S&P Capital IQ

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Intact Financial Corporation TSX:IFC

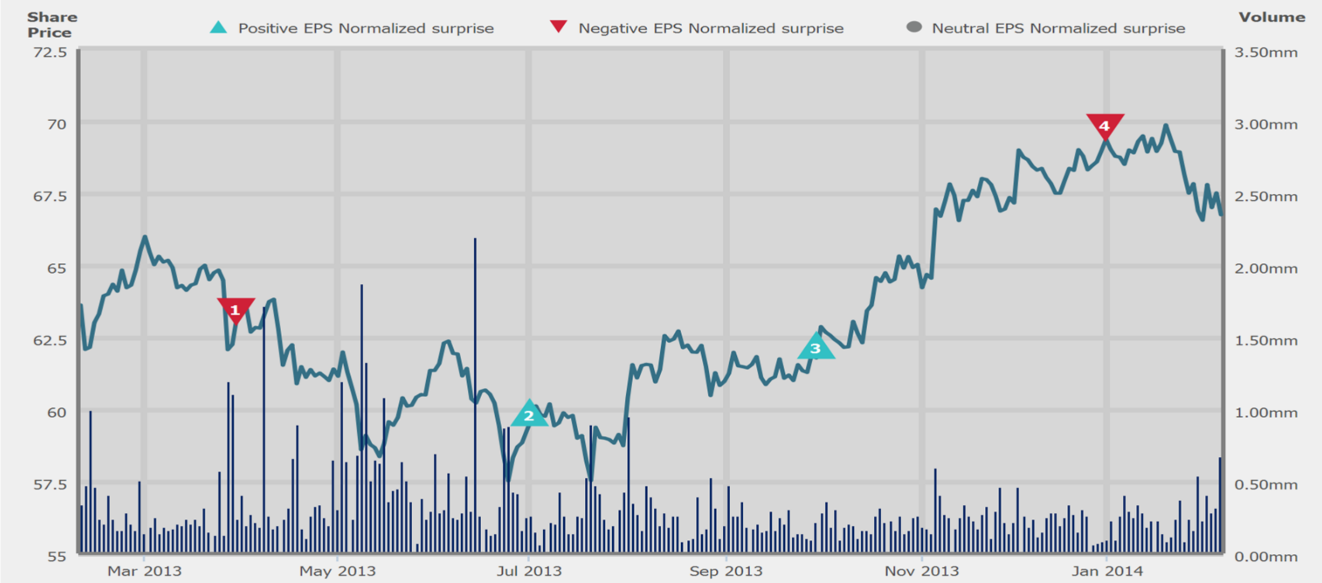
FQ1 2014 Earnings Call Transcripts

Wednesday, May 07, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.17	0.94	(19.66 %)	1.58	5.94	6.38
Revenue (mm)	1803.08	1503.00	(16.64 %)	1928.21	7445.41	7659.95

Currency: CAD
Consensus as of May-07-2014 2:50 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	1.32	1.27	(3.79 %)
FQ2 2013	0.74	0.89	20.27 %
FQ3 2013	0.32	0.39	21.88 %
FQ4 2013	1.21	1.05	(13.22 %)

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

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Patrick Barbeau
Senior Vice President of Claims

ANALYSTS

Brian Robert Meredith
UBS Investment Bank, Research Division

Doug Young
Desjardins Securities Inc., Research Division

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

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TD Securities Equity Research

Paul David Holden
CIBC World Markets Inc., Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning. My name is Sharon, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp. First Quarter Results Conference Call. [Operator Instructions]

Mr. Dennis Westfall, VP Investor Relations, you may begin your conference.

Dennis Westfall
Former Vice President of Investor Relations

Thanks, Sharon, and good morning, everyone. 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 a disclaimer on forward-looking statements, which also applies to our discussion on the conference call.

Here with me today are Charles Brindamour, CEO; Louis Marcotte, CFO; Patrick Barbeau, SVP of Personal Lines; Alain Lessard, SVP of Personal Lines -- Commercial Lines; and Mathieu Lamy, Senior VP of Claims. We will start with formal remarks from Charles and Louis, followed by a Q&A session. The others will also be available to answer your questions during the Q&A.

With that, I would like to ask Charles to begin his remarks.

Charles Brindamour
Chief Executive Officer and Director

All right. Thanks, Dennis, and good morning, everyone.

