan to pay down debt, reducing our debt to total capital ratio to 20%, in line with our long-term target.

In summary, with a strong capital position on target leverage and prudent reserves, we have the balance sheet to tackle an uncertain future with potential challenges and opportunities. We have delivered solid performance so far this year and continue to mitigate the impact of inflation. The rate environment is favorable in all lines of business and interest rates are a potential tailwind. This bodes well for future earnings. With an adjusted ROE of 22% at the end of June, I'm confident that we remain well positioned to outperform this year and beyond.

With that, I'll give it back to Shubha.

Charles J. G. Brindamour
CEO & Director

So Louis, maybe just 1 point of clarification in your remarks. You mentioned sub-90s in personal automobile, and I think you meant a sub-95 combined ratio in the next 12 months to be clear. I don't want to create confusion with investors, sub-95 next 12 months. Shubha, mic is back to you.

Shubha Rahman Khan
Vice President of Investor Relations
Thanks, Charles. [Operator Instructions] Michelle, we are ready to take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Jaeme Gloyn, National Bank Financial.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Yes. I guess, let's dive into personal auto. And so my question is focused on the current year loss ratio and the 9 percentage point uptick in that ratio year-over-year. You talked about reserving and the increase in reserving. Can you elaborate on how much that current year loss ratio would be reserve-driven and how those reserves have changed versus prior years to reflect the inflationary pressures that you're seeing?

Charles J. G. Brindamour
CEO & Director

First point, I don't think we said increased reserves. I think we said we've been, over time, prudent with reserves, lots of moving pieces in the environment. We've been very clear on that for the past 2 years. Our reserving hasn't changed this quarter.

I think the main point I made here is that we remain prudent in reserves, and that's true for the current accident year as it was for the past few years and that's why you're seeing concrete proof of that with close to 5 points of prior year development in auto. And so I think for me, the way I look at the performance of that business today, as I have over time, as I look at both the current accident year and the PYD, of course, when it is stable as it's been in the past year or 2 to look at the underlying performance of that business. I don't think you should ignore the PYD here because the reason why there's PYD is because we've been cautious in the past on current accident year as we are now. No change from that point of view.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. And then in terms of those inflationary pressures, you mentioned that 40% that is, let's say, bodily injury-related hasn't seen any inflation still, I guess that's the case. So perhaps maybe walk through what's driving the increase in that current year loss ratio from a repair and replacement perspective year-over-year?

Charles J. G. Brindamour
CEO & Director

Yes, absolutely. And I think Patrick is very well placed to do that. And on the 40% per se, we've said that in the last few years, we've seen better driving, better frequency. We haven't given full credibility to that in reserving as well as in pricing because there's lots of moving pieces. And then reforms have been, in my mind, effective at keeping stability there. There is caution in reserves and in pricing, and that's why we're not seeing much on this front. It's a good stabilizer, and we feel good about that. So Patrick, why don't you share your perspective on the 60% where there has been pressure so that people understand where that's coming from.

Patrick Barbeau
Executive VP & COO

Yes. Perfect. So the 60% is split half and half between car repairs, so 30% of the total cost and the other 30% is total losses and debt. So on car repairs, it's very consistent with global trends. We saw the increase coming from the price of parts continue in Q2. Labor cost is stable. Our inflation in labor cost is stable at 5% and the inflation in the cost of parts itself is in the high teens. And that creates also delays to receive parts and creates -- increase in the cost of rental in the cases where our shops do not manage their own fleets of courtesy cars. So overall, on the 30% that's cost of repairs, this is facing an inflation rate of around 13%.

On the other 30%, which are total losses and thefts, we see inflation rate in the 15% zone. Both the frequency and the severity of thefts continued to increase in Q2. So that's one, but also on the damaged cars that we declare total losses, we have seen a sharp increase in market values during Q2, definitely an acceleration from the prior quarters. But whilst salvage continues to be a very significant offset to the pressure from market values in the quarter, it did not increase enough to fully offset it.

