S&P Capital IQ

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Intact Financial Corporation TSX:IFC

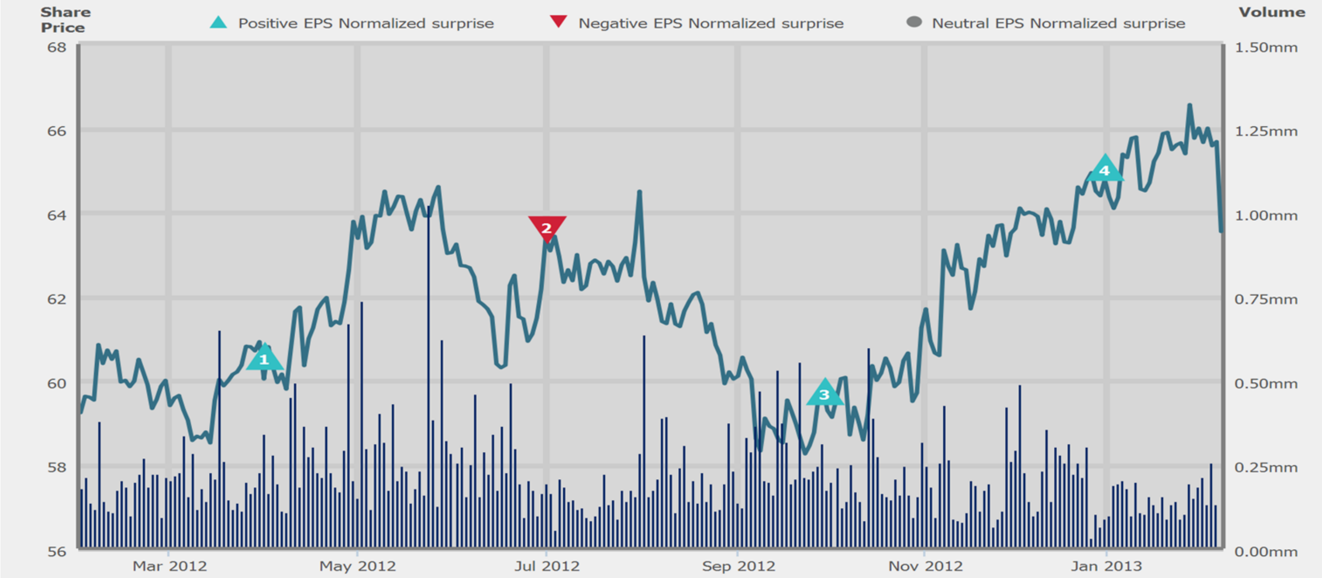
FQ1 2013 Earnings Call Transcripts

Wednesday, May 08, 2013 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2013-			-FQ2 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.32	1.27	(3.79 %)	1.65	6.01	6.57
Revenue (mm)	1778.28	1524.00	(14.30 %)	1918.54	7371.10	7687.45

Currency: CAD
Consensus as of May-01-2013 1:46 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2012	1.25	1.34	7.20 %
FQ2 2012	1.41	1.35	(4.26 %)
FQ3 2012	0.56	0.93	66.07 %
FQ4 2012	1.35	1.42	5.19 %

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Call Participants

EXECUTIVES

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Senior Vice President of Commercial Lines

Charles Brindamour
Chief Executive Officer and Director

Dennis Westfall
Former Vice President of Investor Relations

Mark A. Tullis
Vice Chairman

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

Mathieu Lamy
Chief Information Officer and Senior Vice President

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Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. We apologize about any technical difficulties. My name is Martina. I will be the operator assisting your call today. I would like to welcome everyone to the Intact Financial Corporation First Quarter Results. [Operator Instructions]

I would now like to turn the call over to Dennis Westfall, VP, Investor Relations. Please go ahead, sir.

Dennis Westfall
Former Vice President of Investor Relations

Thanks, Martina, 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 the disclaimer on forward-looking statements, which also applies to our discussion on the conference call today.

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

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

With that, I will ask Charles to now begin his remarks.

Charles Brindamour
Chief Executive Officer and Director

Thanks, Dennis. This morning, we announced net operating income per share of $1.27 or $1.02, excluding a one-time tax benefit, down from the first quarter of last year, which had benefited from exceptionally strong underwriting results. Our combined ratio of 95.1% reflects the impact of more seasonal weather conditions versus last year's mild winter, which led to an increase in claims frequency across all lines of business.

On a top line perspective, premium growth of 9% reflects encouraging early growth indication from the addition of Jevco. I'm pleased with our ability to leverage the Jevco products across our distribution platform. This has offset the expected impact we've seen from re-underwriting parts of the acquired business.

Our earnings over the past year have generated an operating ROE of 16%. A 12% increase in book value per share has strengthened our financial position, as we ended the quarter with close to $750 million in excess capital.

The strength of our financial position enables us to announce our intention to buy back shares under an NCIB [ph]. While we continue to expect capital deployment of [indiscernible] in the form of acquisitions over the coming period. We feel our own shares present such an opportunity. As such, we announced today that we filed to buy back up to 5% of our outstanding shares over the next 12 months. To be clear, our outlook for M&A in Canada has not changed, as we continue to expect 20 points of market share to trade within the next 5 years.

I want to make a few comments regarding the business that has been receiving a lot of attention lately, Ontario auto, which represents less than 1/4 of our portfolio.

