S&P Global
Market Intelligence

Intact Financial Corporation TSX:IFC

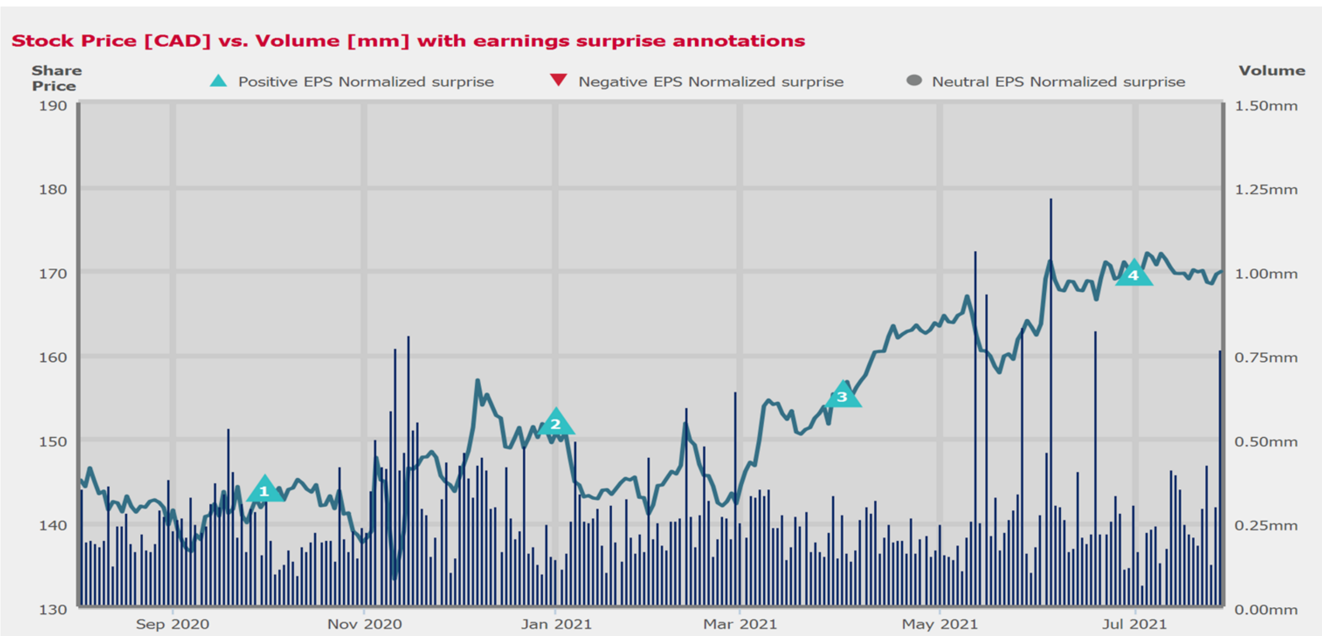
FQ2 2021 Earnings Call Transcripts

Wednesday, July 28, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.40	3.26	▲35.83	2.43	10.18	NA
Revenue (mm)	3243.80	3508.00	▲8.14	5214.00	16738.00	NA

Currency: CAD
Consensus as of Jul-28-2021 5:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	2.14	2.78	▲1 29.91 %
FQ4 2020	2.36	3.18	▲2 34.75 %
FQ1 2021	2.15	2.50	▲3 16.28 %
FQ2 2021	2.40	3.26	▲4 35.83 %

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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

Kenneth Anderson
Executive VP of Corporate Development & Investor Relations

Louis Marcotte
Executive VP & CFO

Patrick Barbeau
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Geoffrey Kwan
RBC Capital Markets, Research Division

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TD Securities Equity Research

Paul David Holden
CIBC Capital Markets, Research Division

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BMO Capital Markets Equity Research

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Intact Financial Corp. Q2 2021 Results Conference Call. [Operator Instructions] Also note that this call is being recorded on Wednesday, July 28, 2021.

I now would like to turn the conference over to Ken Anderson, Executive Vice President, Investor Relations and Corporate Development. Please go ahead, sir.

Kenneth Anderson
Executive VP of Corporate Development & Investor Relations

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

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

With me here in Montreal today, we have our CEO, Charles Brindamour; our CFO, Louis Marcotte; our Chief Operating Officer, Patrick Barbeau; Isabelle Girard, SVP of Personal Lines; and Darren Godfrey, EVP of Global Specialty lines. Sorry, it's Isabelle Girard, EVP of Personal Lines. We'll begin with prepared remarks followed by Q&A.

With that, I'll turn the call to Charles.

Charles J. G. Brindamour
CEO & Director

Thanks, Ken. Good morning, everyone, and thank you very much for joining us this morning. Our communities have made great progress over the past few months, and we're hopeful for a gradual return to normalcy as we emerge from the pandemic. For us, this means continuing to be there for our customers and helping our people adapt to a new work environment. It's reassuring to see that in an important period of change and turbulence, our business can not only be resilient but also thrive and grow.

Clearly, the successful acquisition of RSA is a good example of this. And we're quite pleased with the progress we've made so far. But in the meantime, our business is continuing to deliver strong performance. Yesterday evening, we announced second quarter net operating income per share of $3.26, a 39% increase over Q2 last year, driven by strong underwriting and distribution results. Top line growth of 29% was driven by the acquisition of RSA with approximately 7 points of organic growth, reflecting strength in commercial lines on both sides of the border. The overall combined ratio was 86.7%, driven by strong performances across all lines and geographies. In Canada, the combined ratio was excellent at 85%, driven by strength in underlying performance. The combined ratio included 1 point from the tragic Lytton fire. Our claims team and On Side business have mobilized very quickly to help the community get through this difficult time.

Let's now look at our results by line of business, starting right here with Canada. In personal auto, premium grew 1% year-over-year. Excluding the BC auto exit, growth was 3%, driven by units. The combined ratio is very strong at 82.4%. Our personal auto business is solid, and we expect it to hit low 90s for the remainder of the year. Looking at the industry, we're seeing prudent rate tempering in the current environment, and with driving activity just 5 points below pre-COVID levels, we could see rate momentum return over the next 12 months.

In personal property, premiums grew 5%, driven by firm market conditions. With a very strong combined ratio of 83.3% in the quarter, the business is performing extremely well. Our operating track record in the past 5 years is a testament to the resilience of this business.