So overall, if you look at it, 0% inflation on the 40% of the cost that is injuries, inflation in the low teens for the 30% of car repairs and inflation in the mid-teens for the total losses and that makes up the overall 8% we see in auto. Maybe just 1 note on the availability of car parts because we have started to see some signs of improvement on the supply over the last few weeks. In normal times, with normal -- we would see around 25% of our car repairs that are being delayed by parts ordering and delivery. This ratio started to increase in Q4, and it reached over 50% at the end of Q1. It stayed about at that level for the majority of Q2, but we just started to see it go down over the past 5, 6 weeks, and it stands at 40% today.

Charles J. G. Brindamour
CEO & Director

And I think the actions in the pipeline, whether it's pricing, claims supply chain management, the additional actions that we've introduced in the last few months to deal with some of the dislocation in the supply chain, in my mind, put us on a pretty strong footing. And I think what you're seeing in physical damage is no different than what you're seeing in other markets. The structure strategies we have in supply chain management and our starting point on rates puts us though in a very different position, but you're seeing the same sort of pressure here in PD as you do in other markets.

Operator

Your next question comes from Geoff Kwan of RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, Research Division

My first question was just also on personal auto. The comment in the outlook in the MD&A talking about expecting industry premium growth to progress towards mid-single digit over the next year, given inflation and whatnot. But your combined ratio was, I think, about 91.5%. This year, you talked about less than 95% next year. Is that a disconnect there in terms of like do you think that you are also going to be able to get that sort of rate? Or is it because what you're seeing from competitors that may have not as good numbers that that's what's going to drag the overall industry premium increase over the next year?

Charles J. G. Brindamour
CEO & Director

I think the industry is catching up. We're prudent with our outlook. What's embedded in the system, in our case, between rates and what we call drift is 4 points in Q2 and what's embedded in the systems going close to 9 points by Q4. That's our own perspective. We're -- we've guided in the last year sub-95. We're very much still there and the actions we're taking are consistent with that. Isabelle, do you want to provide additional color on pricing and risk selection in particular.

Isabelle Girard
Senior Vice President of Personal Lines

Yes. So on pricing, as you said, Charles, we're adding about 4% in the system as we speak today, and we were quick to remove the rate decreases we gave earlier in the year. As well as a bit different than our competitors, we gave most of our relief in onetime payments versus rate decreases. So with that already removed with the current action, we have today at about 4% and with the rates that are already filed and approved. That's where we feel that our rates will be close to 9 points by the end of the year, and we expect the industry will catch up on rates in the coming months to reach the mid-single-digit growth.

Geoffrey Kwan
RBC Capital Markets, Research Division

And just -- my second question was on the distribution income guidance of $425 million. I think that seems like it's significantly below the run rate of what we saw for the first half of this year. And you've continued to make distribution acquisitions and that sort of thing. Just wondering, is it like the factors in the first half of this year that were higher than normal or there's things that you expect in second half to be lower than what you saw in the first half? Or is it seasonality? Just trying to get some understanding about the cadence of what we'll see over the next couple of quarters.

Louis Marcotte

Executive VP & CFO

Sure, Geoff, and that's why we give annual numbers to take out a bit the seasonality factor. I will say, in addition, this year, you'll remember Q1 over year-over-year was higher because we still had the additional CPCs coming in Q1 over Q1 last year. So that was an influence that drove a bit Q1 more than it would have been usual. And then Q2, this is going away because it was picked up from last year. We started accruing a lot more CPCs in Q2 in the distribution last year. So that mutes a bit the growth in Q2 as opposed to Q1.

So in the last -- the next 2 quarters, we're going to see good growth, but it is comparing ourselves to last year's when we had the elevated CPCs. Those are coming down, as you've seen in our underwriting results. It puts a bit of pressure, but what we do on the M&A on the organic growth is on the other side, offsetting this and allowing us to drive mid-teens overall growth in total distribution income for the year and that's what takes us to the $425 million.

So quarter-over-quarter, this thing is not linear, clearly. There is seasonality. And so that's why we provide annual guidance to take out a bit that fluctuation quarter-to-quarter.

