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Earnings Call

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Call Participants

EXECUTIVES

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Louis Marcotte
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Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Intact Financial Corporation Q3 2023 Results.

[Operator Instructions]

Note the call is being recorded on November 8, 2023 and I would like to turn the conference over to Shubha Khan, Vice President, Investor Relations. Please go ahead.

Shubha Rahman Khan
Vice President of Investor Relations

Thank you, Cindy. Hello, everyone, and thank you for joining the call to discuss our third quarter financial results. A link to our live webcast and materials for this call have been posted on our website at intactfc.com under the Investors tab.

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.

To discuss our results today, I have with me our CEO, Charles Brindamour; our CFO, Louis Marcotte; Patrick Barbeau, Executive Vice President and Chief Operating Officer; Darren Godfrey, Executive Vice President, Global Specialty Lines; Guillaume Lamy, Senior Vice President, Personal 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 over to Charles.

Charles Joseph Gaston Brindamour
CEO & Director

Thanks, Shubha. Good morning, everyone, and thanks for joining us today. Canadians across the country were once again faced with severe storms, floods and wildfires in the third quarter. As always, our teams played an essential role in getting customers back on track. And it's precisely in these moments that we're able to put our purpose into action and help people, businesses and society be resilient in bad times.

Against this backdrop, our business once again demonstrated remarkable resilience. Yesterday evening, we announced net operating income per share of $2.10 for the quarter despite elevated CAT losses. Our undiscounted combined ratio was 98.3%, and included 12 points of CAT losses, roughly 8 points higher than expected.

That said, we were able to deliver an operating ROE of 12.2% despite a 3-point impact from CAT. I'm also encouraged by strong topline momentum across our platform. Premium growth in the quarter stood at 8%, excluding strategic exits largely driven by rate actions across all lines of business as well as improving unit growth in personal lines.

Let's now look at each of our lines of business, starting with Canada. In personal auto, growth and profitability are developing largely as we expected. Premium growth accelerated to 9% in this quarter, up 3 points from the preceding quarter and a full 10 points from a year ago.

This was driven by high single-digit rate increases as well as unit growth, which has benefited from our improved competitive position. The combined ratio of 95.4% in the quarter was well within guidance if you consider a 2-point negative impact from excess CAT losses and industry pools.

Inflation pressures continued to moderate, slowing to mid-single-digit range in Q3. This was running at 8% only a quarter ago and had peaked at 13% in Q3 last year. In the quarter, the improvement was primarily due to normalizing vehicle prices as well as lower repair costs supported by our integrated supply chain. At the same time, earned rate and insured values increased 8% in aggregate during the quarter, outpacing inflation and driving an improvement in the current accident year loss ratio.

Going forward, we expect rent increases to continue covering inflation and remain comfortable with our sub-95 guidance for this business.

Moving now to personal property. Premium growth was 7%, mostly driven by our rate actions and supportive market conditions.

The combined ratio of 124%, included 34 points of CATs in excess of expectations. Adjusted for excess CATs, the result was otherwise consistent with our strong track record in this business.

Including this year, our combined ratio has averaged sub-90s over the last decade. We believe we've been rewarded for the volatility in this segment and we remain well positioned in the current environment. Elevated severe weather activity and ongoing inflation pressures are also expected to sustain hard market conditions.

Rates and insured values in aggregate will reach the low double-digit range by year-end and expect that our pricing and product actions as well as claims expertise and supply chain capabilities will allow us to sustain our strong track record over time.

In commercial lines in Canada, topline growth of 7% was driven by our rate actions in hard market conditions as well as strong retention. The combined ratio of 92.7% included 13 points of CAT losses, nearly 3x the expected level.

Our underlying performance was strong as a result of our profitability actions over time. This business remains well positioned to deliver sustainable low 90s or better performance.

Moving now to our UK&I business where we delivered a solid combined ratio of 92.5% in the quarter. In Commercial Lines, underlying premium growth was 8%. We continue to benefit from hard market conditions, which are supporting mid- to high single-digit rate increases, particularly in Specialty Lines.

The combined ratio of 90.6% reflected strong underlying performance, which offset an unusually high level of adverse prior year development, which Louis will explain in his remarks. On October 26, we successfully closed the acquisition of Direct Lines brokered commercial lines operation, doubling down on our outperforming Commercial Lines business in the U.K. The transaction enhances the growth profile and profitability of the UK&I platform, which is now better positioned to sustain low-90s performance.

In Personal Lines, premiums grew 13% adjusted for the impact of our U.K. motor market exit earlier this year. This was driven by rate actions in a clearly firming market which also helped drive the combined ratio of 96.6%. We continue to expect the business to deliver upper-90s performance in the near term. As we announced in early September, we're evaluating strategic options for the U.K. Personal Lines business, including a possible sale. We're making very good progress and expect to provide details in the coming weeks.

In the U.S., our business grew 13% in Q3, driven by our rate actions and strong contribution from last year's Highland acquisition. The combined ratio of 88.5% reflected rate actions over time and strong growth in our most profitable lines. While conditions in certain segments have softened, the market overall remains hard, particularly in Special Property, our Builder's Risk business unit as well as Ocean Marine.