Last week's liberal budget included a cost and rate reduction strategy to reduce average auto insurance rates by 15% over a period of time. We believe the government's intention to implement cost-reduction

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measures is important, as it serves to build momentum for actions that will bring, in our view, meaningful improvements to the system, both in the short and in the long run.

The government understands, in our view, that without such measures, the proposed reductions in premium will be very difficult to implement, as it would put additional pressure on the industry and lead to availability issues in the province, particularly as the combined ratio at the industry level was approximately 103 in 2012. So we're working with the government and the Insurance Bureau of Canada to identify and quantify these cost-reduction measures.

On the topic of mediation, I'm pleased to say that good progress is being made on that front. At an industry level, FSCO's work to reduce the backlog is proving to be successful, as it is down approximately 16% thus far in 2013.

As for IFC, our own mediation backlog has been reduced by more than 1/3. The resulting mediation outcomes solidify our view of the effectiveness of the 2010 reforms.

Despite the political noise, we maintained our view on the Ontario auto market. Given the complexity of this market, we've adopted a perpetual improvement strategy, as demonstrated by our own pricing segmentation and claims actions over the past years. As a result, we've demonstrated an ability to maximize our performance in periods of market turmoil. Our teams are approaching the current environment with the same level of determination.

Finally, I think it's important to highlight that our view on the bodily injury environment both in Ontario and Alberta has not changed. We have not seen deterioration in Ontario, and we expect to offset the impact of last year's deterioration in Alberta by taking the full amount of approved rate changes in the mandatory portion of the product.

Moving to personal property. I would say that this year's 93.5% combined ratio is much closer to what one should probably expect in the first quarter than was last year's 83.5%. We continue to strive for a combined ratio sustainably below 95% and implemented a successful batch of improvements in 2012, as well as during the quarter. I remain confident that we have the right action plan in place to achieve our target level of profitability.

When it comes to our outlook for the industry, growth last year played out as we had anticipated. As the drivers behind this growth will likely continue to impact 2013, we foresee similar growth in the coming 12 months. We expect low-single digit growth in personal auto and commercial lines and mid- to upper-single digit growth in personal property. We continue to expect the firming conditions in approximately 1/4 of the commercial P&C industry in 2013, and the low interest rate environment should support our outlook.

Turning to the industry's ROE. We do not expect material improvement in the near term from the 10.6% level reported in 2012. 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 believe we will continue to outperform the industry's ROE by at least 500 basis points, our stated objective.

Mark will provide updates on our integrations in a moment. But clearly, we made some good progress in the quarter on our synergy run rates, particularly for AXA Canada. I continue to be impressed with what's been achieved to-date, and I want to thank our employees for their hard work in ensuring our customers and brokers continue to receive top-notch service.

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

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

I will now turn the call over to our CFO, Mark Tullis.

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Mark A. Tullis
Vice Chairman

Thanks, Charles. Today, we announced underwriting results more indicative of a typical first quarter than those reported in Q1 last year. The 95.1% combined ratio was in line with the 5-year first quarter average of 94.9%, but above the unusually strong 92.3% reported in 2012.

In personal auto, the 11% growth in premiums reflects the addition of Jevco, as well as organic growth. From an underwriting perspective, the combined ratio improved 1.1 points from last year due to higher favorable prior-year claims development and solid results outside of Québec and Atlantic Canada. The current year loss ratio excluding catastrophes, was higher by 1.3 points, as a result of an increase in claims frequency due to the more normal winter weather conditions.

Growth in personal property of 5% was primarily driven by higher rates, though we experienced 1% growth in units despite our rate actions. The combined ratio increased 10 points from the exceptional 83.5% of last year.

Current year results, excluding catastrophes, were negatively impacted by an 11% increase in claims frequency, reflective of more seasonal weather conditions.

Our commercial P&C business experienced fewer large losses than in first quarter last year, but this was more than offset by lower favorable prior-year claims development in Q1. The combined ratio in commercial auto of 97.3% was 12.1 points worse than last year's very strong performance, primarily due to unfavorable prior-year claims development and an 11% increase in claims frequency.

The expense ratio at the total company level was 0.7 points improved versus last year. This change was driven by a drop in variable commissions from the lower level of profitability in the quarter and acquisition-related synergies, partially offset by higher IT expenses, including non-recoverable sales tax.

On the investment side, net investment income of $96 million in the first quarter was down $4 million from a year ago, as additional investments, primarily related to Jevco, were more than offset by declining yields. The market-based yield of 3.4% was down from 3.7% last year. We expect the prevailing interest rate environment to essentially offset the growth in our investments in the coming quarters.

Our financial position remained solid at the end of Q1 2013, with $744 million in excess capital and a book value per share 12% higher than a year ago. We ended the quarter with a debt-to-total capital ratio of 18.5%, below our internal target level of 20%.

As discussed last quarter, we typically use NCIBs to help manage capital, while retaining flexibility for strategic growth. But we did not then have a program in place on the heels of our 2 recently completed acquisitions. We believe we are now at a point where it makes sense to utilize our full array of capital management options.

One of these is to execute buybacks at attractive levels in the context of our objectives for ROE outperformance and net operating income per share growth. This in no way changes our view as to opportunities in the M&A landscape.

From a tax point of view, although we paid $284 million in cash taxes during the quarter, on an accounting basis, we reported a slightly negative effective income tax rate. It's common to have onetime adjustments, which impact the reported accounting tax rate. And this quarter, we had an adjustment related to the recovery of prior year's taxes paid. Without this benefit, our EPS and net operating income per share, would each have been lower by $0.25. The tax rate should return to a normal level for the remainder of the year.

