S&P Capital IQ

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Intact Financial Corporation TSX:IFC

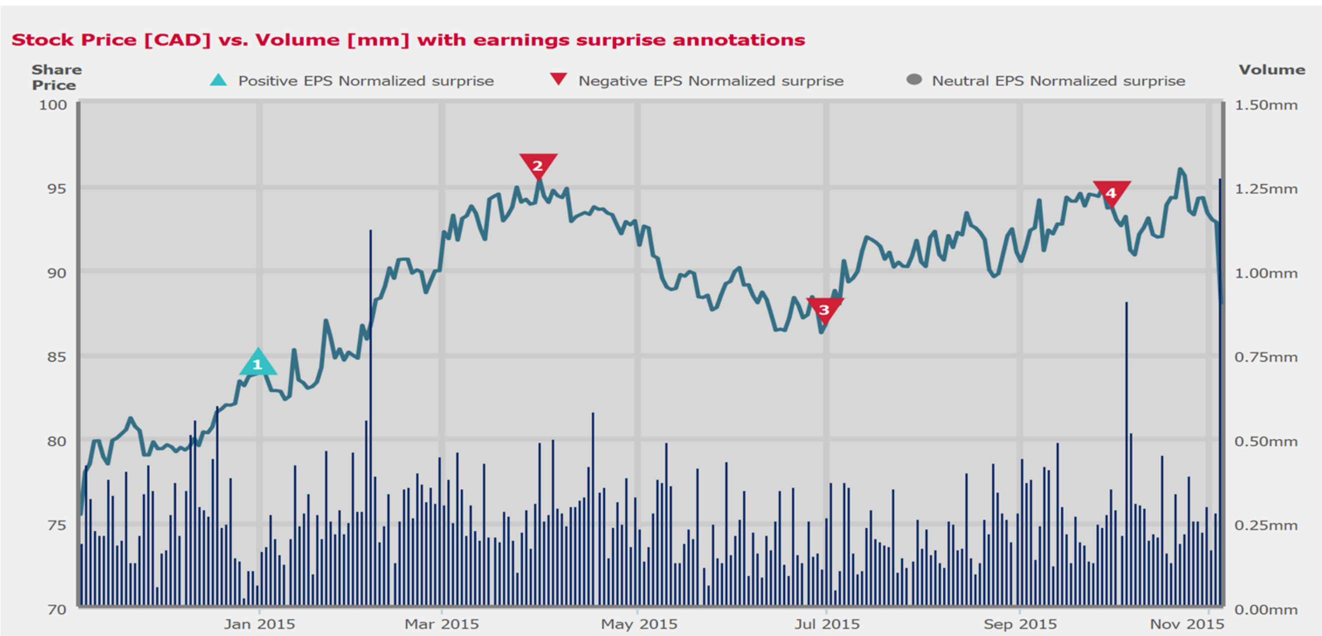
FQ4 2015 Earnings Call Transcripts

Wednesday, February 10, 2016 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.65	1.97	▲19.39	1.47	6.07	6.38
Revenue (mm)	1936.12	1948.00	▲0.61	1969.00	7529.09	7535.00

Currency: CAD
Consensus as of Feb-10-2016 1:39 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	1.46	1.84	▲1 26.03 %
FQ1 2015	1.39	1.37	▼2 (1.44 %)
FQ2 2015	1.66	1.56	▼3 (6.02 %)
FQ3 2015	1.63	1.47	▼4 (9.82 %)

Call Participants

EXECUTIVES

Alain Lessard
Senior Vice President of Commercial Lines

Charles Brindamour
Chief Executive Officer and Director

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Mathieu Lamy
Chief Information Officer and Senior Vice President

Patrick Barbeau
Senior Vice President of Claims

Samantha Cheung
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Presentation

Operator

Good morning. My name is Sharon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. Fourth Quarter 2015 Earnings Conference Call. [Operator Instructions] Ms. Samantha Cheung, Vice President of Investor Relations, you may begin your conference.

Samantha Cheung
Vice President of Investor Relations

Thank you, Sharon, and good morning, everyone. Thank you for joining the call today.

A link to our live webcast and background information for the call is posted on our website at www.intactfc.com under the Investor Relations tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also apply to our discussion on this conference call.

Joining me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Patrick Barbeau, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Mathieu Lamy, SVP of Claims. We'll begin with our prepared remarks followed by a Q&A session.

With that, I would like to turn the call to Charles to begin his remarks.

Charles Brindamour
Chief Executive Officer and Director

Well, good morning, everyone, and thank you for taking the time to join us today. Earlier this morning, we announced fourth quarter net operating income of $265 million or $1.97 per share. That's 7% better than last year's fourth quarter. While weather was on our side, the strong performance in the quarter is a good reflection of our customer-driven strategy and our resolve to address performance issues. Not only was growth strong at 7%, but our underwriting performance, with a combined ratio of 88.6%, was excellent. Our growing distribution operations also contributed to this quarter performance, adding $22 million to our earnings.

Looking at our performance for the full year. We grew our net operating income per share by 13% to $6.38, driven by strong organic growth, better underwriting performance and higher distribution profit. Our operating ROE of 16.6%, 30 basis points above last year, is a testament to the strength of our franchise. We were pleased with the 5% growth in our book value per share over Q3 and our $625 million in excess capital.

We were entering 2016 on a strong footing. Our performance in 2015 exceeds again our objective of growing our net operating income per share by 10%, on average, over time. We expect our ROE to outperform the industry again this year by more than 500 basis points, given we outperformed by more than 600 basis points at the end of Q3. We believe this trend of our platform allows us to do well throughout cycles as well as volatile environments.

So let's look at these results by line of business. During the quarter, personal auto grew 9%, driven by a number of customer experience improvements, better competitive dynamics as well as 3 points from the integration of CDI. The combined ratio rose 3.2 points to 96.9% on less favorable prior year development and slightly higher expenses. Liability inflation in Alberta has perked up in the recent past few years and has impacted our results in the quarter. We have a strong action plan in this province, including price increases around 8%, starting in the coming months, and a continued focus on optimizing our claim strategy. We expect improvements in this segment starting this year.