In the next 12 months, market conditions in most lines are expected to remain hard, given higher reinsurance costs, elevated CAT losses and inflation. And we remain well positioned to continue delivering low-90s performance or better in the U.S.

Looking at our Global Specialty Lines overall, premiums grew 11% with a combined ratio of 88% for the quarter. Performance was especially strong in the U.S. and the U.K. Through our continuous focus on profitable growth, together with our investments in pricing sophistication, we expect to generate sustainable sub-90s combined ratio over time.

Turning to our strategic initiatives. We continue to invest in our business to transform our competitive advantages and maintain our strong outperformance. We strengthened our supply chain capabilities in the quarter, again, opening 3 new Intact service centers and bringing the number of total locations to 27. In addition to improving customer experience, these centers reduced cycle times by up to 30%, supporting our sub-95 guidance in personal auto.

We also bolstered our data and AI capabilities by expanding machine learning to our pricing models and commercial property and deploy new predictive pricing models for Specialty Lines across all of our operations.

On the climate front, we have a strong track record with a 10-year average combined ratio sub-90s in personal property, our most CAT-exposed line. We've achieved this by facing into changes in weather patterns well over a decade ago, transforming our business and turning the change into an opportunity. This involved pricing, product design, data expansion as well as transforming our claims operation and building our supply chain. And I believe we're well positioned prospectively.

In the spirit of pro-activity, given the intensity of this summer, we've tested our value proposition to make sure we can grow profitably and sustainably in this segment and maintain the track record of the last decade. And to do that, with the latest climate science, we've modeled the implications of global warming reaching well north of 3 degrees, double the aspirational target set by policymakers. And based on our work so far, I'm not concerned about our ability to maintain strong growth and underwriting margins over the next decade, consistent with our track record of the past decade.

In the more immediate term, I see a lot of resilience across our business as well as strong growth momentum. Despite unusually elevated severe weather activity, we've delivered mid-90s underwriting performance so far this year and an operating ROE north of 12. And with hard market conditions across all lines, the growth and profitability outlook is favorable. As we look ahead to '24, I'm confident we'll continue to grow our net operating income per share by 10% per year over time and outperformed the industry ROE by at least 500 basis points.

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. Our third quarter results showed excellent underlying performances across all lines of business and I'm pleased to see the topline momentum in Personal Lines. Growing income from our investment portfolio and reliable income from our distribution assets helped drive a healthy operating ROE of 12%.

In the context of the unusually challenging operating environment over the last 6 to 12 months, these results demonstrate not only the resilience of our operations, but also our ability to deliver profitable growth going forward.

CAT losses in the quarter were $611 million or nearly 12 points of net underwriting revenue, primarily due to a mix of wildfires, floods and hailstorms across Canada. As Charles said earlier, we are updating our models with the latest data collected from our claims activities and combining them with science-based predictions. It's still early, but we are confident in our ability to mitigate the impact of climate change using all the tools at our disposal even when using very conservative assumptions.

With that in mind, we see changing weather as a challenge but also as a topline growth opportunity as people, businesses and communities have a growing need for protection and restoration. In this environment, we believe we can maintain our track record and continue to deliver mid-teens operating ROE.

This will be reflected in our updated GAAP guidance, which we will provide in February 2024, along with our Q4 earnings release. Favorable prior year development remains healthy at 3.6% for the quarter but slightly lower than in the recent quarters, primarily due to adverse development in our UK&I business.

A few specific large claims impacted our UK&I Commercial Lines in the quarter. But prior year development remained favorable on a year-to-date basis, which is probably the best way to see how this business is performing. In UK&I Personal Lines, there was adverse development on claims related to the freeze event of December last year as well as on some subsidence claims.

That said, we remain comfortable with our reserving position in both portfolios and do not see unfavorable development in the UK&I this quarter as indicative of a trend. For IFC as a whole, the overall level of prior year development continues to reflect our prudent approach to reserving, and we expect PYD to be in the 2% to 4% range over the near to medium term.

The consolidated expense ratio was 32.9% in Q3, down modestly from last year due to declining variable commissions with an offsetting impact on distribution income. The year-to-date ratio of 33.7% was right in line with our expectations, that is in the 33% to 34% range. Operating net investment income increased by 50% in the quarter driven by higher portfolio turnover and higher rates captured over the past 12 months.

For the full year, we continue to expect investment income to be approximately $1.3 billion, we expect this tailwind to continue into 2024, and I'm happy to share that we expect investment income to grow to around $1.5 billion for 2024, assuming normal portfolio turnover and stable rates.

Distribution income was $116 million in the quarter, up 3% as contributions from recent acquisitions and On Side were offset by lower variable commissions, as I discussed earlier. The pace of acquisitions has been slower to start this year as we have been disciplined in a hot M&A market. Nevertheless, the pipeline remains strong, and the pace of acquisitions is picking up.