In commercial lines, premiums grew 12%, driven by rate actions and solid organic growth while delivering a strong 89.6% combined ratio. Looking at the industry, we expect hard market conditions to continue. And our commercial lines business is really well positioned to deliver low 90s or better performance going forward.

Moving to our U.S. commercial business. Premiums grew a strong 19% in the quarter, benefiting from increased activity in COVID-impacted lines versus 2020. Adjusting for this, the underlying growth in Q2 is in the low double-digit range, supported by the continued hard market conditions. The combined ratio of 90.3% was solid as the team continues to execute on the objective to deliver sustainable low 90s performance.

Turning to our RSA acquisition. A lot has happened since we closed 7 weeks ago. People are largely onboarded with their roles, teams and locations confirmed. Customers in Canada will start to move to our product and systems next week. A number of technology investment decisions have been made and are rolling. Action plans are in place across all segments to drive outperformance. And we acted quickly to rationalize the footprint with the sale of Denmark. So it's fair to say that there's momentum.

Now let me provide a bit more color on Canada, specialty lines, and the UK&I parts of the integration as well as transition. In Canada, the integration is going really well. We're advancing on systems conversions with the first policy renewal on Intact [paper] to be issued in August, allowing us to leverage our core capabilities in data, pricing and segmentation. We're building capacity to drive the internalization of RSA's claims operation and we're starting to leverage our supply chain management expertise as well. This includes engaging our On Side restoration business to handle a large portion of RSA's claims since close. The Canadian integration is definitely on track. It's key as this drives 3/4 of the synergies.

Moving to global specialty lines. The North American portfolio is being integrated as we speak with Paul Lucarelli originally from RSA leading the charge. We're bringing the global network into the fold, which allows us to expand our reach. And we're working across our geographies to better understand our core specialty lines capabilities as we prepare to build our international franchise. We see the expanded specialty lines platform as one of our key growth engines for the next decade.

Moving to the UK&I. So following the close, a few members of the IFC team and I spent 3 weeks in the U.K., engaging with Scott and the RSA team. And together, we're aligned on the main areas that we need to excel to build outperformance: people, simplifying the business, improving pricing sophistication and modernizing technology.

First on people, Scott has put together an excellent team, and we're delighted to be working with them to continue their journey towards building an outperformance machine. Together, we've set midterm strategic objectives for the business, and we've had the opportunity to share our values and the importance of an outperformance mindset. We're also supporting the team as they simplify the business. By focusing the footprint, streamlining the offering and technology infrastructure, the operations will build a robust foundation for outperformance that, in my view, can deliver a second-to-none customer experience. We also have a number of experts working closely with the U.K. team to share our expertise in pricing, risk selection, machine learning as well as claims management.

Overall, in the UK&I, I am pleased with the progress so far. The RSA team has done tremendous work over the past couple of years and are already delivering solid performance, and we have great momentum, and people are engaged.

We've talked about focusing the footprint, and we moved quickly right after the close to announce the sale of the Denmark business, which is expected to complete in the first half of 2022. The sale will generate over $1.2 billion in proceeds to Intact, which lifts our IRR expectations by at least 1.5 points for the RSA acquisition. While we're integrating RSA, our teams haven't missed a beat in executing on our customer-driven strategies.

On the digital front, we're continually adding new features on our mobile app to create value for our customers, driving engagement throughout their journey with Intact. We added roadside assistance to provide enhanced protection for our customers. And our recently launched claims chatbot now handles close to 90% of the digital chats with our customers.

Our distribution channels are also delivering on our customer-driven promise. BrokerLink is now running over $2.3 billion of premiums annually, an increase of over 25% since 2019. And with a robust M&A pipeline, we think that Joe D’Annunzio and team can double that business over the next 5 years. There's a lot going on and the business is firing on all cylinders.

Over the last year, we've made very good progress on all fronts. Throughout the pandemic, we've lived our values and delivered on our purpose to help people, businesses and society prosper in good times and be resilient in bad times. We've also transformed our business with the addition of RSA, all the while continuing to deliver second-to-none customer experiences. This would not be possible without our people, and I want to thank them for their continued drive, focus and energy. We've added an impressive amount of talent and expertise through the RSA acquisition. And I want to welcome everyone into the Intact family.

Our business has a lot of momentum. Our balance sheet is very strong. We have a clear focus on what we need to achieve. And I'm more confident than ever in our ability to deliver on our promise to customers, meet our financial objectives of 10% NOIPS growth annually over time and 500 basis points of ROE outperformance every year.

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

Louis Marcotte
Executive VP & CFO

Thanks, Charles, and good morning, everyone. After 6 months of planning together, on June 1, we closed the RSA transaction and welcome RSA's Canadian, U.K. and international employees to the Intact family. Financially, not only is the deal immediately accretive to net operating income per share, it also brings increased resilience to our balance sheet. Strategically, it expands our leadership position in Canada, bolsters our specialty lines capabilities and opens up new markets in the U.K. and Ireland at scale.

I will provide some more color on the financial impacts from RSA shortly. But first, let me make a few comments on our strong second quarter results. Net operating income to common shareholders increased by 49% (sic) [47%] year-over-year with all earnings sources contributing to this growth. Underwriting income grew 63% compared to last year to $464 million as strong underlying performances across the business continued reflecting the benefits of our actions over time, mild weather conditions and impact of RSA.

Net investment income of $154 million increased by 9% year-over-year. For the full year, we still expect net investment income to be flat before including the impact of RSA, which will add roughly $100 million to 2021 net investment income, including the $13 million recorded in the month of June.

Distribution EBITDA and other income grew an impressive 51% in the quarter, driven by better-than-expected variable commissions as well as solid organic and M&A growth. We expect growth in the second half of the year to taper towards a 10% to 12% range as we compare against a strong second half of 2020. Although RSA was included in our results for 1 month only, it added $57 million of underwriting income and $13 million of investment income to our operating earnings. After reflecting financing costs and dilution from the shares issued, the net operating income per share accretion is high single digit for the month of June. We expect to maintain a similar level for the second half of the year.

Looking at underwriting results in a little more detail. Healthy favorable prior year development contributed to our strong results in the quarter and year-to-date. We have been and continue to be prudent in establishing current year reserves, particularly considering uncertainties related to COVID. We maintain our longer-term expectation that favorable PYD will be in the range of 1% to 3% of reserves annually for the Intact Group in aggregate. Depending on how and when the uncertainties unwind, we expect to see favorable development in the upper half of the range in the shorter term.