Earlier today, we announced the first quarter net operating income of $129 million or $0.94 per share, down 8% from last year, excluding a nonrecurring favorable tax item in 2013. For the second consecutive quarter, the harsh winter took its toll on our underwriting performance. The first quarter of 2014 experienced much colder temperatures than the same period from a year ago, both on average and in the number of days of extreme cold. The winter conditions led to 75 million of cat losses and a 14% increase in the frequency of claims in our auto businesses. Over the past 12 months, our results have been impacted by close to $600 million of cat losses. Despite this, we've generated an operating ROE of 10%. Clearly, we're not satisfied with an ROE of 10%, and we've been taking action.

Progress from these actions is evident in our personal property results this quarter. Although the business recorded 12 points of cat losses in Q1, it generated a combined ratio of 91.8%. This is a great result, but we're not ready to declare victory on our goal to achieve a 10-point improvement in that line of business. Work continues to ensure we can meet our goal on a full year basis.

The industry has also started to move, but as we were an early mover, we continued to lose a couple of points of units in the first quarter, largely in line with our expectations. Despite moving faster than our competitors, we generated an underlying growth of 5.2% this quarter in property, which excludes the impact of converting 2-year policies into 1-year policies, as we discussed last quarter.

Rate actions should bring about 2/3 of our targeted improvement, but rates are only one element of our plan. We recently began implementing meaningful product changes, as well as offering customers the option to reduce premiums through prevention discount. The rise in losses these past few years has forced our peers to also announce profitability measures and begin taking underwriting actions, which should help with our retention in the latter part of the year. I'm pleased to report that this line of business, which has lagged our outperformance in other lines, is now achieving a 2-point advantage versus the industry.

We maintain our positive view towards personal auto, a line of business that generated a combined ratio of 97% in the first quarter, as icy driving conditions led to an increase in the number of accidents. Overall, we're operating in an environment where both competitors and regulators behave fairly rationally and costs have been generally stable in the recent past.

Turning to Ontario. The government's auto insurance cost and rate reduction strategy has been successful thus far at reducing filed rates by 5.7% across the market as a whole. Our process of reducing rates to customers by 5.3% on average began in early April. The government subsequently tabled legislation that would have brought further meaningful cost reductions to the industry. Unfortunately, the dissolution of Parliament has stalled the passing of this legislation. We trust it's very clear, in fact, for all parties that further rate reductions can only come in conjunction with meaningful cost-reduction measures. In the current environment, due to the cost-reduction measures already implemented and our own proactive actions, we're comfortable with our margins in this market and will continue to pursue growth opportunities.

Our commercial P&C business was not immune to the effects of the winter seasons and reported a disappointing combined ratio of 105.6%. And I say disappointing because this line of business is priced to generate a combined ratio in the low 90s on a full year basis. A meaningful portion of the claim cost in the quarter were weather related, including burst pipes and fires from severe cold as well as water damage from rapid thawing. To address these results, we'll continue to take rate action on the least-profitable portions of the portfolio and leverage some of the same actions used to mitigate the impact of cats in our personal property business.

When it comes to our outlook for the industry, we foresee low single-digit growth in personal auto, as well as commercial lines and upper single-digit growth in personal property. We continue to expect the current hard market conditions in personal property to accelerate meaningfully for the foreseeable future. While we did not see significant acceleration in Q1, the commercial P&C market has shown distinct signs of firming in the past year. Rate increases on renewals across the portfolio were up by 4.5% in the first quarter versus 1.9% in Q1 of 2013. The low interest rate environment and elevated losses from catastrophes should support our growth outlook.

From a profitability perspective, we expect the industry's combined ratio to improve in 2014 given the unprecedented level of cats seen in 2013. Overall, we expect the industry's ROE to trend back towards its long-term average of 10% this year. Looking specifically at Intact Financial, we believe we will outperform the industry's ROE by at least 500 basis points.

In conclusion, we're energized by our prospects for 2014 and beyond and believe that the disciplined approach we take towards operating our business will continue to serve us well. I'm confident that we're well positioned to excel in the current environment, aided by a strong capital position, which enables us to execute upon opportunities for profitable growth.

I'll now turn the call over to our CFO, Louis Marcotte.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Thanks, Charles.

Today, we announced first quarter net operating income per share of $0.94, with a combined ratio of 97.1% compared to 95.1% in Q1 of last year. The harsh winter season resulted in 4.3 points of catastrophe losses, 4x higher than last year; and higher claims frequency, which negatively impacted underlying loss ratios in personal auto and commercial lines.

