S&P Capital IQ

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Intact Financial Corporation TSX:IFC

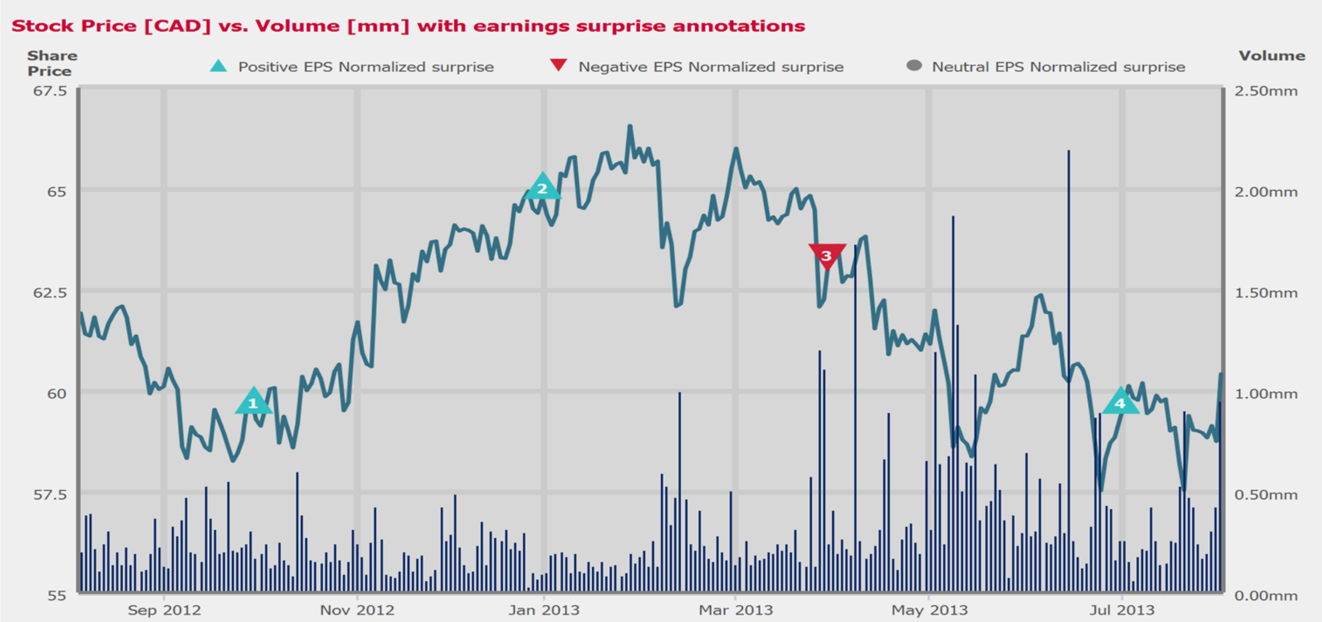
FQ3 2013 Earnings Call Transcripts

Wednesday, November 06, 2013 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.32	0.39	▲21.88	1.47	3.71	6.18
Revenue (mm)	1799.63	1911.00	▲6.19	1857.96	7153.99	7611.19

Currency: CAD
Consensus as of Oct-30-2013 12:29 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	0.56	0.93	▲66.07 %
FQ4 2012	1.35	1.42	▲5.19 %
FQ1 2013	1.32	1.27	▼(3.79 %)
FQ2 2013	0.74	0.89	▲20.27 %

Call Participants

EXECUTIVES

Alain Lessard
Senior Vice President of Commercial Lines

Charles Brindamour
Chief Executive Officer and Director

Dennis Westfall
Former Vice President of Investor Relations

Mark A. Tullis
Vice Chairman

Martin Beaulieu
Chief Operating Officer of Direct to Consumer Distribution and Senior Vice President

Mathieu Lamy
Chief Information Officer and Senior Vice President

ANALYSTS

Asim Imran
Macquarie Research

Mario Mendonca
TD Securities Equity Research

Shubha Rahman Khan
National Bank Financial, Inc., Research Division

Stephen Boland
GMP Securities L.P., Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning. My name is Amy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corporation Third Quarter Results Conference Call.

[Operator Instructions]

I will now turn the call over to Mr. Dennis Westfall, VP of Investor Relations. You may begin.

Dennis Westfall
Former Vice President of Investor Relations

Thanks, Amy, and good morning, everyone, and thank you for joining us on 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 the disclaimer on forward-looking statements, which also applies to our discussion on the conference call today.

Here with me today are Charlie Brindamour, Chief Executive Officer; Mark Tullis, Chief Financial Officer; Martin Beaulieu, Senior Vice President, Personal Lines; Alain Lessard, Senior Vice President, Commercial Lines; and Mathieu Lamy, Senior Vice President, Claims.