With regards to the personal auto industry outlook, we anticipate low single-digit growth in the coming 12 months as mild rate reductions in Ontario will be offset by increases in other regions. Our view in Ontario has not changed. We expect 3 to 5 points in net cost reduction to be implemented in 2016 at the industry level. From our perspective, we proactively recognize a portion of that in our rate actions to date. We believe rate reductions will be in line with government cost-reduction measures, and the operating environment will continue to be rational.

The personal property market remains hard, allowing us to grow premiums by 11%, including 3 points from CDI. With new products on the shelves, including both our lifestyle advantage and extended water protection, we are very well positioned to capture further growth opportunities in this market. With regards to profitability, our combined ratio of 72.7% during the quarter reflects a strong performance, even with benign weather, suggesting that our improvement plan is very effective. Furthermore, on a full year basis, our combined ratio of 85.9% improved by 3.1 points. Overall, our view on the industry for personal property has not changed, and we see continued hard market conditions, leading to upper single-digit growth over 12 months.

When it comes to commercial P&C, we like what we see. This line of business grew 3% year-over-year while taking robust actions to improve profitability in some segments and facing headwinds from a slowing Alberta economy. This line of business, again, delivered strong results with a combined ratio of 80.1% for the quarter, which is 7 points better than last year. Not only did we see lower cat losses and favorable prior year development, but more importantly, the underlying current year loss ratio improved by 3.2 points. On a full year basis, our combined ratio of 86.8% is in line with our low 90s target on a sustainable basis. Competitive dynamics should support mid-single-digit growth in the coming year.

Commercial auto grew 3% in the quarter, below our run rate this year as we've begun to deploy our profitability improvement measures. Our combined ratio of 107.9 was primarily impacted by adverse prior year development. As mentioned last quarter, we are implementing robust corrective actions, including rate increases and segmentation as well as loss prevention measures. We're shooting for a sustainable combined ratio in the low 90s. While the market remains competitive, we believe the market is firmer, which should help the execution of our plan in 2016.

With regards to opportunities, the M&A landscape in Canada and around the world is moving as we expected. We continue to believe 15 points of market share will change hands in Canada in the midterm. While Canada remains our priority, consolidation is also happening outside our boundaries with potential impacts here in Canada. We remain patient and disciplined in this environment but fully intend to continue to be a leader in consolidation.

Overall, 2015 has been a busy and successful year for the company. We were active on the M&A front with the acquisition and integration of CDI, expanding our direct platform from coast-to-coast. We expanded and streamlined our distribution channels, we invested heavily in our brands and in technology, all that while launching new products.

Our success, though, is driven by our people who work day in and day out, improving our customer's experience. They make a big difference, and I thank them for their hard work. Even though we were named one of Canada's top employers in 2015, we remain focused on creating an environment they can be proud to be associated with.

So in conclusion, we ended the year with strong momentum in both top and bottom line while strengthening our financial position. We're in an excellent position to capture opportunities in 2016. And with that, in mind, we also increased our quarterly dividends by 9.4% to $0.58 per share, which is the 11th consecutive increase since our IPO. We're confident that our strategy will continue to help us outperform the industry’s ROE by 500 basis points every year and grow net operating income per share by 10% at least per year over time. We believe our platform can deliver superior results both in good and in bad times.

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

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Thanks, Charles. Good morning, everyone. This morning, we reported strong operating results as our underwriting income grew 21% from last year, thanks to a 91.7% combined ratio and higher net earned premiums. Our net operating earnings per share increased 13% year-over-year on the back of improved underwriting and distribution results. Our book value per share was up 6% from last year at $39.83.

Charles already covered most of the underwriting story, but I will add a bit of color on expenses. Overall, for the year, our expense ratio was 0.2 points higher than last year as lower commissions were offset by higher general expenses, mostly related to growth initiatives. The net impact is marginal for the year, and the Q4 increase is due to timing between quarters, not a general trend. We expect our 2016 expense ratio to be comparable to 2015 with quarterly fluctuations.

We reported investment income of $110 million in the quarter and $424 million for the year, both basically unchanged from last year. We expect a mild erosion of our investment income over the next 12 months as the low-yield environment continues to be challenging. Distribution earnings of $104 million in 2015 exceeded our $100 million expectation. These revenues should grow north of 10% on an organic basis in 2016.

Moving on to nonoperating items. Our nonoperating losses of $99 million for the quarter include common share impairments of $44 million, mainly driven by weakness in the energy and materials sectors. Nonoperating losses led to earnings per share of $1.46 in Q4 and $5.20 for the year, both lower than last year. Overall, we delivered a solid operating performance with operating earnings per share growing 7% in the quarter and 13% for the year.

A few comments on our financial position. Our balance sheet strengthened significantly in the quarter on the back of strong earnings and a recovery in asset values, resulting in a 5% increase in book value per share to $39.83. At year-end, our investment portfolio had recovered most of its value as the unrealized loss position improved by $119 million from the end of the third quarter to near 0.

During Q4, we refined our impairment approach for preferred shares as they tend to behave more like debt instruments than equity instruments. We, therefore, determined that the debt impairment model was more appropriate. Under this model, preferred shares are impaired when credit issues arise with the issuers and cash flows may not be realized as expected. We applied this model prospectively as of Q4 2015 and concluded that no impairments were required at the end of the quarter.

Although the value of our portfolio is impacted by the volatility of capital markets and economic uncertainty, it is composed of high-quality securities and delivers stable and reliable cash flows. The sensitivity of our balance sheet to equity markets and interest rate is fairly limited, particularly in light of our strong capital position. Our exposure to energy common shares is in line with the TSX, but focused on higher-quality names with an overall exposure of 5% across all asset classes. Our excess capital rose to $625 million, nearly as high as where we were a year ago before the acquisition of CDI, and our leverage stands at 16.6%, well below our 20% target.