In Q3, we closed 7 transactions representing nearly $200 million of premiums. And subsequent to quarter end, BrokerLink completed its largest acquisition to date in Western Canada. As a result, we expect growth in Q4 distribution income to be strong, resulting in growth of around 10% for the second half of this year.

Looking at 2024 and beyond, we expect growth to continue at around that level. Finance cost and other operating expenses amounted to $97 million in the quarter, up 10% year-over-year, largely as a result of higher interest rates on short-term debt. Overall, net operating income per share of $2.10 was down $0.68 from last year, but that's after absorbing $1.60 of additional CAT losses, a testament to the strength of our underlying results.

In addition, earnings per share was $0.83 after reflecting unfavorable market movements, rising rates, restructuring costs related to our U.K. motor exit and adverse development on exited portfolios. As you know, it's been a busy year for us, particularly with respect to the UK&I business. After exiting motor in Q1 and derisking the pension plan in Q2, we have now doubled down on the attractive Commercial Lines segment by acquiring Direct Lines broker-distributed Commercial Lines business. Clearly, a good strategic fit, but I also like the financials. IRR above 15%, immediate book value per share accretion of 2% and slightly positive to net operating income per share in 2024.

Although small for IFC as a whole, it is meaningful for our U.K. operations. We expect the transaction will generate GBP 100 million in additional net operating earnings in 5 years, which represents a mid-teens operating ROE for the UK&I, quite a change from the business we acquired in 2020.

Moving now to the balance sheet. Overall, our financial position continues to be strong with total capital margin of $2.8 billion at quarter end, this reflects capital issuances in September to fund the U.K. Commercial Lines acquisition. The adjusted debt to total capital ratio stood at 22.7% and approximately 24% on a pro forma basis reflecting the closing of the Direct Line transaction subsequent to quarter end.

We expect the ratio to return to our long-term target of 20% in the next 12 to 24 months through ongoing capital generation. I'm pleased that the strength of our balance sheet and resilience of our operations are also being recognized by rating agencies.

DBRS recently upgraded our financial strength ratings by 1 notch to AA while Moody's improved its outlook for IFC to positive from stable. It's been a tough year for our book value per share so far. Although it grew 1% in the quarter in challenging circumstances, the trajectory from the start of the year was tempered by elevated CAT losses, unfavorable capital markets, including rising rates and the impact of the pension volume.

These were offset by otherwise solid operating earnings and a successful equity issuance to support the U.K. Commercial Lines acquisition. The good news is that our earnings' power is not adversely impacted by any of these headwinds. On the contrary, industry conditions are supportive, topline momentum is strong, investment income continues to grow and distribution results should deliver double-digit growth. If CATs behave as we expect, I see our business delivering solid ROE next year and that will reenergize our book value per share growth trajectory.

In summary, I'm proud of the strength demonstrated by the business this quarter, which weathered a multitude of CAT events while at the same time, delivering on key strategic objectives and driving profitable growth in all segments. Given the strength of our platforms, the incredible talent we have across geographies and guided by a clear strategic road map, I am confident that we can return to a 10% net operating income per share growth trajectory as soon as next year.

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

Shubha Rahman Khan
Vice President of Investor Relations
Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would ask you to limit yourselves to 2 questions per person. You can certainly reach out for follow-ups, and we will do our best to accommodate if there's time at the end. Mr. Louis, we are ready to take questions now.

Question and Answer

Operator

[Operator Instructions]

And your first question will be from Paul Holden at CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

I want to ask a first question on personal auto. And maybe you can just highlight sort of what the earned premium rates are coming in at versus the written and versus claims inflation. And if the results are what expect, i.e., what you guided to last quarter and you've done already a sub-95% combined year-to-date, like why shouldn't it be something even better in the next 12 months?

Charles Joseph Gaston Brindamour
CEO & Director

Guillaume, do you want to share your perspective?

Guillaume Lamy

Yes. So results in the quarter were 95.4% for personal auto. There's about 2 points that we called out on CAT and industry pools. So that brings up well within guidance. So from a rate perspective, written rates stayed elevated in the high single digits, similar to the last couple of quarters. And what we've seen is the earned rates accelerating and also reaching high single digits during the quarter. From an inflation perspective, we've seen it decreased quite steadily.

I think Charles mentioned in his opening remarks that it went from 13% last year, 8% last quarter and mid-single digits this quarter. So we're seeing with the rates of 8% -- the earn rate of 8% and inflation in the mid-single-digit improvement there and margin expansion as the 2 lines have crossed. So we see that in the current accident here about 1.5 points when we reflect pools and we're pretty comfortable with that.

Going forward, we expect our rates to cover inflation, which will allow us to continue to deliver solid underwriting results. Now your question or the second part of your question was around expansion. I think there's a few factors that we're keeping an eye on like short tail inflation is stabilizing. That being said, there's still volatility around long tail. So we're remaining prudent there.

Our risk strategy is pretty robust, expect, as I mentioned, to cover inflation. But there, we remain dependent on regulators and have we seen in some market like Alberta, there's a bit of outlier there, but most regulators are rational. So I'd say that's why we're confident at this point with sub-95%, but not seeing a reason to get to lower than that.