Charles J. G. Brindamour
CEO & Director

Yes. I think that, Geoff, there's a couple of things that are -- we take. As you've seen over time, we've been cautious on the distribution guidance. I mean there's -- you've got 2 things. There's a speed at which deals are getting done and that's kind of hard to predict, but made really good progress on this front, in particular, in BrokerLink.

Then the On Side performance is a bit lumpy from the perspective that it's driven by natural disasters quite heavily. It's been really good this quarter. I have a lot of confidence that this business will perform really well. But depending on the volume of work, which is driven by natural divestures, you'll see some volatility -- a little bit of volatility there. And so in aggregate, I think -- you're right, it is cautious guidance. There's one-offs, as we have just laid out and a degree of caution on our part because some parts of it are hard to forecast.

Operator

Your next question comes from Mario Mendonca of TD Securities.

Mario Mendonca
TD Securities Equity Research

Louis, perhaps -- or maybe Charles, I'll take you up on that idea that we would look at underlying -- the underlying claims ratio and put in the PYD in personal auto. Obviously, makes a lot of sense to that. And I'm doing that precisely, but I'm looking at it relative to 2019. And that underlying claims ratio plus PYD is still a lot lower, like 900, 1,300 basis points lower than it was in 2019. Does there come a time when you conclude that the environment is so favorable that it actually starts to put pricing pressure in personal auto? Or is that not how you look at it?

Charles J. G. Brindamour
CEO & Director

I think, Mario, that's a very good observation. And I would say part of the issue with 2019 and 2018, you'll remember is when we were filing the inflation on the 40%, that sees no inflation there. Reforms have been introduced. There has been a sharp increase in '16, '17. We moved quickly on rates and pricing and then really strengthened the balance sheet to make sure that we wouldn't be caught by surprise here.

So I would say, for me, the performance in 2019 was not at the level it needed to be. And I don't think it's a good comparison point. And even in 2019, you'll remember, we were guiding towards mid-90s in terms of performance. And for me, that's a much better way to look at that.

When I look at everything that's in the pipeline at the moment, I'm saying, I think if we look out 12 months, we should be sub-95. There are lots of moving pieces. I think the industry is still catching up, Mario. And therefore, I don't think that the market will become irrational, much to the contrary. I expect the market. And if you look to our outlook I expect the market to really act on the inflation that was there before the pandemic and the new inflation.

Now you could have a debate whether frequency is at a structurally different level. I think it's -- I don't -- I wouldn't say structurally, frequency is lower than it was pre-pandemic as driving is returning to normal because people don't drive at the same time. Is this structural? Far from clear to me that it is structural. And I think maybe just to give you a bit of color, Isabelle, why don't you talk about driving patterns and what you're observing. But the punch line to your question is, I don't see a structural shift at this stage that we're prepared to price upon. Isabelle?

Isabelle Girard
Senior Vice President of Personal Lines

Yes. In terms of driving and frequency, as we sit here today, the driving is pretty close to pre-pandemic sitting about a couple of points before COVID. Workplace mobility and weekdays congestion especially the morning rush hours as we said in the past, while still higher than 2021, it remains below pre-pandemic level. So we believe it's explained in part why despite driving being very close to pre-pandemic, there's still frequency is still below what we were seeing in 2019 and before. We also observe via our [indiscernible] tools though that some driving behavior has changed. So there's a bit of less acceleration and less breaking events that are trending downwards. So is that behavior still there to continue, we'll see in the coming months, but we expect that frequency will continue to rise over the fall as people continue to return to the office during that period of time. But we're pricing for increase in severity versus what we see today, and that's embedded in our pricing strategy.

Mario Mendonca
TD Securities Equity Research

Okay. Second question -- my second question related to both personal auto and personal property in Canada. Because of the RSA deal, looking at the growth in the policies written or written insured risks has been a little more challenging because it obviously -- it's affected by RSA. Can you -- with RSA now in the business for a year, can you talk about what you'd expect policy growth to be like and maybe written insured risks in those 2 businesses, personal property and personal auto?

Charles J. G. Brindamour
CEO & Director

I think, Mario, out of experience. So first of all, a big portion of the book now has migrated to our system, that's good. Very happy with the retention we've observed. I mean, the retention on the RSA transaction is almost in line with the retention of the Intact portfolio itself, which is quite something in the context of an acquisition, it's better than what we anticipated, frankly.

