S&P Capital IQ

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Intact Financial Corporation TSX:IFC

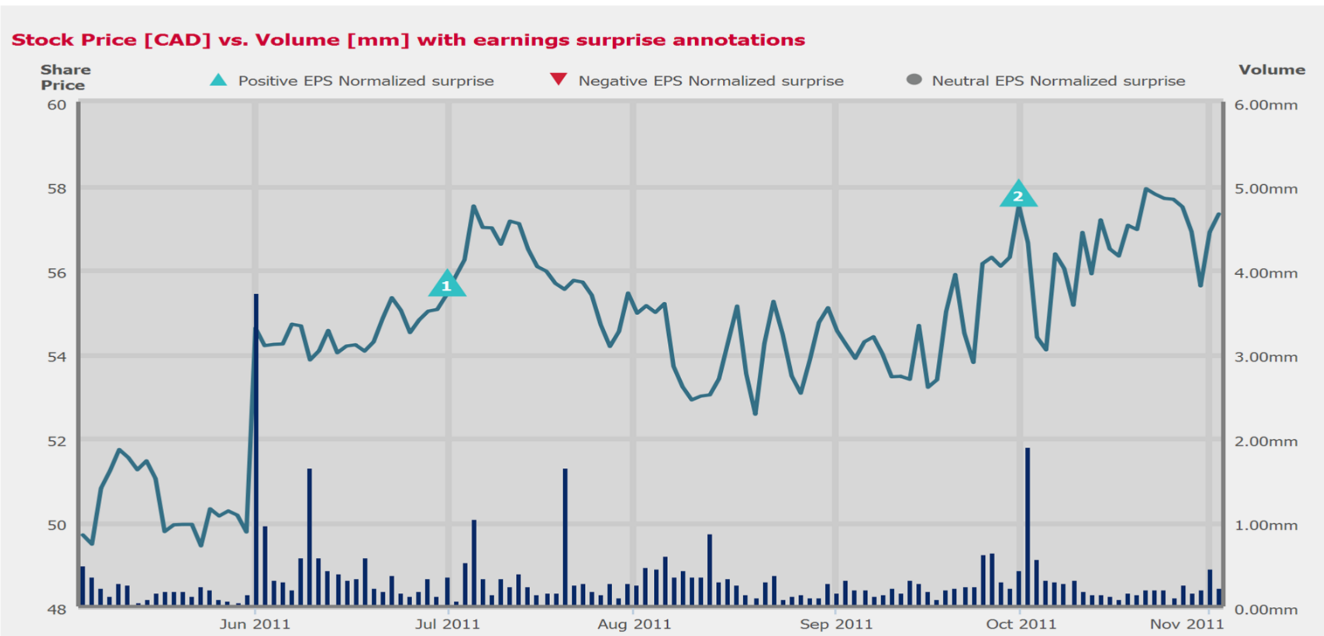
FQ4 2011 Earnings Call Transcripts

Wednesday, February 08, 2012 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2011-			-FQ1 2012-	-FY 2011-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.12	1.14	▲1.79	1.40	3.97	3.91
Revenue (mm)	1568.45	-	▲6.03	1543.62	4744.64	-

Currency: CAD
Consensus as of Feb-02-2012 12:02 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	-	0.91	-
FQ2 2011	0.72	1.36	▲1 88.89 %
FQ3 2011	1.03	1.11	▲2 7.77 %

Call Participants

EXECUTIVES

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

ANALYSTS

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Macquarie Research

Doug Young
TD Securities Equity Research

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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 Steve, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corp.'s Q4 Financial Results Conference Call. [Operator Instructions] Thank you. I will now turn the call over to Dennis Westfall, Director of Investor Relations. Please go ahead.

Dennis Westfall
Former Vice President of Investor Relations

Thank you, Steve, and good morning, everyone. 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 today.

Here with me today are Charles Brindamour, Chief Executive Officer; Mark Tullis, Chief Financial Officer; Martin Beaulieu, Senior Vice President, Personal Lines; and Alain Lessard, Senior Vice President, Commercial Lines. We will start with formal remarks from Charles and Mark followed by a Q&A session. Martin and Alain will 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. This morning, we announced a fourth quarter net operating income of $152 million or $1.14 per share, that is 61% higher than last year, reflecting an excellent underwriting performance. Our combined ratio of 92.7% is a reflection of strong underwriting results across all lines as a result of disciplined deployment of our strategy as well as relatively mild winter conditions. From a top line perspective, we reported premium growth of nearly 50%, reflecting the addition of AXA Canada and a rebound in our organic growth. As anticipated, our earlier decision to restart marketing in the Ontario direct channel proved successful, generating growth of 4% in the fourth quarter versus a decline of 4% last quarter in this channel. Overall, our underwriting performance and steady investment income resulted in an operating ROE of 15.3%, while book value per share increased 12% from a year earlier.

We ended the year in a solid financial position, which enabled us to increase our quarterly dividend by 8% to $0.40 a share. This marks the seventh consecutive year of dividend increase for IFC shareholders.