Our MCT rose from 195% in Q3 to 203% at year-end, mainly driven by operating results. We are in good position to enter 2016. Since the beginning of the year, 2016 that is, capital markets have seen further volatility with an estimated impact of 5 points on our MCT as of yesterday. The recent changes to the MCT guidelines, which better reflect a risk-based capital framework will further strengthen our capital position in 2016 and mitigate some of the capital market headwinds we are currently facing.

Our capital management framework remains unchanged. We use excess capital to maintain and grow dividends, to invest in organic or inorganic growth opportunities and, ultimately, to buyback shares. In 2015, we deployed capital on dividends, on organic growth, on the acquisition of CDI and we invested some $77 million in distribution assets. Today, we announced the 11th consecutive increase in our dividends on the basis of our confidence in the quality of earnings and our strong financial position. We firmly believe consolidation in the domestic P&C industry will continue, and we prefer to keep our excess capital to deploy on these opportunities.

However, there are times when the market price of our shares may be undervalued, and we believe that buying back shares in those circumstances is a responsible use of funds to increase shareholder value. We think a buyback program adds flexibility to our capital management toolbox, if used with discipline. Accordingly, we announced today our intention to reopen a normal course issuer bid for up to 5% of the outstanding float. Again, this decision in no way signals a change in our view of opportunities for market consolidation.

In conclusion, I'm pleased with our strong performance in the quarter on multiple fronts: on growth, operations and capital. We strive to continuously deliver strong returns to shareholders while being a company that our employees are proud to work for.

With that, I'll return the call to Samantha.

Samantha Cheung
Vice President of Investor Relations
Thank you, Louis. Sharon, we're now ready to take questions. [Operator Instructions]

Question and Answer

Operator

[Operator Instructions] Your first question comes from Geoff Kwan from RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Just a couple of questions. First off, just the comments you had with respect to Alberta auto situation. Just wanted to get some color, I guess, in terms of how much of a potential drag or impact that we might see in the upcoming quarters and how quickly you think you can improve that situation.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think the -- we've talked about Alberta from time to time in the past 2 years. There's been a number of common-law decision that have created a bit of inflation and, in the past few months, really strengthened our position there, not only in terms of reserves, but more importantly, in terms of action plan, I think action plan being pricing-related, underwriting-related and claims-related. One of the big things that's happened in Alberta inside as a result of our claims action plan is that our folks in the West are changing the way or have changed the way in which they handle claims as a result of inflation, and we put also more people on the front line. So I would say that that's in pretty good shape there, and I do expect concrete improvements in 2016 as opposed to drag at this point. I think the -- my read is the worst is behind, given everything that's in the pipeline. And I'll let Patrick add a bit of color on what we're doing there.

Patrick Barbeau
Senior Vice President of Claims

Yes. I fully agree. One of the key elements we have done in Q4 in light of this emerging trend or this acceleration in the trend was to quickly file for additional rates, though we just got an approval for plus 8% in the personal auto environment, that's being implemented as we speak and to be effective towards the end of Q1. And there's additional action items on the underwriting side and segmentation coming in very soon in 2016. So we think that, that will offset the trend that we have observed so far.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Okay. And then last September, you guys announced that partnership with Uber about the ridesharing, and then we saw, recently, a competitor had come out with a product addressing that part of the market. Just wondering if you kind of clarify what that does in terms of how you guys are looking to capitalize on that part of the market.

Charles Brindamour
Chief Executive Officer and Director

Yes. The partnership we've announced with Uber is subject to regulatory approval. But the product that we have in mind would cover all customers of Uber from wall-to-wall. The alternatives that are on the market have to be selected -- self-selected by the drivers. And from our perspective, the solution that's in front of regulators at the moment, which, of course, is a little bit more complex for regulators because it involves personal and commercial lines, is definitely, by far, the best solutions for Ontarians. I think the alternatives require the driver to insure first, and the driver has to be insured by one of the few insurers who actually offer that solution. So we think that the better solution is definitely an agreement with Uber to cover customers, all customers through one policy.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Okay, great. And then just one final question, just on the M&A environment. You talked about things are playing out as you expected. Was just curious at the margin with what's going on in terms of the markets, kind of the macro uncertainty. Is that having an impact kind of either way in terms of what might be happening from an M&A perspective?

Charles Brindamour
Chief Executive Officer and Director

I think those sorts of environment are positive for M&A, as far as I'm concerned. I think it can accelerate people reconsidering their use of capital. And I don't know how significant that is, but I don't see this as negative. And I think our history on that front has been one where we've capitalized on periods of volatility, like the one we're going through at the moment.

Operator

Your next question comes from Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

The first question on the commercial auto. You made some improvements on the underlying current year loss ratio, but still, it's at loss at more than 100% combined ratio. I just wonder, what more could be done? And how soon can we get to a -- the target level you're aiming?

Charles Brindamour
Chief Executive Officer and Director

Yes. I think I'll let Alain talk about the action plan, but let me put things in perspective here. Commercial auto started to have results that were not as good as history last year. And you'll recall that for a couple of quarters, we said, "Hey, we're seeing large losses. They're happening sort of across the land." And then in third quarter, we sort of became a little bit fed up with the large losses and told you guys that we actually would roll out an action plan. I think our appointed actuary throughout the year also saw a bit of unfavorable development and, I think in the fourth quarter, wanted to make sure he wouldn't see those sorts of trends in 2016. I think that's what you have to keep in mind. I'll let Alain talk about the action plan, which I would qualify as robust, that is rolling out as we speak.