Our disciplined approach to the business somewhat tempered our top line, resulting in a 1% underlying growth rate for the quarter. This approach includes the continued reduction in our B.C. earthquake exposure and our actions to increase rates in the least-profitable segments of our commercial portfolio. The top line impact of these initiatives should decline in the coming months.

The combined ratio in personal property was 91.8% despite the winter -- the difficult winter weather. Our actions to improve the performance of this line of business are clearly proving effective, as we reported one of our best underlying loss ratios in the past 6 years despite the difficult winter. I believe we are well on our way to accomplishing our targeted improvement and have recently begun to roll out the next wave of product changes.

Moving to auto. Our underwriting performance in Q1 was negatively impacted by the extreme cold, as a higher incidence of claims resulted in a combined ratio of 97% versus 94.1% a year ago. Favorable prior year claims development remained healthy at $61 million versus $71 million in Q1 2013.

Our commercial P&C line of business experienced a challenging first quarter of the year both from a top line and bottom line perspective. I mentioned our actions to improve our profitability, including reducing quake exposure and focusing on the least-profitable segments of the portfolio. These actions contributed to a 3% decline in premiums in the quarter. Our $21 million underwriting loss reflected the difficult winter conditions, including $28 million of cat losses and an increase in both frequency and severity of claims. Commercial auto premiums declined 2% from a year ago, reflecting competitive market conditions and the impact of reunderwriting actions taken subsequent to Q1 2013. The combined ratio of 89.3% improved 8 points from last year.

Our expense ratio of 29.8% in the quarter was down from last year, driven by lower variable commissions and compensation, both driven by weaker underwriting results.

I'm pleased to report that we've achieved our after-tax synergies target of $100 million on the AXA acquisition and also essentially completed the system's decommissioning. This is an achievement that was made possible by thousands of dedicated employees and something of which we are all very proud. We are also on track to decommission Jevco systems throughout 2014 and have already reached synergies run rate of $21 million. This is well in excess of our expectations when we announced the purchase 2 years ago.

Net investment income of $105 million was 9% higher than a year ago, driven by higher dividends. Dividend income was helped by a higher-than-usual turnover in our dividend rollover strategy. We also received 2 dividends in the quarter from one of our holdings. Despite the elevated level of income in the quarter, we expect full year net investment income will remain relatively stable in 2014 versus 2013.

Our financial position at the end of Q1 was strong with $670 million in excess capital and a debt-to-total capital ratio of 18.4%, below our target of 20%. Our MCT improved to 213%.

Keep in mind that Q1 typically sees a favorable seasonality impact, while our earnings in the quarter and improved capital markets also contributed to the 10-point improvement from year end. We intend to maintain our robust capital position given the potential growth opportunities we see in manufacturing and in distribution. I believe that Intact continues to have sustainable competitive advantages due to our disciplined approach and quality operations. We have been innovative in our actions to improve profitability and grow the business, as evidenced in our traction with the home improvement plan and the launch of UBI. With $670 million in excess capital to support our business decisions, I am happy about the range of options available to us.

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

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

Question and Answer

Operator

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

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

I just had 2 questions for you. Just first off was, Charles, you were talking about, with Ontario, auto and the election. I guess just, is the way to maybe think about it is with the election and then the eventual hopeful implementation of cost-reduction measures, that not much of an impact in 2014, maybe a bit of a slight impact, negative impact, in 2015, to the extent these cost reduction-measures are delayed a bit?

Charles Brindamour
Chief Executive Officer and Director

Let me ask Patrick Barbeau, our SVP, Personal Lines, to give you his perspective on it.

Patrick Barbeau
Senior Vice President of Claims

Yes. The reforms so far have been quite efficient in containing costs. We have seen -- the cost-reduction measures implemented in February are now in place. The new Bill 171 that passed second reading just prior to the general Ontario election was called would further reduce costs by a few points. So all of that are good signs that government is wanting to align cost-reduction measures -- or rate reduction with cost-reduction measures. So it's very positive sign for us. In fact, also on top of it, the fact that all parties largely supported the elements part of the bill is also very positive for us. So the really -- the only downside is those additional cost-reduction measures are probably postponed now because of this election, but [indiscernible].