Charles Joseph Gaston Brindamour
CEO & Director

I think specifically to your first question, at this stage, correct me if I'm wrong, Guillaume, there's about 1 point spread between written and earn, which will earn itself in the coming period. We like the operating environment. And at this stage, you're seeing the growth has really picked up in personal automobile. And so we want to capitalize on that, but we feel good about the performance of that segment.

Paul David Holden
CIBC Capital Markets, Research Division

Understood. And then second question is related to personal property and the use of reinsurance and a couple of disclosures you added this quarter kind of caught my attention, 20 CAT events this year that were below your reinsurance threshold. And you also called out only 4 CAT events in the last 10 years would have reached the retention threshold. So the obvious question reading that, I think to myself is why not lower the retention threshold to reduce some of this earnings' volatility and to make the book value growth maybe more consistent from year-to-year.

Charles Joseph Gaston Brindamour
CEO & Director

Paul, I think we're using reinsurance for tail event. Because we're comfortable with our pricing in terms of the direct business. From time to time, we look at the pricing for reinsurance solutions that would limit volatility. But quite frankly, we prefer to keep the margin. And if you look at personal prop, we're saying sub-90s. It's actually 89-ish with this -- these results at the end of September '23. We prefer to keep the margin at this stage.

It's clear as we look out in the next 10 years, alternatives to share risk will be looked into. But if we can run that business in that zone, which we think we can, which generates return on capital, which in my mind starts with the 2, I think we want to keep most of that for us. We'll just need to explain volatility for quarter to quarter, but it's been a great business in the last decade.

Operator

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

Jaeme Gloyn
National Bank Financial, Inc., Research Division

I wanted to ask a question on distribution and expense ratio. So with distribution growth, obviously, a little more tepid this quarter.

Can you quantify -- I'll use the term drag from variable commissions in distribution. And then how did that tie into the expense ratio as well? And my view would be you would prefer to have lower variable commissions through distribution with the offset that your expense ratio looks better. But maybe walk through some of those moving parts and what you would rather see on an ongoing basis.

Louis Marcotte
Executive VP & CFO

So the drag, just to answer the first part, Jaeme, the drag was roughly 4 points in the quarter. So if you take the actual growth of 3 plus a drag of 4%, there is underlying growth of 7%. And we've tried to explain that around, I will say, a bit late M&A, our activity later in the year, that's why it's going to grow in Q4, so that's roughly the drag. The relationship with the expense ratio, I would say, was somewhat directional in nature. They're not directly linked. It's a bit tricky to...

Charles Joseph Gaston Brindamour
CEO & Director

But the commission ratio would be linked to that -- it is not like...

Louis Marcotte
Executive VP & CFO

We don't mathematically put them together. The timing is not always perfect in the end. And the scale is not the same either. Because the distribution income is a portion of our broker lines while we pay commissions to all the brokers on the distributed business. So that's really the relationship between the 2. There's more benefit if we would have a lower overall expense or commission ratio because of the scale. But we actually like to see our -- the offset coming from our brokers returning some of that margin back to us through the distribution income.

Charles Joseph Gaston Brindamour
CEO & Director

I think it's well said, we saw high level, directionally, you're right. And if you look at our net commission, it's down a bit, and a portion of that is the fact that variable commission might have come down a bit.

It's directionally hitting distribution income the other way. One should not look at 1 quarter but at the trajectory. And I think Louis was very clear about the trajectory, which is 10-ish percent for the second half of '23.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. Great. Second question, I think, Louis, you talked about UK&I, are we generating mid-teens ROE at this point? I might have missed some of the color around that comment, but can you break down the drivers of that mid-teens ROE in the U.K. platform where you are today? And then I guess, what that looked like 3 years ago, I guess, on the acquisition of RSA?

Louis Marcotte
Executive VP & CFO

Sure. So firstly, my comment is really talking forward-looking as we are repositioning the business towards a Commercial Lines-focused area. So it's not necessarily today, but it's what we have in plan that's going to drive us there. So it's the additional earnings plus the capital base that we have been able to rationalize over time through different actions, but we're reducing the overall capital level deployed in the U.K. to be able to optimize it and then additional earnings' power from the repositioning towards Commercial Lines will drive towards that mid-teens ROE.

Charles Joseph Gaston Brindamour
CEO & Director

And the improvement of overall underwriting performance across the board. Ken, I don't know if there's more color you want to add there?

Kenneth Anderson
Executive VP & CFO of UK and International

No, that is -- I mean, as Louis have said in relation to the Direct Line Broker Commercial acquisition when you put that together with our existing Commercial Specialty Line business, driving for a 92% combined ratio in 2024, coupled with the investment income at the U.K. platform is generating by the capital base at work in the U.K. we're aiming to be in the mid-teens zone in 2024.

Charles Joseph Gaston Brindamour
CEO & Director

We're already in the teens and I think if we look at the repositioning that both Ken and Louis are talking about. What I see here is a better anchoring around mid-teens, better growth, less risk, and that's why strategically, this move makes a lot of sense.