We will start with formal remarks from Charles and Mark, followed by a Q&A session. Martin, Alain and Mathieu will also be available to answer your questions during the Q&A session.

With that, I'll ask Charles to begin his remarks.

Charles Brindamour
Chief Executive Officer and Director

Thanks, Dennis, and good morning, everyone. Earlier today, we announced the third quarter net operating income per share of $0.41, despite reporting our first underwriting loss in the last 10 years, driven by extreme weather events.

As we announced in September, Cat losses from the early part of the quarter amounted to $1.52 per share.

From a top line perspective, premium growth of 6% reflects the continued successful integration of Jevco. September marked the first month of purely organic growth that we've reported in 2 years. Although growth slowed somewhat in the quarter, we believe our action plan can generate low- to mid-single digit growth in 2014.

Our earnings over the past year have generated an operating ROE of 12.7% and a 5% increase in book value per share. From a capital perspective, we're comfortable with our MCT of 199%, and expect it to remain relatively constant through year end.

As we outlined on our last earnings call, the extreme weather events from the summer have made it clear that the sustainability of home insurance in its current form is being challenged. I indicated then that we must bring meaningful change to that line of business and established an objective of generating 10 points of combined ratio improvement over the next 24 months.

As we've shown in the past, we're quick to act when we feel the bottom line is under pressure. In fact, renewals, effective November 1, now reflect our new pricing algorithm, which should lead to average rate increases in the low-teens, varying by province.

But we cannot reach our objective with pricing alone. This fall, we began communicating our action plan with brokers from coast-to-coast. Our plan focuses on ensuring customers have a better understanding of the risk they face and what they can do to better adapt to climate change. In the coming months, we will implement meaningful product changes, including higher deductibles, as well as the introduction of sub-limits.

We'll also show separate pricing by peril to provide customers with a better sense of the cost of various types of coverage.

At the same time, we'll offer customers the option to reduce premiums through loss prevention discounts.

As I said, this issue is not one solely affecting the insurance industry, but rather society as a whole. And as such, we're continuing to work with the University of Waterloo to raise awareness amongst communities and to provide guidance as to how they can better protect themselves against the impact of extreme weather.

Moving to automobile insurance. We maintain our positive view on this line of business. We're operating in an environment where both competitors and regulators behave fairly rationally, and costs have been generally stable in the recent past.

Understandably, Ontario continues to be a source of concern with investors. But our view has not really changed. The government has outlined its timetable for expected rate decreases overall, and it's really what we anticipated, as the targeted rate reduction will be phased over a couple of years.

What's important now is for the government to come out with the details for the cost portion of the cost and rate reduction strategy. I maintain the view that they understand the importance of meaningful cost reduction measures to ensure availability of the product, given the industry operates near breakeven at the moment.

We're encouraged that the government reaffirmed through legislation during the last quarter that minor injury guidelines are, indeed, binding. And we continue to work with the government and the Insurance Bureau of Canada to identify additional cost reduction measures that would be effective in the coming years.

We expect concrete measures to be announced in the near term.

We're pleased that the mediation backlog in Ontario has been fully assigned and is expected to be cleared by year end. This really should help alleviate some of the inherent uncertainty in the system.

It's important to bear in mind, though, that a file is not necessarily closed after mediation, as the insured could still choose to dispute the outcome in arbitration.

Consequently, we've seen the number of arbitrations increase 68% at the industry level during the first 8 months of 2013.

Due to our proactive approach to managing our files and dispute, IFC's arbitrations have increased only 3%. Beyond that, our view of the Ontario market is largely unchanged, and we feel strongly about our ability to grow and outperform in that market.

This morning, we announced the upcoming launch of a telematics-based solution that will allow drivers in Québec starting this year to save on their annual insurance premiums based on their driving behaviors. We expect to introduce a similar program to the Ontario market in early 2014 and 2 other provinces throughout next year.

We believe this will allow us to attract and reward safe drivers with discounts based on their driving behaviors and will also contribute to the Ontario government's policy objectives in the coming years. When it comes to our outlook for the industry, we foresee low-single digit growth in the near-term, with upper single-digit growth in personal property and low-single digit growth in personal auto and commercial lines.

We continue to expect the current hard market conditions in personal property to accelerate meaningfully for the foreseeable future.

We also expect firming conditions in approximately 1/4 of the commercial P&C industry in the near term.

The low interest rate environment and elevated losses from catastrophes should support our growth outlook.

Turning to the industry's ROE. We do not expect the industry to reach its long-term average of 10% in 2013, largely due to the elevated Cat activity, which has already materialized.

Looking specifically on Intact Financial, we believe we'll continue to outperform the industry's ROE by at least 500 basis points.