Charles Brindamour
Chief Executive Officer and Director

Yes, I think that's right, Patrick. And I think we're -- given the -- all the parties' stance on Bill 71 (sic) y, I mean our expectation is that once the elections are done, we'll see this bill back early in the fall. So clearly, this delay there is a cost to 2014, though not clear to me that it will be a cost to 2015. And it's not clear to me that further cost-reduction measures that folks were thinking about will not necessarily take place. I think on the contrary. And we don't want to speculate on the outcome of the elections, but we certainly look at the range of options here, and I think that there's many options that are as good, if not better, as the current setup.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Okay. And the second question I had was, with the pricing changes that you've been making in terms of price increases, changing to the product features, is it too early to say or are you seeing changes in terms of client behavior as they come up for renewal on their policies?

Charles Brindamour
Chief Executive Officer and Director

Patrick...

Patrick Barbeau
Senior Vice President of Claims

Yes. On residential, yes, we've seen a bit of people on -- our prevention discounts have just been launched. So this is one way that customers can act by being active on the prevention side. So we are seeing a little bit of that. We are seeing also clients increasing their deductibles to try to alleviate the rate increases. So those are the 2 main parts that we have started to observe.

Charles Brindamour
Chief Executive Officer and Director

Geoff, was your question for prop, or for automobile insurance?

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

More so around the property side.

Charles Brindamour
Chief Executive Officer and Director

Yes, okay. So I think that's exactly right. And I think if you get down to understand the top line, we said that the top line was up 5.2% in personal property. Rates are up obviously closer to 10% at this stage. Units are down a couple of points, as I've mentioned in my remarks. So the reconciling factor here other than some insured is what we call change in mix. And change in mix is essentially this behavioral change that you're talking about, and that's -- the examples that Patrick gave are exactly that. And that's had an impact on the growth of mid single-digit range, which has nothing to do with the bottom line but everything to do with customer's decision in terms of options. But we're quite pleased with what we're seeing in prop at this stage.

Operator

Your next question comes from Tom MacKinnon from BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

A couple of questions. Did you talk about the commercial premium rate hikes you've been getting in the quarter? Was that 4.5% in this quarter? Is that the average? And that was up across...

Charles Brindamour
Chief Executive Officer and Director

Yes, versus 1.9 a year ago.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And maybe you can talk a little bit about the -- what's happening in personal auto outside of Ontario. What's that environment like? What's the pricing like? We certainly do talk a lot about Ontario auto, but maybe if you can talk about outside Ontario auto and what regions you're getting some price firming in there and what's the environment like there.

Charles Brindamour
Chief Executive Officer and Director

Well, Tom, that's a refreshing question. We feel like we've been talking Ontario for the past 3 years now. So I'll let Patrick give you sort of an overview there about our automobile markets.

Patrick Barbeau
Senior Vice President of Claims

Overall, I guess the main area where we're seeing firming conditions on price for personal auto is Alberta. The -- we are increasing our rates by 5%. The industry is as well. The loss ratio of 2013 was demanding it. In Québec, this is fairly stable; and a slight increase also in Atlantic. So overall, when you combine that with the minus 5% in Ontario, rates are fairly stable all in the -- in Canada for personal auto.

Charles Brindamour
Chief Executive Officer and Director

Yes, no, exactly right. When we look at the first quarter average rate change in personal automobile business, it's about 1.5% on a direct written basis...

Tom MacKinnon
BMO Capital Markets Equity Research

Positive 1.5%?

Charles Brindamour
Chief Executive Officer and Director

Yes, positive 1.5%, driven by some of the things that Patrick has talked about. Clearly, this will change direction as the rate reductions in Ontario take place, but as we've mentioned before, I think we're pretty comfortable with our margins there.

Tom MacKinnon
BMO Capital Markets Equity Research

And can you just remind us what percentage of your premiums earned are from auto, split between Ontario and outside of Ontario?

Charles Brindamour
Chief Executive Officer and Director

Well, I think the automobile portfolio, I stand to be corrected here, but -- is 46%, 47% of our overall portfolio, and automobile in Ontario is about half of that roughly.

Tom MacKinnon
BMO Capital Markets Equity Research

This is personal, excludes commercial, does it?

Charles Brindamour
Chief Executive Officer and Director

Yes, that excludes commercial, yes.

Operator

Your next question comes from Paul Holden from CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

I'm going to start with a less-refreshing question. I'm going to go back to Ontario auto. Charles, it seems like the message I'm getting from you is there's not room for rates to decrease further today based on announced cost reductions, but for the industry, we're still 2 points away from the August 2014 objective. Is that how we should be reading it? Is -- or are we not going to reach the 8 point objective?