Operator

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

Doug Young
Desjardins Securities Inc., Research Division

So my eye twitches a little bit when I hear about Canadian personal auto and adverse pool impacts because of history and -- so I apologize for maybe digging into the reads on this one. But can you talk a bit about what happened in personal auto around the pools? Like, can you quantify what the negative impact was? Yes, is there an issue with any of the pools in Ontario and Alberta? So just hoping to get a little bit more detail on that.

Charles Joseph Gaston Brindamour
CEO & Director

Yes. No issues. Directionally, you shouldn't see much of an impact there. It changes from quarter-to-quarter. Guillaume will give you his perspective on that.

Guillaume Lamy

Yes, pools were about 1 point higher than expected this quarter, driven by really the assumed results of what we assume from the industry pools as they adjust reserve levels mostly on the current year, reflecting the trends in the market. So I think pools bring volatility from quarter to quarter.

On a year-to-date basis, it's pretty immaterial and no cost for concerns. And we do have visibility on what's coming in Q4, although not final, and we expect it to be material as well. Immaterial, yes, exactly. So we don't expect that to be an issue going forward. And again, this year, if you look at the year in total, it's not an issue.

Charles Joseph Gaston Brindamour
CEO & Director

Louis, do you want to add any color here?

Louis Marcotte
Executive VP & CFO

Well, I'm one who thought we should call this out simply because we're so specific on our guidance of sub-95%. It happens this quarter, we're printing a bit above, and the pools happened to be a bit of a headwind in the quarter, which we had not anticipated in our guidance, and that's why we're calling it out a bit the same with the excess CAT. So there's no issue behind it. It's purely to -- compared to our guidance and explain what drove it slightly away from the printed number, but that's it. Nothing to read in -- year-to-date -- there's no nothing there.

Doug Young
Desjardins Securities Inc., Research Division

Okay. So there's no adverse reserve development issues or reserve issues that should be...

Charles Joseph Gaston Brindamour
CEO & Director

No.

Doug Young
Desjardins Securities Inc., Research Division

Okay. And then my second question, I think I've asked this in the past, and the exited lines is something that we just keep an eye on. And the underwriting loss here which is not in your operating numbers has been growing. And I kind of get what you're doing. But how long does it take to kind of run this off? Or is this just something that ex bid line losses are always going to average give or take, between $20 million to $30 million per quarter? Just trying to figure out how to kind of think about that.

Charles Joseph Gaston Brindamour
CEO & Director

I mean, there's been a lot of heavy lifting in terms of repositioning portfolio. Think of the few lines that were shut down in the U.S. and a number of moves that we've done here in the U.K. And so as we plan forward, there should not be drag because of exited lines, would be my perspective. And that's how we plan. So I don't know, Louis, if you want to add color there but...

Louis Marcotte
Executive VP & CFO

I think you're absolutely right. The idea is not to have a drag, but one has to recognize the actions we've been taking and the actual exiting. I will say right now the big ticket is the motor exit earlier in the year, where we are still earning premium in exited lines. It was a bit neutral in this quarter from an exited lines point of view, but it still means we're going to be earning premium over, I think, another 3, 4 quarters.

So that's probably the best way to measure it and in terms of the length. And then afterwards, we expect those numbers to migrate towards 0.

Now the numbers you're quoting at 20 to 30 per quarter seem elevated unless we've just recently exited the line like we have in motor exit. I don't think it will stay ever 0, 0 all the time. But much smaller numbers that should not be meaningful to the results.

Doug Young
Desjardins Securities Inc., Research Division

Maybe I can ask it this way, let's say, you don't put anything further into exited lines. Like is this a 3-year to get to 0? Is it 2 years to get like how...

Charles Joseph Gaston Brindamour
CEO & Director

Should be much shorter than that. Because what is closed where there's nothing enforced, you should be reserved adequately and see no noise. Okay. Now keep in mind, the lines of business we've shut down in the U.S. were long-tail lines where we felt pricing was really tough. That's why it's a bit more volatile. And then when you have a line that you exit, take motor in the U.K. that still has an in-force, then, of course, the combined ratio on the earned premium of that line will hit the bottom line. But as we look at our plan prospectively, this should not be structural at all, in fact, it should be managed to 0.

Operator

Next question will be from Tom MacKinnon at BMO Capital Markets.

Tom MacKinnon
BMO Capital Markets Equity Research

Maybe just 1 question, just with respect to your thoughts on Alberta here, they got a freeze for 2023. They got caps for 2024. How should we be thinking about that impacting any of your personal auto business or your desire to do business in the province?

Charles Joseph Gaston Brindamour
CEO & Director

Good question. Tom, look, a cap is better than a freeze. But at the end, in a highly competitive industry where segmentation is the name of the game, the best deal for customers is when people can segment as much as they want. And so this is temporary and CAT is better than a freeze, but none of those things are better for customers at the end of the day. That's my take on it.

I'll ask Guillaume to share his perspective.