In personal auto, the underlying loss ratio of 59.6% was strong despite the impact of premium relief and reflects our actions over time. The relief program launched in March is now closed, and we returned an additional $30 million to customers in Q2, bringing the total program in 2021 to $105 million.

Looking at commercial lines in Canada, the underlying loss ratio of 51.3% is the best performance we have delivered to date. In the U.S., the underlying loss ratio of 51.6% was strong, driven by corrective underwriting and profitability actions as well as rate gains across the book. Momentum in commercial lines is strong on both sides of the border and well positioned for low 90s or better performance over time.

On expenses, the overall Canadian expense ratio of 32.9% for the first half of the year increased 2.2 points over last year. This was driven by higher variable commissions consistent with the strong underwriting performance in the first half of the year. The combined ratio of 90.7% for RSA in June was solid, driven by underwriting performances in both Canada and the UK&I. These results are also largely the result of lower frequency, mild weather and profitability actions, offset by elevated CAT losses in Canada. Although one should not assume that results for June are indicative of full year results, we are pleased with the results so far and are increasingly confident in our ability to deliver the earnings accretion we promised.

We are entering the second half of the year on solid footing while closely monitoring driving habits as people progressively go back to their offices as well as CAT activity. In terms of RSA's underwriting results for the second half of the year, we believe the best starting point on top line is to use half of the premiums of 2020 as reported in their annual report for both Canada and the UK&I. The combined ratio is difficult to predict, of course, but we would use the 2019 as the base year to exclude the impact of COVID in 2020. Both Canada and UK&I reported combined ratios in the mid-90s range. If you shave a point or two for profitability improvements already achieved and add a bit of synergies, you have a good idea where RSA's underwriting results should land in the second half of the year. Keep in mind, it's important to anchor any expectations with our accretion estimates.

To further de-risk the acquisition, we entered into a transaction with a reputable reinsurer. Subject to specific exclusions and limitations, this agreement provides us with a recovery of 50% of adverse development up to GBP 400 million on the UK&I claims liabilities for 2020 and prior accident years. The net cost of this reinsurance will be recorded in Q3 2021. With the addition of RSA, it is also appropriate to revise our annual estimates for CATs, which reflect a long-term view of trends. We are raising our annual CAT expectation from $300 million to $570 million per year to reflect the growing premium base and change in business mix. We now expect 2/3 to impact personal lines and continue to expect 1/3 of the annual CATs to occur in each of Q2 and Q3. Having said that, 1 month into Q3, we have experienced a couple of weather events in the U.S., which will translate into CAT losses for the third quarter. As of today, based on early estimates, these losses are within our revised CAT guidance.

On synergies, we are on track to realize the stated $250 million in run rate synergies within 36 months largely generated from claims internalization and consolidation of shared services. We continue to expect integration and restructuring costs for the transaction to run at 1.5 to 1.7x the annual run rate synergies. In the second quarter, we recorded approximately $35 million of these costs, and we expect to incur half of the cost by the end of 2021. The remainder will be recorded progressively over 2022 and 2023. These costs are reported as nonoperating results and do not include the net cost of the adverse development cover.

Moving to our balance sheet. On closing of the acquisition, we recorded the acquired assets and liabilities of RSA at fair value together with the associated transaction financing. Coupled with our strong performance in the quarter, this took our book value per share to $77.67 on June 30, an increase of 44% compared to Q2 last year and up 25% compared to last quarter. Our operating ROE increased to 19.8% for the 12 months to June 30. For full year 2021 and going forward, we are aiming for a mid-teens operating ROE level in line with our historical average.

Our financial position continues to be strong. We closed the quarter having incorporated the RSA acquisition with approximately $2.6 billion in total capital margin, a healthy buffer to absorb potential shocks. On a debt-to-total capital -- our debt-to-total capital was just above 24% at the end of the quarter, better than we projected, thanks to the strength in our book value. Deleveraging will accelerate in 2022 as we expect to use most of the proceeds from the sale of Denmark, assuming it closes, to reduce our debt and reach our 20% target earlier than planned.

With the acquisition close and integration and synergy realization underway, we are on track to generate high single-digit accretion to net operating income per share in the first 12 months, moving to upper teens within 36 months. We produced an excellent set of results for the first half of the year while accelerating our strategic roadmap. Our focus is now on capitalizing upon the momentum across the business while delivering on the strategic and financial merits of the RSA transaction. With the strength of our teams and our platform, we are well positioned to deliver on our financial objectives in the years ahead.

Before giving it back to Ken, I will take a second here to thank our teams in finance, actuarial, legal and IR on both sides of the Atlantic for their significant effort over the past months to produce quality financial information for investors on a timely basis. I'm very proud of what the teams have achieved, and I want to thank them for their contribution.

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

Kenneth Anderson
Executive VP of Corporate Development & Investor Relations
Thanks, Louis. In order to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourselves to 2 questions per person. Of course, if there's time at the end, you can certainly re-queue for follow-ups. So Sylvie, we're ready to take questions now.

Question and Answer

Operator

[Operator Instructions] And your first question will be from Geoff Kwan at RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, Research Division

My first question was on personal auto. I think you've talked in the past about potential for premium increases when driving returns to more normal levels. But I was curious around how much the combined ratio may also influence the timing of any sort of premium increases. So for example, like if we get driving back to normal, that presumably from a timing perspective, the combined ratio is probably going to increase in a reasonable amount of time. But what if we have a scenario where driving is back to normal, but the combined ratio remains better than before? Do you worry about any sort of potential optics for the industry from consumers around increasing premiums if traffic is back to normal and the combined ratios remain better than usual?

Charles J. G. Brindamour
CEO & Director

Geoff, thanks for the question. I'm not worried about that. This market is super competitive. It's always been very competitive. The industry on average has been a single-digit ROE business, and catching up with cost in a highly competitive environment has been a challenge for the industry. That's why our performance is the name of the game in that business, and that's why we built a big outperformance margin in automobile insurance.