When it comes to our outlook for the industry, growth for the industry last year appears to have played out as we had anticipated. After 9 months, the industry has recorded 6% growth in Auto, primarily driven by Ontario, 8% in Personal Property in reaction to years of heavy weather-related losses, and 3% in Commercial Lines. As the drivers behind this growth will likely continue to impact 2012, we expect similar growth in the coming 12 months. The low interest rate environment and reinsurance market conditions should support our outlook and will likely lead to firmer conditions over time.

From an underwriting perspective, again after 9 months, the industry is tracking to about a 102% combined ratio. For 2012, we anticipate some improvement in Personal Lines resulting from reforms in Ontario, as well as continued premium increases, while Commercial Lines should remain relatively steady. Overall, we anticipate that the industry will report a breakeven underwriting result in 2012.

Turning to the industry's ROE, we do not expect material improvement in the near term from the current 7% level that it stood after 3 quarters. Although underwriting might improve slightly, we anticipate this would be offset by the negative impact on investment income from the low-yield environment.

Looking specifically at Intact Financial, we strongly believe we'll continue to outperform the industry's ROE by at least 500 basis points, our stated objective. When it comes to auto Ontario, the reforms as well as our own initiatives to combat fraud continue to yield the benefits anticipated. Throughout 2011, we have referred to an expected loss ratio improvement of about 12 points within 18 months of report. With only one quarter remaining in this timeline, we maintain our view that these benefits should materialize as outlined.

However, we remain disciplined in this market and maintain our caution for 2 reasons. First, we continue to believe that the degree of uncertainty of the potential outcomes in the mediation or dispute process warrants continued monitoring. Second, a court decision in December allowed the stacking of physical and psychological impairments when determining catastrophic injuries.

Although Ontario auto industry results for the first 9 months of 2011 show meaningful improvement, we estimate that the combined ratio for the industry in that province is likely still ranging between 105% and 110%. As such, the level of approved rate changes for the industry announced in the past few quarters is a positive sign, but further rate action is likely without further meaningful improvements in results.

Our profitability gap with the industry in that province remains strong at about 14 points, which affords us the flexibility to continue our action to improve growth. Outside Ontario, while conditions remain stable, we're monitoring trends of increased pressure on existing legislation and reforms.

In Personal Property, losses from catastrophes primarily relating to a severe windstorm in Calgary during the quarter amounted to $24 million. Overall, cat losses totaled $32 million, in line with the bottom of our expected range, given the larger size of our company post the acquisition of AXA. For the full year, the combined ratio in that line of business was 103.5%, a non-acceptable long-term level, but one that included about 15 points of cat losses. We continue to monitor and adapt the increasing level of severe weather occurrences in order to create a sustainable competitive advantage.

Pricing conditions in Commercial Lines remain very competitive. We expect modest improvement over time likely to be driven by catalysts, including continued low interest rates, firmer reinsurance conditions and the fact that the industry's loss ratio deteriorated by 9 points after 9 months in 2011 in that line of business. However, we do not anticipate meaningful improvements in the short term.

Mark will provide an update on some of the metrics related to the integration of AXA business, but let me make a few comments. Overall, I'd say that our integration is on track. I'm pleased with the response we continue to see from employees, brokers and customers. This is important because ensuring that brokers and customers embrace our offer and continue to receive top-notch service is really important, particularly during the integration phase.

Bear in mind that we remain in the early stages of the integration and the fourth quarter did not provide enough information to determine an ongoing success rate. We believe we'll have a good visibility in 3 to 6 months as customers receive our product offering and the associated price changes that come with the moving from AXA to the new offer from Intact Insurance. I want to take this opportunity to thank our people from coast to coast for the huge effort going into our continued industry-leading service to both brokers and customers despite what is an incredibly fast-paced integration.

In conclusion, I believe the importance we place on underwriting results will continue to serve us well in the current low interest rate environment. Given the quality of our operational platforms, the flexibility provided by our financial position and the combination with AXA Canada, we believe that we'll continue to outperform the industry and strengthen our leadership position.

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

Mark A. Tullis
Vice Chairman

Thanks, Charles. Today, we announced strong operating income driven by improved underwriting results. Earnings per share of $0.62 were down from a year ago, reflecting restructuring and integration expenses as well as a contingent consideration payable to AXA France. On an adjusted basis, excluding acquisition-related items, we recorded EPS of $1.14, up from $0.96 a year ago. As a reminder, our agreement for the acquisition of AXA included a contingent consideration, which requires us to pay up to an additional

$100 million based upon the development of AXA's 2010 year-end reserves. After our review of their reserves and on the heels of a favorable fourth quarter, we recorded a payable of $89 million, $48 million as an increase in the purchase price and $41 million as a nonoperating expense in the quarter. If the AXA business continues to develop favorably in the future, we would take additional charges to nonoperating income up to a maximum of $11 million.

Top line growth of 49% was excellent. We estimate that the addition of AXA Canada contributed approximately 45 points of the increase in premiums and the recovery in our organic growth contributed the rest. As Charles mentioned, AXA retention is holding up so far, but it is early so we remain cautious. In 3 to 6 months, we should have a much better idea of the true retention.