We continue to make good progress on both of our integrations. For AXA Canada, system shutdown projects are well underway. We maintained our $100 million after-tax synergy target and estimated our run rate at the quarter end was $84 million. About half of the synergies come through in general expenses and the rest are reflected in claims expense. Much of the remaining synergies should coincide with the system shutdown in early 2014.

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Early indications are positive with respect to the Jevco acquisition. The impact on growth from cross-selling the new product suite within our distribution platform has been better than expected, while overall retention is in line with our expectations. Initial underwriting results are also positive. We continue to expect the acquisition to be accretive to net operating income per share in 2013 and annual synergies amounting to $15 million after-tax are expected from a combination of external loss adjustment expense reductions, shared service savings, reinsurance and system-related cost savings. And we expect our run rate to be at this level by the end of 2014.

In summary, we're pleased with the significant progress made to-date on both of our integrations. We plan to leverage our solid position to take advantage of opportunities in the market and to bolster our excellent long-term earnings power. This, combined with our disciplined approach to the business, provides a strong foundation for continued growth.

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

Dennis Westfall
Former Vice President of Investor Relations
Thanks, Mark. Martina, we are now ready to start the question period.

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Question and Answer

Operator

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

Tom MacKinnon
BMO Capital Markets Equity Research

Question, I guess, with respect to -- you've done a good job of talking about quarter -- year-over-year results, but I'm trying to get a handle on some quarter-over-quarter results. The 92.1% that you reported in the fourth quarter, you said, was indicative of the underlying performance in that quarter. And based on what came in this quarter, it would suggest that there was a much bigger quarter-over-quarter seasonality factor. So what was driving that bigger quarter-over-quarter seasonality factor? And what would you deem to be the kind of an underlying performance of this quarter, if you had a -- more of a seasonal -- or more of a long-term, I don't know, seasonal quarter-over-quarter factor? I know it's really difficult to judge a property and casualty insurance company based strictly on quarterly results here, but anything you could give here would all be helpful.

Charles Brindamour
Chief Executive Officer and Director

Yes, I know. I think it's a good observation, Tom. It's fair. You're right. It is tough to judge quarter-by-quarter. But I think your observation is a good one. And maybe -- Mark, maybe you can share your perspective on that?

Mark A. Tullis
Vice Chairman

Yes, I'll make a few comments here. I mean, first of all -- and I know you're addressing Q1, Q4. But Q1 last year, keep in mind, did have exceptionally mild winter. And generally, we plan and expect more seasonality in Q1 certainly than the recent track record. I think the other thing to keep in mind here, our increased penetration in Québec, post AXA, means we're more subject to winter weather exposure than we had been in the prior few years prior to that, and this really translated into a meaningful increase in frequency in Québec and Atlantic Canada in the quarter. The other thing that was going on in this quarter, I think, in addition to the weather-related items, is that the commercial lines performance at 97% to 98% was worse than one would expect in the long run from that line of business.

Charles Brindamour
Chief Executive Officer and Director

Yes, exactly. And I think, Tom, sitting back and looking at the historical seasonality that we present in our public disclosure, well, first of all, I think we've had a few exceptional first quarters in the past few years. But the second comment I would make, and Mark touched on it, which I think is probably more important, that is the distributional shift by province as a result of the AXA transaction has had an impact there. And I think one of the things we need to do on the back of this quarter is go back on the public disclosure there and see if there's not an improvement we could bring because I think your observation is a good one.

Tom MacKinnon
BMO Capital Markets Equity Research

And then, one final question, if I could squeeze it in. It looks like -- was there any Jevco -- of the $15 million after-tax, was any of that in the quarter, or is that supposed to be all -- virtually, all of that $15 million, we should expect through by the end of 2014, along with the additional $16 million from the AXA acquisition in terms of AXA synergies?

Mark A. Tullis
Vice Chairman

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Yes. We actually did experience some in the first quarter a little less than $3 million, about 50-50 split between expenses and through the claims side.

Tom MacKinnon
BMO Capital Markets Equity Research

And what would it take in order to exceed those numbers? What would you see as happening if you were able to exceed these targets?

Mark A. Tullis
Vice Chairman

On the Jevco side?

Tom MacKinnon
BMO Capital Markets Equity Research

Both the Jevco and AXA side?

Mark A. Tullis
Vice Chairman

We feel very confident about the targets we've laid out on the synergy side.

Charles Brindamour
Chief Executive Officer and Director

Yes, and I think that, in the case of Jevco, I mean, we're 6 months into the conversion. So far, so good, I would say, on the retention level. The combined ratio that we experienced after a quarter is a little better than that we had modeled. The piece that we're a little bit surprised by on the Jevco front is the -- I don't know, if excitement is the right word, but we're certainly cross-selling a fair bit, and there was a fair bit of demand for the new product across the channel and that's in part why growth was at that level -- at this stage, and the indications so far are that, that's likely to continue for a portion of the year.

Operator

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

Doug Young
TD Securities Equity Research

I guess, just -- my first question is just on the Ontario auto. And, Charles, I guess on your Slide 4, you talked about -- you think the outcome could be margin neutral, but additional cost-reduction measures are critical. I guess, 2 parts to my question. I guess, margin neutral doesn't mean that earnings can't come under pressure. And I just want to confirm if that's the case? And the second is, what gives you confidence around that? And maybe you can unpack some of the things -- or some of your thoughts behind that statement?

