S&P Global
Market Intelligence

Intact Financial Corporation TSX:IFC

FQ1 2021 Earnings Call Transcripts

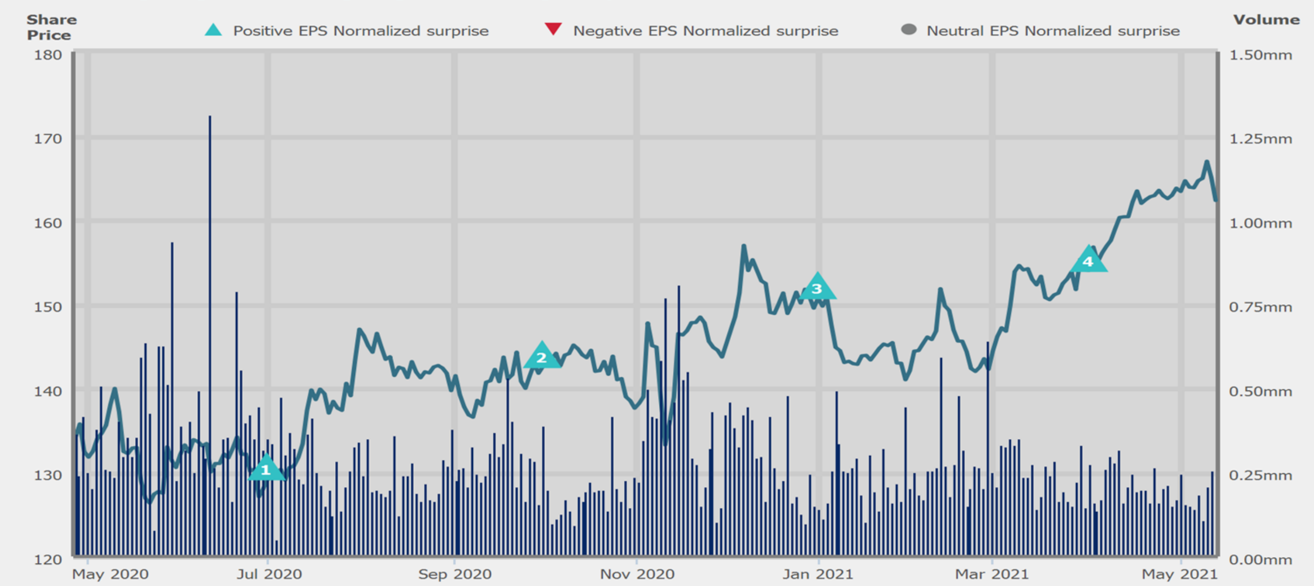
Wednesday, May 12, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2021-			-FQ2 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.15	2.50	▲16.28	2.46	9.97	NA
Revenue (mm)	2793.80	2777.00	▼(0.60 %)	3323.50	15360.00	NA

Currency: CAD
Consensus as of May-13-2021 1:41 AM GMT

Stock Price [CAD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2020	1.94	2.35	▲1 21.13 %
FQ3 2020	2.14	2.78	▲2 29.91 %
FQ4 2020	2.36	3.18	▲3 34.75 %
FQ1 2021	2.15	2.50	▲4 16.28 %

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Call Participants

EXECUTIVES

Charles J. G. Brindamour
CEO & Director

Darren Christopher Godfrey
Senior Vice President of Commercial Lines

Isabelle Girard
Senior Vice President of Personal Lines

Kenneth Anderson
Senior VP of Investor Relations & Corporate Development

Louis Marcotte
Senior VP & CFO

Patrick Barbeau
Senior Vice President of Claims

ANALYSTS

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UBS Investment Bank, Research Division

Geoffrey Kwan
RBC Capital Markets, Research Division

Jaeme Gloyn
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Mario Mendonca
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Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Intact Financial Corp. Q1 2021 Results Conference Call. [Operator Instructions]

Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Ken Anderson, Senior Vice President, Investor Relations and Corporate Development. Thank you. Please go ahead.

Kenneth Anderson
Senior VP of Investor Relations & Corporate Development

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

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

Our executives are again joining us from across the country. In Toronto, we have our CEO, Charles Brindamour. With me here in Montreal are Louis Marcotte, CFO; Isabelle Girard, SVP of Personal Lines; and Patrick Barbeau, SVP of Claims. And from Calgary, we're joined by Darren Godfrey, SVP of Commercial Lines. We'll begin with prepared remarks, followed by Q&A.

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

Charles J. G. Brindamour
CEO & Director

Thanks, Ken, and Good morning, everyone. Thanks for joining us.

For over a year now our people, customers and society have faced incredible challenges, and we're thankful to health care professionals and front-line workers who've supported all of us throughout the pandemic.

And while the vaccine now gives us hope that we'll see some return to normalcy in the second half of the year, it's really important that businesses continue to protect and support their employees and the communities where they operate. In March, we introduced a new relief program for our personal auto customers in recognition of the continued lockdowns. This CAD 75 million of additional relief complements our existing and ongoing measures to protect and support customers most impacted by the pandemic and brings the total amount of relief to over CAD 600 million.

We're committed to be there for customers in both good and bad times, and our ability to provide meaningful relief is enabled by our track record of outperformance.

Now let's turn to results. Last night, we announced first quarter net operating income per share of CAD 2.40, a 49% increase over Q1 last year, driven by strong underwriting and distribution performance.

Top line growth of 1% was tempered by 3 points of relief and 3 points from exiting BC and 1 large contract.

The overall combined ratio was 89.3%, with strong performances on both sides of the border. In Canada, the combined ratio of 88.2% was driven by continued strength in underlying performance and benign weather, offset by 4.6 points of relief. In the U.S., the combined ratio of 96.3% included 7.6 points of CATs related to the severe and unusual winter storm in Texas.