So my perspective -- the industry entered into the crisis with a meaningful amount of work left to be done to deal with the things that we were focused on since 2016. Think about inflation on the liability side of things, inflation and physical damage. We put much of that work behind us. I don't think it's the case at the industry level. You don't need to go back too far to see that the industry, even in 2020, had adverse development and still poor results in the first half. So I'm not really worried about that. I think the industry is quite competitive. I think what people should be focused on, in my mind, is to make sure that prices are adequate when driving returns to normal, taking into account the pressure that existed in the system before COVID.

So not worried about that, Geoff, one bit, and I feel like we're really well positioned with the work we've done on relief, our pricing position and the flexibility we've covered to react when the time comes.

Geoffrey Kwan
RBC Capital Markets, Research Division

Okay. And just my second question was with respect to the RSA acquisition, for the non-Canadian businesses that you acquired. I know -- I think you've talked about evaluating them over the next year. But have you -- are you able to say whether or not there's been any third parties that have approached you with interest about some or all of those assets?

Charles J. G. Brindamour
CEO & Director

Well, clearly, when there is a transaction of that nature, first of all, many people were surprised by the transaction. Yes, you get inbound calls from time to time. I think that we said very clearly at the start of this transaction that we would evaluate our strategic options for Denmark. We did, and we acted on the inbound that we've received a couple of weeks after closing. As far as the rest of the platform is concerned, we're really focused on building outperformance here and making sure that we're being rewarded for the risk and the capital that's being deployed. Clearly, the U.K. is the biggest part of this, and we're focused on building outperformance there, and there's good traction. We have a very good team.

Operator

Did you have any further questions?

Geoffrey Kwan
RBC Capital Markets, Research Division

No, that was it.

Operator

Next question will be from Paul Holden at CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

My first question also relates to personal auto. And Charles, you gave an outlook for the remainder of the year, but it's a little bit different than what we've seen from some of the U.S. auto insurers where they start seeing a spike in claims or accident frequency related to returned activity and then also have called out an acceleration in severity. So wondering how your outlook is different than the U.S. insurers and maybe specifically drill down a little bit more on what you're seeing on the severity trends today?

Charles J. G. Brindamour
CEO & Director

Good. Well, Paul, thanks for your question. Obviously, if you compare frequency in Q2 2021 with frequency in Q2 2020, you'll see an increase. It's obvious. The state of the world was very different a year ago than you see now. So I think that one needs to look past what happened Q2-over-Q2 and look at where driving is going and then look at where inflation is going. And so what I'm thinking, Paul, maybe we start with Isabelle, who will give us her perspective on what we're seeing in terms of activity. And then Patrick will take us through what we're seeing on the severity on inflation side of things. So Isabelle, why don't you take this?

Isabelle Girard
Senior Vice President of Personal Lines

Yes. So in terms of driving, what we see with the latest wave of cases in 2021, we saw some reduced driving in the spring 2021. But as you were mentioning, Charles, nothing to the expense we saw in the spring of last year in 2020, where we were in full lockdown. Having said that, driving activities are on the rise since early May, and we're now sitting about just 5 points below the pre-COVID levels of driving. So as vaccination continue to progress, we expect that the driving will also continue to rise in the coming weeks.

Having said that, looking at the average of driving, we can think that we're close to normal, but normality may be a bit different in the coming months. So we've been looking closely at various data coming from our telematics. And while number of miles driven is one factor that changed with the pandemic, there's also other habits that have changed. So when people are driving, where people are driving and how people are driving are examples of things that we saw some changes during the pandemic. So a few examples, I think, that we observed that are not necessarily back to normal yet. Rush hours and congestions are examples of things that when we look at the weekends, we're pretty much at historical levels. But when we're looking on the weekdays, especially for the rush-hour morning, we see that we're still below historical levels. We also have observed that driving has been recovering faster than public transit usage. And in the last few weeks, we have seen public transit picking up.

So those are examples of things that we're continuing to follow, and we believe with our data, we'll be ready quickly identify any new trends that may last post-pandemic and adapt our pricing accordingly.

Charles J. G. Brindamour
CEO & Director

Thanks, Isabelle. Patrick, maybe we can talk about inflation a little bit?

Patrick Barbeau
Executive VP & COO

Yes. In auto, the main driver of inflation on severity continues to be the technology in cars. That increases the cost of parts and the complexity of the repair process, but this is not something new in our view. We've been talking about it for a while. It's what's central to our action plan 2 or 3 years ago. And it continues to put pressure on severity. It is important to mention that we can quickly reflect this trend in our pricing, given our price is specific to each make, model and year. So as new models come out in the market, we leverage our claims data to price that complexity in the parts and repair process even before, I would say, the claims experience actually shows it. We supported that with our actions in claims and supply chain to allow to mitigate that turnover the past couple of years. So overall, we've seen mid-single-digit increase in repair costs over the past year.

With regards to maybe the price of new cars and the inflation of used cars, it is there. But again, here, our pricing can adjust very quickly on the new cars as well as representing the depreciation patterns, if you want, in older model years.

Maybe my last comment is, overall in Q2, when we look at both our experience here in Canada and in the U.K., the total losses, which is where we settle the claims based on market value instead of repairing the car, has seen low single-digit inflation rate. So about half what we see in the cost of repair.

Charles J. G. Brindamour
CEO & Director

Thanks for that, Patrick. So we try to make sure that what we read in the newspaper is not what we talk about in the earnings calls. We have a fair bit of granularity here. And I'll say there's a lot of moving pieces at the moment, and that's the sort of environment that we love because the pricing strategy that we have is super focused and segmented to take into account behaviors. And on the inflation front, I think Patrick and team have done a fair bit to tame some of that inflation over the past few years. And a big chunk of it is reflected in our pricing thought process. The last point I'll make is that there is flexibility at the moment in terms of our ability to react, and I think the team is on top of that.

Paul David Holden
CIBC Capital Markets, Research Division

Got it. Okay. And then my second question is related to the revised CAT loss guidance. Are you able to unpack how much of that is related to the RSA acquisition and how much of it is related to increase in expected claims trends?

Charles J. G. Brindamour
CEO & Director

Yes. Paul, there's not much in terms of increased expected trend. I think it's the makeup of the business at this stage. But I'll let Louis give you a bit of color on that.

Louis Marcotte
Executive VP & CFO

Well, I think that's the answer. It's mostly RSA-driven. So you're taking into account the [Canadian addition] of the Canadian exposures into our Canadian expectations and then the addition of the U.K. perimeter as well maybe a slightly different business mix. When you combine that, this is what drove the increase we shared with you today. So it's much largely the RSA impact that we took into account.