Now in year 2 of a transaction, you have to keep in mind that there's risk selection activities taking place when you migrate to the portfolio, that is happening over a 2-year period. You migrate in year 1, we're capping the dislocation in year 1 and we're gradually bringing people to the actual Intact price over 2, 3 years. That can lead to less growth than you otherwise would get in the following 12 months after the first year of an integration.

So we take a cautious stance, I would say, on organic growth, NPL, as we look out the next 12 months and the backdrop that we're still, I think, cautious in relative terms from a pricing point of view, though we see that narrowing in the coming period. I don't know if there's any color we can add.

Isabelle Girard
Senior Vice President of Personal Lines

Maybe what I would add to this is that during the same period, we were integrating RSA. We saw a lot less quotes in the market than we were seeing before that. And it's not of course, due to RSA integration, but due to the context of being in the pandemic and many competitors and us tempering our rate increases. So that also was a factor for us not seeing or seeing a muted growth in units. But as the market is returning to a rate position, given inflation, we expect that to generate more people that will shop for their insurance. So then with our best-in-class segmentation, we feel that will be best positioned to take some opportunities there.

Operator

Your next question comes from Michael Phillips of Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

Can you talk -- switch off to personal auto for a second and maybe talk about what you're seeing in loss trends in your U.S. commercial business?

Charles J. G. Brindamour
CEO & Director

Sure. Darren, do you want to give your perspective on that?

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Yes. And maybe just -- in terms of before I go to loss trends, just to give you a bit of an insight in terms of the makeup of the portfolio in the U.S. I think we've talked about this before, but I think it's worth repeating. Roughly 60% of the book is I would classify more of a casualty type exposure with another 20% more property focused. Now you can include auto physical damage in that as well. And then about another 20% in terms of other pure specialty lines when we talk about surety, A&H, tuition reimbursements, et cetera.

When you look at each of the different components there, Mike, we see similar things in the U.S. from a property standpoint, like we see in our commercial property book in Canada. We see severity increases sort of in that mid-single-digit ranges. Now remember again that we have indexation of amounts of insurance here as well, too. So our net trend, obviously, is lower than that level.

Obviously, from a casualty standpoint, watching our triangles very, very closely. No real uptick in terms of what we see from a loss trend standpoint. But obviously, that's an area that we're paying very, very close attention to. And then when I look on the pure specialty side, whether it be A&H and tuition, surety, for example, not a lot of pressure there at this point in time.

Charles J. G. Brindamour
CEO & Director

Yes. And I think, Michael, in the U.S. first of all, the duration of our liabilities is 2.2 years roughly. So it remains fairly short tail given the makeup of the portfolio. And keep in mind the areas where we sell the distribution of outcomes from a claims point of view or the probability distribution outcome from a claims point of view, where it was too wide, we exited. And health care, architect and engineer and public entity more recently, special cases on their own from an inflation point of view, and we're out of these segments, which I think really helps the profile and the liability profile of our portfolio.

Michael Wayne Phillips
Morgan Stanley, Research Division

Step back in a kind of high-level longer-term question. One of the things we're seeing a lot more of today than I think we have in a while in personal auto is the core manufacturers kind of dipping their toes back into being an insurance company again, either farm that off to companies or wanted to get a slice of that business. How do you see that for you guys? Is that an opportunity for you to kind of do some partnering? Or is that more of a threat maybe for you and maybe think about for the industry as well?

Charles J. G. Brindamour
CEO & Director

Yes. I think that our thesis for the last decade, Michael, is that disruption in the personal line space will come at the distribution level. And that can come from manufacturers, that can come from other forms of distribution, et cetera. We haven't seen a ton of that, but that's what we've been preparing for and transforming the business to still grow in an environment that is disrupted. And so investments in brands, investment in building a relationship with customer, digital investment, et cetera, et cetera, is -- has been our focus.