The benefits from our 2 most recent acquisitions are undeniable, with growth and profitability metrics both exceeding initial expectations.

Thanks to extraordinary efforts of our employees from coast-to-coast, integration efforts have gone very well and are now in the final stages. We remain on track to complete the system decommissioning of AXA in early 2014, with Jevco following shortly thereafter.

In conclusion, I believe the disciplined approach we take towards operating our business will continue to serve us well. I'm confident that we'll confront new challenges with the same level of transparency and determination that has brought us to where we are today.

Given the quality of our operations and the flexibility provided by our financial position, we believe we'll continue to outperform the industry and maintain our superior level of profitability.

And with that, I'll turn the call over to our CFO, Mark Tullis.

Mark A. Tullis
Vice Chairman

Thanks, Charles. This morning, we reported third quarter results greatly impacted by previously announced Cats. These losses added more than 15 points to our combined ratio, driving it above 100% for the first time since being a publicly traded company.

However, despite the Cat losses, we reported net operating income of $0.41 per share on the strength of our underlying performance.

In fact, this quarter, we've reported one of our strongest underlying loss ratios, which excludes Cats and prior year development.

Personal property was hit especially hard by the Cats, however, we reported a 7-point year-over-year improvement in the underlying results. Although we benefited from relatively good weather outside of the Cats, the actions we've taken in this line of business over the past 12 to 18 months are also clearly bearing fruit, and we remain committed to operating our property business at or below a 95% combined ratio.

Part of our plan to improve results is via pricing, where we are taking meaningful rate actions. We realize that this might translate into some loss of units in the short-term, but we believe protecting the bottom line is essential.

We are also on track to roll out new product features in the first part of next year.

Losses from Cats also impacted our results in personal auto, although to a lesser extent than in 2012. This quarter experienced $27 million of such losses, down from $45 million in Q3 of last year when hail, which hits auto harder, was a larger contributor to Cat losses. Our 93% combined ratio was almost 2 points better than a year ago as favorable prior year development was also quite healthy at $56 million.

On a year-to-date basis, our performance remains quite strong with a combined ratio of 91.4%. From a top line perspective, growth of 8% in the quarter reflects the addition of Jevco.

Growth in our commercial lines businesses was 4% versus Q3 of last year, reflecting the addition of Jevco. This quarter, the combined ratio of 102.5% in commercial lines was significantly higher than a year ago, reflecting nearly $100 million of losses from Cats.

We continue to expect firmer conditions in commercial P&C, driven by industry groups that represent approximately 25% of the market.

Our expense ratio was higher than last year when we benefited both from a onetime release, as well as from favorable timing of accruals. Also, this quarter, the accruals, which tend to vary from quarter-to-quarter, went the other way.

Our net investment income of $104 million was 13% higher than a year ago, as we continued to benefit from reinvesting the additional assets from Jevco into our higher-yielding portfolio.

Now that the Jevco assets have been fully integrated, we expect investment income will remain flat in the coming quarters, given the continuing low yield environment.

The combination of our underwriting loss and the impact of tax-free dividend income resulted in a negative effective tax rate this quarter. Our tax rate is always higher in quarters with more underwriting income and lower or negative in quarters with less underwriting income.

Our financial position remains solid at the end of the quarter with $515 million in excess capital and book value per share, 5% higher than a year ago.

Our estimated MCT improved slightly to 199% within the 195% to 205% range previously outlined. The ratio was helped by our earnings in the quarter, improved equity in capital markets and a slowdown in our share buyback activity.

In the absence of unusual events or growth opportunities, we anticipate, in the near-term, our MCT will remain in the 195% to 205% range.

Acquisition synergies remain on track as our integration is near completion. Though we're not yet done, I want to thank our employees for their hard work over the past 2 years. With the expertise they now have, we are even better positioned for future opportunities that may arise.

I believe that Intact continues to have a sustainable competitive advantage due to our disciplined approach and quality operations.

As this summer has demonstrated, our employees have shown that they will work hard to provide our customers with world-class service even in the face of unprecedented levels of weather events.

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

Dennis Westfall
Former Vice President of Investor Relations
Thanks, Mark. Amy, we are now ready to take questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Tom MacKinnon of BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

Two questions here, Charles. I wonder if you can elaborate, first of all, on what the tone has been like in terms of the dialogue with the government on the cost reduction measures. Kind of what you're looking for implementation and how you're prioritizing these. And I have a follow-up.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think, as I mentioned in my remarks, these guys really understand, I think, they're constructive, and they know that cost reduction measures will be critical to ensure that the product is available in the market. I think there's been, actually, concrete measures that were implemented in August, actually, such as reaffirming that minor injury guidelines are actually binding, and this was done through legislation, which, in my mind, will have a positive impact on the inflation in the system going forward, an important measure to strengthen the impact of the minor injury. We're working with them to provide concrete ideas that can have an impact in the short-term and that are palatable from a public policy objective to be rolled out in the short-term. And I'll just to give you a bit of flavor, I'll ask Mathieu to share with you a number of ideas that are currently on the table.