Slides 8 and 9 show results by line of business. In Personal Auto, growth in premiums benefited from the addition of AXA as well as a rebound in our organic growth. Our 93.3% combined ratio was almost 10 points better than a year ago, reflecting benefits from Ontario reforms, our anti-fraud measures and relatively mild winter conditions. The improvement came despite less favorable prior year claims development, in part to reflect the recent Ontario court decision that Charles mentioned.

Growth in Personal Property was helped by what we estimate was a slight upturn in our underlying unit growth. The 88.6% combined ratio reflects our continued focus on improving those results in this line of business, mild winter weather and a more normal level of cats versus the elevated level of the past 2 quarters. AXA's contribution was most evident in our Commercial Lines business as premium growth reached 78%. The Commercial Auto combined ratio remains strong at 93%, and Commercial P&C remains solid at 95.7% despite lower favorable claims development. On the investment side, net investment income of $103 million in the fourth quarter was up 45% from a year ago as a result of the additional investments related to AXA. However, declining yields continue to offset the underlying asset growth and the market-based yield of 3.9% was down from 4.1% in Q4 2010. We expect the declining interest rates to negatively impact our market-based yields in the coming quarters.

Our financial position remains solid at the end of 2011 with an MCT of 197%, $435 million in excess capital and book value per share of $29.73, 12% higher than a year ago. We ended the quarter with a debt-to-total capital ratio above our target levels. However, we intend to allocate most of the $300 million proceeds from the January 1 sale of AXA's Life Insurance business towards reducing our debt. As a result, our debt-to-total capital ratio is expected to be back in line with our target early in 2012.

As Charles mentioned, we have made good progress on the integration of AXA Canada. Essentially, all business is now being issued on Intact's systems and we are closely monitoring the renewal action of AXA customers. We maintain our $100 million after-tax synergies target and expect to reach this run rate progressively by the second half of 2013, with an $18 million run rate already secured in 2011 and a $50 million run rate expected by the end of 2012.

During the fourth quarter, we recorded $42 million of restructuring and integration expenses bringing the full year 2011 level to $71 million. Because of accounting rules, the amount expensed in Q4 was below our expectations, but our overall view of these expenses has not changed. We expect the majority of the remaining integration expenses to be charged in 2012.

On the reinsurance front, we increased our cat coverage to bring the combined entities coverage back up to our standard, and we continue to expect short-term supply chain benefits to offset the $15 million cost of bringing AXA up to our standard.

In summary, our disciplined pricing, underwriting, investment and capital management have positioned us well for the future. We continue to expect the acquisition of AXA Canada to be accretive to net operating income per share in 2012 and by 15% in the midterm. With the progress made to date in the integration, we are well under way toward building a world-class P&C insurer.

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

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

Question and Answer

Operator

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

Tom MacKinnon
BMO Capital Markets Equity Research

A couple of questions. One with respect to the $18 million run rate in the synergies at the end of 2011. Do you know what the actual synergies would've been in the quarter? I can't imagine they would've been $18 million because the run rate probably at September 30 was pretty well 0. But do you know what that was in the quarter? And I got a couple of follow-ups.

Mark A. Tullis
Vice Chairman

Sure. A little short of the $10 million.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And with respect to the $15 million in the reinsurance, is that going to be already in the first quarter results of 2012? Does that...

Mark A. Tullis
Vice Chairman

Yes.

Tom MacKinnon
BMO Capital Markets Equity Research

And where there any supply chain benefits in the fourth quarter? And how would you -- or where there any of those, and what do you expect -- how do you expect your supply chain benefits and over -- is it going to be equal in offsetting adjustment that we should expect over the $15 million cost?

Charles Brindamour
Chief Executive Officer and Director

Yes, I think, Tom, the -- you start with the $15 million, it's ceded premium, and ceded premium here kicks in January 1. It's on 12-month basis. So you'll got the full 15 additional spread over the full year. I think it's important to point out, Tom, that the overall cost of the reinsurance program went up by about $30 million. The other $15 million being general price increases on the ceded premium. So it's important to keep that in mind. The supply chain benefits themselves -- I mean, there might be mismatch by quarter, but clearly, for the full year, the supply chain benefits will ramp up unlike the ceded premium, which is even throughout the year.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. So we'll just have it -- the net earned, with all things equal, will be down about $4 million each -- lower about $4 million each quarter, and we'll just see how the supply chain benefits roll out, is that...

Charles Brindamour
Chief Executive Officer and Director

Yes, I think that's a good way to look at it.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And then finally, the difference in the tax rate versus what you guys normally had just on the operating basis, how should we look at this going forward? It was closer to 28, you've been 22. I know it's a function of the investment portfolio you would've picked up from AXA and how much say dividend deductibility was in there and also kind of some -- a function of a bit of the underwriting income you would've had. But how should we look at these rates on an operating basis going forward?