Now OEMs have been manufacturing or distributing the product before, pulled out, came in, pulled out. It is a threat, no doubt about it. It's not new. It's very hard to be an insurance manufacturer. I think what we're watching for is the role they can play in distribution, obviously. Is this an opportunity? Potentially, but frankly, our own perspective is proximity to customers from a strategic point of view, is very, very important and that's what we're focused on at this stage. But obviously, we're open to all opportunities, but our strong strategic bias is proximity to customers.

Michael Wayne Phillips

Morgan Stanley, Research Division

Yes. It makes sense. I think that's what we're seeing here too is it's more of a distribution play. As you said, it's hard to be a carrier, but it's more of getting in front of the customer here. So more of a distribution play.

Operator

Your next question comes from Paul Holden of CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

I want to ask a couple of questions on the outlook for commercial that you still have a fairly positive outlook on premium growth because of perspective. One is at what age will higher interest rates impact that rate momentum, at what stage economic essentially impact that rate momentum, [indiscernible] related and would you expect the sensitivity to those factors to be different between [indiscernible]

Charles J. G. Brindamour
CEO & Director

So Paul, before your question. There's something with the line, your line. So maybe you can put yourself on mute. And I'll ask Darren for perspective on the rating environment in commercial lines. Go ahead, Darren.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Thanks, Charles. When you look at the market conditions across our various franchises today, whether it be North America, U.K. or in Europe, the market conditions are very, very consistent with past quarters. So how would I describe these market conditions has not changed. We continue to see rates in the upper single digit and tight capacity.

Now obviously, as we've talked before about inflation concerns, whether it be both physical and social inflation, together with the ongoing impact of climate change as signaled by the reinsurance markets, I continue to expect that all of our CR markets across our different geographies will continue to operate for some time as they currently do today, namely upper single digits in rate and tight capacity.

As I mentioned before in my response to Michael, I mean obviously, as while inflation is evident, we do have the benefit on the property side of indexation offsetting that. So together with that plus our rates and our ongoing profitability actions, we definitely see that we have confidence in our commercial lines portfolios to continue to operate in the low 90s or better.

Charles J. G. Brindamour
CEO & Director

So I guess, Paul's question and the line was cutting on Paul, but part of it was with interest rates going up, do you change in any way your outlook? Maybe you can share your perspective on that.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

I think we've talked in past quarters about the impact of rising interest rates. Obviously, we don't have significant turnover within the portfolio, that sort of has a significant impact...

Charles J. G. Brindamour
CEO & Director

Not for us, more for the market.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

I think the pressure point from both inflation and changing weather, I think, very much outweighs any potential tailwind you could get from an interest rate. And I think that's the overarching theme that you see in the industry today, and I think you'll see in the industry in the foreseeable future.

Charles J. G. Brindamour
CEO & Director

Yes. I think, Paul, the increase in the yield curve, of course, in relative terms is significant in absolute terms, though, it's not a big needle mover to your permissible combined ratio when you price at this stage, first.

Second point is the interest rates that one would use in calculating the permissible combined ratio tends to be cautious in general, and I don't see -- if I look at the headwinds that the market is fighting for and the potential upside of additional investment income at the industry level. Given duration, given asset mix, I don't really see this as a needle mover at least in the next 12 to 24 months in terms of market behavior. Paul, the line was cutting. I'm afraid we missed the first part of your question. So do you want to try again to ask if there was anything we haven't covered to your question and the answer we've just given.

Paul David Holden
CIBC Capital Markets, Research Division

Sorry, yes. No, I think you covered most of it. I guess the last part was if you'd expect there to be any difference in the sensitivity between general and specialty line?

Charles J. G. Brindamour
CEO & Director

Yes. Darren, your thought process there.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

I think you've got to look at the specialty lines in terms of the different makeup of the portfolio. Obviously, we've got a lot of diversification within the portfolio from short tail to long tail to casualty to property between lines that are sensitive to economic cycle versus insurance cycle. So I think it's difficult to make broad brush comments generally in the SL space simply because the makeup of everyone's portfolio is quite different.

Having said that, do I see dramatic impact between retail, commercial and SL in terms of the impact of rising rates? No, I don't. I think both markets are facing the same sort of headwinds and pressures, and I would expect them to operate accordingly.