Paul David Holden
CIBC Capital Markets, Research Division

And if I can ask just a quick follow-up on that answer then. Is the mix also different within RSA Canada? It looks like there's a little bit more CAT exposure within their book versus in tax legacy book. Is that accurate?

Louis Marcotte
Executive VP & CFO

No. I would say the -- when we refer to the change in the mix, it's more adding the U.K. volume that more -- has a bigger weight on property. So forecasted adds a bit more than its share from a volume perspective, but the books in Canada don't have a big difference. It's mostly proportional.

Operator

Next question will be from Doug Young at Desjardins Capital Markets.

Doug Young
Desjardins Securities Inc., Research Division

It was stated in the release that there's regulatory reforms coming in the U.K. that could result in some volatility and opportunities for RSA's personal line business. And I think that's early next year. So I just wanted to delve a little bit into that, more specifically, what do you mean by volatility and opportunities?

Charles J. G. Brindamour
CEO & Director

You're right. Yes, these reforms are reforms that will take effect largely at the end of the year and, therefore, early January. They are driven by the FCA, so market conduct regulator in the U.K. Let me give you a bit of context to understand what the intention is there and then maybe share my view on what it means for the marketplace, and this will help answer -- opportunity and volatility are the words that you're interested in. I think if you look at the U.K. personal lines market because this is largely about personal lines, we've seen massive shifts in distribution over the past couple of decades. It's really driven the market to be a price-only type market. And as a result, you see that customer retention or loyalty is much lower than what we're observing in other markets and certainly here in Canada. And there's a lot of pressure to attract new customers at low prices. And so when you put all that together over time, a meaningful disconnect has been created between new customer pricing and existing customers' pricing, which in effect penalizes loyalty. So obviously, that's a problem.

And the FCA reforms, while there are a few pieces, that is the big issue in my mind. It really aims at restoring a better balance between new business and renewal pricing. We think it makes sense, actually, and we support the intent of the regulator. There's debate as to how the rules will be applied and so on as there always is. But we think the intent is a good one.

So what it means for the market and what it means for us, the reforms really are focused on home and auto. We think that because there is a meaningful difference in market practices between new business and renewal, that in January, you'll see significant price dislocation. And new business pricing is likely to go up somewhat materially in my mind, while renewal pricing will go down. The net effect of these changes is yet unclear. It's a very competitive marketplace, and we'll take a prudent approach as we approach this change. But this location, we think, is an opportunity to grow our personal lines portfolio and take advantage of that to improve price sophistication.

So the teams in the U.K. are totally focused in my mind, and we spent a fair bit of time on that, Doug, when we were in the U.K. a few weeks back. Team will be ready. And we're using this opportunity to lend Canadian pricing experts to support the good work of our teams in the U.K.

What we really like about the U.K. personal lines market is the fact that there's tremendous flexibility to modify prices and leverage pricing sophistication very quickly. In fact, much greater than what you can see in most provinces here in Canada. So clearly, our plan, Doug, is to intend -- is to really use all that flexibility to deploy the best science in predictive analytics.

So overall, I think the reform is a positive one for the U.K. personal lines market in the long run. In the near term, it'll be windy. There'll be a fair bit of dislocation. But again, lots of moving pieces. We like that, and I think the team is ready for that in the U.K.

Doug Young
Desjardins Securities Inc., Research Division

And just -- so basically, what I'm getting that to is like when I heard you talked about dislocation, which I've heard you talk about many times, I always think of M&A, and that's really not kind of the focus here. The focus is not when you think of dislocation and opportunity M&A, it's more taking advantage of a change in the marketplace to better your business essentially.

Charles J. G. Brindamour
CEO & Director

Yes, yes. I think that's right, Doug. And M&A depends on the extent of the dislocation in the market. But our comments were far more geared towards day in, day out market activity.

Doug Young
Desjardins Securities Inc., Research Division

Yes. And then second, just on the prior year reserve developments, another quarter of strong results there, and you kind of had your ups and downs over the last few years. It feels like you've adjusted down your guidance in the past. Are we heading into another level here? And can you talk a bit about some of the drivers and what you're expecting in terms of contribution from RSA on the reserve development side?

Charles J. G. Brindamour
CEO & Director

Yes, sure. I think, Doug, it has not been the same number every quarter, I'll say this. There's no doubt about that. When you say up and down, it varies over time. But if you look at the track record and if you look at every year, it's positive pretty much all the time. So I think I want to make sure that this is clear when we look at our historical track record.

Structurally speaking, a lower interest rate environment leads to a lower expectation of prior year development. I think that's one key element that drove the guidance we've provided between 1% and 3% over time. There's a number of moving pieces. We're being cautious. Maybe I'll let Patrick give you his perspective on PYD in aggregate. And then we'll see if it covers the elements of your question.

Patrick Barbeau
Executive VP & COO

Sure. Yes. So Charles was introducing the lower levels of interest rates over the past 2 years and still today, led us to provide guidance in the 1% to 3% range for favorable PYD. On the other hand, over the past few years with pressure -- inflation pressure in auto and more recently, the additional uncertainty around claims and to be specific here, we're talking the indirect effect of COVID-related claims on the long-tail line. We took a very prudent approach in the reserving in that context. So in the short term, this might create a little more volatility in the PYD. But our cautious approach on these aspects give us a very good likelihood in our view to be on the higher part of the range of 1% to 3%. And that's for total IFC, including the RSA book. But probably, we can expect Canada to be slightly above what we will see in the other parts of the book.

Q2 was largely an illustration of this. The -- it was helped by a couple of large files. And the fact as well that in short-tail lines, we always expect to see a bit more of that in the first half of the year than the second one. But I would say largely aligned with reflecting, I guess, that dynamic.

Now the last thing I would say is we need to be careful not to totally isolate PYD from the current year because reflecting additional risk in the reserves in the current accident year is what creates potentially more favorable PYD afterwards if and when the risk does not fully materialize.

Charles J. G. Brindamour
CEO & Director

Yes. I think it's a very good and an important point, Patrick. When I look at the underlying performance of the business today, I think in aggregate, we're not too far off from what the underlying is at the moment when PYD is in.