Mark A. Tullis
Vice Chairman

All right. So I know you asked operating, but let me answer nonoperating and then come back and do operating, because nonoperating, it's even a bigger -- our effective tax rate in total was 34.3 compared with 21.7. There's 3 items in there relating to AXA. The $41 million contingent consideration is nondeductible. There's transaction fees of $12 million nondeductible, and then we have a tax of $3 million that was a onetime sort of deal. So if you adjust for those 3 items, if you look at overall tax rate, you get down to 21.9, which is fairly similar to last year's run rate. The big change in the operating is due to the mix between dividends and non-dividend income, so regular income. And there's really 2 components of that. One is last year in Q4, the underwriting income was a lot lower. So the higher underwriting income is fully taxed, sort of dwarfs the benefit we get from the dividend. The other thing is the investments that we brought over from AXA had fewer dividend-paying investments. Our plan is, over time, to migrate those more toward the Intact mix, but you're not going to see immediate change in that. So that's something you'll sort of see some movement through the year into the next year. But you're not going to see a big cliff at some point.

Tom MacKinnon
BMO Capital Markets Equity Research

So the operating tax rate is effectively a reasonable run rate, but probably could come down as you migrate these investments?

Mark A. Tullis
Vice Chairman

Correct. So if the underwriting income stays at the current level, I would agree with that statement. There's always some noise from quarter-to-quarter. But the 2 big impacts are, if we make more underwriting income, the tax rate will be higher. If we make less, underwriting income tax rate will be lower. And then as you pointed out, as we migrate the AXA investments over to more of an Intact policy, the tax rate should come down.

Tom MacKinnon
BMO Capital Markets Equity Research

And no change in that even that the -- even the effective tax rate, just with declining statutory tax rates going forward, is there any movement there?

Mark A. Tullis
Vice Chairman

Yes. So we will benefit from that this year. So on top of the stuff we just talked about, yes.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay, and what does that impact, about 2%.

Mark A. Tullis
Vice Chairman

I think its about 2% down this year, yes.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. So all things being equal, if this was under the 2012 tax regime, that 28% tax rate would have been a 26% under operating?

Mark A. Tullis
Vice Chairman

That's correct. And the 34.3% would have been 32.3%.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay, so maybe somewhere around a 26% is okay.

Operator

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

Stephen Boland
GMP Securities L.P., Research Division

Does I guess sort of one question relating to, I guess, the mediation and Ontario auto. You mentioned that you remain conservative with the reserving, when it comes to the outcome of mediation. I guess we've heard recently that there's thousands of mediation cases backlogged and some of the measures that FSCO are taking are not really working very effectively. So is there a point where the -- there's continuing or increasing pressure on the insurance industry to try and settle these cases, and what's your thoughts on that?

Charles Brindamour
Chief Executive Officer and Director

Yes. Well, let me first say that FSCO has put in place in the past 3 months a number of measures to improve the mediation process, which are having a favorable impact, and I applaud the work that they've been doing. But when it comes to mediation, you often settle before mediation. So clearly, there is a lot of activity to try to accelerate settlement before mediation. But beyond that, we'll have to go through it and make sure that at the end of the day, the indemnity settlement is what we think is fair as opposed to focus on speed here. So we're going with the flow, making sure that we give the best service we can in the meantime. But certainly, the amount of the fair indemnity is more important than the speed for us, and that's why the approach we're taking is one of caution in reserve because it pushes the ultimate settlement date a bit, and as such one needs to take a cautious stance.

Stephen Boland
GMP Securities L.P., Research Division

Is there any impact with the 2-year anniversary coming up with the reforms that arbitration also becomes a bigger risk or that cases get settled more through arbitration? And what does that pose for -- with your outlook in terms of reserving as well?

Charles Brindamour
Chief Executive Officer and Director

Yes. Well, think you're touching on an important point, and the point is that when you look at mediation and arbitration, a big portion of the backlog right now comes from claims dating back before the reforms. There's been a rush of claims in 2009 and 2010, and many of these are being mediated. Then a portion of backlog is related to post-reform claims, but it's clear that because you have about indeed a couple of years to file up to arbitration, it's clear that there are claims that are not yet reported, that we're not aware of, that will end up in mediation. And that's in part why our stance on this is one of caution. Martin, I don't know if you want to add anything on that, but...

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

That's very clear.

Stephen Boland
GMP Securities L.P., Research Division

I guess, sorry, just -- I've heard from some people on the legal department, health care industry as well that the measures that FSCO taking the blitz days, their hiring of mediation firms, they don't expect that to be very effective in terms of your -- of sort of getting rid of claims, and I guess that, that's positive for you because you're holding onto cash longer. I mean, is that -- you said that some of the things that they've done have been effective, but that's sort of contrary to what a lot of other people are saying.

Charles Brindamour
Chief Executive Officer and Director

Yes, look, I think the bottom line is that you've got at the industry level now probably close to more than 30,000 files outstanding. And the measures that FSCO has put in place are providing acceleration, but the sheer size of the backlog is huge. And so when you look at the whole picture, the measures of FSCO are effective to deal with a portion of it, but you're starting from a very, very large backlog to start with, and that might be where your contacts are coming from. But FSCO is definitely focused on it, and they're working at it on many fronts, whether it system, process, blitz days, as you say and so on, and so I think we'll go with the flow on this one.