Charles Brindamour
Chief Executive Officer and Director

Well, I don't want to say that, Paul. I think that there's still a portion of the industry that has not filed, okay? I think, at this stage, if you look at the first wave, which was announced in early January; if you look at the second wave that was announced in April, what is it, Patrick, 70% of the industry?

Patrick Barbeau
Senior Vice President of Claims

Close to 80%.

Charles Brindamour
Chief Executive Officer and Director

Close to 80% that has filed, so you still have the 20% of the industry that might move the needle a bit. But I think as far as we're concerned and in discussion with various stakeholders that are involved in that process other than our competitors, obviously, it's pretty clear that there is no room to pressurize the industry at this stage. And I think that we've said that all along, with a combined ratio at the industry level close to 100% in the past year or 2, I think people get it. And corrective measures are being taken at the industry level. You can see that in a number of companies. These are signs of capacity tightening. And I think that the government and -- or the prior one, anyways, and the regulator clearly get that. They understand very well the dynamics of the market. And I think availability is objective number one. So I think that's where we stand. I don't know what -- Patrick, what you think, but...

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And then maybe moving on to personal property. You mentioned that competitors are starting to move on rate and, I guess, product action more similar to what you've done. Should we expect customer attrition in the next couple of quarters to be roughly in line with what we saw in Q1, though?

Charles Brindamour
Chief Executive Officer and Director

I will let Patrick take a stab at this.

Patrick Barbeau
Senior Vice President of Claims

Yes, I think we should see similar levels in the coming 2 quarters even if some of our major competitors are starting to take rates and take actions in -- on the product and underwriting side. Some of our recent actions are not yet fully reflected in our results, but we think the 2 should leave us to project the same kind of retention for the coming quarters, which were very satisfactory.

Paul David Holden
CIBC World Markets Inc., Research Division

Right. And then once we hit Q4, you've probably rolled over most of the portfolio and competitor actions will be more reflected, so less attrition once we hit Q4

Patrick Barbeau
Senior Vice President of Claims

Very likely.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think that's the likely scenario, Paul. If I can give you an industry perspective: First half 2013, industry's top line in personal prop was up 5%. Second half 2013, industry's top line growth in personal prop was up 7.2%, clearly a sign. When we say upper single digit and accelerating, hardening market in commercial lines in our outlook, you see the trajectory. I mean 2 points over a 6-month period is actually quite something. And it's not just rates. I think our competitors behaving fairly rationally, are taking action on the product side as well. There's a time lag, and I think we've talked about that with investors in the past 6 to 9 months. People were concerned about retention. And quite frankly, this is panning out as we anticipated. I think product changes will kick in in April or additional product changes will kick in in April. I think we'll see how that goes, but then the industry will catch up as well. So I think we feel pretty good about where we are and what we see in the market.

Paul David Holden
CIBC World Markets Inc., Research Division

Right, okay. A couple questions on telematics, and not necessarily based on your experience so far. So I guess the first question is how are the brokers you're dealing with responding to the marketing push with respect to telematics? Are there any kind of incentives you're providing to the brokers to market this product?

Patrick Barbeau
Senior Vice President of Claims

There's no incentives per se in the 2 products. So first, our UBI initiatives now is -- has been launched in Québec and Ontario in our -- in both channels. On the broker side, in Québec, which has been a few months, we're seeing good uptake from our brokers, very good signs, but no incentivizing. I think the main incentive is UBI is a powerful business development tool on your business, and this is what's driving the behaviors of our brokers so far.

Charles Brindamour
Chief Executive Officer and Director

Yes, yes. And we think that UBI is a great customer-driven option. And our brokers have the customer's interest at heart. And when that fits, they go for it. And we're surprised about the uptake so far. So far, so good.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And is there any kind of data you can provide us behind the uptake in Québec? Or is it too -- still too early?

Charles Brindamour
Chief Executive Officer and Director

Patrick, you might give a brief indication.

Patrick Barbeau
Senior Vice President of Claims

Yes, yes. It's easier, for the moment, to measure on our direct channel side. So it's a good uptake there. Close to 30% of our new business is entering in the product. Overall, we have enrolled more than 6,000 clients at this point, very early.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. So that's quite good uptake in the direct channel. And then maybe you can give us a little more commentary or sense around the initial profit drag-out I would expect from launching this program. Like, there's going to be startup costs associated with technology as well as marketing, so is there any kind of idea you can give us regarding profitability over the first couple of years?