On the U.K. per se, we spent a lot of time -- a number of us spend a lot of time on looking at these reserves over the past few years. We're quite comfortable with where we are. We strengthened the balance sheet at closing. We bought an adverse development cover. The idea here is not because we were uncomfortable with reserves, it's more with the fact that there's an unknown. We're not from the U.K., we haven't been involved historically. It's an organization that has a long history, and, therefore, there is some unknown. And we felt that having an adverse development cover similar to what we've done in the U.S. was a good risk management practice as you enter a new market. But we're comfortable with the position we've taken in the U.K. and believe have established a degree of caution that's very consistent with how we reserve in general.

Obviously, if you're new in the market, you will take a more prudent approach over time. And that will not be different this time around. That's why our perspective is within the aggregate range, as Patrick said, of 1% to 3%, should be at the upper end, and the Canadian business should, in the near term anyways, help us be at the upper end of that range.

Operator

Next question will be from Mario Mendonca at TD Securities.

Mario Mendonca
TD Securities Equity Research

Louis Marcotte, probably best for you. I'm looking precisely at what Charles just referred to when he said that took a conservative look at the balance sheet on closing. So I've been focusing on Note 4 of your financial statements. And obviously, I'm not going to go through every line. There's a lot of complexity here. But could you speak to the magnitude of the adjustments made to RSA's claim liabilities from what you saw on the financial statements to what you arrived at, the $11.6 billion or $11.7 billion of claims liabilities? Was there a meaningful increase in claims liabilities from what you saw in the financial statements to where you're at today?

Louis Marcotte
Executive VP & CFO

So the word meaningful is may be questionable here. But what we have done in the closing process was, firstly, align our accounting practices between ourselves and the acquired balance sheet. So they weren't necessarily providing for the reserve the same way we were. And we needed to have consistent accounting policies and approaches across. And that drives most of the adjustments we've done. There were some areas where we thought we should top up a bit, which we have done. And this is what I think Charles refers to as strengthening. But overall, I would say, very comfortable in the U.K. perimeter with where they were and just topped up a bit where we thought it was needed. And then in Canada, aligning ourselves between how we viewed, the need for reserves was aligned between the 2 -- those 2 countries. So I won't qualify specifically the magnitude here, but there was strengthening and alignment needed to bring the balance sheet to the same standard as ours.

Charles J. G. Brindamour
CEO & Director

Yes. And maybe, Mario, when I say -- if you look at some of the strengthening we've done, I'd say 2/3 of it is probably Canada and the bulk of it was accident benefit driven in Ontario. And Mario, I think we've taken the street along over the past 3, 4 years on the issues there. We've said that we felt that the industry was a bit late. So we were very consistent with our observation with the RSA reserves. And then a third in the UK&I market focused on longer tail lines of business, commercial liability, just to make sure that we were on par with how we otherwise would have reserved.

Mario Mendonca
TD Securities Equity Research

Yes. My inclination and sort of the nature of the question is not so much that I think the company wasn't conservative, but rather that the company has been very conservative in so far as like how this acquisition was accounted for. But maybe more generally, where I'm going with this is, the PYD in personal auto and PYD generally has been good, and we've talked about that a little bit on this call. I understand that that's not unique to Intact, that the industry as a whole seems to have been somewhat conservative in setting up the IBNR in personal auto over the last little while. So the nature of my question is this can an industry experiencing this level of PYD apply for pricing increases? Are those 2 things -- can you actually do those 2 things simultaneously, record big PYD and apply for pricing increases at the same time?

Charles J. G. Brindamour
CEO & Director

So you can. And so I think, Mario, if you go back to the industry results right to June 2020, there was adverse development. And I'm talking automobile insurance in particular. And if you look at PYD for us in automobile insurance, indeed, so far in 2021, we have 3.5 points, a favorable development. And not that I want to bring back all the hard work we've done in the 3, 4 years before that, but what you will see is that the PYD in the few years before that was out of sync with the historical context because of inflation. It was essentially flat.

And therefore, pricing -- so how does pricing work? Pricing works in the following fashion. You go back, you take 3 to 5 years, the last 3 to 5 years, you project them in the future, and you use that to figure out whether your prices are adequate. And I would suggest that if you look at the past 5 years, where there's been no favorable development or adverse development at the industry level, you project them in the future, you restore performance for driving. The answer is, if you do your job properly from an actuarial point of view, you can have favorable developments in a year and see great increases over time. Now there's a lot of actuaries in this call. If I'm wrong, guys, you can correct me, but the mechanics of this would suggest you can.

Operator

Next question will be from Tom MacKinnon at BMO.

Tom MacKinnon
BMO Capital Markets Equity Research

Yes. Just to start off, just to be clear, the increase in the CAT guidance has nothing to do with your NOIPS accretion that you're expecting from the RSA acquisition. Is that correct? So I mean, we -- that was all factored in, but you're just announcing that to the street, but all that $570 million CAT stuff is factored in when you did your NOIPS accretion, correct?

Charles J. G. Brindamour
CEO & Director

Correct.

Louis Marcotte
Executive VP & CFO

100%.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. I just wanted to make sure everybody is clear on that. Now as you look further at the RSA portfolio, in particular, the $250 million in expense synergies doesn't have anything to do with improving the loss ratio at RSA or really improving the yields at RSA. Do you have any update as to what the potential is for those kind of improvements as you've gone another 3 months here with digging into these portfolios?

Charles J. G. Brindamour
CEO & Director

Yes. Tom, thanks for your question. It's the daily question at Intact, and we want to make sure we leave nothing off the table, to be clear. But why don't I ask Louis to share his perspective, and then I'll add some color.

Louis Marcotte
Executive VP & CFO

Thanks, Charles. So on the $250 million, so that number is still the target we're aiming for. You're right, it is largely expense-driven. And we have not yet updated any guidance for loss ratio improvements. Those are the ones we're working on, but they may be a bit longer to develop as we study the data and compare it to ours. I am the one asking the question to Charles every day and how I can reflect that in my estimates. But still waiting for those estimates to come back. But at this point, we're sticking to the expense synergies of $250 million, working on making sure that those are delivered as quickly as possible. And our visibility on those is quite strong. So we're not -- we're very confident in realizing that. And then the loss ratio ones will be incremental to those synergies.