Operator

Your next question comes from the line of Doug Young with the TD Securities.

Doug Young
TD Securities Equity Research

Just wanted to start big picture wise, Charles. And you mentioned in your opening comments that there's 2 things that drove your improved results, obviously strong underwriting, but obviously mild winter conditions and mild weather conditions. And I'm just trying to get a sense, big picture wise, I mean, is this a normal quarter or is there -- can you give us a sense of what -- the split between those 2 items. I mean, how -- I guess what I'm trying to get at is the weather conditions obviously were more adverse earlier on in the year, but in Q4, they were quite favorable. I mean, what was the impact from that in the quarter? And I guess the second part of it is, is there any reason to believe the seasonality that you've shown us in past -- in quarterly seasonality will change going forward as a result of the AXA transaction?

Charles Brindamour
Chief Executive Officer and Director

All right. So to put your finger exactly on weather and break the change in result is a real tough one, Doug, even when you have 190 actuaries. But let me just say that the most tangible sign of milder winter conditions is through what we observed in frequency changes in the fourth quarter. And when you look at our frequencies in the fourth quarter across all lines of business, we're seeing a drop in frequency north of 5%. And I would say that a meaningful portion of the current accident year improvement may be a little bit less than half would be driven by the frequency movement. So if you're brave enough to say that frequency movement is driven by mild weather conditions, you have your answer, I think. I'm not just not prepared to go that far, but clearly the frequency is correlated with winter conditions here. Your second question was related to the impact of seasonality on the AXA portfolio. And this is a good one, and I'll point to 2 big distributional shift that might have an impact. The first one is that we have more Québec business than we used to in relative terms because half of AXA's business was in Québec, and given the nature of the business at Québec, it tends to be more seasonal than for the rest of the country in automobile insurance. The second factor is the fact that AXA's business was -- half of the AXA's business was Commercial Lines. And as you recall, at the Investor Day, we've pointed out that our Commercial Lines distribution actually increased because of the AXA acquisition. Commercial Lines tend to be less seasonal in nature. We haven't gotten to the extent of assessing what those 2 trends would have on seasonality. But one goes one way, the other one goes the other way, so I suspect it wouldn't make a big difference. But we'll make a note of this one, Doug, and provide some visibility next quarter once we have a better grasp of what it will pan out.

Doug Young
TD Securities Equity Research

Okay, just going back to the first one, Charles, is there any way -- I mean, you say 5% give or take lower frequency, is there any way to kind of give us a number of how that would go from a combined ratio perspective, how -- what the impact would be, or is that...

Charles Brindamour
Chief Executive Officer and Director

No, I think that would be too adventurous for me to do that at this stage.

Doug Young
TD Securities Equity Research

Fair enough. And then the other question I had was around just the integration cost from AXA. And I think, and correct me if I'm wrong, it was indicated that the integration cost would be roughly 1x what the potential cost synergies would be. And if I look at what you've said the integration costs so far have been $71 million, that's roughly half of the total. And I know this is pretax, and the $100 million is after-tax, but -- so that would indicate there's going to be $140 million of integration costs. I guess I'm just trying -- curious, is that correct? And why the change, and are you expecting to get higher synergies as a result of the higher integration costs?

Mark A. Tullis
Vice Chairman

Right. So I think we've always talked in terms of ranges, and we do expect when the dust clears, we will have integration cost approximately equal to the pretax, and the $100 million is an after-tax number. So the $71 million we're saying, we're approaching the midpoint.

Charles Brindamour
Chief Executive Officer and Director

Our view has not changed on that, Doug, I think $140 million after-tax is very close to $100 million, and $100 million is a fairly firm number of synergies. I think Mark could comment -- so no change from our point of view there. And I think Mark could comment on the timing difference here, which is...

Mark A. Tullis
Vice Chairman

Yes. I mean, so basically, there's -- we know what all the synergy expenses are. To the extent we haven't expensed them, they're built into our budgets next year. So they are identified, we know exactly what they're going to be. So if we could do what we like, we would have accrued everything at year-end and just gotten that over with and we tell you what the number is. The problem is in order to reflect them in the accounting, you have to meet certain standards. So to reflect severance cost, you have to be at a certain stage in the severance. To reflect leased costs, you have to be at a certain stage in terminating the lease and subletting. So what we had booked is what we're allowed to book from an accounting point of view. We expect almost everything else will flush out over the next few quarters. There may be a little bit going into '13, but basically, we thought we'd be able to get a little more in the Q4 that's going to get pushed into 2012.

Charles Brindamour
Chief Executive Officer and Director

Primarily because of how operating leases are treated.

Mark A. Tullis
Vice Chairman

Correct.

Doug Young
TD Securities Equity Research

Okay. And just one last one. You mentioned as a result of your positive reserve developments, I mean, they were a little bit below percentage wise in your historical average. And I think one of the things you actually marked out was the whole idea of that psychological and physical damages can be additive to get to your catastrophic claim. And I'm just kind of in a sense of how worried you are about that because there's been a big flip-flop on that front? I mean, how significant is that particular item concern wise?