Patrick Barbeau
Senior Vice President of Claims

Most of the costs of this program is variable. So it's not mainly startup. It's the asset [ph] technology, so it's linked with the volume we receive. So we don't see a big drag on the profitability coming from UBI because of the structure of the cost we incur with that.

Charles Brindamour
Chief Executive Officer and Director

Yes. And I would add, Paul, that if you look at the marketing strategy, when you try to make the phone ring or people click, you use new ideas, new product. And I think we've tabled on UBIs, the idea or the product, as opposed to necessarily overly heavy load of additional marketing to sell UBI. I mean it was part of the inflow that we have every year to make the phone ring, so to speak. So not a drag there, for sure. That's not to say that we won't increase marketing in the near term. I think it's important to keep in mind it's early, but the experience we find is actually pretty slick now and offer all sorts of upside from a customer experience point of view. So as we think through how we can improve the customer experience, we might invest more in marketing. But so far, no change compared to what we've done in the past.

Operator

Your next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I guess the first one, just on the commercial P&C business. You said you're taking 4.5% rate. How does that compare to what loss trend is in that business? Is 4.5% enough given you've got an underlying, let's call it, 100, a little bit north or 100 even with the adverse weather?

Charles Brindamour
Chief Executive Officer and Director

Alain, do you want to take this?

Alain Lessard
Senior Vice President of Commercial Lines

Yes, okay. Well, our overall plan to improve profitability on the commercial lines include what you're talking about. The rates, 4.5 points increase in the first quarter. That's up from 3.8 in the last quarter of 2014 -- 2013 and well above last year's. And we expect those rate to continue throughout the year. We also, as part of our plans, have aspect to manage a lot on the flood and SBU. These have been implemented, higher deductible on flood, without any rate change. We're reviewing our SBU also, rates, coming up in the second quarter. And on top of it, the management of our earthquake exposure in B.C., where we exited some of the worst, I would say, or the most difficult to reinsure part of the business, basically condo book in B.C., also will bring improvement to the profitability. We think that all of those aspect combined will basically give us and lead us to operate in the low 90s. Basically, we see that, excluding catastrophe, we're running right now on a 94% combined ratio for the last, let's say, 5 quarters and even lower than that if we take on more year. And basically, there's a little bit of seasonality in looking at those results. So we're quite confident that the impact of the 4.5% rate increase, combined with the action on the earthquake exposure and flood, are in fact bringing us back to low 90s.

Charles Brindamour
Chief Executive Officer and Director

Yes. I think, if you look at the underlying current year loss ratio over a number of years, clearly the sort of rate action that we're taking is enough. I think if you look at how prior year dev impacts that picture, you see a very healthy level and certainly not less than what it was a few years back. I think, as Alain is saying, when you look at the commercial P&C performance, cats and large losses are the issue. And so for me, the answer is really dependent on our ability to tame the impact of cats, and our recognition of what is the new level of cats going forward in that line of business. We think that 4.5% is enough at this age, in particular in combination with the measures that Alain is talking about, but this is up for debate. I must admit that, I personally, after 5 or 6 quarters of what I would call bad results in commercial lines, whether it's large losses and cats, we're on high alert on those 2 points. And so actions are being taken. And if we feel that there's a new normal there and the actions don't tame completely the new normal, we'll crank it up.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then are you seeing any impact yet -- Charles, of some of that acquisitions, like Travelers acquisition, the State Farm acquisition, yet in the marketplace?

Charles Brindamour

Chief Executive Officer and Director

So there's a personal side -- personal lines side to this -- not personal -- and there's a commercial lines side to this. I think -- so State Farm is not closed. So we don't see anything concrete at this stage, but Desjardins are really good operators. And when this deal closes, I'm sure that their behavior will be rational and good for the market. But no clear signs in the short term because the deal has not closed. I think Travelers, rational folks, disciplined, and we understand that there's work being done at the moment to improve the performance of the Dominion, which I think helps the market and is consistent with my comment earlier in my remarks that competitors behave fairly rationally. Does it change the market dynamic dramatically? Not at this stage, but the sort of moves that we're seeing certainly make sense to us. And Patrick, I don't know -- or Alain, if you guys have anything to add on that.

Alain Lessard
Senior Vice President of Commercial Lines

I'd say, on the Dominion and Travelers, they're still not integrated. They have their issue integrating the 2 organization. And for commercial lines, Dominion was roughly about 5% of the Ontario market. It was not a big player, so it's not enough to change the dynamics, okay? Right.