Our underwriting and pricing discipline, along with our strategic focus on growing distribution earnings, led to 570 basis points of ROE outperformance last year, again surpassing our 500-point objective.

In Canada, we beat the industry combined ratio by 5 points, with broad-based outperformance in auto, property and commercial lines. In the U.S., our focus on profitable segments meant we beat our benchmarks combined ratio by 4.5 points. We seek to outperform not just on average, but everywhere we play.

Let's now look at our results by line of business, starting in Canada. Personal auto premiums declined 8% year-over-year. Excluding the additional relief and the BC auto exit, growth was about 3%. The combined ratio of 93.4% was in line with our expectations, given the 9.3-point impact from customer relief. Overall, our personal auto business is really solid, and I expect it to deliver at the low end of our targeted mid-90s range this year.

Looking at the industry, insurers have prudently slowed rate increases to reflect the reduced driving activity, while competition remains consistent. Given the weak industry performance over the past 3 years, we expect corrective measures to resume as driving activity returns to historical levels.

In personal property, premiums grew 6%, driven by firm market conditions and modest unit growth. The combined ratio at 77.4% in the quarter was very strong and was helped by benign weather and favorable PYD. With the actions we've taken over time, I do expect this segment to continue to operate sub-95 every year, even in bad CAT years.

In commercial lines, premiums grew 5%, reflecting hard market conditions and strong new business. When we adjust for the loss of 1 large contract, Q1 growth was approximately 10%. The 90.1% combined ratio is solid, reflecting strong rate actions in the ongoing hard market. The Q1 combined ratio included 2 points of earned relief from 2020, which offset the higher-than-expected favorable PYD in the quarter. Our commercial lines business is performing very well, and I expect this segment to deliver low-90s or better, going forward.

Moving to our U.S. commercial lines business, premiums grew a solid 6% in the quarter, driven by the continued hard market conditions and the benefits from recent tuck-in acquisitions. When we adjust for timing change from Q1 to Q2 for a few large renewals, growth is actually closer to 11%. The combined ratio at 96.3% was solid considering the elevated CAT activity I mentioned earlier. The business is positioned to deliver sustainable low-90s performance as we remain focused on portfolio quality and capturing rates in the current hard market.

Turning to RSA, we are nearing the June 1 closing date, and we're ready to hit the ground running. The areas of focus for us are building the best team, integrating the business and creating value. And we look forward to welcoming the RSA folks into the Intact family in 3 weeks. The teams are collaborating really well as we work together to put the final touches on the integration and transition plans. We're also finalizing our leadership structure with an aim to further strengthen our bench, elevate top talent and operate with the best team in the insurance business.

On integration and value creation, our teams have performed detailed bottom-up planning to ensure we can immediately begin to deliver on our strategic and financial objectives. In Canada, we have a proven playbook for the integration, and it's where we expect to capture 3/4 of the added value. In the U.K. and international business, we're zoning in on the opportunities to leverage our core capabilities and RSA's scale to build out performance over the coming few years. In specialty lines, we're well advanced on mapping out how we'll best leverage the enhanced distribution and global platforms we'll have following the close.

So overall, we're well positioned to hit our net operating income per share accretion targets which have us reaching high single digit in the first year and increasing to upper teens within 36 months. The deal will generate an IRR well north of 15%, our stated objective.

In North America, we're continuing to invest in our business to drive outperformance and to build earnings momentum. One strategic area of focus is growing our stream of distribution earnings. Over the past 5 years, distribution EBITDA has grown by 17% per year, on average, and we expect to generate well over CAD 300 million this year.

Our brokerage, BrokerLink, has more than doubled its business since 2015, thanks to both solid organic and an active pursuit of inorganic growth. With ambitious goals on winning new business and a healthy acquisition pipeline, I see a lot of opportunity for the BrokerLink team.

In the MGA space, Frank Cowan Company, which we've rebranded recently to Intact Public Entities, is performing well and we're putting underwriting capacity behind it. We'll continue to leverage our investments in distribution to expand our North American footprint in specialty lines.

Overall, our distribution EBITDA generated 170 basis points of ROE outperformance last year, and we're continuing to build scale in this unique competitive advantage.

Our customer-driven digital strategy is helping us engage with our customers like never before, while also leveraging data to bolster outperformance. Digital adoption accelerated significantly since the start of the pandemic. We've increased the number of customers using our Client Centre app by north of 60% year-over-year. In the broker channel, adoption has more than doubled, and while our direct business sees 3 out of 4 customers now actively engaged digitally with us.

As customers adopt our tools and the experiences we provide, we see benefits on both the claims side, with over 40% of appraisals now done virtually, and on the telematics side. As we continue to gain scale on the digital front, it certainly further expands our ability to leverage data and AI, working with our 370-strong data lab to further our outperformance.

So in conclusion, we started 2021 with a lot of momentum across the business. NOIPS is up 49%, book value is up 20% year-over-year, and we produced a 19% operating ROE over the last 12 months. Our teams are very engaged, delivering an outstanding customer experience every day and working hard to ensure that we hit the ground running when the RSA deal closes.

We know it's been tough for everyone, including our employees, but we're starting to see light at the end of the tunnel, and we're quite optimistic about the months to come. So a big thanks to our employees for really stepping up and pulling through. And to our RSA colleagues, we look forward to welcoming you and to working together to strengthen our outperformance further.

Over the past decade, we've compounded NOIPS at over 10% a year and beat the industry ROE by 680 basis points, on average, yearly. With strong momentum in our business, a robust game plan to capture the benefits from the highly strategic RSA transaction, I think we're well positioned to continue to thrive well into the future.

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

Louis Marcotte
Senior VP & CFO

Thank you, Mr. Brindamour. Good morning, everyone.