Guillaume Lamy

So we said in the past, Alberta is 5% of IFC, 17% of personal auto. And looking back at the year, we've been able to maintain quite a good quality portfolio despite the restrictions in place due to our early reductions, good segmentation and strong underwriting guidelines.

So our book is still pretty solid in Alberta. So there's 2 things in the last measures that the government announced. I think we mentioned rate-freeze essentially replaced by a rate cap at CPI. That's affecting vast majority of drivers. It's intended to be temporary. So that's good. But at the industry level, it's going to continue to create subsidy, and that's never a positive outcome for customers.

What's encouraging, however, is that the government has recognized that things need to be done to address the root cause of the issue through really cost reforms. And the long-term solutions that are being looked at by the governments are largely in line with what we've been advocating as a company to contain the cost. So that's good.

Secondly, I think government granting more authority for a regulator to address profitability. That's not new in the market, that our regulators have similar authority. But details on how it's applicable are still pending, so we'll follow that closely. But industry as a whole was unprofitable in the last decade. We've had, as in fact, strong outperformance and that allowed us to return almost $100 million, $86 million and release the customer during the pandemic. So we believe more intervention doesn't necessarily send a good message to the industry. And we've already seen actually reduced availability in the market even in the last couple of weeks with some competitors moving on a few things.

Charles Joseph Gaston Brindamour
CEO & Director

I think that's good, Guillaume. And I think here, Tom, we will work with the government to get to the right place. We think it's really important. We've been working with the government. I personally have been involved since the early 2000. We have close to 3,000 employees in the province. We want to make sure the government works for customers and our ability to grow our business there, it's important for us.

Tom MacKinnon
BMO Capital Markets Equity Research

Yes. Okay. And a follow-up question is, I think, Louis, you made some comments about a mid-teens ROE outlook. And -- but then I think you also said that depending on how CATs behave. I mean, that's the biggest challenge here and I think the last CAT guidance had been around 700 and it's significantly higher than that in 2023. Is there anything that you can provide with respect to CATs? Or do we just have to sort of wait until what you say for your guidance for the year when we look at -- when you announced your Q4 results?

I think that's important for us to try to determine going forward, where and how CATs might sit with respect to this? And hey, maybe your guess is as good as ours, but if there's any -- anything you can provide in the meantime, that would be helpful.

Charles Joseph Gaston Brindamour
CEO & Director

So Tom, if you look at the operating environment, you look at the underlying performance of the business.

We'll update the CAT guidance at the next earnings call, I think, as we've done last year. Our perspective is we're in a very good environment to generate mid-teens ROE next year. Just no doubt in this -- in our mind, and we'll update the guidance in Q4. But based on the work we've done to date, we've done a lot of work, feel pretty good about what we'll be able to generate in this environment. Louis, I don't know if there's more you want to provide there.

Louis Marcotte
Executive VP & CFO

I was trying to address 1 key issue here is, is the long-term ROE structurally impaired by the CAT losses. And our belief is no. And we're doing the work right now and we'll update our findings in Q4 with the earnings release. But that's a very important point for us. We see that we think we have everything we need in hand to tackle the climate change that we're observing and that's being predicted. So that was the first one. And then we're actually doing the work right now, planning through the year next year.

And the notion of if CATs behavior is really saying -- if they come in terms of where we expect, yes, we feel very comfortable, we'll be delivering the teens ROE in the coming years. So that -- those were the 2 messages. The confidence in next year and then the long-term erosion of ROE because of increasing severe weather events.

Charles Joseph Gaston Brindamour
CEO & Director

Yes. So we don't see long-term erosion one bit. If you look at the CAT load in this quarter, it's been at that level 3 times in 30 years. So it's within the realm of what can happen, but it's a rare occurrence to a certain extent. And I think if you look at the track record, it's priced in. It swings from quarter-to-quarter, but we're being rewarded for taking the risk. I think what gives me confidence, Tom, is that we said, okay, our track record is strong. The value proposition has generated very good performance.

What if the world warms up by 3 to 5 degrees, which is twice what policymakers would like to see happen. We've done an in-depth parole by parole, province by province, modeling analysis for the next 15 years to express the confidence we've been expressing during this call.

And I'll ask Guillaume who's been spearheading this effort to give you a bit of a perspective on the work we've done there and some of the key conclusions. And I'll come back after. Go ahead, Guillaume.

Guillaume Lamy

Yes. So we've been looking at literature available on climate change, really looking at the 2 scenarios and focusing on a 2040 horizon. Why 2040? I think our product pricing can be changed on an annual basis. So we wanted something long enough to be representative of the trend but short enough to be in the -- like within the realm of the control that we have on pricing and products.

So first thing we did was look at our starting point. And looking at our business, it's important to know that less than 40% of our lost cause are weather-related.

That means that there's another 60% that should not be impacted by climate change and about things like electrical fire test, plumbing, liability claims. So that's 60% of our lost cause. So on the 40% of losses that are impacted, we believe 2 things will happen under the scenario that Charles mentioned the kind of 3 to 5-degree warming scenario. So, one, weather losses will increase by around 50% between now and 2040.