Charles Brindamour
Chief Executive Officer and Director

Yes.

Operator

Your next question comes from Doug Young from Desjardins Capital.

Doug Young
Desjardins Securities Inc., Research Division

I won't comment on State Farm. So first question, Charles, to you, I guess, is that -- I know in the past, you've mentioned -- and I hate to bring up Ontario auto, but it's a big topic...

Charles Brindamour
Chief Executive Officer and Director

Yes, yes, don't worry about it.

Doug Young
Desjardins Securities Inc., Research Division

And I know in the past, the -- you've mentioned how you think that it's going to be margin neutral with all of the changes. And I don't know if I'm reading into this, but it seems like you talk in the slide deck about you think you'll be able to protect your profit, but there's no mention of it still being margin neutral. So I'm just wondering, do you still think, net-net, with all the changes coming down the pipe, it's margin neutral? That's my first question.

Charles Brindamour
Chief Executive Officer and Director

Yes. Patrick, do you want to comment there?

Patrick Barbeau
Senior Vice President of Claims

Yes. We definitely would continue. We still have the same view on profit margin neutral with our rate changes that are coming in in April, given the cost-reduction measures that are already implemented since February and some of the other internal measures we discussed the last quarters. The view hasn't changed on that.

Charles Brindamour

Chief Executive Officer and Director

Yes. Absolutely not. I think, when we expressed that view at the first quarter, the measures were approved essentially by regulators and our own measures were in the pipeline. So that's, in our minds, sort of pretty solid.

Doug Young
Desjardins Securities Inc., Research Division

Okay. And then I wanted to go to the commercial. You talked about 4.5% increase. That's on renewals. And you've given us the data in terms of year-over-year and sequential. Is that on -- is that across your entire book?

Charles Brindamour
Chief Executive Officer and Director

Yes. 4.5% is a global picture of how rates increase across the whole commercial portfolio. I'll let Alain give you a bit of flavor there.

Alain Lessard
Senior Vice President of Commercial Lines

Yes. That's 4.5% on renewal and that's for the whole book, but it's not distributed evenly on every policy. Like we've mentioned, we have a segmented approach to rate increase at renewals and we're in fact targeting much more 25% of the book, the least-profitable part of the book, where we're seeing rate increase, in average, close to double digit. But even within that segment, rate increase will go up to 15% or 17% depending on the region or the characteristic of the accounts. So we're seeing those translate, when we look at it average on the whole book, on basically 4.5% on renewal. And on the new business, if you look at new business to new business rate increase Q1 over -- 2014 over Q1 2013, we're seeing something around 8% on the new business side.

Doug Young
Desjardins Securities Inc., Research Division

And is there much differential between pricing on a new business versus a renewal? Or is that basically pretty tight?

Alain Lessard
Senior Vice President of Commercial Lines

I would say, on average, probably not that much, okay? It varies account by account. It varies on the different situation, but overall, I would say it's pretty close.

Doug Young
Desjardins Securities Inc., Research Division

Okay. And then just wanted -- had a question about frequency. Because you've itemized your prior year reserve developments so we can get our heads wrapped around that, around the cat losses. But I think you've also disclosed that the increase in frequency of losses there, well, came -- frequency of losses increased in the quarter. And that's not really necessarily broken out as a separate item, but it's probably fairly important. So can you give us a sense, or can you quantify what you think the frequency trends were in the quarter from a combined ratio or a loss perspective or anything?

Charles Brindamour
Chief Executive Officer and Director

Yes. Doug, are you talking commercial P&C, or all lines? Or...

Doug Young
Desjardins Securities Inc., Research Division

I think, all lines. Commercial P&C was hit in particularly hard, but I mean all lines in general.

Charles Brindamour
Chief Executive Officer and Director

Yes. So if you look at automobile lines of business, frequency quarter-over-quarter was up 14% in personal auto and 11% in commercial auto, largely because of the same reasons. And here, you have to understand winter conditions, certainly our take on it. If you look at commercial lines, frequency was up mid single digit in commercial P&C, not commercial auto. In automobile, severity was down, but in commercial P&C, on top of the frequency increase, severity was up. It's very different profile of losses than in automobile lines of business. And I don't know, Alain, if you want to comment on commercial P&C frequency.