Charles Brindamour
Chief Executive Officer and Director

Yes, I think that of -- margin neutral means that the sort of underwriting performance we see in that market, we'll do everything we can to maintain in that environment, I think, as we've shown historically as well an ability to outperform it. I think that the government understands very well, I think, what needs to be done in the Ontario automobile environment in terms of additional measures to, a, reduce cost in the system; but, b, and almost more importantly to me, reduce the risk of inflation going forward. The government has a very good grasp of that. I think they also understand the reality that the industry is running at 103 right now, and you don't need to go back in history very far to understand that if you force the industry into a position of unsustainable loss, that there'll be an important availability issue. I think they get that. These are rational and responsible people, and I think they're focused on improving the environment for Ontarians. And my interactions with them, I'm impressed with their intent on that front.

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Now 15% [ph] is a big number for sure. There is a number of things that are on the table that would be, I think, good for the system, that could bring premium reductions. And maybe I can ask Mathieu to give you a few examples of the sort of things that could be considered to improve the system. So, Mathieu?

Mathieu Lamy
Chief Information Officer and Senior Vice President

Yes. As discussed in the budget already, we see that's confirming that MIG being binding would be a good thing to solidify the reform benefit that we saw [ph] in 2010. Reform of the cat definition would be a good initiative, and it's discussed right now. The anti-fraud task force reported a series of measures that was recommended to government. Some of them were regarding regulating the clinics and the tooling [ph] industry, and that, we think, would have a positive outcome on the industry. And some BI reform, bodily injury reform, such as eliminating the disappearing deductible, such as lowering the pre-judgment interest, would have positive outcome on the claims side. So those are some of the suggested measures that we're discussing with government.

Charles Brindamour
Chief Executive Officer and Director

I think, Doug, in all of these, we are not naive. It is a politically charged environment. I trust the government's intention that they will do the right thing for Ontarians, but we're not naive and I think the timing is certainly not clear at this stage. But our view is that this will take some time for this to take place. We've given you high-level examples. There's a difference between high-level examples and the actual measures that are being implemented. That will also have an influence there. And so, when you face some uncertainty like that, our approach has been here to double up inside and bring improvements on our side ourselves to make sure that we remain in a position of strength in that environment. And these are not just words. If you go back over the past few years, whether it's the pricing moves that we've made ahead of the curve in '07 and '08, whether it's the fact that when the reforms took place in 2010, we doubled up on actions that we've taken ourselves to make sure that we would get the full benefits of the reforms and more. And obviously, in an environment that is politically charged with this one -- like this one, our approach and mindset is exactly the same. So the folks in claims are focused on pushing the actions that we have in the pipeline further, coming up with new actions to make sure that our ability to outperform, regardless of the scenario, is very strong and healthy.

Doug Young
TD Securities Equity Research

So I just wanted to follow up. And I guess, the -- when you talk about margin neutral, should I think of that in the combined ratio neutral? Is that the way we should kind of think about that?

Charles Brindamour
Chief Executive Officer and Director

Yes, I think it's one way to think about it in a world where the investment income doesn't change. I would say that's probably a fair way to think about that.

Doug Young
TD Securities Equity Research

And then, the -- I guess, the big benefit you could get from the government would be around the cat definition, and it seems like that they want to have another study after doing multiple studies already. How confident are you around that one topic or one issue being addressed?

Charles Brindamour
Chief Executive Officer and Director

Just to be clear, I think Mathiue lined up a number of ideas here. Cat is one of many ideas. And so, cat is -- the cat definition, in my view, is important, but it's not the panacea to Ontario. I mean, there are more ideas on the table. I think that this one is -- certainly has a lot of stakeholders involved. And I'm not as confident as I was, let's say, 6 months ago that this will get through given how politically charged

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the environment is. And that's why one needs to have a long list of things to put on the table, and that's the sort of stuff we're putting in front of the government and the ministers -- the minister of senate [ph]. We're starting to see a change in the cat definition as an effective measure, along other effective measures. I mean, the sort of percentage cost reductions that the government is talking about will call for many measures, as far as I'm concerned, and cat being one of them.

Doug Young
TD Securities Equity Research

Yes. I guess -- but I guess, just to be clear, like, I'm confident with what you guys have done. And you're, obviously, improving, you can outperform the industry. I'm more concerned about the rationality on the government side, and it's obviously a tougher thing to handicap. And I guess, just my last question and -- is just around the commercial side. And it just seemed like there was a pretty big deterioration. And I understand the claims frequency and the reserve developments were less. Is there anything else unusual that kind of came through? Because, Mark, it seems like, in your comments, you signaled that this was an unusually bad quarter. Can you help me think through that?

Charles Brindamour
Chief Executive Officer and Director

Doug, I think we'll ask Alain Lessard, our SVP of Commercial Lines, to talk about the performance there. I just like to point out, combined ratio of commercial P&C Q1, Q1 was roughly in line 98:98. Commercial automobile went up from 85 to 97. And I'll let Alain comment.