So 50% might seem high, but over a decade and a half and just on the 40% of claims that are impacted by weather, it's quite manageable in aggregate and not unlike what we've observed in the last decade. So it's not an existential threat for us and for personal property.

Secondly, we believe that evidence that our high-return periods today will become more intense. So that's kind of at the Canada level. As Charles mentioned, we looked at it by province, by parole and things will be live differently in different parts of the country. So Eastern Canada will be more impacted by wind, water.

Western Canada will be more impacted by hail and fire. But we're a bit surprised like looking at the numbers, like those things kind of even out. And there's no 1 province that will see all the burden of climate change according to our modeling and analysis. So overall, I think, we think for the part, this expected impact can be addressed through rates. But rates alone really shouldn't be the only tool. So we'll focus on segmentation, prevention, stakeholders education like educating municipalities and things to be more resilient that will really strengthen our outperformance, and we'll also continue to evolve the product and our supply chain to manage that volatility.

Charles Joseph Gaston Brindamour
CEO & Director

So Tom, I think we've gone deep. As you know, we have climate expertise in our deep climate expertise and climate modeling expertise in our operations, on top of a network of scientists we're working with and feel pretty good about our ability to replicate what was a sub-90s combined ratio track record in the last decade in the next decade. We'll test and power watch that from time to time as we have now. But there's greater demand for the product as it's been the case over the last decade. And I think we're really well equipped to meet that demand and do it profitably as we have in the past.

Operator

Next question will be from Brian Meredith at UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple for you. First, Charles, I'm just curious, looking at the U.K. commercial insurance business, maybe you can talk a little bit about -- what are the kind of similarities and differences in that retail commercial business versus Canada? And really, where can you drive a competitive edge in that marketplace similar to what you've got in Canada?

Charles Joseph Gaston Brindamour
CEO & Director

Thanks, Brian. Indeed, if you look at the Canadian footprint in the SME and mid-market space, we have a market share that's probably north of 25%.

And so this is a business that we've grown up with and grown -- and some of the edges that we have built in the Canadian context are very much centered on pricing and risk selection, where I think we pushed the science in that space very close to what we're doing in personal lines with billions of data points and have strong systems, pricing expertise and governance that is a key element of what we're exporting in the context of the U.K.

Second, we have broad and deep relationships with brokers and have service models to service brokers, whether it's SME or mid-market to meet the demand, not only of brokers and of customers. And that's a core skill set that we have in the Canadian marketplace. And frankly, the direct line operation, which is tilted towards SME and our regional business, which is tilted towards mid-market, you bring those 2 companies together and the complementarity of product and customer profile is amazing.

The other thing we do in the Canadian landscape, which can be exported is the management of broker relationships across the board. And we don't deal just with the biggest brokers. In fact, we deal with small and mid brokers across the land. Here, you look at this deal, the Direct Line broker footprint is at the smaller end of brokers where the RSA broker footprint is at the larger end of brokers.

So again, here the complementarity of the distribution footprint is excellent and we have the expertise in the Canadian context to manage large number of broker relationships and provide a service and value proposition that is consistent with that. And I would say, these are things that can clearly, I think, be exported in this market. But then what I think our business here in the U.K. will have as a key advantage even compared to the Canadian business is the focus that we'll be able to put on Commercial Lines because we're rationalizing the footprint to be even more focused on Commercial Lines.

Brian Robert Meredith
UBS Investment Bank, Research Division

That's helpful. And then I guess on that topic, obviously, one of the nice advantages you also have in Canada is BrokerLink, right? So -- which is terrific. Is that exportable to the U.K?

Charles Joseph Gaston Brindamour
CEO & Director

I think, Brian, if you think about the genesis behind BrokerLink, about 15 -- I don't know, I forget, 10-plus years ago, 15, time passes, we were concerned about the risk of disruption in personal lines. And as a result, identify a number of responses, investing in digital and AI, investing in the brands, consolidating distribution. That's what triggered the buildup of BrokerLink, which as you point out, is an amazing machine.

The trigger to build BrokerLink was not necessarily Commercial Lines-driven, where here, if you look at the U.K. marketplace, personal lines is very much driven by aggregators, et cetera, and therefore, the opportunity to do the same thing here does not really exist. And in Commercial Lines, it's not clear to me, we need to put much capital on the table to expand our distribution relationship and harvest the relationships that direct client currently has with brokers and that we, as RSA, have with brokers as well.

And so while there might be transportability, it's not clear to me that from a strategic point of view, we need to do that at this stage. We should concentrate in the next 3 years to really integrate those businesses and make sure that the service proposition, product proposition for brokers is the best in the market bar none.

Operator

Next question will be from Mario Mendonca at TD Securities.

Mario Mendonca
TD Securities Equity Research

Perhaps for Charles or Louis, the notion that you accept some volatility in your earnings and book value from catastrophe losses, that probably makes sense. That's a judgment call. But 1 thing that may not -- that I don't think is negotiable is capital strength. So what I'm asking is how do you structure the reinsurance to make sure that while you'll absorb some earnings volatility, capital is never at risk. How many think of that?