Charles Brindamour
Chief Executive Officer and Director

Yes. So on the prior year development, lower the long-term range, I think there's the general caution in Ontario. There's this item you're referring to, and then we strengthened a few large claims in Commercial Lines. On the stacking of psychological and physical impairments to determine a cat, we're not overly concerned by it. What we've done, Doug, is went back to all open claims and assess where we're at -- where we could end up with a different settlement based on this new decision, increase the reserves accordingly case by case. The real question for me is what happens prospectively, and our view is that if a new cat definition was not introduced -- and as you know, a new cat definition is highly likely to be introduced in 2012 by FSCO. But let's assume this doesn't happen. The cost of that decision could be between 50 basis point and 100 basis point of loss ratio in Ontario, prospectively. My view is that within 1 year, we'll have a new cat definition and this additional pressure, so to speak, will be gone then. But the 50 to 100 basis point of Ontario auto loss ratio, this is a little less than half our business could be the impact. But as you might have heard in my remarks, my view is still that's within 18 months, we'll have generated 12 points of loss ratio improvement despite this decision.

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

And the definition, the preliminary definition that had been tabled by the working group in 2011 was going in the other direction that you could not stack psychological and physiological. So I think there's a certain level of urgency in putting that in place to bring back things to normal.

Charles Brindamour
Chief Executive Officer and Director

Exactly, that's a very good point, Martin. I think this decision indeed highlights to FSCO the importance of carrying on their work and putting in place the new definition of catastrophic injuries.

Operator

Your next question comes from the line of Bryan Brown with Macquarie Capital.

Bryan Brown
Macquarie Research

In Ontario, we saw that the auto rate approvals were about 0.8%. But for Intact Insurance Company, the rate approvals were down 2.3%. Are you able to comment on this from a strategies perspective?

Charles Brindamour
Chief Executive Officer and Director

Definitely. You want to take this one, Martin?

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

Yes, certainly. Well, we had started back in the 2007 to take rate increases faster than the market. In fact, we were one year ahead of our next competitors at that point. And we have developed over the period a

14-point advantage over the market and that has given us the margin to use some of that advantage to become a bit more competitive. So the 2% we've taken is because we have the margin to take it and still return the proper margin.

Bryan Brown
Macquarie Research

Okay, thanks. And I guess just one broad one. The quarter-over-quarter increase in the Personal Auto loss ratio, maybe if you could just speak to that briefly.

Charles Brindamour
Chief Executive Officer and Director

Yes. If you look at the Personal Auto combined ratio in the quarter, it's actually dropped by 10 points, okay? So it's not an increase, it's a decrease. And how do you explain that? Well, it's been largely driven by the current accident year as opposed to prior year development. And when you look at the current accident year, there's 2 elements that have big impact. One, the severity or the average cost of claim was down materially, driven by the Ontario reforms. The second factor that explains the improvements in the combined ratio between quarter 4 in '11 versus quarter 4 in 2010 is the fact that the frequency was down driven by the mild winter conditions as we've talked about before, primarily in the province of Alberta and in the province of Québec. And it's the sum of these 2 factors that explains why the combined ratio in automobile insurance improved so much in the quarter.

Operator

Your next question comes from the line of Mario Mendonca from Canaccord Genuity.

Mario Mendonca
Canaccord Genuity Limited, Research Division

A follow-up question on the stacking. Looking at the reserve development in Personal Auto, it was still relatively good. There was still a redundancy, we see that coming through in the quarter. But it was a little surprising that it wouldn't have been larger given the comments made about the contingent consideration associated with AXA. So if in fact the development from AXA is coming in strong enough to warrant the total, the $89 million or whatever -- whether you want to look at it as the total basis or just $41 million, you would have expected the redundancy to be particularly large and not small. So I guess what I'm getting at is how important is -- was this stacking then to your reserve development in the quarter?

Charles Brindamour
Chief Executive Officer and Director

I would say that this was a meaningful increase, Mario. I think -- as I said before, when you look at the overall development, and the idea is not necessarily to report AXA and Intact separately going forward. But that being said, being the first quarter, the stacking decision would have taken our run rate materially lower than what it's been historically, 3% to 5%. But as I said, we've done a number of moves from a reserving point of view beyond and above the stacking, including our general caution in Ontario because as I've said, the field activity is very, very good, very, very strong and therefore, caution needs to take place at the reserving level. And then we've made a few adjustment on large commercial claims as well. I think the best reference point I can give you is that -- is what I've said earlier that the cost of that decision, in our view, in the Ontario auto market is 50 to 100 basis points of Ontario automobile loss ratio.

Mario Mendonca
Canaccord Genuity Limited, Research Division

That was the impact in the quarter?

Charles Brindamour
Chief Executive Officer and Director

That's the prospective impact on the loss ratio. The amount in the quarter taken was slightly above 20 for that decision.

Mario Mendonca
Canaccord Genuity Limited, Research Division

Sorry $20 million or 20 basis points.

Charles Brindamour
Chief Executive Officer and Director

$20 million, slightly above.