While the pandemic has had a severe impact on people and communities coast to coast, I'm pleased to see the progressive return to normal has started. We remain committed to supporting our customers, brokers and employees throughout these difficult times.

With this in mind, an additional relief program was launched in personal auto to assist customers who need it most and to reflect their temporary change in driving habits. The cost of the new relief program was estimated at CAD 75 million and impacted IFC's top line by 3 points. The relief was entirely written and earned during the quarter, and any amount claimed in excess of the CAD 75 million recorded in Q1 will be reported in Q2. We expect any amount to be fairly modest.

Let's now turn to our Q1 operating results. First quarter net operating income per share of CAD 2.40 was up 49% from last year on the back of strong underwriting and distribution performances. Underwriting income grew 87% over Q1 last year, with strong performances across the business. The quarter was characterized by strong underlying loss ratios thanks to our continuing profitability actions, benign weather and strong prior year development.

Net earned premium in the quarter were down 0.3%, due to the impact of CAD 157 million, or roughly 6 points, of premium relief earned in the quarter, including the CAD 75 million discussed earlier, both of which offset the impact of the reduced driving activity.

With regards to prior year development, we expect Q1 to be a bit more volatile than other quarters due to its proximity to prior year, but we maintain our long-term expectation that prior year development will be favorable and in the 1% to 3% range. In the short term, given the strong start in 2021, we should finish the year at the upper end of this range.

Net investment income of CAD 141 million was stable compared to prior quarters, but was CAD 9 million lower than in Q1 2020, as the crisis led to lower interest rates and dividend cuts. For the remaining quarters of 2021, and excluding the impact of RSA, we expect quarterly investment income to be comparable to Q1 2021.

Distribution EBITDA and other income grew a solid 41% in the quarter, driven by strong underwriting results, profit sharing commissions and accretive acquisitions. On the back of these results, we are raising our full year distribution EBITDA growth expectations to mid- to upper teens. RSA will have a positive impact on distribution income. However, this will only begin in 2022.

Looking at a few areas in more detail. In personal auto, the combined ratio of 93.4% was strong, despite a 9.3-point impact from current and prior year earned relief. Prior year development improved 1.5 points, half of which was due to pools.

On expenses, the overall Canadian expense ratio of 31.7% increased 2.4 points from Q1 last year. Half of the increase was driven by the impact of relief measures on net earned premiums, with the balance coming from higher variable commissions, consistent with the strong profitability in the quarter.

The overall U.S. expense ratio of 40.2% was largely in line with our expectations, reflecting the business mix and seasonality of our operations.

IFC's earnings per share for the quarter of CAD 3.51 were significantly above last year, thanks to the strong operating results and the nonoperating gains recorded in the quarter. Included in these gains are CAD 273 million pretax from a ventures investment that went public in February. The investment is now accounted for in the same way as our other publicly traded equity investments and is held as available for sales. As such, any unrealized gains or losses are captured in AOCI and book value.

Moving to the balance sheet, we ended the quarter in a strong financial position, with a total capital margin of CAD 3 billion and all financing for the RSA acquisition fully secured. This includes the CAD 250 million of subordinated hybrid notes issued on March 31 of this year.

Our book value per share increased 20% year-over-year, to CAD 62.19 on March 31, reflecting strong operating performance and mark-to-market investment gains following the market rebound over the past year.

Let me now provide a few comments on the RSA deal as we continue to drive towards a June 1 close. First, from a value creation standpoint, we expect immediate NOIPS accretion for the first month following close. This will come from a combination of adding RSA's existing earnings to ours as of June 1 and a small share of the synergies we expect to generate over time.

Our visibility on the expense synergies is improving steadily as we approach closing, imbuing further confidence that we will deliver on them as planned. These synergies still do not consider loss ratio improvements driven by the benefits of our data and analytics advantage.

Our Q2 results will include 1 month of RSA's operating earnings, which we will report in aggregate in our Corporate & Other segment. Both underwriting and investment income, net of financing costs, will be included in our pretax operating results. This will include the results of UK&I, Canada and Denmark.

From a balance sheet point of view, at close, we will consolidate RSA's entire balance sheet for the perimeters we are acquiring. Our investment portfolio will grow by some CAD 15 billion following close and reach a total of CAD 35 billion.

As usual, following an acquisition, the yield on the invested assets acquired will be reset and the investment income going forward will be consistent with current yields. We expect the acquisition will generate approximately CAD 100 million of additional investment income prior to any asset mix for the 7 months in 2021.

From a book value point of view, our November subscription receipts offering of CAD 4.5 billion will be converted into common shares and added to our book value upon close. When combined with the impact of the purchase price accounting and deducting financing fees, we expect the book value to grow by some CAD 4.6 billion and the share count by 33 million shares. Consequently, our book value per share will grow by approximately 25% on close. That's roughly 50% higher than where we were a year ago.

The financing of the transaction is entirely secured, and we continue to expect our leverage ratio to be below 26% at close and return to 20% within 36 months. We will undertake to optimize the capital structure of the group, including the replacement of acquired RSA debt where appropriate.

Starting in Q3 and going forward, RSA's underwriting results for Canada will be reported in the Canadian business within each of our existing lines of business. The underwriting results for UK&I will be reported under a new segment, with personal and commercial lines granularity. We will continue to report separately on our U.S. commercial segment, and the results of Denmark will also be reported separately.

In summary, we will pick up additional earnings from June 1 and for 7 months in 2021. Synergies are expected to be generated immediately and accumulate gradually over 3 years, reaching a run rate of CAD 250 million pretax.

We continue to expect high-single-digit accretion for the first 12 months, 7 months of which will impact 2021. Accretion should reach up upper teens within 36 months.