Alain Lessard
Senior Vice President of Commercial Lines

Yes, well, I think the most unusual piece really would be on the commercial automobile, where we saw an important deterioration on the loss ratio, and that is very much driven by severe weather condition. Just to give you an idea, the snowfall during the first quarter on Eastern Canada was an increase in Montréal about 70% and an increase in snowfall in Toronto about 170%. And we have to think that our -- in the case of commercial lines, we are very much concentrated in cities. So this affected, not only the current year, but it also affected the prior-year developments since some of those snowstorms and even the big one was December 27, 28. And basically, we underestimated the amount of reserve or impact on that snowstorm. So that was really probably during the first quarter, the most I would say unusual event that happened, okay? But overall, if we look at the performance of the commercial automobile, also, if we look -- compare it to the industry, in 2012, we basically outperformed the industry in terms of loss ratio for the year by about 15 points, which is also more than double the outperformance of about 7 points in 2011. So that confirms that during 2012 was an exceptionally good year on the commercial automobile side.

Charles Brindamour
Chief Executive Officer and Director

I think, in commercial auto, Doug, when we look at the numbers, we're seeing frequency is up 11%, which talks directly to the point that Alain is making.

Operator

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

Paul David Holden
CIBC World Markets Inc., Research Division

So, Charles, you mentioned that your view on M&A hasn't changed. Wondering if your view has changed at all with respect to the type of acquisitions you will want to make? I guess, specifically, would you be comfortable buying a business today with a high weighting in Ontario auto?

Charles Brindamour
Chief Executive Officer and Director

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Yes, I would be comfortable today -- knowing where we are today, I would be comfortable growing through acquisition in Ontario. I think I would do it, obviously, at a price that reflects some uncertainty, and I'd want to make sure that the reserves are on the basis of our own reserves. But at this stage, given our ability to outperform in that province, I think there's a good opportunity to create value. I mean, the value you create in a transaction, it comes from the fact that you've outperformed and you can replicate that outperformance on a target, provided that the starting point is what you think it is.

Paul David Holden
CIBC World Markets Inc., Research Division

All right. Okay. Good. And then, in terms of some of some of the cross-selling opportunities you were talking about related to Jevco, wondering if any of that is related to specialty lines and the opportunity you have to expand that line of business, given that Intact is currently underrepresented in specialty lines?

Charles Brindamour
Chief Executive Officer and Director

I'll ask Alain to take this one, Paul.

Alain Lessard
Senior Vice President of Commercial Lines

The 2 strategic additions that came from Jevco from the commercial lines were -- would be on the surety side and on the trucking side. On the surety side, clearly, that's an interesting addition. And so far, it's been very profitable. Surety, for Jevco, was targeting small contractor. That's an area where we wanted to move. We are more focused on larger contractor, and we're currently focusing on opening small contractor units out west and in Québec, so that's going well. On the trucking side, while -- basically, the trucking, right now, we're integrating both Jevco and AXA integration. We have opportunity on the trucking side, mostly in Ontario, but I would think, at this time, it would be fair to say that we have not maximized or opened the cross-selling on the trucking side.

Charles Brindamour
Chief Executive Officer and Director

Yes, fair enough. I think, Paul, if I give you my sort of high-level perspective on top line in the context of Jevco, there's 3 blocks in my mind. There's how much of the actual business you retain in personal lines, how much of the actual business you retain in commercial lines and how much new business you actually generate because of the products. And so, overall, we're retaining a little better than we thought in personal lines. We're retaining less than we thought in commercial lines. We're deep in re-underwriting that portfolio. And so, net-net, I think we're sort of retaining what we thought. But then, in particular, on the recreational vehicles, across the country, we're getting more new business than we originally anticipated, which -- that was part of the strategy, so we're pleased with that development. Would you agree, Martin?

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

Yes, and that the additional new business that we're getting is mostly our broader reach in the distribution channel. So we have more brokers than Jevco has to sell their product, and that's where I think we're getting some of those benefits.

Charles Brindamour
Chief Executive Officer and Director

Yes, exactly.

Paul David Holden
CIBC World Markets Inc., Research Division

Great. And final question. So with respect to cost synergies from AXA. So I know you mentioned that you're comfortable maintaining your $100 million target. But I mean, given where you stand today and

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given that policy retention has been better than you first assumed, is there not a reasonable expectation that probably synergies will come in above that $100 million target?

Mark A. Tullis
Vice Chairman

We're confident in hitting the $100 million. We're not publicly adjusting the target at this point. And I think it's important to keep in mind you'll probably see a bit of a plateauing of the reported synergies the next few quarters before the system shutdowns come through in 2014, which is when you'll see a ton of them. I think the other thing to keep in mind, there's some additional synergies that we don't include there, such as subrogation and things like that, that we get on top of that. But we're comfortable with the $100 million target. I...

Charles Brindamour
Chief Executive Officer and Director

Yes, and I think at the Investors Day, Mathieu actually made it relatively clear, the additional sources of synergy, in our view, has not changed there. So I'd refer people to the claims presentation at the Investors Day.

Operator

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

Bryan Brown
Macquarie Research

In Ontario auto, you talked about the rate cut and cost-reduction strategy to be margin neutral. Does that include the reduction in the ROE benchmark for rate filings?

Charles Brindamour
Chief Executive Officer and Director

Yes, I think this is one where we'll have to see what that means in practice. Are we talking about average ROE? Are we talking about flat ROE? Are we talked about a range, et cetera. And depending on how that looks like, we'll -- that's our strategy to make sure that we're not overly impacted by that. This one is hard to assess at this stage. I think the reality is that there's a benchmark at 12 right now, roughly. And the industry has generated about 7 over 10 years. And we've outperformed over that period. So for me, I'd sort of wait to see exactly what that looks like, when that comes to the table. But I must admit, this is not an item that is critical in my mind at this stage. And I -- again, I don't want to be naive. It's a politically charged environment, but I don't see that the industry has room for forms of ROE compression here just because it has not achieved the sort of target ROE that this market anticipated.