Mathieu Lamy
Chief Information Officer and Senior Vice President

So I'm working with IBC. We've proposed a few items to the government. We're expecting antifraud or some other recommendation by the anti-fraud task force measure to be implemented. We're expecting a review of the ADR process, the mediation process, to help simplify the process and make it more streamlined. Some recommendations were proposed in terms of the main guideline, in terms of the pre-existing medical condition are there defined. So a series of measures to help on the cost side -- on the claim side.

Charles Brindamour
Chief Executive Officer and Director

Tom, my sense, and I have a fair bit of interactions with folks there. And, I mean, these guys want to do the right thing for Ontarians. I think it is a politically-charged environment, but they're approaching the issue from the perspective of Ontarians and Ontario drivers. And, I think, they want to do the right thing, and so in my mind, people's intentions are well aligned. It is politically-charged. I've described to investors that there is a base case scenario where I think you'll see good symmetry between cost and rates. Then there are more adverse scenarios, where there would be a disconnect between cost and rate. And as I've mentioned before, we have a number of measures that we're ready to act upon should we move in that scenario, but we're certainly not there at this stage.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And then on the telematics, what was the thinking behind the implementation of this? Presumably, it has some sort of profit motive or top line growth motive. I wonder if you can share what you think would be the impact of that as you continue to roll out this product, not just necessarily in Québec, but in some other provinces in 2014.

Dennis Westfall
Former Vice President of Investor Relations

I'll let Martin take that one, Tom.

Martin Beaulieu
Chief Operating Officer of Direct to Consumer Distribution and Senior Vice President

Using telematics, in fact, is well-aligned with what we are. An item that's leveraging our scale, and this is the way to segment even further with new information, our pricing and our underwriting. So we're expecting margins expansion through this. We don't have, at the moment, an exact impact because it will depend on how the claim side materializes versus these variables. We don't have a lot of data yet as to -- we anticipate the correlation, but we don't have the exact data. And we're expecting, as well, that through that segmentation, we'll expand our growth in the markets. So -- and we're really aligning ourselves with what the Ontario government is trying to achieve, which is reward safe driving behaviors.

Charles Brindamour
Chief Executive Officer and Director

Yes, so Tom, I mean, this is a profit growth play that we're trying to achieve here. I think, will it move the needle in the short-term? Hard to tell. As far as I'm concerned, I think we have a plan that we are aiming for. I think we'll be in a better position to clarify the impact that this will have in the coming 3 to 6 months, probably in 6 months from now, once we get a good sense of the take-up in terms of new business and then what our existing clients actually choose to do. We'll get first the picture in Québec. We'll likely get a picture in Ontario in the first half this year. I think the rest of the country will see deployments for the rest of the year. It's something that we have been monitoring very closely for many years. I think, as I've mentioned before, we had made a conscious choice not to be the first ones with that, but we had agreed upon a few years back that as soon as somebody is out with that, that within 6 to 9 months, we should be out, and that's what we're announcing this morning.

Tom MacKinnon
BMO Capital Markets Equity Research

And are there any costs associated with starting up these efforts?

Martin Beaulieu
Chief Operating Officer of Direct to Consumer Distribution and Senior Vice President

Yes. The startup costs are minimal. I would not consider this as substantial. There is a cost for the device, but this is something that -- those ongoing costs are really manageable within the way we're going to associate discounts to that -- to those behaviors.

Charles Brindamour
Chief Executive Officer and Director

It's reflected in how we price the offer.

Operator

[Operator Instructions] Your next question comes from the line of Shubha Khan of National Bank Financial.

Shubha Rahman Khan
National Bank Financial, Inc., Research Division

Just on reserve development in personal auto. It's been quite strong for 3 quarters in a row now, and I assume that most of that is coming from Ontario. And I also assume that you continue to reserve conservatively there, I guess, because the environment remains uncertain. My question is, at what point would you be comfortable dialing back that conservatism? Because judging by your comments, it appears that the environment, at least with respect to bodily injury, for example, has been fairly stable for a few quarters now, and the impact of the 2010 reforms appear to be unfolding as expected. Your arbitration backlog is up only 3%. So I imagine that isn't generating too much uncertainty either. So when would you be comfortable dialing back that conservatism in personal auto?