Alain Lessard
Senior Vice President of Commercial Lines

Yes, yes, because like we mentioned, the severity was up. Basically, we saw more fires during the first quarter, and those most fire are mostly in apartment buildings and everything, where we have a lot more heating that was required during the first quarter due to cold winter situation. We also saw some pipe breaking -- bursting, mostly sprinkled -- sprinkler pipes or anything, and these created some water damage that can be also affecting the severity size there because they can be large. When you burst a huge sprinkler pipe, you affect the larger element of the building or the content. So there's -- that's what's affected mostly the severity in commercial P&C during the first quarter, all related to what we saw to a longer and colder winter situation.

Charles Brindamour
Chief Executive Officer and Director

Do we answer your question, Doug, or...

Doug Young
Desjardins Securities Inc., Research Division

You gave a good flavor to it. I may come back. I'm -- this is probably a little maybe too technical for the call, but I may come back on a few other ones, but that's fine. And that's all for me.

Charles Brindamour
Chief Executive Officer and Director

In automobile, Patrick, do you want to comment on what it means in loss ratio terms maybe or combined ratio terms, this frequency increase?

Patrick Barbeau
Senior Vice President of Claims

Yes. As you said, 14% frequency increases combined with a reduction of about 7 points in severity for auto. When you add on top of that the about 2-points increase in average earned premium, that leads to an underlying loss ratio that's improved when you're including the prior development by around 6 -- or how is it, by 4 points in it. So I think, clearly, frequency was the drag in the quarter. Everything else pointed in the right direction.

Operator

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

Mario Mendonca
TD Securities Equity Research

Charles, first, on capital. It's been a little while since the capital level has been this strong, the MCT specifically. Are buybacks still in the toolkit for you? Because we haven't seen that in some time.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

So listen, that buyback actually expires mid -- 12th of May. And we have not been active since last year and we do not intend to renew the buyback for now. So we've always said we would execute the buyback if we intended to. At this point in time, given what we see in the markets, we do not intend to renew.

Mario Mendonca
TD Securities Equity Research

When you said -- what do you see in the market?

Charles Brindamour
Chief Executive Officer and Director

The opportunities. I think, if you look at manufacturing acquisition opportunities, if you look at distribution acquisition opportunities, there's fair bit going on at the moment on both front. And if you recall, the toolbox, when we think about excess capital, you first try to reinvest your capital in good growth opportunities that would -- will meet your hurdle; make sure, of course, you increase your dividend, which we've done before. And then you move to buyback. At this stage, we look at the opportunity set and we're pretty pumped, actually, about what's going on in the market. And that's where we stand. And I think when we intend to actually use the buyback, then we'll reinitiate it, but just to leave a buyback open for the sake of it is not how we think about capital management.

Mario Mendonca
TD Securities Equity Research

Okay. And then if we can go to the AFS gains this quarter, $67 million. I'm not sure I follow how the derivatives generated that gain and if there were any -- was there anything special, I think you referred, equity strategies? Is there anything special you can describe there?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Listen, I guess the uptick there was really driven by the equity markets in Q1. So we were -- the market is up. On the interest side, the interest rates were down, which combined with the uptick in equity markets, provided gains. So we gained, essentially, on those 2 drivers.

Charles Brindamour
Chief Executive Officer and Director

There was no abnormal activity on that front.

Mario Mendonca
TD Securities Equity Research

Okay, and the derivative gains, anything you can refer to there?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Well, we were a bit extended on duration at the early part of the quarter with the rate decreases. That drove a bit of derivative gains. And we've reduced the duration at the end of the quarter. So a bit of it was driven by the fact that the rates declined and we were a bit long on the duration at the beginning of the quarter. And that helped and generated those derivative gains.

Mario Mendonca
TD Securities Equity Research

And when you say duration, you're referring to...

Charles Brindamour
Chief Executive Officer and Director

Fixed income.

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Fixed income.

Mario Mendonca
TD Securities Equity Research

But not supporting your contract liabilities but your surplus?

Louis Marcotte
Chief Financial Officer and Senior Vice President of Finance

Yes.

Operator

[Operator Instructions] We have no further questions at this time. Let me turn the call over to the presenters.

Dennis Westfall
Former Vice President of Investor Relations

Thank you, everyone, for participating today. The webcast will be archived on our website for 1 year. A telephone replay will be available at 2:00 p.m. today until Wednesday, May 14. And a transcript will be made available on our website.

Please note that our Annual and Special Meeting of Shareholders will be held at 2:00 p.m. Pacific Time today at the Pan Pacific Hotel in Vancouver, while our second quarter results for 2014 will be released on July 30.

That concludes our conference call for today. Thank you, and have a great day.

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