Bryan Brown
Macquarie Research

Okay. And the -- in the mediation backlog, are you guys seeing good progress? And what does that mean for the possibility of redundancies. I guess, if you are seeing interpretations of the 2010 reforms through the mediation?

Charles Brindamour
Chief Executive Officer and Director

Yes. I'll let Mathieu give his perspective on what we've seen so far, and I'll come back at the end.

Mathieu Lamy
Chief Information Officer and Senior Vice President

Okay. On the mediation, we see both, at the industry level, a good reduction and, in our own open cases, a good reduction and our mediation pending. So in our view, that classifies as benefit of the reform. As expected, though we see a small increase in the backlog of arbitration, so that keeps a certain level of

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uncertainty there. But overall, in what we've settled so far in the post-reform mediation, we have settled nearly 20% of our cases in mediation. So that, too, we think, reduces uncertainty going forward.

Charles Brindamour
Chief Executive Officer and Director

Yes. And I think that, of course, arbitration is where a bit of a backlog is being created. We remain cautious, but there's nothing we've seen in the mediation outcomes that would lead us to take a more conservative view than we've had so far. And we're looking forward to development on the arbitration side of things. And I think that the sort of measures that the government has in mind, in relationship with what's in the budget, would be helpful in terms of increasing the comfort level that the reforms will remain effective.

Bryan Brown
Macquarie Research

Okay. And just one last thing to clarify. In Alberta, you guys mentioned that, I guess, you plan on taking the full amount of the approved rate increase.

Charles Brindamour
Chief Executive Officer and Director

Yes.

Charles Brindamour
Chief Executive Officer and Director

Is that correct?

Charles Brindamour
Chief Executive Officer and Director

That's exactly right.

Mark A. Tullis
Vice Chairman

That's already done.

Charles Brindamour
Chief Executive Officer and Director

It's done.

Operator

Your next question comes from the line of Shubha Khan from National Bank Financial.

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

I just wanted to look at commercial lines for a second here. Just looking at the less favorable prior-year claims development, particularly in commercial P&C, I guess, versus prior quarters. In the past, you talked about the favorable impact of the AXA book in this regard. And I'm just wondering, has the impact waned on that front? And is the Q1 reserve development more sort of representative of what we should expect going forward?

Charles Brindamour
Chief Executive Officer and Director

Well, I think, 2 aspects, okay, at this point. Last year's prior development at 13% was in -- I think, exceptionally high. It's not something we can expect that will continue time over time. This year, there was kind of an -- well, not an extraordinary event, but an event relating to surety. And when it comes to

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surety, surety losses is when it comes to assigning an accident date to our surety losses, especially in the first quarter, it's always a little bit tricky because the contractors' condition gradually deteriorated. And we had 1 surety losses discovered during the first quarter, but was reported and targeted to an accident date of 2012, which affected the prior year development. So we've got a little bit of both. Is 6.1, we see right now, more normal? It's difficult to call that. We don't track that year-over-year. And like you said, the AXA portfolio will change that over time.

Charles Brindamour
Chief Executive Officer and Director

Exactly. So I think, for me, there's 2 key points there. If you look at Q1 -- and that's what we're talking about, versus last year, '13 was on the high side in commercial P&C. I think there's no doubt. And this time around, for that line of business, 6 was probably lower than it would otherwise have been, had it not been for this large surety bump.

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

Okay. Irrespective of that, I mean, you still expect the AXA book to have a favorable impact in the sort of order that we've seen in previous quarters. Is that fair?

Charles Brindamour
Chief Executive Officer and Director

Yes, it is fair. And overall, we're pricing the business and running the business to be in the low-90s in commercial lines.

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

Okay. And if I could switch gears to Ontario auto again. To what extent is the planned 15% reduction in auto rates tied to cost reductions? In other words, based on your discussions with the provincial government and based on your interpretation of what -- of the language in the budget, will the rate and cost-reduction strategies be implemented separately, or are they somehow tied together?

Charles Brindamour
Chief Executive Officer and Director

There has not been a lot of talk about execution here, and you can understand that the context of ongoing improvement in the system was sort of disturbed by the political noise that's taken place in the past month. So I think that there has not been a lot of talk about execution. Clearly, I think, if you go back to the government's intention of being responsible, which I think they've been so far, it's hard for me to see how premiums go down before cost-reduction measures actually get implemented. There's always -- if we go back to the reforms in 2010, you make assumptions about what those cost-reduction measures are worth, you make them effective and you move your rates accordingly, which has been the case with the reform. The industry reflected the fact, in their reassessment of adequacy or inadequacy of pricing, that reforms were taking place. And you adjust the impact of the reform as you go along, and I suspect that this is likely to happen in the same way. Now again, I want to be clear, we're not naive. It's a politically charged concept. And sometimes, responsibility and accountability is put aside to deal with political pressure. But our interactions to-date have shown responsible people being in charge. And so, we'll help them deliver what is best for Ontarians, I think.

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

Okay. That's helpful. And one final question, a very quick one. Just on the -- you mentioned that your view on BI in Ontario and Alberta hasn't changed. It sounds like you haven't seen any deterioration in sort of litigation activity from last quarter. I think that's what you mentioned, as far as Alberta was concerned. Is that a fair assumption, or -- I mean, how's that -- how is litigation activity, court decisions -- how are those stacking up?