Mario Mendonca
Canaccord Genuity Limited, Research Division

Okay. So -- and that answers the questions. Where I'm going with this then is, if the company has made that entire adjustment in the quarter by looking at all the files and making the changes, then presumably the adjustment doesn't come through next quarter. So unless there is an entirely different reason to be cautious next quarter, do you naturally assume that the redundancy, the reserve development could at least be $20 million higher? Or is the premise too restrictive when if I say assuming nothing changes, is that the problem? That too many things change to be confident?

Charles Brindamour
Chief Executive Officer and Director

Yes, too many change because you have to keep in mind that we integrated the AXA reserves in our system at the same time, so there is a number of change going one way, other change going the other way. But one thing that's clear, Mario, is that the adjustment we've made for the stacking, we're not going to do prospectively because we've done it for all open files in the past. But I think my view has not changed of the ongoing run rate of a favorable development prospectively.

Mario Mendonca
Canaccord Genuity Limited, Research Division

But bottom line, it was $20 million on the quarter, so it was meaningful?

Charles Brindamour
Chief Executive Officer and Director

It was a meaningful adjustment, yes. That's why we highlighted it.

Operator

Your next question comes from the line of Andre Hardy with RBC Capital Markets.

Andre-Philippe Hardy
RBC Capital Markets, LLC, Research Division

Another question on Ontario auto. In your outlook, Charles, you mentioned that you expect further increases in price given still high loss ratios from the industry. I understand that perspective, but do you feel FSCO was on board with this? They just -- the government of Ontario introduced very material reform that reduced benefits in late 2010. And what do you feel their appetite is for approving rate increases after doing that?

Charles Brindamour
Chief Executive Officer and Director

Yes. I think that they understand that the industry was in a really tough position a year ago. And because automobile insurance is 5% of disposable income of Ontario, and it's going to 6%, they knew they had to stop the inflation. They've had a big impact I think, on stopping the inflation, but the industry started the reform with a big gap and I think the government understands that. And this translates into a number of actions they have taken the beyond and above the reforms, including the upcoming cat definition. It's clear that as reforms become effective, government is probably looking forward to improvement in rates. But they're rational and they understand that if the industry is not allowed to operate at a decent rate of return, there'll be capacity issues in the market as there have been 5 years ago. And I think that these guys really understand what is important for Ontario drivers. And that's why I'm confident about additional improvements in the Ontario market. And in time, rates will improve, but I still see a need at the industry level for corrective action in pricing.

Andre-Philippe Hardy
RBC Capital Markets, LLC, Research Division

Okay. And the other one is probably for Mark. You're pointing out again that investment yields are likely to decline given where rates are, but you're not pointing out that growth in the investment portfolio should offset the decline in yields. So have we reached a point where in your view we're going to see some pressure on investment income in absolute dollars?

Mark A. Tullis
Vice Chairman

Yes. So -- and I think at our Investor Day we gave a little guidance on this one. We -- I think, we would -- we don't see big growth in the assets going forward. You're correct on that. And we do see further decline in yields, whether they exactly offset. But I wouldn't expect to see, yes, lots of growth in that going forward.

Charles Brindamour
Chief Executive Officer and Director

I think the Investors Day illustration on investment income for 2012 remains still valid, quite valid as far as we're concerned.

Operator

Your next question comes from the line of Paul Holden with CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

Another question on Ontario auto, this one related to the minor injury guideline. Hearing that some insureds are trying to get out of -- bounce their way out of the MIG guidelines by filing for mediation and then claiming failed mediation if it's not resolved within 60 days. Can you provide any color on that? How many such cases you're seeing through your system?

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

Well, that's not necessarily related to the minor injury guidelines themselves, but there are 20% of our open cases, which are in mediation. And what we observed there is that there is an attempt to say, well, if mediation does not happen within 60 days, they are deemed to have failed. But up until now, this has not been successful. So these files are staying in the mediation backlog and they are being handled as -- on a one-by-one basis.

Charles Brindamour
Chief Executive Officer and Director

Yes, and we're not overly concerned by that, and I would say FSCO is on it as well. I think they'll try to find solution because this clearly was not the intention that a backlog would drive a delay that would deem a mediation to fail, that was not the intent. And I think FSCO, I suspect, will try to deal with that in the coming months.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. So my understanding -- the way I read it was that claims have been filed under MIG that were not resolved under mediation of 60 days could bounce out of the MIG guidelines, but you're saying that's not the case?

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

Well, I think technically, this is how this is supposed to happen, that if within 60 days the mediation has not been successful, but now it's not been heard. So I think the mediators understand that these are circumstances that are outside of the party's control to make a mediation successful.

Charles Brindamour
Chief Executive Officer and Director

Yes.

Paul David Holden
CIBC World Markets Inc., Research Division

And then final question is with respect to capital allocation for the upcoming year. MCT ratio, while you still have a nice buffer versus your target, have come down. So is your preference to build excess capital or buy back -- continue to buy back stock?