Alain Lessard
Senior Vice President of Commercial Lines

Okay. So maybe just to add a color also on the result. Like we said last year, we tend to look at the results of that line of business, because of the size, more on a yearly basis than quarterly basis. But even at 99% for the year, this is unsatisfactory, not the level we want to. We know, like Charles mentioned, that during the year, there has been some elements which are not necessarily recurrent. We believe that those elements, between adjusting the reserve for certain trends, fully separating the IBNR between personal lines and commercial lines, a bit more large losses and some impact coming from the exchange rate in the U.S. We believe those nonrecurring events are probably in the range to 4 to 6 points, but that still leaves a combined ratio in excess of the 90% where we want to operate. But we've already started rolling out some corrective measure. The corrective measure, I would say, are hinged around 3 heads. The first one regarding the rates. Basically, we've started implementing rate increase in the fourth quarter and continue to implement more rate increase starting in the first quarter this year. Those rates are going to be mid-single-digit overall, and they're going to be segmented towards the part of the business or the book that is -- required more rate increase. We're introducing also more GLM pricing, more precise algorithm to improve the segmentation. And I think it's important to understand that our commercial lines book is about 2/3 non-price regulated. So there's about 2/3 of the book where we can go very rapidly in implementing rate measures and implementing new GLM. So this is an important. We're starting the implementation of the GLM by the end of the first quarter and will -- we think we'll have completed the review by the end of the year for every segment of the portfolio. And on top of that, we've already adjusted our U.S. exposure, U.S. rates -- or U.S. exposure for trucking to the more recent exchange rate level. That started at the end of the fourth quarter. So we have strong action coming up on the rates. We also have some action coming up on the underwriting side where we are basically reviewed our session to risk-sharing pool to be more efficient. We are reviewing our eligibility rule for hazardous transportation, driver turnaround and antitheft device, and we're putting more eyes on the larger accounts to make sure we're not leaving anything not understood. And finally, we're putting more visits on the loss prevention side. We've hired more loss prevention people. We're seeing more account, and we're going to be using my Fleet Solution, which is a way to equip the fleet manager with a better understanding of what's going on at the driver level, be able to identify pattern and then train more the behavior of the driver there to improve the loss prevention. So we're quite confident that with this action plan, we're going to be bringing the combined ratio back to 90%. The full earning of the action plan will take about 12 months to get to the full impact of the earning, but we have in our mind everything that is needed to bring it back to the 90% level.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think that's a very good summary, Alain. I think if you go back this year, I mean, the commercial auto combined ratio was 96% in Q1, 94% in Q2, 97% in Q3. That's not good. But that's not a reason to panic. I think after the third quarter, we said we need to improve the performance of that line of business. And if you look in Q4 per se, the underlying current year loss ratio improved by a few points, but the prior-year development was 10 points worse than last year. And this is, I think, where I'm saying our appointed actuary wants to make sure that we're not in a non-favorable development position starting in 2016. So I think you have that coming, and then you have the -- what I think is a robust action plan rolling at the same time.

Kai Pan
Morgan Stanley, Research Division

My second question regarding -- on the capital management side. It looks like initiate a buyback program that could work up to maybe more than $500 million. How do you decided -- sort of like at what valuation you buy back your stock and the size of it versus your excess capital currently run at $600 million?
And then on the other side of the capital management, on the acquisition front. Recently, one of your competitors like -- have a sizable acquisitions. Wonder, have you -- you guys have been always looking for the opportunity like that. I just wonder what's the reason behind it. And does it change anything in terms of valuation, change your appetite going forward?

Charles Brindamour
Chief Executive Officer and Director

Excellent. I'll let Louis comment on the capital framework. And then I'll share with you my perspective on the buyback, because we talked about that last quarter during the earnings call, and then we'll talk about M&A. Go ahead, Louis.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Thanks, Charles. So firstly, just a reminder here. We have a bias towards keeping capital for M&A opportunities, as you know. So we took our decision with -- keeping that in mind, and it's important. The way we execute, and don't get into the details, but the more we get away from what we believe is intrinsic value of our stock, the more we'll buy. So the pace of buyback is accelerating as much as the price is discounted to the internal value that we've calculated. And the concept behind the -- or the reasoning is that we are in strong capital position. We have a good capital outlook for next year, and therefore, we can deploy some of the capital when we believe the discount intrinsic value is quite high. So that's a bit how we're going to execute the buyback.

Charles Brindamour
Chief Executive Officer and Director

Yes. We intend to be opportunistic with the buyback here. I don't think the intention is really to buy $500 million worth of shares. I think we'll find good opportunities and in the hierarchy of capital management, that's what we intend to do. That being said, if you look at what happened in the past 3 weeks to a month, shares have been beaten up. And for me, it's a clear reason to be out there and operate the buyback and be opportunistic. I think that there's no justification for what we've seen, and therefore, we'll be on that in the near term. So it's not because we don't see opportunities in the market. We just think that the fall is truly hard to justify, and the distance with our perception of intrinsic value is such that we want to be out there with the buyback. On the M&A, I think this really just proves our thesis that there will be consolidation in the marketplace. It also underlines a view we've had that P&C is very different from banking, and our acquisition of CDI earlier this year was a proof point of that. I think the transaction you're referring to is another proof point of that, and therefore, for us, sort of the canvas that we think we're operating in is very consistent with the view we had a few years back. It's happening.

Kai Pan
Morgan Stanley, Research Division

And what prevent you from pursuing that deal? Is it on the valuation side?

Charles Brindamour
Chief Executive Officer and Director

Yes. I'm not going to comment on specific deal.

Operator

Your next question comes from Meny Grauman from Cormark Securities.

Meny Grauman
Cormark Securities Inc., Research Division

Definitely better-than-seasonal weather was an impact in the quarter, and I'm just wondering -- you referenced it, but wondering if you could give us a little bit more granularity on the impact, specifically in personal property and commercial P&C?

Charles Brindamour
Chief Executive Officer and Director

Of the good weather? So in Q...

Meny Grauman
Cormark Securities Inc., Research Division

Yes.

Charles Brindamour
Chief Executive Officer and Director

If I look at Q4 for personal property, it was -- yes, good weather, generally normal levels of PYD, and so no impact. And that's why we reported a healthy underlying loss ratio of 41.6%. That's slightly above prior year. There was a few things that maybe affected the results. But overall, 72.7% combined is -- we're very happy. It's tough to say, when there's no weather, how much it improved your results. But compared overall for the year, the weather, mostly in Atlantic, the non-cat weather events that we referred to, has affected our results for the full year by 1.5 points. So that's more on the other side. But in Q4, I think the action plan that we have implemented was fully reflected in our earnings, and that's more, in our view, has created the good results.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

I think in aggregate, it's hard to put a number on that in terms of cat and weather patterns broadly. Our take is that, in aggregate for the quarter, you'd probably have $0.10 after tax of upside because of the good weather, plus or minus a few cents there. But there's a bit of speculation, so to speak, with regards to what that number is. It's very clear to us that what you're seeing this quarter is action plans taking effect in commercial P&C and, on the other end, bit of strengthening our position in the automobile lines of business as we introduce action plans in auto.

Meny Grauman
Cormark Securities Inc., Research Division

That's very helpful. And then if I could ask another question. You talked about expected improvement on the bodily claim issue in Alberta in 2016 and expect improvement in commercial auto in 2016. So I'm wondering, when you look into 2016, what's the most -- what worries you most? It seems like a lot of the issues that we've seen kind of develop over the last year seem to be being dealt with quite effectively with action plans that seem to be working out, but when you look ahead, what gives you the biggest headaches going forward?

Charles Brindamour
Chief Executive Officer and Director

Headaches. We don't have headaches. I would say that -- I'm hoping that -- not counting on that, but I'm hoping that the government and the regulatory authorities in Alberta work alongside the industry to tame inflation in the system. I think we're taking actions. Our claims, we, Mathieu and I, were in Alberta last week to meet lots of claims adjustors to make sure that we were on top of things, and I do think we are. And I'm hoping that the government to tame inflation for Albertans, because that's the last thing we need right now is inflation in automobile insurance in Alberta. I'm hoping that the government works on finding ways in the product to tame chronic pain inflation as well as minor injuries being treated as non-minor. But overall, every time an issue emerges, we direct the organization's energy towards the problem, try to understand the problem. When we don't fully understand it and it persists, we put an action plan in place, and that seems to work for us. And quite frankly, I think the operating environment is such that the action plans that we put in place and that we're putting in place shouldn't harm too much our top line, and the fourth quarter clearly shows that it's -- that is the case. I think Alberta, in general, not just in automobile insurance but in commercial lines as well, is an area we'll spend more time in this year to make sure that we win as an insurer in that marketplace in a period of slower economic environment and a bit of inflation in automobile insurance. But I don't have short-term worries. I think as I've mentioned at the Investors Day, we're totally focused on transforming the organization to make sure that we provide our client an experience that's second to none. So that if and when disruption takes place in the marketplace, in particular in first lines, we're positioned to come out on top. That, I would say, is the organization's -- I don't know if worry is the right thing, but that's certainly is where we're investing our energy.

Meny Grauman
Cormark Securities Inc., Research Division

And just to clarify. That issue of an inflation in Alberta, is it -- do you see it being impacted by the worsening economy there? Is there...

Charles Brindamour
Chief Executive Officer and Director

Not clear. No, it's not clear. I think anecdotally, you hear of a pressure, but I think the pressure was building up before the economy slowed down. We're certainly on high alert on that front, but it's not clear to me. I don't know Mathieu if you want to add to the perspective there.

Mathieu Lamy
Chief Information Officer and Senior Vice President

No. This is exactly it. We're watching for death frequency to see if we'd see an increase. We see a bit of it at this point, but at the end, death represents 5% of our losses. So -- but it's something we watch carefully in those downturns.

Charles Brindamour
Chief Executive Officer and Director

I think the teams out there are on high alert is what I will say. And so we'll report on that if there's anything of substance to report on in the coming quarters.

Operator

Your next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Just a couple of questions here for you. Quickly, on the M&A front. Charles, does the weak Canadian dollar at all kind of make you think twice about looking into the U.S. market or outside of Canada at this point?

Charles Brindamour
Chief Executive Officer and Director

It doesn't -- it puts pressure on the model. There's no doubt. But it doesn't make us reconsider to look outside.

Brian Robert Meredith
UBS Investment Bank, Research Division

It's going to make it more challenging to get your price.

Charles Brindamour
Chief Executive Officer and Director

Yes, that's it. I think that the combination of shooting for IRRs and then the devaluation of the dollar, depending on the country you're looking at, certainly is a source of pressure. But it doesn't change the strategy as far as I'm concerned. The other thing is it also depends on your perspective on what the long-term exchange rate should be, depending on the currency you're looking at. And I think -- if you think you're not too far from the equilibrium level, then that's also reflected in your model. If you're far from what you think the equilibrium model is the wrong way, that puts a fair bit of pressure on your model and your ability to act outside the country.

Brian Robert Meredith
UBS Investment Bank, Research Division

Got you. And then just quickly, what's the outlook for '16 for distribution acquisitions?

Charles Brindamour
Chief Executive Officer and Director

I think the outlook is pretty good for '16 for distribution acquisitions, actually. I think that, what I would call, super fragmentation of distribution in Canada offers a lot of opportunities. We're partnering with about 50 entrepreneurs where we have equity stakes to consolidate. BrokerLink is a consolidator. So in terms of footprint to find opportunities, it's as -- I think as good as it gets. The fragmentation is really significant. The returns on these trades have been really good for us, and therefore, we'll put as much capital as we can find good opportunities there. I think it's actually pretty good. It's -- I'll ask Louis to give additional color.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Well, I think you're right. I think it's good that we're active out there. Brokers are moving, some are retiring, whatever they're transacting, and so it's still, we think, a good environment to operate in. It's hard to predict specifically, but I think the environment is positive for consolidation.

Charles Brindamour
Chief Executive Officer and Director

I think people increasingly understand that scale is key in first lines distribution, and that's what we're after in that exercise.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay. So the rate of growth you had in '15, would it be unreasonable to expect it at '16 as far as distribution revenues?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

So we're suggesting north of 10 organically. So I would stay there. It's just hard to predict, Brian. So what we have in the book right now should drive that, and then hopefully, we'll be able to [indiscernible] more.

Brian Robert Meredith
UBS Investment Bank, Research Division

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Great. And then just last quick question. On Ontario auto, you noted here that first quarter '16, you put through the remaining rate reductions. Just curious, tell us how much of the acceleration in growth in personal auto do you think is attributable to the fact that you've been cutting rates faster than the industry. And could the fact that the industry is going to have to catch up to you guys at some point maybe offset some of that growth?

Charles Brindamour
Chief Executive Officer and Director

I'll let Patrick give his perspective. It's important to bear in mind that we were shrinking in Ontario at the same time last year. So why don't share your perspective.

Patrick Barbeau
Senior Vice President of Claims

Yes. So Brian, our last rate decrease was implemented in Ontario in last April or May. So this is not a recent action. And we've seen continuous acceleration throughout the year 2015. I think one of the key reason for our success there is our -- well, on the distribution side, but more importantly, the -- our UBI offers, which is very competitive in the market, and we've seen the takeup there increase significantly in the latter part of the year. I think that will continue to be an advantage for us. Even if we forecast that we might have a slightly lower rate reduction coming in 2016 than the average of the industry, I don't think it will affect significantly our ability to grow.

Charles Brindamour
Chief Executive Officer and Director

Yes, I think that's right. You talk about UBI, which is a big driver of growth. I think the digital experience, quick quote and so on, has also driven a fair bit of traffic, and we've increased response advertising meaningfully this year by close to 50% across business units. And as you know it, we think it's really important to build household names. We've shrunk our expense base to allow us to spend more in marketing, and we'll keep doing that this year. So I think there'll be a few points that will lose. I think in relative terms. Rate wise, what this will translate into from a top line point of view, I'm not sure nor overly concerned. I think we'll have to watch our top line in Alberta. Because an 8% rate increase, I think we'll be ahead of the market there, and that might be a bit of a source of pressure. But I'm not concerned, in aggregate, with our rate actions and what it's going to do on our top line.

Operator

Your next question comes from John Aitken from Barclays.

John Aiken

Barclays PLC, Research Division

So the prior year development that we've seen in 2014 accident year, now obviously the commercial auto side has definitely seen some improvements, and we did see a tick up on the personal auto. Is there any parallels between the 2 that we can read into? And are we facing additional stresses in 2016 on prior year development on personal auto?

Patrick Barbeau
Senior Vice President of Claims

Well, as we -- I think the slight decrease in prior year development or favorable prior year development in Q4, as we mentioned earlier, is all due to the situation in BI Alberta. I think we're comfortable with what we've done on the reserve side as of the end of 2015. So I think we can expect the PYD for that line to go back to probably the high range of what we have discussed -- higher parts of the range of what we've talked about in prior quarters. So I don't think there's a pressure on the PYD for this year. That was mostly a onetime reflection of the trends in BI Alberta.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think that's a fair statement. I think some of the pressure we've seen in Alberta in personal, we already seen in commercial auto, and that's part of the action plan. But otherwise, I'm not really concerned about prior year development in '16 because I think the action plan in pricing, some of the moves we're making in claims management and then the appointed actuary sort of reacting to a bit of adverse development in some of these lines earlier this year, by being corrective, so to speak, in Q4 gives me a fair bit of confidence what I'm thinking about this year.

John Aiken
Barclays PLC, Research Division

Great. And Louis, just for clarification. You mentioned that there was actually 5-point impact on regulatory capital ratio because of the capital markets action to date. Did I hear that correctly?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

That's right. So the hit from January 1 til yesterday is roughly equivalent to 5 points.

John Aiken
Barclays PLC, Research Division

Yes. And obviously, as you mentioned, offset by changes to the regulatory regime. So not complete deterioration. But when we look at your investment portfolio, the investment in equities really is to get the tax advantageous nature of the dividends. Is there any thoughts or discussion to altering your energy portfolio, given the fact that we actually have seen some dividend reductions coming out of that space?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

So globally, I would say we're quite comfortable with the mix. Whether there are some decisions at the individual levels, perhaps, but globally, the mix, I would think, will be stable.

Charles Brindamour
Chief Executive Officer and Director

I think this is up to our PMs at this stage to go in and out, depending on their perspective. I think the other thing that's important to bear in mind, in the past 24 months, if you look at our common share portfolio, which is about 13% of our investment base, 5 points out of the 13 is in the U.S. And if you go back 24 months, this was very close to 0. So this sort of macro perspective on Canada's concentration for certain sectors, namely energy and financial, has been, in part, addressed by a meaningful reallocation of our portfolio in the past 24 months towards the U.S. So that's the macro piece. That's sort of where Louis and I are involved with the investment team. Then at the common stock level or securities by securities level, it's the PMs job to make sure that they're focused on the strategy and the objective of total after tax return. I don't know, Louis, if there's anything that can be added there.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

No, I think you've covered it.

Charles Brindamour
Chief Executive Officer and Director

Okay.

Operator

Your next question comes from Tom MacKinnon from BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

Just with respect to commercial P&C, what's the average rate increase you're seeing right now? And what are you seeing in terms of the commercial market in Alberta? And I've got a follow-up.

Charles Brindamour
Chief Executive Officer and Director

Thanks, Tom. We'll ask Alain to give his perspective on that front.

Alain Lessard
Senior Vice President of Commercial Lines

Okay. So on the commercial lines rate increase, it's been, for us, the eighth quarter in a row in the fourth quarter of 2015 that we've seen rate increase in the 4% or 5%, so mid-single digit. So we don't see any momentum currently to go further than that, but that's about where we are right now. So it's a very -- it's still, in our mind, a fair market, okay? We are anecdotally also hearing from the market, from our different region, action taken by our competitors either on rates or nonrenewal that are basically indicating the same thing. So we see, currently, still affirming market. And on an earn-level basis, we'll see our earn rate level continue to increase, at least, for the next 12 to 18 months.

Tom MacKinnon
BMO Capital Markets Equity Research

And with respect to Alberta, yes?

Alain Lessard
Senior Vice President of Commercial Lines

On the Alberta, this is -- this one is a tough question, trying to see the perspective of the impact on the Alberta market. Right now, I can tell you that we estimate the impact of the reduction in the economy in the Alberta to be about a reduction of growth of 0.5 point in commercial P&C. And just let me explain. What we've seen so far on -- in Alberta, on the oil and gas segment, is basically a reduction in premium in the 10% to 15%, and that's been fairly stable throughout the year in 2015. So since the oil and gas is about 20% of our portfolio in Alberta, that means a reduction in Alberta of roughly 3%. And Alberta being 17% of our commercial portfolio, we see an impact of about 0.5 point. And that -- I would say that phenomenon is being contained solely to Alberta. Where it becomes more difficult is when we look at emerging trend and trying to foresee again in the future. What we saw in the last fourth quarter of 2015 is also a reduction in Alberta in the contractor segment of our portfolio, which represent about 10%, and we saw reduction again in the range of about 10%. So if the -- there's a negative trend possibly on the Alberta, that it could reduce or improve -- not improve, but grow the impact of the negative economy to a reduction from, let's say, 3% to 6%. But on the other hand, there are positive sign on the export side. Lately, Statistique Canada published that the export are picking up in the last month. That would affect our manufacturing sector. It will affect our service sector, which represents 15% of our book. A low Canadian dollar also will affect the replacement cost of the stock of our clients for retailer and wholesaler, conducive of higher premium, and this represent about 15% of our portfolio. So overall, we have, going forward, positive vectors and negative vectors. So the end result is very difficult to forecast and, in our minds, could be relatively minimal.

Charles Brindamour
Chief Executive Officer and Director

I think, Tom, just so we're clear. We've seen in the past 4 months, in commercial P&C, a deterioration in the top line. General days, I think Alain is talking about the oil and gas practice surety now. And the past few months, we're seeing some pressure at the contractor level. So clearly, it's a source of pressure and it's changed a fair bit in the past 4 or 5 months. I would say in June, it was almost a nonissue, limited to surety in oil and gas. And I think in the fourth quarter, right up to January actually, we're seeing a bit of pressure there. I think Alain is absolutely right. This is a small portion of our commercial lines portfolio, and there's all sort of moving pieces. So the overall outlook from a pure top line point of view is not a concern. But Alberta has changed, that's for sure, and we'll keep our eyes on what's happening there.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And then just on the positive impact of the MCT expect over the next 2 years, the final guidelines you put out in November 30. Maybe you can just refresh our minds as to what the positive impact on the MCT would be?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Sure. So if you remember, the guidelines give more credit, in fact, to the hedging positions that we have, and OSFI is working towards a more -- a better risk-based framework. So that provides a bit of additional points. We estimate about 1.5 to 2 points per quarter of additional MCT from the 2016 guidelines rolling out over 2 years, starting in Q1 this year.

Operator

Your next question comes from Paul Holden from CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

So 2015, overall, obviously, was a very good year for the company, particularly in commercial P&C and personal property. And then when we look at the result for personal auto, in terms of combined ratio, at 95.4, like how do you view that result? Is that kind of -- is it a mediocre result? Is it a good result? Is there room for improvement there?

Charles Brindamour
Chief Executive Officer and Director

Yes. I think 95.4%, we don't view as good. I think we are -- in that sort of interest rate environment, if you want to be in the -- we price from -- using ROE targets. And 95%, 95.4% doesn't cut it as far as we're concerned. The pressure point this year, we've had a fair bit of weather in Q1 where we've seen frequencies go up. And you'll recall the maritime story in Québec and then Alberta. And I think if it wouldn't be for those 2 issues, the results would be meaningfully better. But 95.4% is not something we consider really good.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And then second question is going back to the discussion on the MCT and the estimated 5 points impact post Q4. Based on the sensitivities you provide in your MD&A, it would suggest that the vast bulk of that impact is from the pref share market. And then if that's the case, implication would be that that's all mark-to-market impact with very little probability of impairments. So just looking to clarify that I'm working along the right lines.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

You are. You are, absolutely. So the Q1 is driven by pref shares. They are mark-to-market, but in OCI. So it would hit -- it hits the capital, but not the P&L.

Operator

Your next question comes from Doug Young from Desjardins Capital Markets.

Doug Young
Desjardins Securities Inc., Research Division

Just -- can you remind me -- on the personal auto side Alberta, can you remind me of that, what size that is of your total portfolio? And where I'm going, if I -- and I also want to kind a dig into the -- just the Alberta auto a little bit more in terms of -- I think in the mid-2000s, there were some issues around minor injury, around trial lawyers and some inflation pressures. And it sounded like your description of what's going on now in terms of inflation pressure is similar, but maybe it's different. And so I'm just trying to get a sense of that. And then when's the last time in Alberta there was actually reform put through on the personal auto side?

Charles Brindamour
Chief Executive Officer and Director

So ballpark, Alberta's automobile portfolio in relationship with the overall portfolio is less than 20% in auto.

Patrick Barbeau
Senior Vice President of Claims

12%.

Charles Brindamour
Chief Executive Officer and Director

It is definitely less than 20%. The reforms took place in '03 or '04. At the time, the issue, let's -- just so we're clear, that's 12-13 years ago. The issue was that minor injury has led to a lot of inflation, and what the government did, like other governments from coast-to-coast at that time, was to introduce a cap for pain and suffering awards on minor injury. This cap was introduced back then. It choked inflation in the system completely. There have been a couple of court decisions in 2012 and last year that have weakened a bit the impact of the cap, and that has been a source of inflation in the system. But there's been very little inflation until 2011 or '12. We'll ask Patrick to give his perspective and also to talk about other reforms that have taken place, which I don't think there was, but...

Patrick Barbeau
Senior Vice President of Claims

No. In fact, that -- there was no other reforms. And through our discussions with IBC and the Government of Alberta, there are some opportunities to adjust the product that we're seeing, and hopefully, that will eventually help containing that inflation. But no other reforms in the recent past, as you say. On the how big it is for our portfolio, if I combine both personal auto and commercial auto in Alberta, it's -- overall, it's 12% of the IFC book at this moment, and about 1/3 of that is -- represent the BI piece of it, that there's obviously a physical damage. So we're talking about 4% of our overall book that's exposed to BI.