After completing the transaction, the operating ROE will be lower than current levels, as the NOIPS accretion in Year 1 is lower than the book value per share accretion. As we get closer to Year 3, we expect the operating ROE to be running at our mid-teens historical average as synergies fully kick in and we see upper-teens NOIPS accretion in our results.

With an IRR well north of 15%, solid earnings accretion and a price below book value, the financial merits of the transaction are compelling.

But proof is in the pudding. With 75% of the transaction's value creation coming from Canada, we will lean on our successful track record of Canadian integration to deliver on our targets. In the UK&I segment, Scott Egan and team have been improving the performance over the past 24 months, and this momentum continued in the first quarter of 2021. We are looking forward to joining forces with Scott's team and supporting their efforts to build a solid outperforming business in the UK&I market.

The addition of RSA to our strong operations is highly strategic and transformational. Our teams are already hard at work to ensure we deliver on our expectations. And now the real work begins. With the help of our new colleagues at RSA, we can create a tremendous amount of value for all stakeholders.

Finally, the acquisition positions us well to continue delivering on our financial objectives of growing NOIPS at 10% annually over time and beating industry ROE by 500 basis points annually.

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

Kenneth Anderson
Senior VP of Investor Relations & Corporate Development

Thank you, Louis. In order to give everyone a chance to participate in the Q&A, we would ask that you kindly limit yourselves to 2 questions per person. If there's time at the end, you can certainly requeue for a follow-up.
So Mike, we're ready to take questions now.

Question and Answer

Operator

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

Jaeme Gloyn
National Bank Financial, Inc., Research Division

My first question is actually on some of the guidance, Louis, that you just provided around investment income. And I just want to make sure I heard it correctly that net investment income coming from the RSA transaction would be about CAD 100 million for the 7 months in 2021. And if I heard that correctly, I guess that suggests quite a bit of a step down in the yield earned on those assets, more than what I was actually anticipating. So is there anything that you're looking at doing to potentially improve that yield and drive that investment income higher?

Louis Marcotte
Senior VP & CFO

So Jaeme, it's a good question, and I'm happy you're raising it. So as you know, and this was my point about the fact that we have to reset basically the book yield to current yields at the time of acquisition. So what happens is their book yield right now is higher than the reinvestment yields. And when we take over the balance sheet, we need to reset those yields to the current yields, and then the investment income will be based on current yields. So that's a step down from what they're earning now.

Now it's on their balance sheet, and they're seeing -- there is what they call a pull-to-par impact that they are impacted with. We net this out and then we start fresh from the date of acquisition at current yields. And those, again, are lower than their book yields.

So that is really what happens from the acquisition. All our modeling has been based on that. So it's not a surprise to us. But certainly wanted to flag this as you guys are modeling for the future.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. And a follow-up on that is just related to their, I guess, their average life. Is there an opportunity to more quickly roll that portfolio into higher-yielding assets based on a maturity that might be lower than the current Intact books?

Louis Marcotte
Senior VP & CFO

So the work is being done right now to optimize the asset mix and the position. I think there's a strong feeling it was very well managed already. We are in the U.K. environment with their own rate environment. So the numbers I gave there were prior to making asset mix changes. So we are looking into those. I don't think you'll see a massive change in the asset mix, but there will be a bit of shift, particularly in that market, towards a bit more equities because they're right now on a fairly conservative portfolio structure.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. Great. And then my second question is just around unit growth in personal lines. I think they're down in personal auto on the BC exit, and then personal property slowdown probably related to just the GCNA acquisition last year. Can you just talk about how you're feeling about unit growth in personal lines and how that looks heading into the rest of the year based on some of the moving parts with COVID and pricing and competitiveness?

Charles J. G. Brindamour
CEO & Director

Jaeme, we're feeling good about our position in the marketplace, and we do expect momentum on that front. I would say unit-wise you're probably talking about low single digit. And maybe, Isabelle, I don't know if you want to add any color.

We're comfortable growing in this environment. We're comfortable with our price position. And we're out there in the market trying to grow the business. Isabelle?

Isabelle Girard
Senior Vice President of Personal Lines

You're totally right, Charles. I would just add that, as you mentioned, [indiscernible] BC has an impact on units. So the underlying growth, removing the BC impact, is quite consistent with what we saw in Q4. And on the same front, for the property piece, you're also right that the GCNA impact is not there anymore in Q1. So the underlying growth also is very, very strong in Q1. And for both of those lines, the mid-single-digit number is what we're looking for, for the quarters to come.

Operator

Our next question comes from Geoff Kwan, from RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, Research Division

My first question was on RSA. For the countries that you'll now be operating in, just wanted to get a sense of do you need more time to kind of assess your strategy of either improving them or pursuing alternatives. And if you do need some more time, like, how much time might that be doing that exercise?

Charles J. G. Brindamour
CEO & Director

I think we're pretty clear about what needs to take place in 2021, Geoff. From the perspective that for most markets we are putting the final touches of how outperformance will be built, and I think there's a couple of areas where we're exploring strategic alternatives at the moment. And as such, our game plan is pretty clear.

Then I think the second round of questions comes later in 2022, which is, have we gained traction in building out performance? And can we get outperformance in the midterm? That's the second round of questions.

But at this stage, there's a couple of areas where we're exploring strategic alternatives in other markets. We're focused on building out performance, and I feel pretty good about the plans that we have in place at the moment. I think we'll be ready to hit the ground running in 3 weeks from now.

Geoffrey Kwan
RBC Capital Markets, Research Division

Okay. Perfect. And just my other question was on the auto side. Can you talk about with the telematics data that you've got kind of relative to pre-pandemic levels, what it looked like in Q1 and then what you've seen so far in Q2?

Charles J. G. Brindamour
CEO & Director

Isabelle, do you want to share a bit of color on telematics observation?