Charles J. G. Brindamour
CEO & Director

Yes. I would say, Darren, that when I look at our specialty lines portfolio, you probably have 2 elements of it, which have a slightly different behavior than the rest of the market. Accident is one area. Sureties the other area. The risk is different. These are 2 very profitable segments, but otherwise, I think, directionally speaking, we're seeing the same thing. A broader distribution of outcomes around upper single-digit low teens, definitely depending on the line. But in aggregate, I agree with you. I think directionally, it's pretty much in the same ballpark.

Operator

Your next question comes from Tom MacKinnon of BMO Capital Markets.

Tom MacKinnon
BMO Capital Markets Equity Research

Switch back to Canadian personal auto again here, I think the guidance now is you want to run a sub-95% level for the next 12 months. I think your previous guidance was you were going to be at the low end of the mid-90s target range for the year. So I mean, is this just word play, but is there any difference in terms of these 2 statements? And how much reserve development is in this guidance because the current levels have been running higher than what we've seen in the past for personal auto?

Charles J. G. Brindamour
CEO & Director

Yes. Yes. It's not just word play. I think it's us saying, look, historically, we've guided to mid-90s, right? And then in the last couple of years, we said -- or last 18 months, I forget, we said, look, we'll be running at the lower end of the mid-90s and it's very much what you're seeing -- 91.4 in the first half this year in personal automobile. There's lots of moving pieces here. I think we're saying, look, we'll run this sub-95, when we look 12 months out and we map out our best guess of trends and some of the actions we're taking and some of the caution we have, we're saying, "Hey, we'll run that business sub-95 in the next 12 months." And so there's an added degree of caution maybe in the guidance, but you're not in 2 different zones than where we were 3 months ago, but you...

Tom MacKinnon
BMO Capital Markets Equity Research

Any PYD in there?

Charles J. G. Brindamour
CEO & Director

Yes, I think that when we think about PYD here, yes, I mean, there's an expectation of PYD in our guidance definitely maybe 1 to...

Tom MacKinnon
BMO Capital Markets Equity Research

And would that be 1 to 2 points?

Charles J. G. Brindamour
CEO & Director

1 to 3 points.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. Because it's been running a little bit higher than that just of late. I guess you're not going to run at the same kind of levels is what you're suggesting.

Charles J. G. Brindamour
CEO & Director

Yes, Patrick.

Patrick Barbeau
Executive VP & COO

Yes, the reason it was higher is directly linked to what we discussed about the fact that the 40% of long tail right now, we don't see the inflation. So we -- as we close these claims, we can see more favorable PYD. It doesn't mean that it will be always like that. If it comes back with a bit of inflation in that line, it would be in the 1% to 3%. If it doesn't develop, we might be a bit higher.

Charles J. G. Brindamour
CEO & Director

Yes. Yes, that's it. And that's why I think we're seeing sub-95 and giving ourselves a bit of room here. But we feel pretty good about what we're seeing now. And as I said, you've got reforms who have played an important role in keeping stability there as well. It's not -- for me, it's not lag. I think it's a different sort of outcome. But then we've been cautious throughout the pandemic and reserving for long-tail lines. And so far so good.

Tom MacKinnon
BMO Capital Markets Equity Research

And then as a follow-up for maybe a question for Louis. The tax rate, 20% is kind of better than what we were looking for. You're a bigger global company right now. There's always different tax advantages and disadvantages associated with that. How should we be looking at modeling your overall operating tax rate going forward?

Louis Marcotte
Executive VP & CFO

Listen, we've been suggesting to stick in the 21%, 22% range overall. I think what I see as a benefit right now is a bit more recovery of losses in the U.K. business that are not recognized on our balance sheet. And that, for 2 quarters, has taken maybe a point of the tax rate. So what was 21%, 22% might be 20%, 21% right now in terms of expectations. It doesn't change drastically, but there is a bit of a positive angle with the ability to recover losses in the U.K. faster than earlier anticipated.

Tom MacKinnon
BMO Capital Markets Equity Research

And do you see that ability to recover those losses extending through to 2023?

Louis Marcotte
Executive VP & CFO

Yes.

Operator

Your next question comes from Nigel D'Souza of Veritas Investments.

Nigel R. D'Souza
Veritas Investment Research Corporation

I wanted to circle back to personal auto and your comments on what's driving your losses. So if I look at that 60% component not related to physical injury, you mentioned inflationary pressures of low to mid-teens. So assuming the 40% stays relatively stable, that implies growth rate on the loss side of about mid- to high single digits. If I combine that with your expectations for premium growth in the mid-single digits, that would imply you get some upward pressure on your combined ratio of about 1 percentage point each quarter.

So I can understand being sub-95 over the next 12 months. But if those trends continue, especially if you couple it with higher claims frequency, does that imply that after 12 months, you could see that combined ratio hit or exceed 95?

Charles J. G. Brindamour
CEO & Director

No. I think that you're seeing in Q2 8-ish percent driven by physical damage. Frequency is below where it's been historically, keep that in mind. Rates and sum insured are going to 9% based on what's embedded in the system by year-end and then there's the upside of claims, supply chain management and risk selection initiatives we've talked about. And the prudence in reserving is anticipating already on the balance sheet some inflation.

So when I put all that together, I'm pretty comfortable we'll operate that business sub-95 in the next 12 months. There's lots of action in the pipeline here that can withstand deterioration in what we're seeing in Q2, in fact.

Nigel R. D'Souza
Veritas Investment Research Corporation

Okay. But would it be fair to say that you'd be closer to 95 than 90 at the end of 12 months from now?

Charles J. G. Brindamour
CEO & Director

Closer to 95 than 90, I mean we're -- we will be sub-95, but we might be -- yes, if closure is anything above [92.5]. We're getting pretty tight, and I don't want to get into too specific guidance because there's lots of moving pieces here, but we're not planning for a world with a risk of going beyond 95 here.

Nigel R. D'Souza
Veritas Investment Research Corporation

Okay. And just last question for me. When I look at your comments on inflation in last quarter, you had a pretty muted outlook for premium growth. You didn't really point to any outsized inflationary pressures. And then 3 months later, you're seeing or you're at least highlighting substantial inflation outside of the physical injury component. So just trying to get a sense of what's your confidence that inflation may not surprise again to the upside 3 months from now and costs could run higher than what you're currently anticipating?

Charles J. G. Brindamour
CEO & Director

I think we were guiding last quarter with regards to the industry's direction pretty consistent with what we're guiding this quarter. If you look at the outlook in auto for the past 24 months, we've also been saying that we expected the industry's behavior to pick up on inflationary trends that we've been on for a number of years, not a big change there. I think that the inflation in Q1 was 5. It's 8 in Q2. This gives us greater confidence, and we're seeing it in the market that the market will react. And I think that we're happy growing in auto, by the way. We have probably not grown at the speed of the market because our rates were more cautious. I think the market will gradually reflect these trends. We've been on it for a longer period of time, and we're happy with that. There's not a major -- there's not a big change in perspective here in terms of where things are going and what we're observing in the field.

Operator

Ladies and gentlemen, that is all the time we have for questions today. I'll turn the conference back to your hosts for closing remarks.

Charles J. G. Brindamour
CEO & Director

Thank you.

Shubha Rahman Khan
Vice President of Investor Relations

Thanks, everyone, for joining us today. Following the call, a telephone replay will be available for 1 week, and the webcast will be archived on our website for 1 year. A transcript will also be available on our website in the Financial Reports and Filings section.

As a reminder, we will also be hosting our Investor Day on Thursday, September 22 in Toronto with presentations by senior executives starting at 9:00 a.m. Please visit our website for further details. Our third quarter 2022 results are scheduled to be released after market close on Tuesday, November 8, with the earnings call starting at 11:00 a.m. Eastern on Wednesday, November 9. Thank you again, and this concludes our call for today.

Charles J. G. Brindamour
CEO & Director

Thank you.

Operator
Ladies and gentlemen, this does conclude your conference call for today. We would like to thank everyone for participating and ask you to please disconnect your lines.