Charles Brindamour

Chief Executive Officer and Director

I'll let Mathieu explain his perspective on bodily injury, which is an important portion of our reserves in our IBNR. I think you have -- you're seeing healthy favorable development beyond and above our long-term average there. I think that it is fair to say that Ontario contributes to that. I think there's favorable development, as you can see in the stat supplements for all accident years. So it's not all Ontario, and it's not all accident benefit or post-reform driven. That's the first point I will make. The bulk of the favorable development that we observe in Ontario is driven by actual files that we closed, as opposed to meaningful changes in our thought process as to the degree of conservatism that is needed. There is still some uncertainty in the system, which we take into account as we reserve. And, I think, BI, in particular, is one of those key elements. And I'll let Mathieu comment on his perspective of the BI environment and why he thinks we should be cautious on that front.

Mathieu Lamy
Chief Information Officer and Senior Vice President

Well, we should be cautious, and we are cautious. And we see an increase in the number of claims filed and pre-reform level. This was expected as some of the AB claims are transferred on the BI side. Although the increase that we see is less than our reform expectations, you have 2 to 2.5 years to submit the claims, and that claims may stay -- on average stay open for another 2 years. So we're looking at a 4, 5 years duration here. So that's why the post-reform claims we're not there yet. So that's why we need to remain cautious.

Charles Brindamour
Chief Executive Officer and Director

Exactly. What we're seeing in the field day in, day out our claims adjusters' work is pretty good. I think, at a high-level, we have to take into account what Mathieu has just mentioned, and that's the basis on which we're reserving right now. And I think, we're pretty comfortable with that position. And I think as files close, then you see favorable reserve development at that stage, but no change in stance on our part.

Shubha Rahman Khan
National Bank Financial, Inc., Research Division

Okay, that's helpful. And if I can just switch gears quickly to commercial P&C. It looks like Cat losses have been elevated through the summer. And you seem to suggest that this could result in firmer pricing over time. In the more immediate term, do these elevated Cats provide the necessary impetus to reduce coverage or implement other sort of product tweaks, similar to what you've been doing in personal property? Or in other words, do you intend to -- or do you need to or intend to take actions to tame Cat activity in commercial P&C?

Charles Brindamour
Chief Executive Officer and Director

So I think there's 2 elements to your question, which are distinct. And, I think, let's first go over what we think we need to do in relationship with catastrophes on the product, and then we can, maybe, give you a broader sense of where we see the market heading and what we're seeing right now in the market. And I'll ask Alain Lessard, our SVP, Commercial Lines, to share his perspective on that.

Alain Lessard
Senior Vice President of Commercial Lines

Okay. So if you look at -- the first thing when you are talking about commercial property is that we do provide flood coverage. We provide sewer backup and flood coverage. In general, if we look at our portfolio, roughly about 40% of our insured -- really insured for flood and sewer backup. So like you said, the summer event, either the rain in Ontario or the flood in Calgary, has led us to really reconsider some of the action there. The first thing we're -- right now in the process of implementing is minimum deductible. We had variable minimum deductible between $10,000 and $25,000 varying by provinces. We're now in the process of harmonizing that going to $25,000 everywhere. We also have measure, where we don't offer flood coverage in flood recurring territory, and basically, those 2 events. Right now we're reviewing those territory to see if there are somewhere we see more flood than we were expecting. So normally this will also have an impact on availability of coverage. And we are going to be reviewing our rates for flood and sewer backup in Q1 2014. So on the market, we've been, I think, pretty consistent since the beginning of the year, saying that we were expecting firming conditions for about a 1/4 of the market. The market that was the worst performing. I think the flood -- the event of the summer is adding a pressure. The renewal of the reinsurance that will be coming for some company will also, I guess, add some pressure, low interest rates. So we're now seeing, I would say, still a very healthy market in the sense that new business is really still competitive, but we are seeing more and more companies coming out with profitability message on some classes of business and on some like flood and sewer backup, where they're seeing and implementing underwriting rules. So I would say, right now, we were expecting firming conditions on about 25% of the market. I would say that we are slowly seeing those firming condition emerge. And if I look more on number side, we were pushing rate increase throughout the last few years, small rate increase in renewal. And now we've been achieving like 1.9% rate increase on the first quarter, about 2.3% in quarter 2. And during the summer, we've kind of, I would say, review our renewal strategy, pushing more rate increase on underperforming segments. And now we're achieving 3% in Q3 on rate increase at renewal, going to 3.3% in the month of September. So we're seeing some traction in that movement, but it's still slowly firming up. It's not like happening on every risk everywhere. But the 25% we're seeing really firming condition gradually, and we expect that to continue next year.

Charles Brindamour
Chief Executive Officer and Director

You might comment -- I guess, to judge the markets, you might comment on what you're seeing in terms of retention and new business production and so on.