Charles J. G. Brindamour
CEO & Director

Yes. On the expense side, given where we are in integration, I'm very comfortable with those because we have the bottom-up view of the synergies we can generate on the expense side of things. We're tracking that on a monthly basis and a process we're very, very familiar with. On the loss ratio front, it's clear that there are opportunities here. We're moving fast in bringing the business on our platform in Canada and in the U.K. I mean, we've done a lot of work with the team in the past few months. It's been demanding. No doubt about that for the team, but they had really good momentum. I'm very pleased with the action plans they have. We've got detailed metrics to keep track of the performance improvement plan, and I see some upside in the UK&I portfolio as well. Now I think that the upside in my mind is good, and we'll try to get as much as we can. And the market, I think, is conducive. I see this also as a way to offset potential surprises. So we want to refrain at this stage from updating views on accretion and loss ratio improvement, but we're certainly focused on those.

Tom MacKinnon

BMO Capital Markets Equity Research

And the yield performance? Or the -- any way of increasing the yield on the RSA portfolio? It was pretty low.

Louis Marcotte
Executive VP & CFO

Yes, absolutely. So we're working on this. We're working on the asset mix. Of course, we've reset the yields to the current yields upon the acquisition. So that took them down to market yields essentially. But as we integrate the portfolios together, we are moving to a bit more of an Intact mix over time. And we are sort of leveraging some of the opportunities and expertise they have at RSA to move it up. At this point, our guidance reflects some of the asset mix that will be taking place in the next 6 to 12 months. That was in my $100 million investment income I shared with you earlier. And then we're going to be working on trying to optimize that a bit further and creep it up. At this point, though, we're sticking to the $100 million for the next -- for this year at least.

Charles J. G. Brindamour
CEO & Director

Yes. So Werner Muehlemann and Dave Tremblay, who run the asset side here at Intact have been totally on top of the integration. First order of business, obviously, is governance and the operational integration of the asset side, done a big asset optimization exercise in the past few months. There are, indeed, opportunities. As you know, our thought process on the asset side is total after-tax return optimized for regulatory capital requirement, local tax regime and obviously, risk. And so the fact that we're operating across really 3 big platforms creates opportunities to optimize the mix. We've got a plan for that, and we'll start to execute on it in the coming weeks.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And the quick follow-up is on the integration costs. Were those $35 million in the quarter because I think that's what you said, because it shows acquisition integration, restructuring costs as being $138 million in the quarter. So maybe you can describe what the differences are and whether how recurring this $138 million number in this quarter will be?

Louis Marcotte
Executive VP & CFO

So the $138 million includes the acquisition costs as well for the transaction. So it's the acquisition part of the expense. There are also some integration from prior acquisitions that are still going in there. And specifically for RSA, it was $35 million and then what we expect in the future quarters. Not so much on the other restructuring costs, but on the RSA one is what I guided to half of the guidance of 1.5 to 1.7x synergies.

Tom MacKinnon
BMO Capital Markets Equity Research

And no acquisition costs that would have been baked into the second quarter number, I assume, correct?

Louis Marcotte
Executive VP & CFO

They're largely done.

Operator

Next question will be from Jaeme Gloyn at National Bank Financial.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Just a couple of quick clarification questions first. The CAT guidance increasing from $300 million to $570 million. Did you state how much of that increase is in Canada and how much is in UK&I?

Louis Marcotte
Executive VP & CFO

We have not. We sort of stayed away from that and simply because this -- the perimeters give us a bit more diversification opportunities. Not sure whether those spike in one country or the other. So we stuck to an overall team and provided guidance in terms of [personal] and timing, but we stayed away from the countries.

To be fair, if I was to model something, maybe I put 2/3 in Canada, 1/3 in the U.K., but we're sort of not committing to it in terms of being a firm commitment here. It's more of a -- bit of a guidance. Rather than that, I wouldn't go further than that.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Understood. And then in terms of the Denmark asset sale, is the valuation of that asset -- and I'm assuming there's a gain that will be attached to it as part of the transaction, is that in the book value as you stated today? Or should we expect to see a gain on Denmark in the next year when it closes?

Louis Marcotte
Executive VP & CFO

So the asset -- our share of the asset is recorded on the opening balance sheet at the value that was agreed upon with our partner, Tryg. So that's how the value there comes up. The transaction has been announced as not closed yet, so there's a couple of conditions to get to closing, and that's expected somewhere early in 2022, probably end of Q1 or early Q2. And the difference between the price agreed to on the sale and the value that we've agreed to with Tryg will be recorded at that time of closing.

Charles J. G. Brindamour
CEO & Director

Yes. I think what I mentioned in my remarks, Jaeme, is that when this transaction at the aggregate level, from an economics point of view, should help the IRR by 1.5 points. And as a result, if you're consistent, then you would expect a gain when we close.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. Good on the same page on that front. In terms of the distribution income in this quarter, significantly higher. Can you break out or walk us through the drivers of that gain in commissions on variable revenues to sort of explain what that is? And then how much is On Side contributing to the upside here?

Louis Marcotte
Executive VP & CFO

Thanks for the question, Jaeme. So quite happy with the growth here we're seeing in our distribution income, very well aligned with our objective of growing distribution and to add a strong earnings stream that supports our mid-teens ROE. So this is clearly going in the right direction. It grew 51% in Q2, and I would say about 33% of the 51% -- or 33 points of the 51% is really driven by the variable commissions that has been part of our underwriting performance so far. So you see it in the insurance business with an extra expense ratio or a higher expense ratio from commissions, and this comes back in the distribution income. And of the 51%, 33 points are driven by these variable commissions. The -- there's another 13 points that's driven by what we consider to be organic growth of the business. And you'll recall last year in the second half of the year, we had a pretty solid organic growth in our distribution network, and this is carrying on in the first half of the year. So those are the 2 main drivers.

You asked about. On Side. So interestingly, On Side, you remember when we bought, it was meant to be a countercyclical earnings stream when we had multiple CAT events. Well, half year 1 has been fairly quiet on the weather side. So On Side has been probably a bit more quiet than we wanted. So it has not been a huge contributor to the growth in Q2 so far. There's lots of potential for On Side going forward and particularly with the RSA acquisition. But from a Q2 point of view, it's not a big driver.