Isabelle Girard
Senior Vice President of Personal Lines

Yes. So as we saw in 2020 in the fall, we saw driving that has returned progressively as economies were reopening. But entering into 2021 and with the second and now third wave of the government restrictions, we saw some variation across the regions. But what we observed in Q1 2021 was that the driving reduced a little bit again, but not to the extent that we saw in the spring 2020, for sure. So that's why, as a result, we decided to announce the new relief program in March.

So as we are today, we're still seeing driving being below historical level. But as I said, not to the extent that we saw when the crisis started in April 2020.

Charles J. G. Brindamour
CEO & Director

Geoff, you're in the low-teens range as of this week. If you look at this week versus pre-pandemic, you're in the 13-ish sort of range less driving than pre-pandemic. So nowhere near the levels we saw in the spring of 2020.

Operator

Your next question comes from Brian Meredith, from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of questions here for you. Charles, I'm just curious. A lot of discussion this quarter down in the U.S. with respect to pricing in commercial lines and just the level of rates starting to decelerate and also some lines of business approaching rate adequacy. I'm just curious. You didn't change your outlook with respect to commercial lines in your commentary. Maybe you can give a little color on what you're seeing, what your expectations are. Are we getting some rate adequacy in some lines? And should we see that rate start to moderate some?

Charles J. G. Brindamour
CEO & Director

Darren, do you want to take a first crack at that question? And then I'll provide additional color.

Darren Christopher Godfrey
Senior Vice President of Commercial Lines

Yes, absolutely. Thanks for the question, Brian. When we look at our Q1 rate, another very, very strong quarter, very much consistent with prior quarters. Our rate increase in Q1 came at 8.7%, to be precise.

Now in our accident portfolio, which is pretty competitive given the profitable performance of that portfolio, so ex-accident, we're pushing close to 11% in the quarter. So really, really strong momentum.

Now obviously, within that 11%, there's quite a range, as you could imagine. But in fact, 8 of our 11 business units were up sequentially quarter-on-quarter, and 6 of them were at all-time cycle highs. So really, really strong momentum across many, many of those different lines with hard market environment. You can think about the auto environment, [indiscernible], D&O, excess property, marine, umbrella. All of those are in clear, clear hard market conditions, with rates close to mid-teens.

So we don't see any change in momentum. And obviously, as you could expect, those rates are well in excess of our loss cost trends. So we very much like the market conditions that we see right now in the U.S., and we don't see any sign at this point of any slowdown.

Charles J. G. Brindamour
CEO & Director

Brian, I would add, to your question, we track pricing adequacy at very high frequency at Intact. It's one of the core governance elements of how we run the business. Everybody needs to stand on their own when it comes to price adequacy. And when we don't have price adequacy, we press the brake pedal. We just don't go along with the market dance. That's why there is some dislocation in growth amongst the business units.

My view today is that the vast majority of the book is at or above adequacy. So no concern there. And the lines of business we're trying to improve, the 3 of them, are also writing new business at adequate prices and beyond.

My observation on momentum and trajectory would say that the rate increases, as Darren just mentioned, are very healthy. They're above inflation. Market remains tight. But if you take a 2-year perspective and we talk in terms of derivatives, the second derivative here, which is the acceleration in rate change, built up from early '19 right until December-ish 2020, and now it's flattened. So the second derivative has reduced, but the rate increases have not. They're actually flat and flat in the sort of 10-ish range and pretty healthy. And the market is, I think, pretty tight still.

So good environment for us to grow. I think the run rate of the U.S. business is very healthy, and same thing on this side of the border as well.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then second question. I'm curious. On the personal auto book, frequency obviously remains very, very favorable. You can see that in your results. As you look out here over the next, let's call it, 12 months, what are your kind of views with respect to claim severity trends, particularly in the physical damage side, given potential labor cost increases, commodity prices up, those types of things? And how do you factor that into your kind of pricing algorithms?

Charles J. G. Brindamour
CEO & Director

Why don't we ask Patrick, who oversees claims and has the best pulse on inflation, to first start his perspective on inflation. Then we'll ask Isabelle to give us a perspective of how she's thinking about that in relationship with our pricing strategy. So Patrick, why don't you kick it off?

Patrick Barbeau
Senior Vice President of Claims

Sure. So on auto, in the claims cost, we haven't observed an acceleration of inflation, even recent months. However, it is a sustained pressure that we've talked about over the past 4, 5 years that's coming from more technology in cars. That creates an inflation in the cost of parts, and it makes the repair process more complex to perform.

That was central to our action plans in pricing, risk selection and claims over the past 3 years. So we have a good view on that rate. It is -- when you look at auto PD, so the replacement of cars and repair of cars, there's a yearly or annual inflation rate and severity in the mid-single-digit range that we've seen. But that's nothing new. It's been sustained over the past few years, and we have a good sight on it. We're very close between the claims and pricing team of Isabelle to identify these trends and reflect it in the pricing.

Charles J. G. Brindamour
CEO & Director

I think the other point I would add, Brian, before we ask Isabelle to share her perspective on pricing, is the area where there's been some inflation over the past 6, 7 years is on the liability side of things. And you've seen us, starting in '16, taking bold actions from the pricing, risk selection, claims, supply chain management to tame that trend, which I think we have, but this has been a pressure point. And as we look at the current COVID environment on long-tail lines, in other words, lines that are subject to liability exposure and accident benefit exposure, we've taken a really cautious stance in reflecting the impact of the reduced driving to ensure that it doesn't come with meaningful increases in severity for various reasons. We're not really observing that now, but learning from the inflation in liability we're taking a fairly cautious stance at this stage.

Let's talk about pricing, Isabelle, for a moment.

Isabelle Girard
Senior Vice President of Personal Lines

So on the pricing side, as Patrick mentioned, we're working very closely with the claims team and making sure that in our overall profitability assessment of our book we reflect the projected trends we think we'll have in terms of inflation in costs. And that's exactly why in the past we've put some measure and action plan around our pricing to make sure we would cover those inflation.

So as we are sitting today, we have tempered our rate momentum because of the temporary reduction in driving. But as soon as we see that the level of driving is picking up, we'll get back to our rating strategy and making sure that we'll cover for the inflation in cost we project.

Charles J. G. Brindamour
CEO & Director

So the severity inflation which we've observed for a number of years, Brian, is fully baked in, in our rate position and our rate adequacy. We're temporarily reflecting a drop in frequency, but we've done that in a way where we can revert back to pre-COVID rate levels without too many obstacles as driving returns back to normal. And I think our stance on severity has been quite cautious.

Operator

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

Tom MacKinnon
BMO Capital Markets Equity Research

A question really on the favorable prior year development. Just 1 quarter ago, you said that although you held the 1% to 3% over the long-run guidance, you said in the near term you expect to be at the low end of the range. And then 1 quarter later, you report some pretty good favorable prior year development. So how should we be thinking about what happened in this quarter? To what extent is it -- could it continue? And it seems to me that -- are you suggesting that you may be running more at the midpoint of that level in the long run as opposed to the low end of that level in the long run? And then how should we be thinking about favorable development with respect to the RSA book of business as well?

Charles J. G. Brindamour
CEO & Director

I think very good observation, Tom. And I think we pointed to the bottom end of the range last year in relationship with the fact that with a lower interest rate environment your provision for adverse deviation is, as a result, reflective of that. And as such, in a low interest rate environment you should expect to be at the lower end of the range.

Now all sorts of conditions can drive where you sit in the range. I'll give Louis Marcotte maybe an opportunity to share his perspective on PYD, going forward.

Louis Marcotte
Senior VP & CFO

Sure. Thanks, Charles. So firstly, we know that Q1 is typically a bit more volatile than other quarters because it is very close to the prior year. So there's not much time between the prior year and the actual quarter to elapse and to absorb the changes. That is typical.

In this Q1, we identified, I would say, 3 factors that led to a stronger PYD. Firstly, we saw that prior year CATs developed more favorably than we anticipated. So that impacted favorably.

Generally speaking, the lower claims activity that we've observed, I would say, over the past year since the crisis started is also a factor here. Just having lower claims volume has enabled a bit more favorable development to gather steam now.

And then the last element was what I mentioned in my remarks: the pools have also had a positive impact in the personal auto.

So those were, I would say, the 3 main drivers in Q1.

We have maintained our long-term guidance to 1% to 3%. And I have noted in my remarks that given the strength of the start of this year, obviously, for 2021, it's reasonable to assume that we may finish at the upper end of that.

Of course, we are -- it's a COVID environment. There is uncertainty, and we've been cautious in the reserving. So as time passes, we're hopeful that, that will have an upward momentum on PYD. But we've had a couple of years where it was tougher. And before sort of hinting towards a permanent shift in the expectations, I think we're cautious here, and we'll see the quarters develop as they come around here.

But I think we're in a good stance here, both Canada and the U.S., and we'll monitor as the quarters pass.

Tom MacKinnon
BMO Capital Markets Equity Research

On the RSA book, if you could continue with that, is that guide related to the RSA book as well?

Louis Marcotte
Senior VP & CFO

No, not at all. Sorry. So my comments do not relate to the RSA book. And the expectation is fairly muted on development on the RSA book itself.

Charles J. G. Brindamour
CEO & Director

So I think, Tom, bottom line, Q1 tends to have a bit more PYD than previous quarter. Sitting where we sit today, looking at the environment in which we operate and the position we've taken on reserves, we think we'll be at the upper end of the range for a number of months, for a number of quarters. That's the first point.

With regards to RSA, we have a bottom-up view of where their reserves stand, and what we'll do upon closing is we'll make sure that these reserves are brought to a level that's consistent with the IFC conservatism, I will say. And so obviously, our work on that started a long time ago because that's the first place we start, and we'll make adjustments as a result upon closing.

As a result, this should not really change the view of our ongoing -- there might be noise in the near term, but nothing major. And this shouldn't change our long-term guidance on PYD, because we'll manage the claims ourselves and we'll make sure upon closing that reserves are at a level that is consistent by line of business, by province, by country that are consistent with our standards.

On top of that, we're in the process of buying protection for the past to make sure that we're not held back in terms of generating outperformance because of the past.

So feel pretty good about where we are. We'll provide more clarity once we own the business.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And just you spoke fairly positively about what you're seeing with respect to the U.S. commercial lines. With respect to Canadian commercial lines, we've had I guess -- to what extent has any of this lockdown or economic downturn impacted the Canadian commercial business? And what do you see in terms of -- I think you're talking upper-single-digit premium growth in hard markets continuing. Is this accelerating at all? And would it change as we kind of move out of lockdowns here?

Charles J. G. Brindamour
CEO & Director

I'll ask Darren to share his perspective on the market, and I'll give you a bit of color in terms of the COVID implications. Go ahead, Darren.

Darren Christopher Godfrey
Senior Vice President of Commercial Lines

Thanks, Tom. I think as we referenced in the remarks, obviously, there was an impact of a loss of a single contract in the quarter that was worth about 5 points from a growth standpoint. So our run rate is more in the 10% range at the moment. That's very consistent with what we've seen in past quarters as well; obviously, ex-GCNA.

When I look at the rate environment today or even just the general market conditions today, it still is a very hard market. Rate momentum is continuing. Capacity remains very, very tight. We have not seen any form of new underwriting capacity enter into the market. Obviously, we saw a bit leave Canada last year; none of that has returned. So the operating environment is very, very consistent at the moment compared to, I would say, where we were at the start of the pandemic.

From a rate standpoint, we're very much still upper single digit. Obviously, we're being very protective in terms of vulnerable customers. Obviously, as you can remember, back in Q4 with our relief program that we put in place for small business vulnerable customers, we're watching and very much protecting the renewals for those particular customers because that's the right thing to do. But outside of that, rate momentum very much continues.

It very much varies, obviously, based not only on class of business, but also profitability of risk as well. And our level of rate execution at the desk level is exceptionally strong right now, in addition to, obviously, managing quality, which is, as we've talked about in the past, is really critical during this market cycle as well, too.

So all in all, Tom, I would say very, very favorable market conditions, which I would suspect will continue for a little bit here.

Charles J. G. Brindamour
CEO & Director

So I would say, Tom, the biggest difference between the environment in which we operate and the post-pandemic environment is the lines of business where there are gaps in adequacy that are subject to lockdown at the moment. There's not much rate activity going there because we feel this is not the right time to do that. Once we return to normalcy, we'll make sure that the segments that are most vulnerable, rate increase will resume. That's the main difference I think.

Operator

Your next question comes from Lemar Persaud, from Cormark Securities.

Lemar Persaud
Cormark Securities Inc., Research Division

I just want to revisit the distribution EBITDA and the revised guidance from 10% last quarter to the mid- to upper teens. Maybe you could touch on what's changed over the course of the past quarter to drive this increased optimism?

And then secondly, I think I heard Louis mention that RSA won't add to distribution EBITDA until 2022. Maybe you could explain why that's the case.

Louis Marcotte
Senior VP & CFO

Sure. Thanks for the question. So on the growth here, so we have to keep in mind that we're comparing Q1 this year to Q1 last year, which was the start of the pandemic. And I would say you would expect all the brokers to hold back on their expectations for variable commissions. So that was true last year in Q1, given the uncertainty.

We're now far into the -- well, a year into the crisis. Things have stabilized. And you'll remember for the second half of the last year, the business was growing at a very healthy pace, and of course the brokers were benefiting from increased margins and variable commissions.

So the gap year-over-year is really driven by a different view. We're today in a much better position, and the confidence in earning the variable commissions is higher and, therefore, flows through the earnings.

So it's a combination of organic growth from last year impacting the Q1 results this year, and then the additional earnings.

So when we look at the solid start of Q1 and we look at what's left for the year, the impact of our view of profitability for the year, plus the organic growth, has led us to increase our expectations, our guidance towards the mid- to upper teens this year. So that's really what changed in our mind.

Then the second part of the question, for RSA. So we don't expect a huge change to distribution income. And I'm careful there might be a bit more distribution income, but it's not incremental to what is already reported by RSA. It might just shift geography because they don't have a distribution line in their reports. So it will come in our distribution, but may come out of another line. So it's neutral.

Where we do see some clear upside example is in the on-site business, which we expect to serve more customers going forward in the on-site operations. But that is, I would say, not going to happen until next year. So the benefits will start kicking in, I would say, in 2022. You won't see a lot of it in 2021. That was really why I pointed to 2022.

Lemar Persaud
Cormark Securities Inc., Research Division

Okay. And then just another question, just on the relief programs. Should we assume that the remainder of the unearned relief from the 2020 programs will come through similar to what we saw in Q1? So we'll see some come through in Q2, a smaller amount in Q3, and then we're done heading into Q4? Is that the right way to think about it?

Louis Marcotte
Senior VP & CFO

It is. As long as you take what's left, the big chunk of it is in Q2, I would say, probably comparable to what we had in Q1, a bit lower. But that would happen in Q2; then Q3, a small portion; and Q4 is almost nothing.

Charles J. G. Brindamour
CEO & Director

And to be clear, the CAD 75 million was written and earned top and bottom line in Q1.

Louis Marcotte
Senior VP & CFO

So you really have to go back to the 2020 unearned. A portion of it was earned in Q1, and the remainder will be earned in the next 3 quarters. But the 2021 new relief is already earned.

Operator

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

Mario Mendonca
TD Securities Equity Research

Could we go, Charles and Louis, right back to that point? The earned premium, net earned premium, Q1 '21 relative to Q1 '20, it was down only about CAD 46 million. Now I guess I would have expected a little more than that, given the in-quarter premium relief and then the unearned from previously, from the previous year, from 2020. Can you help me sort of reconcile the difference? Is the difference just essentially other pricing increases, growth in units? What gets -- what bridges the gap between those 2?

Charles J. G. Brindamour
CEO & Director

Isabelle, do you want to take this?

It is, in fact, units, earned rates and a bit of drift; in other words, increase in the value of the carpool.

But Isabelle, do you want to give some color on that?

Isabelle Girard
Senior Vice President of Personal Lines

Yes. Sure. So you're exactly right, Charles. I think it's a combination of, yes, net earned premium in 2021 are a bit impacted by relief, but we're still getting momentum from the past rate increases we had in the pipeline early in 2020 that are earned throughout the year. So that's creating momentum. Plus, unit growth and also increase in value of the new cars, for example. So that's also a positive impact on net earned. So that's why, overall, the overall impact is not that different or that big in terms of comparing 2021 to 2020.

Charles J. G. Brindamour
CEO & Director

Just to put things in perspective, Mario, the increase in the value of the car pool in the quarter earned is 1.8%, and the average rate change earned in the quarter is 2.9%. It might not be 100%, but I think it's as precise as you'll get it on these calls. And then you throw some units on top of that.

Mario Mendonca
TD Securities Equity Research

Okay. I think that gets me there. So looking at next quarter, the 4.5% decline we saw in net earned premium in Q1, presumably, it should be a little less than that because you've essentially recognized most of that in-quarter or the 1-month release.

Charles J. G. Brindamour
CEO & Director

Exactly.

Mario Mendonca
TD Securities Equity Research

That's a fair statement? It should be a lot less than the 4.5%.

Charles J. G. Brindamour
CEO & Director

Yes.

Isabelle Girard
Senior Vice President of Personal Lines

Yes.

Louis Marcotte
Senior VP & CFO

Yes.

Mario Mendonca
TD Securities Equity Research

Okay. Great. And let me just get to my final question then, and this is one that I've kind of been struggling with when this all came down, the pandemic. In Q2 2020, just simply looking at underlying claims, so ignoring anything to do with prior year development and anything to do with CAT, not that there were a lot, what I noticed is that the year-over-year, the underlying claims declined substantially in Q2 2020, a little bit in Q3, and this is all on a year-over-year basis, and the underlying claims remain low. So it's exactly what you've highlighted, that we haven't seen a return.

What is confusing to me, however, is you talk about driving being down. I think at one point you talked about maybe 30%, 40%; this quarter, maybe 13%. But we're not seeing that kind of a decline in claims. So I imagine, very much like my first question, there's a lot more going on here. Can you help me understand then why the actual underlying claims are not dropping as much as, say, driving is dropping?

Charles J. G. Brindamour
CEO & Director

Well, there's a number of factors, Mario. One would be the relief that we have provided, which obviously is reflected in the underlying loss ratio.

I think the other one, Mario, is that the sudden drop, meaningful drop in frequency was really just in Q2. Then it increased from there.

Third, for long-tail lines, Mario, as I mentioned in Brian's earlier question, we're taking a fairly cautious stance in terms of what we'll see because we think there might be upward pressure in severity. And as a result, we've reflected that in how we've reserved the accident tier 2020 and 2021. And therefore, that will tame a portion of the reduced driving that you would see in accident.

And I would say these are high level, the main factors that would explain why you're not seeing such a drop; relief being a big-ticket item in that equation.

Isabelle, any additional color you want to provide there? I assume, Mario, you were looking at underlying loss ratios, right?

Mario Mendonca
TD Securities Equity Research

No. In fact, I was talking about underlying claims, ignoring anything to do with ratios, just the dollar amount. I wanted to see if that tracked some of the commentary you were offering. So I'm not talking about the ratio.

Charles J. G. Brindamour
CEO & Director

Go ahead, Isabelle.

Isabelle Girard
Senior Vice President of Personal Lines

I would just maybe add that as well under short-tail lines we saw a bit of an increase in severity due to the mix of claims as well since the type of driving was different during the crisis. So I think that's also something that influenced the level of claims you see.

Mario Mendonca
TD Securities Equity Research

Okay. I think the answer is mostly severity, and that's what I'm just trying to understand. Because it does sound like severity has changed, because there is such a difference between just the basic change in underlying claims relative to the amount of driving we're seeing. So I felt like there's something else happening here that I didn't understand. I think the answer might be severity. Or if you come up with a better answerâ€¦

Charles J. G. Brindamour
CEO & Director

But I think a key point, Mario, was the point I've made. If you think about the losses in automobile insurance business, ballpark, 65-ish is bodily injury and liability. And 35-ish, and some would say 70/30 depending on the province in which you operate, the rest, so 1/3 of it, say, is repairing the cars.

What you see in the results and the impact of the drop in frequency is far more pronounced in short-tail lines and it's far less pronounced in long-tail lines. And why? Because long-tail lines are indeed long-tail. And as a result, we take a cautious stance until we see what severity will do.

I wouldn't conclude, other than the severity that Patrick has talked about, that there's plenty of inflation in the system at this stage. I think, more so, we're being careful as we think about bodily injury and liability.

Mario Mendonca
TD Securities Equity Research

I think that goes a long way towards explaining the difference as well.

Operator

That was our last question at this time. I will turn the call back over to the presenters.

Kenneth Anderson
Senior VP of Investor Relations & Corporate Development

Thank you very much. Maybe before closing, I will turn it over to Charles just for a brief word on the recent leadership changes.

Charles J. G. Brindamour
CEO & Director

Indeed. Thanks a lot, Ken. You've seen this week that we've announced the retirement of Mathieu Lamy, a leader at Intact that many of you have met in the course of Investors Day and so on. And you've seen at the same time that Mathieu will be succeeded by Patrick Barbeau, also a leader that you have seen and heard every quarter for many years.

Let me first say that Mathieu has been a pillar for Intact, one of my key partners in building Intact. He's respected across the organization. He knows the business cold, shrewd, fast. He defines what hands-on actually is and made a big difference for us. Mathieu will remain as Vice Chairman on a part-time basis and will help us continue succeed in technology innovation as well as in security.

Patrick, you've been exposed to as well. A tremendous leader, very well respected in the organization, also knows the business cold. Has overseen, in fact, done a lot of pricing himself. Overseen first lines, overseen claims, drove a big portion of the claim strategy and has been exposed to both distribution channels, used to oversee marketing in the direct channel. And I'm very confident in Patrick's ability to step up.

So I want to congratulate Mathieu and thank him for quite an impact he's had on the organization and congratulate Patrick on his new role.

And on that, thanks a lot for your attention.

Ken, I don't know if you want to close this?

Kenneth Anderson
Senior VP of Investor Relations & Corporate Development

Thanks, Charles.

So following the call, a telephone replay will be available for 1 week, and the webcast will be archived on our website for 1 year. A transcript will also be available on the website, in the Financial Reports & Filings section.

Just to note, we'll be hosting our virtual Annual Meeting of Shareholders shortly after this call, at 1:00 p.m. Eastern today, and you may join that meeting via live webcast from our website.

Lastly, second quarter 2021 results are scheduled to be released after market close on Tuesday, July 27.

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

Operator
This concludes today's conference call. Thank you for participating. You may now disconnect.