Charles Joseph Gaston Brindamour
CEO & Director

I think you nailed how we think about reinsurance, Mario, our thought processes never be on the defensive. And that's how we think about capital. And that's how we think about reinsurance. You, I think, in my mind, nailed how we're thinking about reinsurance, but Louis, maybe you want to add or correct me and Mario on the exercise.

Louis Marcotte
Executive VP & CFO

Thanks. I won't try that. No, I think you're right. And we've been focused on tail because I think we can absorb within the earnings we generate on the business, the lower end of the losses from CAT. So I think it's worked out so far well and has enabled us to capture, I think, the highest returns we could capture in that environment. So I'm not sure I would...

Charles Joseph Gaston Brindamour
CEO & Director

The only thing I would say, Mario, is that we test how much volatility protection is worth and cost and is available. But it's hard to convince ourselves that it's a good way to use money. That's one. Second, the availability for volatility, which is at the lower end has diminished over time in traditional reinsurance markets. That's why you want to keep an eye on alternative markets. But at the end of the day, it is about capital protection.

Mario Mendonca
TD Securities Equity Research

Okay. But my specific question is, what structures might be -- are in place now to ensure that the tail is never breached?

Charles Joseph Gaston Brindamour
CEO & Director

While the reinsurance program, quite frankly, with a $250 million retention in Canada and $125 million, et cetera, in the U.K. in itself is we're in the earnings zone. We never get close to the capital zone even with the sort of coinsurance that we have. Even in the case of 1 in 500 year earthquake to put things in perspective. So the reinsurance protection is conservative in absolute terms, conservative in relative terms but it's meant to manage sales and capital. So you think of a big West Coast earthquake, 1 in 500 years, not even a capital event based on how much reinsurance we're purchasing.

Mario Mendonca
TD Securities Equity Research

How about the scenario that we saw this quarter where there were just so many individual CAT losses, none of which hit the threshold? Is there an aggregate cover that covers you in that circumstance where there are just so many individuals that don't reach the reinsurance coverage?

Charles Joseph Gaston Brindamour
CEO & Director

Our aggregate covers available you need to pay for them. And as far as we're concerned, pricing has been really challenging. We look at that from time to time, and we'll keep looking at those but these things tend to be a bit expensive.

Mario Mendonca
TD Securities Equity Research

So you're covered against the one very, very large individual cap, you're not covered against a significant number of individuals that don't meet the threshold. Is that the right way to look at it?

Charles Joseph Gaston Brindamour
CEO & Director

That's the right way to look at it. Yes. And I think given our size, given a lot of large numbers, given the fact that home insurance is less than 20% of the IFC business, given the fact that commercial prop, commercial liability, specialty lines, personal automobile is not overly exposed to CATs. We think that the footprint of the organization makes it such that we shouldn't throw away dollars of return just to smooth quarters.

Mario Mendonca
TD Securities Equity Research

And so to knock that point home then, I'm looking at your capital margin disclosure, the waterfall you present in your MD&A is the message I should take away from this that even in a quarter as extreme as this, the net income with expected CATs was still well in excess of excess CATs. So the way to really look at it is your best line of defense against these extreme CAT quarters is your profitability. Is that the right way to expect that?

Charles Joseph Gaston Brindamour
CEO & Director

It is 100% right. It's profitability, which comes from outperformance which is the focus. And that's why, Mario, we're running the business with earnings growth in mind and ROE outperformance in mind.

Mario Mendonca
TD Securities Equity Research

Okay. I think I understand the total picture now. One other related thing, now this is not a ratio you referred to very often or at all, but it helps me in understanding your personal auto business. I look at the year-over-year change in your net earned premium, and I compare that to the year-over-year change in your claims. This has been negative for so long and it abruptly turned positive. Now I appreciate it's not a number you focus on or provide guidance on and look at.

But what are we seeing here? When this rate -- the difference in the 2 so abruptly goes from negative to positive, is this simply what you've been telling us for now for a few quarters that the pricing would eventually catch up to the inflation and inflation is moderating and now we're seeing the benefits of all that? Is that all I'm saying? Or is there something more going on?

Charles Joseph Gaston Brindamour
CEO & Director

I'd need to replicate the math you've done, but directionally, I see where that's coming from. And the abrupt nature of it might, to a certain extent, reflect the fact that in 2021, there was a bit less driving and a bit less accidents. But directionally speaking, you're right, that's what we've been talking about. I mean, inflation has been coming down. Frequency has been stable and then rates have been moving up meaningfully to compensate for that change. We'll do the math. The way you do the math, Mario, just to make sure that the answer we're giving is accurate, but directionally speaking, that makes sense to me.

Operator

Ladies and gentlemen, this is all the time we have for questions today. And now I would like to turn the call over to Shubha Khan. Please go ahead.

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. The transcript will also be available on our website in the financial reports and filings section. Our 2023 Q4 and full year results are scheduled to be released after market close on Tuesday, February 13, of the earnings call starting at 11:00 a.m. Eastern Time the following day.

Thank you again, and this concludes our call for today.

Operator
Thank you. 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.