Alain Lessard
Senior Vice President of Commercial Lines

Yes. Like we said, we've increased our rates on new business in Q1 that had about no impact on our closing ratio. We're pushing a new rate increase in October. On the renewal side, when we started pushing more rate increase during the summer, we saw a slight decrease in the renewal retention, going from 86% to 85.5%. So we're applying something like 0.5 point to 1 point reduction in retention, but this is because we're pushing more rates on underperforming segments.

Operator

Your next question comes from the line of Stephen Boland of GMP Securities.

Stephen Boland
GMP Securities L.P., Research Division

Couple of questions. Just under the minor injury guidelines. You said 54 -- or you stated 55% of the industry claims are falling under the MIG. But your number is actually higher. So what are you doing differently than the industry to get, I guess, cost -- I guess, contain costs under the MIG?

Mathieu Lamy
Chief Information Officer and Senior Vice President

I'd say the reform expectation, we're at 55%. We don't know for sure what the industry number is, and we know our number, and we're still experiencing above 55%. Hard to say what we're doing differently than the industry.

Charles Brindamour
Chief Executive Officer and Director

Like -- I don't know what the others are actually doing, but I know that what we're doing translates in a meaningful loss ratio advantage in the market. And I think there's clearly a degree of proactivity on our side, which is paying up. I mean, the shorter the claims is open, the better for the client and the better for us. And that's the mindset that we're in here at this stage. When these reforms came out, we really embraced these things, not only with the reform, but you will recall, Stephen, that 2 years back, we said we'll match the impact of the reforms with our own actions on top of the reforms. And I think it's our own actions on top of the reform that are really paying up for us at this stage.

Stephen Boland
GMP Securities L.P., Research Division

Okay. Second question, on your home insurance and the changes that you're being proactive on, sub-limits, higher deductibles, rewording of policies, again, how much more, I presume all the industries moving to contain cost here. Where would you say you are in terms of -- are you being more aggressive than the industry? And, I guess, my point is that if you are being more aggressive within the industry, is there a chance here that you end up losing more business as you're increasing rates a lot faster than the competitors and you lose premium?

Charles Brindamour
Chief Executive Officer and Director

Yes. Well, we don't look at what happened in the past 2, 3 years as freak occurrences. And I don't think that many of the players are in that mindset. I think that the sense I'm getting is people are waiting to see what we're doing now. Our colors are becoming increasingly clear, because we're actually taking actions, but there's no doubt in my mind -- I'm in Alberta this morning with the team here. We're sitting here in Calgary and met with lots of brokers in the past couple of days, and it's very clear that we're ahead of everybody else on these things. And there is a risk that units will suffer. There's no doubt about that. I think the industry will follow. I don't know when. And at this stage, it's tough to be a leader, but that's what it's all about. We're doing what we think is right, and we'll live with the consequences there. So there might be pressure on the unit front, but it's not something we're overly concerned about. I think what we're concerned about is making sure that: a, we have a product that's sustainable; b, that clients understand and have incentives to make sure that the product remains affordable for them; and c, that the brokers and the employees are well-equipped to explain why changes are taking place and why it's important for these changes to take place. I think coming 6 to 9 months, we'll be very demanding on our troops. I think it's creating additional work for brokers. There's no doubt about it. But it's really important for us to do this. I think it's also important to understand, Stephen, that we're not spreading with a broad brush. I forget what's the expression in English, but we're taking a segmented approach here in the area -- in the areas where the risk is actually the highest. And so it's not as if there was risk on all units, I think. The segments where we're acting are segments where we feel that it's not sustainable at this stage. And so I think, if you look at our big financial objectives, which is ROE outperformance and growth in operating income per share, we're very comfortable with the actions that we're taking so that it will contribute to those 2 objectives.

Operator

[Operator Instructions] Your next question comes from the line of Mario Mendonca of TD Securities.

Mario Mendonca
TD Securities Equity Research

Just a couple of quick questions. First, on telematics. Do you see any potential that, to the extent that it becomes widespread, Intact's sort of informational advantages could deteriorate somewhat? Is that something that is possible? Or do you maintain those advantages?

Charles Brindamour
Chief Executive Officer and Director

Well, I think that's why it's important to be out there quickly, first point. Second point, I mean, I take you back to Ontario, which, in my view, is the province where we have the most constraints when it comes to pricing and segmentation. And we have $1 trillion price points. And we have a team -- an R&D team that is not sitting on their hands at the moment. They're working on the next 2, 3 ideas to keep segmentation advantage. So I think we'll see what the take-up is, Mario, on telematics to assess that point. But I will think there's lots besides telematics that contributes to a segmentation advantage. And our folks are not sitting on their hands. The other thing is that with telematics, there's what you do and what you price for. And then there's the data you collect that you're actually not using. And for me, that adds a lot of value from a segmentation point of view. And given our size, our ability to match this data with claims experienced and obtain credibility on that, I think, is much greater than everybody else in the market. And so, I think, there's actually an opportunity there on the segmentation front, beyond and above what the program is doing today.

Charles Brindamour
Chief Executive Officer and Director

No. And I would say, to the contrary of, is there a potential that we would lose some of our advantage? I think, it's further advantage for us because our larger databases are going to allow us to slice and dice this new information faster than most and have credible information to apply this in our segmentation technique. So I'm very upbeat when it comes to that new way of doing business.

Mario Mendonca
TD Securities Equity Research

But it's fair to say we won't have a good answer on this for, probably, several years?

Charles Brindamour
Chief Executive Officer and Director

Well...

Mario Mendonca
TD Securities Equity Research

Like whether it narrowed the gap or not.

Charles Brindamour
Chief Executive Officer and Director

I think the take-up rate and the amount of data we'll be able to collect, we'll get a sense in the coming 6 months, Mario, I think. And then based on that, we'll assess where we can take this. It's something we'll talk about at the Investor's Day, as well as give you a bit more color on that, but it is indeed, fair to say that it'll take a bit of time before we get full clarity on that. But certainly, an avenue that could provide us segmentation advantage over time.

Mario Mendonca
TD Securities Equity Research

Going to personal auto for a moment. The claims ratio -- the current year claims ratio, it is up now, I think, it's 5 consecutive quarters. And there's been very good explanations in the past. Is there any particular thing you would point to this quarter that would drive the year-over-year increase in the current year claims ratio in personal auto?

Charles Brindamour
Chief Executive Officer and Director

So the current accident year claims ratio is up 1.9 points, basically, year-over-year. And I'll let Martin gives his perspective on that.

Martin Beaulieu
Chief Operating Officer of Direct to Consumer Distribution and Senior Vice President

Most of that deterioration we're seeing is coming from the seasonal nature of the Jevco portfolio, which was not present last year at that time in our numbers and bringing it this year in our numbers. Motorcycle seasonality is, during the summer, these are larger claims that you see coming in. This comes also with an offset with respect to the average premium going up, but since the seasonality in Q3 of motorcycles is higher, this is what is most of the explanation for the increased experience.

Mark A. Tullis
Vice Chairman

I think the thing to keep in mind is we booked a premium for that ratably throughout the year. But we incurred the bulk of the claims in the summer because people drive the motorcycles less in the winter. So there's -- this is a new seasonality that's been added that we didn't have before Jevco.

Mario Mendonca
TD Securities Equity Research

And Jevco wasn't around 12 months ago, that's why seasonality...

Charles Brindamour
Chief Executive Officer and Director

That's right.

Mario Mendonca
TD Securities Equity Research

And then is there any connection -- can we draw any inferences from this year-over-year increase in the current year claims ratio and acknowledging that this is, maybe, perhaps, a special quarter? Is there anything we can take from that in relation to the very strong reserve development? Could -- is there a connection there? If we -- for example, we continue to see year-over-year deterioration on the core claims ratio or the current year claims ratio, does it say anything about the future insofar as development is concerned? Or are these 2 really independent in your thinking?

Charles Brindamour
Chief Executive Officer and Director

So the stronger reserve development you're seeing is largely driven by field activity, where we actually settle claims. So you could argue that if the world didn't change and the field activity continues as is, as we observe it today, you could argue that the current accident year loss ratio might be overstated. I think, we look at it, and we're seeing the field activity is great, but there's been a number of changes in Ontario, in particular, which lead us to remain cautious. So I would not infer at this point, Mario, that the current accident year loss ratio might be overstated because we're seeing in previous accident years favorable or greater favorable development this year. I remain cautious on that front.

Mario Mendonca
TD Securities Equity Research

I'm not sure which direction to go, whether to call it current year overstated or to suspect that the reserve development will eventually fade. Does it feels like one of those two things is going to happen is just sort of hard to say, but...

Charles Brindamour
Chief Executive Officer and Director

Yes, one should not -- if you think a very long-term perspective, you should think about favorable reserve development in line with sort of guidance we've given in the past, 3 to 4 points. I think it's no surprise that reserve development has been more favorable than the long run average in the past few years, because we have taken a cautious stance. So should one expect reserve development to move towards 3% to 4% over time? I think so. Would it be the case in the coming 12 to 24 months? Not clear to me. If the reforms remain effective, we might see favorable development in that sort of order.

Mario Mendonca
TD Securities Equity Research

Okay. And I'll try to be quick with Mark. The impairment on the callable preferred shares, you call that onetime in nature. Can you just provide a little color on what's going on there?

Mark A. Tullis
Vice Chairman

Sure. So we bought preferred shares a number of years ago at a premium. And when they change the capital rules for the banks, they're now more apt to be called earlier. So our expectation is now many of these preferred shares that we bought at a premium may be called in 2014. So what happens on a market basis is the market values tend to move down toward the call premium, but the way IFRS works is you don't do the write-off until you pass the bright-line test. So when the market value gets below a certain point, it triggers an impairment. So it's not a credit-driven impairment, it's an impairment driven by the fact we bought it at a premium. There have to be -- when we -- the price we paid for was based upon being called. So economically, this is not an economic impairment. It's an accounting-driven thing caused by the fact that we bought it at a premium, and we've passed the bright-line, which causes it to be written off. And the reason it's onetime in nature is we can model this out, and we know there is not going to be significant more of these in the future.

Mario Mendonca
TD Securities Equity Research

That was the nature of the question, why it was you felt it would only be onetime. And I suppose...

Mark A. Tullis
Vice Chairman

It's because when we bought them, this is the quarter when they passed that bright-line.

Mario Mendonca
TD Securities Equity Research

And can you give us -- like how large that was?

Mark A. Tullis
Vice Chairman

Sure. It was $17 million this quarter, and I would expect nothing significant in future quarters.

Operator

Your next question comes from the line of Asim Imran of Macquarie.

Asim Imran
Macquarie Research

With respect to your plan for delivering a 10-point improvement in the personal property combined ratio, is there any way you can guide us whether a majority of it will come from the low-teens rate increase? Or would it be more from the product improvements?

Charles Brindamour
Chief Executive Officer and Director

I think there's 3 angles to think about in the coming 24 months: there's pricing, there's product and there's claims. I think that we front-loaded our actions in pricing because that's the easiest first step you can do. And the increase in pricing actions on top of what was in place already could explain 2/3 of that. We think that the remaining portion will come from product. We think there's a fair bit of upside in claims as well. I think putting our finger on how much claims it's worth is not clear at this stage, and I'll let Mathieu maybe talk about some of the things we're doing in claims on that front. But out of 10 points, I think there will be a good 2/3 coming from rates within 24 months.

Mathieu Lamy
Chief Information Officer and Senior Vice President

Well, on claim, we're focusing on -- part of it is going to come to improve our execution. In Cat time, we've increased our resources that handled the loss internally. So we think that as -- is at least to improve the expense of managing the claims as a customer service aspect to it and improvement on that, and certainly, a control on indemnity, because we have high SGI's on the scope of the claims. So this is certainly one aspect. We continue to have activity on the supply chain side of things. Like you said, Charles, it's difficult to measure exactly how it's going to bear in terms of exact percentage, but we're certainly active on that front.

Charles Brindamour
Chief Executive Officer and Director

And I would say that when I think about claims, the one where there's fair bit of upside, in my mind, is the control point that you've talked about, Mathieu, where we're much tighter in the appraisal process to make sure that we're not being taking advantage of, in periods where lots of claims need to be appraised. So we're really boosted our troops and our efforts on that front have done a, what we call, a leakage study after the hailstorm last year and figured out that there was upside for us to increase our control. We had prepared to roll out that plan in May, and we had an opportunity to execute on it with a vengeance to a certain extent, given the summer we've had. But fair bit of it left to be deployed in the coming years. Hopefully, we won't have as many opportunities to use it, but we're preparing for the worst.

Martin Beaulieu
Chief Operating Officer of Direct to Consumer Distribution and Senior Vice President

And on the claims front, we're introducing the notion of settling roofs on the basis of age of that roof in Alberta, so that's hail related that measures, so that's going to take a chunk out of those settlements. And in addition to price, product and claims, I think the one thing that's difficult to quantify, but where our actions are focused is, is trying to make people and society change behavior towards climate change. And this is something that needs to happen to put the equilibrium in the system, and many of our actions are geared towards education prevention, but also even when the product is changing, we're giving people opportunities to change behavior therein and improve the overall scheme.

Charles Brindamour
Chief Executive Officer and Director

So we've done a very good job giving you a very long answer to a small question. The answer is 2/3 from rate for sure.

Operator

[Operator Instructions] And there are no further questions on the phone line. I'll turn the call back over to the presenters.

Charles Brindamour
Chief Executive Officer and Director

Thank you, everyone, for participating. The webcast will be archived on our website for 1 year. Also, a replay will be available by 3:00 p.m. today until Wednesday, November 13. A transcript will be made available on our website. Please note that we'll be hosting our annual Investor Day in Toronto on November 27, and our fourth quarter and year end results for 2013 will be released on February 5. That concludes our conference call. Thank you, and have a great day.

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