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Charles Brindamour
Chief Executive Officer and Director

Yes, it's a fair assumption. Let me ask Mathieu to give a bit of color here, and we'll see if it answers your question.

Mathieu Lamy
Chief Information Officer and Senior Vice President

Yes, it is a fair assumption. In Ontario, we don't see the increase in frequency predicted by the reform at this point. Same view as in Q4. In Alberta, our views from Q4 have not changed. What happened in Q4, we still maintain we see no change in the environment versus Q4 and Q1 2013.

Charles Brindamour
Chief Executive Officer and Director

I think the thing you need to keep in mind when it comes to BI is 2 things. First of all, we're not talking about a lot of numbers, lot of files. So the notion of credibility of experience is always thin in BI. That's why, from our perspective, it's important to be cautious with that line of business and not reach conclusions based on a year worth of data settling because you're talking about small numbers. The other thing that's really important to understand when it comes to BI is that, not only don't you get a large number on which to base your view on, but it takes a while before the number actually becomes credible. So small number of claims, and then the ultimate takes a while. And that's -- our stance in that environment has been one of caution. And the reason why our stance has been one of caution is because I think we learned from what happened, at the industry level, 10 or 15 years ago in many jurisdictions across the country. The thing that surprised the industry at that time was the fact that the BI trend has been perking up for a while. But because of the late reported nature of BI claims, people find out, and the trend is already well baked in the system. We sort of learned, I think, from that period, and we're being prudent in that environment. And this motivates, to a certain extent, the caution that we've expressed in Q4 despite what I thought was a good quarter.

Operator

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

Mario Mendonca
Canaccord Genuity Limited, Research Division

Just a quick follow-up. Charles, you talked about, -- let me just go back to Ontario auto, that at some point, if things went too far, the issue would become availability. If you could just take that train of thought one step further, so if availability is threatened, is the next step just folks -- some folks are pushed into facility association, and then it becomes a big difference then between -- like, the difference in what some people pay for auto insurance in Ontario and others becomes much wider? Is that the sort of the logical progression?

Charles Brindamour
Chief Executive Officer and Director

That's exactly right, Mario. I think that what one needs to understand is there is rate levels within a company and then there's rate levels within the market. And the rate levels within the market, I would argue, in Ontario in the past 2 years, has gone down compared to what FSCO publishes because people shop for better deals. Inversely, in a period where people feel that profitability is difficult to achieve. And let's keep in mind, this is a highly competitive market. So this whole notion of ROE is funny from the perspective that people have competed historically below the sort of ROEs that were on the table. But in a world where profitability is under pressure, direct writers in general, would stop advertising, for instance, would devote less energy to writing business. Companies that distribute through brokers would not offer the same capacity across Ontario as they would in periods of where they have an expectation to actually earn a return. And as a result, free writers benefit, such as Jevco, who are priced higher than the average market, and the facility association. And this is where -- if you go back 10 years, Mario -- I sound like an

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old guy now. But if you go back 10 years, the FA in Ontario had a 10% market share. That was $1 billion worth of business. So you can do whatever you want with the rates of one company. But if the business goes to the FA, guess what? The average price that the Ontarians are paying goes up. And I think the government understands that, and they don't want to go there.

Mario Mendonca
Canaccord Genuity Limited, Research Division

The next question is sort of related, is when we talk about a 12% benchmark ROE, is that applied on an industry basis -- on industry average basis? It doesn't seem like it would be, if the industry is at 7% today. Or is it applied on a company-by-company basis?

Charles Brindamour
Chief Executive Officer and Director

So the way this works, Mario, is that the rate approval mechanism in Ontario is one where you actually go with your experience of the past 3 years, and then you load up a number of theoretical factors, such as how much capital you allocate to Ontario, which is a theoretical number. The ROE number, your expected investment income, depending on your asset mix and so on. And that sort of drives the rate indication, so to speak, that you'll be asking for. So in theory, this number is applied company-by-company, as you file for rates. And so, the thing that's important to keep in mind -- and I talk about theoretical numbers because you use 3 years of data in the past to charge for the coming year or 2. And the notion of perpetual improvement, so to speak, in running the business is you want to make sure that your operation runs, so that you outperform how you've run your operation in the past 3 years. A long-winded answer, Mario, to say the 12% is a factor you use that's unlevered in your filings with FSCO to justify the rate position that you want to take.

Mario Mendonca
Canaccord Genuity Limited, Research Division

If I could just follow up on that for a second. If the industry is at 7%, I would guess then that there's only a handful of companies in Ontario, including your own, that would be up against the cap. And if the cap is reduced, it would seem to me then there would only be a handful of companies that would be affected by it. Am I thinking about it correctly?

Charles Brindamour
Chief Executive Officer and Director

No. I mean, I think everybody tries to achieve the sort of ROE benchmark that the regulator has put on the table. And I think, a few have been able to achieve that. But everybody is trying to get that sort of ROE, and I think that, prospectively, this will be the same thing. Some people use data and use the experience of the past 3 years to achieve a certain level of ROE and run the business as is. Other companies are continuingly trying to improve what they were doing in the past 3 years to make sure that, over time, you have a reasonable likelihood of hitting that ratio. So, Mario, I don't think that the average companies have filed for 7%. I think that's the outcome here. And so, that's -- I think that's where we stand on this one.

Operator

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

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

Just a clarification on Ontario BI. You said that the activity is not increasing since the reform. Did you mean not increasing or not increasing faster than expected because I thought it was pretty crystal clear that BI was going to increase in Ontario, and everything we read seems to indicate that, for the industry, it is indeed increasing?