Mark A. Tullis
Vice Chairman

I think in the near to mid-term, our goal is to get back to the 20% debt-to-total capital ratio and then we'll go back to the same -- our long-term capital management, which is ensure we can do the dividends, consider strategic options in the short to midterm and whether there's actionable uses of the capital, either to grow organically or through acquisitions. And then to the extent we've got excess capital beyond what we need for that, we do have a preference for share buybacks.

Charles Brindamour
Chief Executive Officer and Director

Yes. And I think the other factor, Paul, is the general capital market volatility, as you know, which is an integral part of our framework that we used to determine whether we'll do buyback or not. And in the current environment, this is not our intention in the short term.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay, that's helpful. And then finally any comments with respect to the 12% ROE cap that's being in place on Ontario auto, are you hearing anything in terms of the possibility of that cap coming down?

Charles Brindamour
Chief Executive Officer and Director

You want to talk about that, Martin?

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

Yes. Well, FSCO has received the Auditors General report, and I think they have signified that they have an -- they would have an interest in reviewing the adequacy of the 12%. But I think that they're educating themselves at the moment, and we're participating in that exercise to put in perspective what that 12% means on the long-term perspective.

Charles Brindamour
Chief Executive Officer and Director

Exactly. And I think it's important to bear in mind that this is a non-leveraged ROE target that FSCO is putting. The other thing that's important to bear in mind for FSCO is that if you go back in time and look at the industry, it's a highly competitive industry. The ROE in the past 3, 5 or 10 years in Ontario for the industry has been nowhere near 12%. So for me, this is not talking about the right things in the Auditor General's report. And I think FSCO, as Martin said, is thinking through these things at the moment, but this is really not a concern of mine at this stage.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. So that cap could be lower, but if it does, it's irrelevant anyways?

Charles Brindamour
Chief Executive Officer and Director

I'd be very surprised if it was.

Operator

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

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

Just a follow up on Paul's question there on capital allocation, specifically from a long-term perspective. Now I understand that you're probably fully focused on integrating AXA, but perhaps I can ask you to look ahead to future acquisition opportunities, particularly given the backdrop of your financial flexibility and what looks, at least to me, looks like a increasingly probable de-mutualization of the P&C sector. So given that backdrop, I'm wondering what your thoughts are on acquisitions specifically in Ontario auto? Are we likely to see more or increase in industry consolidation there since you mentioned that combined ratio is still ranging between 105% and 110%. And would Intact be a willing participant or are you sort of satisfied with your current exposure to Ontario auto?

Charles Brindamour
Chief Executive Officer and Director

So let me talk about consolidation and then let me talk about the impact of that on Ontario auto. So our view has not changed that there should be, over the coming 5 years, probably 20 points of market share that will trade. And given our financial condition and given our experience in integration, and our out-performance of the industry, it is an element, an important element of our strategy to continue to be a consolidator. And so indeed, we're really focused on the integration of AXA, but AXA was not last acquisition that we will do. And so that's the first point. The second point is that the conditions at the moment, I think, are good for consolidation of the industry and they are likely to be good for a few years. You point to de-mutualization, but I think for me this is way broader than that. This is just one thing that is changing at the industry level. There are changes taking place abroad. The industry performance is not great with the mid-single digit, 6% to 7% ROE. And as such, you've got all the conditions, in my view, to see continued consolidation in the market. Your point on Ontario auto, I mean, in general, most -- many if not most companies tend to be spread in more than one province and one line of business. But given our approach operationally in claims, underwriting, pricing, our out-performance of the Ontario market and the fact that there is a government that's proactive at trying to keep costs under control for Ontario drivers, this is certainly a line of business where we would not shy away from getting additional exposure through consolidation. In other words, there are very few Ontario auto-only companies, but we won't prevent ourselves from doing an acquisition because there's heavy Ontario auto exposure. We feel that we've done a very good job on that front over the past 3, 5, 10 years. And our out-performance right now is a proof of that.

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

So if the right opportunities were to present themselves, you wouldn't be averse to getting back to the same set of business mix -- Ontario as being part of your business that you had prior to the AXA acquisition, then?

Charles Brindamour
Chief Executive Officer and Director

No. I think we're not motivated by distribution of the book of business per se. We're motivated by outperforming in every segment where we operate. And once you outperform in every segment where you operate, how much of the business you write in that segment in relationship with the size of your business is really quite secondary.

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

Okay, and just one follow-up to that then. Specifically on Ontario auto, then again if the right opportunity present themselves, would you be -- would you come up against any competition Bureau obstacles or any other sort of regulatory hurdles if you were to seek significant or sizable acquisition opportunities here?

Charles Brindamour
Chief Executive Officer and Director

I don't think so.

Operator

There are no further questions at this time. I'll turn it back to Dennis Westfall.

Dennis Westfall
Former Vice President of Investor Relations
Thank you, everyone for participating. The webcast will be archived on our website for one year. The telephone replay will be available at 2 p.m. today until Wednesday, February 15. The replay number is 1 (855) 859-2056. The passcode is 42475261. A transcript will be made available on our website. Please note that our first quarter results for 2012 will be released on May 2. That concludes our conference call. Thank you and have a good day.