Charles Brindamour

Chief Executive Officer and Director

Overall automobile portfolio.

Doug Young
Desjardins Securities Inc., Research Division

Yes. And so is there discussions with the government around them?

Patrick Barbeau
Senior Vice President of Claims

Sorry. Just to make sure. 4% of the overall IFC is total auto BI Alberta.

Doug Young
Desjardins Securities Inc., Research Division

Okay. I got that. Then is there discussion with the government right now about implementing reforms? Typically, you had -- you got a lot of inflation built in as people kind of learn to work the system a little bit, and it sounds like maybe some of that is coming through. But is there conversations with the government around -- like price increases are great, but is there reform discussions with the government ongoing right now?

Charles Brindamour
Chief Executive Officer and Director

Yes. I mean, a number of us, myself included, have been engaged since 2013, basically, with the superintendent and the government in Alberta to highlight where we saw pressure points and how they could fix it. And that's why when somebody asked earlier, what's your -- what are you wishing for, so to speak, this year is I'm wishing for the government to take action on what are, I think, very concrete proposals that would help alleviate the pressure. Just so we're clear, Doug, we're not losing sleep over this. I think we've got a pretty good action plan. I think it's well contained. But I think it is in Alberta's interest and the government's own self-interest, I think, to take a few of the concrete measures we've laid out for them.

Doug Young
Desjardins Securities Inc., Research Division

And then just secondly, I mean, Ontario auto, I think you mentioned that you expect about 3 to 5 points of further cost reductions for Ontario personal auto to come through. Could you remind me where that's coming from? Because I think most of the catastrophic -- the introduction of the new catastrophic definition, correct me if I'm wrong, [indiscernible], but maybe I'm wrong in that. But where's the additional 3 to 5 points coming from?

Charles Brindamour
Chief Executive Officer and Director

We'll ask Mathieu to give you his perspective on...

Mathieu Lamy
Chief Information Officer and Senior Vice President

The bulk of the reduction will come on the accident benefit side. There's 3 type of claims we're considering accident benefit. There's the smaller claims or what we call the minor injury claims. There's the basic claims that are the middle of the road, and there's the cat claims, the more severe claims. And on the basic and the cat, at the middle of the range and the higher portion of the range, there's a reduction of coverage with an offer to buy back for insurers. So that's where the reduction in benefit will be. And on the minor injury claims, like it's just a different approach to treat these claims that the government will introduce this year, and most of it will be effective in 2016.

Doug Young

Desjardins Securities Inc., Research Division

I'm sorry. So I guess the cat -- the benefit from the cat claim definition is not in the results yet. So that's coming through in 2016?

Charles Brindamour
Chief Executive Officer and Director

That's right.

Mathieu Lamy
Chief Information Officer and Senior Vice President

Yes.

Charles Brindamour
Chief Executive Officer and Director

I think there's meaningful stuff coming in June. And in aggregate, when I look at where we were 3 years back, when the 15% number was thrown on the table where we are today, I mean, the government worked really hard to find as much as they could out of the current system to get a better deal, so to speak, for Ontarians and better allocate coverage, so to speak, where the need really is and try to get fraud out of the system. So it's been a pretty healthy process, as far as we're concerned, and we're happy to grow in that province.

Doug Young
Desjardins Securities Inc., Research Division

And then just last. Louis, I guess $625 million of excess capital is the number you put out there. What's the MCT you're assuming with the $625 million of excess capital?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

It's 203%.

Charles Brindamour
Chief Executive Officer and Director

No. It's 170%.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

I'm sorry. Where it's measured from? 170%, yes.

Doug Young
Desjardins Securities Inc., Research Division

Yes. So I guess where I'm going is, is that something -- will you be comfortable running at 170%? Or is -- what's a more normal MCT that you're comfortable running at? I'm just trying to wrap my mind around what excess capital, in my view, would be.

Charles Brindamour
Chief Executive Officer and Director

I think, Doug, the -- we would not run on the line. We'd run in the upper 80s and the 90s. But bear in mind that we have a number of things in our toolbox that are not reflected in the excess capital position we have today. So there's meaningful capital that could be -- I won't say released, but capital required that could be reduced if we unlock a number of those elements in the toolbox.

Doug Young
Desjardins Securities Inc., Research Division

And what would those be, Charles?

Charles Brindamour
Chief Executive Officer and Director

Do you want to comment on the high level?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Yes. So as you know, we carry some long positions on stock with a hedge on the other side or which works on the other side. On the capital front, we're -- we pay the capital on the long end. We don't get the credit on the short end. So those are typical buffers. So we can unwind those fairly quickly if we needed to generate additional capital. So when we say we run, we're comfortable running in the upper 80s or low 90s. It's because we know we can absorb volatility because we own those buffers and could eventually deploy them to absorb some shocks. So those are -- that's where we say we're in a strong position because we are -- we do have excess capital well above the minimum limits. But if we had to absorb some shocks or use capital on -- deploy capital, we always have those buffers to sort of absorb some of the volatility or the capital needs.

Operator

[Operator Instructions] Your next question comes from Mario Mendonca from TD Newcrest.

Mario Mendonca
TD Securities Equity Research

One quick question. Louis, when you refer to the 5% reduction in MCT, if you could apply those assumptions to arrive at that 5% reduction, apply those to your book value per share, what sort of percentage hit would you expect?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Between 2% and 3%, I would say.

Operator

[Operator Instructions] We do not have any questions at this time. I will turn the call over to the presenters.

Samantha Cheung
Vice President of Investor Relations

Thank you all for your participation today. Following this call, the telephone replay will be available for a period of 1 week while the webcast will be archived in our website for a period of 1 year. A transcript will also be available in the quarterly financial archive. Our first quarter 2016 results will be released on May 4 of this year, and our AGM will follow thereafter.

With that, I would like to conclude the call. Thank you for your participation today. Thank you.

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