Charles Brindamour

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Chief Executive Officer and Director

Yes, I think it's at the expected level [indiscernible].

Operator

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

Stephen Boland
GMP Securities L.P., Research Division

Sorry to keep harping on the [indiscernible], but I think the litigant side of the industry I think has got pretty excited during the quarter over that -- the one case, that Belair went to arbitration. They challenged the MIG definition. I guess, in your view, is the -- I guess, the cost containment going to be defined by the sort of a new catastrophic definition, or is it going to be settled by precedents like this coming out of arbitration? And how are you positioned for that?

Charles Brindamour
Chief Executive Officer and Director

I'll let Mathieu to take this one.

Mathieu Lamy
Chief Information Officer and Senior Vice President

First, on this case, specifically, we're appealing that decision. So we think we have -- we're appealing on both from-- on the point of law and procedural fairness in this case. So hopefully, we'll see a positive outcome out of that. The beginning of the question, what's that?

Stephen Boland
GMP Securities L.P., Research Division

Yes. Just basically how stable, I guess, is the MIG definition of it if it's being challenged in arbitration, where it's not defined. Like you said, you are appealing it. But there's probably, from what you've heard, hundreds or maybe thousands of cases lined up behind this one that have similar traits and challenging the MIG, but it doesn't mean that they are going to get catastrophic definition but evidently increase cost for the insurer?

Mathieu Lamy
Chief Information Officer and Senior Vice President

So on this front, so we're appealing this one, and I think there's a positive news in the budget where they want to make the MIG guidelines binding as opposed to just in the guideline.

Charles Brindamour
Chief Executive Officer and Director

And I think, Stephen, the other point, which is implicit in our remarks here, is that as the backlog shrunk, it increased our comfort that MIG -- the minor injury guideline actually held in a large number of cases. Our caution remains that there's a bit of a backlog being built in arbitration. The decision you're talking about is a preliminary arbitration, and I think there's good grounds to appeal that decision, which we've done. And to avoid uncertainty in that respect, I think the government, in the budget, is seeing some of the loose ends that emerged out of that decision will appear in the budget.

Operator

Your final question comes from the line of Tom MacKinnon from BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

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I know, Charles, you talked a little bit about some of the measures with respect to the budget and one being the tightening of the cat definition. But can you remind us? I think you've actually gone through 2 reserve builds with respect to that interpretation of the cat definition. I believe there's got to be over $30 million that you put -- that you already set up in terms of reserve build for that. I'm just trying to get -- am I correct in that?

Charles Brindamour
Chief Executive Officer and Director

Yes. I think...

Tom MacKinnon
BMO Capital Markets Equity Research

I mean, one was stacking and one was...

Charles Brindamour
Chief Executive Officer and Director

Yes. I think, yes.

Tom MacKinnon
BMO Capital Markets Equity Research

[indiscernible] single functional environment?

Charles Brindamour
Chief Executive Officer and Director

Yes, I think, Tom, you're right on. There were 2 court decisions in 2012, one at the start -- or late 2011 in December, and then, I think, in August or September of 2012, that sort of weakened the cat definition. And as a result, we indeed strengthened close to $30 million worth of reserves for these files. I don't know. Mathieu, anything you want to add on that front?

Mathieu Lamy
Chief Information Officer and Senior Vice President

That's exactly right. 2 court decisions that weakened the cat definition so far. And, yes, the number, I think, is $30 million.

Charles Brindamour
Chief Executive Officer and Director

Yes. And that's why we think that having a scientifically-driven objective cat definition is a really good thing. That's why it's one of the recommendations that we're making to the government. But this is an issue that's maybe a little more politically charged than some of the other measures that are on the table. So that's why I expressed caution at the start of the earlier questions.

Mathieu Lamy
Chief Information Officer and Senior Vice President

And the government expert panel, in their recommendation, were addressing these 2 decisions. So if that expert panel recommendation was to be accepted, this would remove that uncertainty that has been created by these 2 decisions.

Charles Brindamour
Chief Executive Officer and Director

Yes, exactly.

Tom MacKinnon
BMO Capital Markets Equity Research

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And if that was the case -- I mean, you never like to release these reserves, but would they become redundant?

Charles Brindamour
Chief Executive Officer and Director

Well, I think that's -- we'd have to see what happens, Tom. I wouldn't want to speculate on redundancy [indiscernible].

Mathieu Lamy
Chief Information Officer and Senior Vice President

And these 2 -- these cases are already occurred [ph]. So the decision if there was a new cat definition would be prospective. So the reserves we have are for past cases. It would change our view of the future, but not the past.

Charles Brindamour
Chief Executive Officer and Director

We have to see the execution on this one.

Tom MacKinnon
BMO Capital Markets Equity Research

All right. So you're not sure to what extent they're going to apply to open claims files?

Charles Brindamour
Chief Executive Officer and Director

Right. Exactly.

Operator

We have no further questions at this time. I'll turn the call back to the presenters for closing remarks.

Dennis Westfall
Former Vice President of Investor Relations

Thank you, everyone, for participating. The webcast will be archived on our webcast for 1 year. The telephone replay will be available at 2:00 p.m. until Wednesday, May 15. The replay number is 1 (888) 859-2056, and the passcode is 33222558. A transcript will also be made available on our website. Please note that we are holding our Annual General Meeting today at 2:00 p.m., and our second quarter results will be released on July 31. Thank you, and have a great day.

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

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