The last comment I'll make there is, of course, 51% looks really good. It is, but we're also comparing to Q2 last year, which was a tough quarter from a distribution point of view. You might remember, we were very cautious in our earnings expectation there, given the uncertainty around COVID. So not only we have good variable commissions, we have good organic growth, but we're comparing to a weak Q2 last year. So those are the main drivers. And I would say we're guiding right now to 10% to 12% growth in the second half of the year. And that's really taking into account that last year's H2 was very strong. And if you combine 10% to 12% growth in H2 with what we've done so far to date, this business is growing north of 25% for the full year. So big contributor to our earnings growth.

Charles J. G. Brindamour
CEO & Director

Thanks, Louis. I think there's a couple of things that are worth highlighting in this. The organic growth of BrokerLink is really strong and clearly commercial lines hard market is helpful and really conducive to strong performance in distribution. It might be good, Darren, if you highlight your view on the state of the commercial lines market. And the other point I think we should touch on is because we're bringing On Side into the question, just to help you visualize what we can do with On Side. I'll ask Patrick to talk about what's going on in BC in Lytton and what can be done. So Darren, maybe quickly.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Yes. Thanks, Charles. I mean I think I would describe the conditions in Q2 as very consistent with Q1. Hard market, north and south of the border. Our capacity continues to be tight. Rate increases are very consistent from Q2 to Q1. And we see no signs of that abating at all and really strong performance from a rate standpoint north and south of the border. Now obviously, you've got to be careful in terms of the portfolio in the U.S. compared to some of the other benchmarks that are out there. I mean, different segments of the portfolio are quite strong. I think I mean accident is one area that due to profitability, there's a little bit of pressure from a rate standpoint. But again, that's a line of business that's operated consistently in the '80s, so no surprise there. But otherwise, outside of that, we're pushing well into the double-digit range in other lines, and that's very consistent with what we've seen in the last quarter, but also in the last 12 months prior as well.

Charles J. G. Brindamour
CEO & Director

And we're seeing good strength in the U.K. as well. Maybe on, On Side, Patrick.

Patrick Barbeau
Executive VP & COO

Yes, just to illustrate a little bit. We talked, I think, in the remarks about the wildfire in Lytton, BC, that happened in the last few days of the quarter in June. First of all, just to reiterate that the full estimate of the ultimate cost, that was reflected in Q2. But from an operational perspective, we were able to deploy our internal CAT team, but also our national capacity of On Side to support the team of Lytton. Examples of what this brings to the response is On Side has been retained to provide all the security fencing and checkpoints in the city. We've been retained as well by the Lytton First Nation to coordinate all the white goods removal, fridges and freezers which always require [indiscernible] and [laying], and we continue to work very closely, both with our internal CAT team and On Side with the [Talent Lytton] and Lytton First Nation as well as Team Rubicon, who is an organization of military veterans who's leading the response for the industry there. So we've been deploying a lot of capacity to support our customers who are facing obviously a difficult time.

Charles J. G. Brindamour
CEO & Director

Thanks, Patrick.

Operator

No further questions, Jaeme?

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Well, actually, if nobody else, I did want to touch on one aspect, and that's the ROE objective, 500 basis points. I presume that applies to all of -- or each of Canada, U.S., U.K., and I was just hoping you could dive into what that means from an ROE perspective in each geography and perhaps any time lines around that?

Charles J. G. Brindamour

CEO & Director

Well, that's a good question. We're firm on the ROE outperformance objective of 500 basis points every year. That's the first point. As you know, outperformance, Jaeme, is a mindset, and it's driving the strategic choices we're making, the investments we're making on the data front, on the AI front, risk selection, claims and supply chain management. No change. And this is the lens we use when we go into other markets as well. So if you look at the work we've done and the work we'll do with Scott and team, we're really focused on risk selection. And we're working with Karl Helgesen. Really strong, the claims had the -- of the U.K. business as well to help them create outperformance there. So there's no change. Obviously, our outperformance position in Canada is really strong. And as we increase our scale advantage will be now 2.5-ish times bigger than number 2. This is really helpful to expand our advantage. We'll be focused on this.

If you look at the U.S., in the U.S. from my perspective, we have created now close to 4-ish points of combined ratio advantage against our peers in specialty lines. I don't think we're 100% there, but we're clearly well on our way. And I think in the U.K, we'll need probably 3-ish years in my mind to go from being in the industry back to creating some distance. And that is the definition of success for us.

So a bit of headwind, I would say, in terms of ROE of performance as you enter new jurisdictions. But I think there's no doubt as to what success looks like, and this shapes where our time, our energy and where money goes.

Louis Marcotte
Executive VP & CFO

I can add, Charles. So operating basis is still aiming for that mid-teens level and confident that we can maintain that in the current environment. So I think that's strong. When we look at outperformance, what we're building now is, in fact, a blended industry ROE that will integrate a weighted level of industry are we in the U.S. and then eventually industry are we in the U.K. that we'll compare ourselves to. So publicly, because remember, we manage our balance sheet centrally from -- all the asset is essentially managed centrally. And therefore, the ROE of IFC is the one we want to compare to. And the best comparative for us would be a blended ROE between the 3 parameters we operate in. So we're building that and trying to build it. It's difficult to have industry -- good industry data in the U.K. right now. But we're putting those together, and you'll see them getting published more and more over time in our financial report. So you'll be able to see how we track. But I would say most importantly, on the operating ROE part, that is still firmly in the mid-teens range going forward.

Charles J. G. Brindamour
CEO & Director

Yes. I think it's important to keep in mind, outperformance is the mindset. But at the end of the day, if outperformance leads in certain jurisdictions to single-digit ROE, it's not good enough. And we're not shying away from being rewarded for the risk we're taking even if we outperform. And I think there's work to be done, but those 2 core principles are the lenses we're using to assess the footprint at the moment and how we're positioned in each market where we operate.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

That's a great answer and look forward to the upcoming disclosures.

Operator

And at this time, Mr. Anderson, we have no other questions. Please proceed.

Kenneth Anderson
Executive VP of Corporate Development & Investor Relations

Well 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. Transcript will also be available on the website in the Financial Reports and Filings section.

Lastly, we'll be hosting an Investor Day on Tuesday, November 30. The event will be held virtually and will be accessible via the webcast. More details on the 2021 Investor Day will be available on our website in the coming weeks, and we look forward to welcome you at -- welcoming you at the event.

Finally, our third quarter 2021 results are scheduled to be released after market close on Tuesday, November 9.

So thank you again, and this concludes today's call.

Operator

Thank you, Mr. Anderson. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines.