S&P Global
Market Intelligence

Intact Financial Corporation TSX:IFC

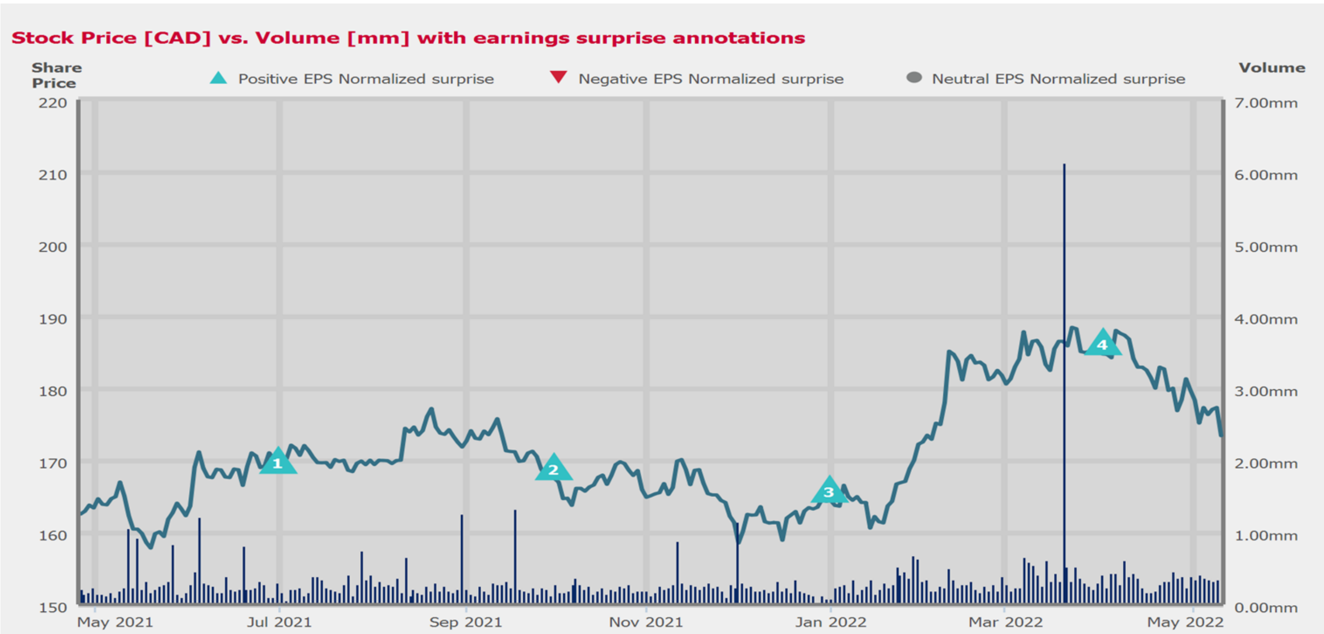
FQ1 2022 Earnings Call Transcripts

Wednesday, May 11, 2022 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.43	2.70	▲11.11	2.81	11.68	NA
Revenue (mm)	4940.80	4891.00	▼(1.01 %)	4891.67	20076.68	NA

Currency: CAD
Consensus as of May-11-2022 6:00 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	2.40	3.26	▲1 35.83 %
FQ3 2021	1.73	2.87	▲2 65.90 %
FQ4 2021	2.52	3.78	▲3 50.00 %
FQ1 2022	2.43	2.70	▲4 11.11 %

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Call Participants

EXECUTIVES

Charles J. G. Brindamour
CEO & Director

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Isabelle Girard
Senior Vice President of Personal Lines

Kenneth Anderson

Louis Marcotte
Executive VP & CFO

Patrick Barbeau
Executive VP & COO

Shubha Rahman Khan
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UBS Investment Bank, Research Division

Doug Young
Desjardins Securities Inc., Research Division

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Jaeme Gloyn
National Bank Financial, Inc., Research Division

Paul David Holden
CIBC Capital Markets, Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Intact Financial Corp. Q1 2022 Results Conference Call. [Operator Instructions] This call is being recorded on Wednesday, May 11, 2022.

I would now like to turn the conference over to Shubha Khan, Vice President, Investor Relations. Please go ahead, sir.

Shubha Rahman Khan
Vice President of Investor Relations

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

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

With me today, we have CEO, Charles Brindamour; our CFO, Louis Marcotte; Isabelle Girard, our Senior Vice President of Personal Lines; Patrick Barbeau, Executive Vice President and Chief Operating Officer; Darren Godfrey, Executive Vice President, Global Specialty Lines; and Ken Anderson, Executive Vice President and CFO, UK&I. We will begin with prepared remarks, followed by Q&A.

With that, I'll turn it over the call to Charles.

Charles J. G. Brindamour
CEO & Director

Thanks, Shubha. Good morning, everyone, and thank you very much for joining us today. As society gradually emerges from the pandemic, other global challenges are coming into sharper focus. The humanitarian crisis caused by the war in Ukraine has exacerbated global macroeconomic conditions. Supply chains remain disrupted while labor markets continue to be tight. Central banks are responding to inflationary pressures with higher interest rates and economic growth is poised to slow. And another quarter of elevated CAT losses certainly underscores the reality of climate change. But regardless of the environment, we continue to be there for our customers. I think our teams are doing a tremendous job in integrating our largest ever acquisition and both the strategic and financial strength of our business are stronger than ever before.

The resilience of Intact was again evident in our quarterly results. Last night, we announced first quarter net operating income per share of $2.70, a 13% increase over Q1 last year, driven both by the accretion from RSA and strong growth in our distribution business. Top line growth of 86% this quarter, was driven by the RSA acquisition as well as robust organic growth of 8%, in large part driven by the strength of our commercial lines platform across all operations. The overall combined ratio was 91.7% with strong performances in all segments, especially after taking into account nearly 4 points of CATs, and the fact that Q1 tends to be a high season when it comes to weather.

Let's now look at our results by line of business, starting with Canada. In personal auto, premiums increased 37% year-over-year, mostly driven by RSA and the impact of pandemic relief provided last year. Organic growth continued to be muted as driving activity remains below pre-pandemic levels. The combined ratio of 93% was in line with our expectations, reflecting typical first quarter seasonality. Overall, our personal auto business is very solid, thanks to the profitability actions we took prior to the pandemic. And I continue to expect it to deliver at the low end of our mid-90s target range this year. Looking at the industry, a gradual pickup in claims frequencies and inflation are driving insurers to slowly resume rate actions as we anticipated. However, we expect premium growth to remain muted in the near term.

In personal property, premiums grew 38%, again driven by the RSA acquisition as well as 5 points of organic growth on the back of firm market conditions. Despite 6 points of CATs, the combined ratio of 87.6% was very strong, reflecting solid growth in earned rates. With weather continuing to support firm market and given our industry-leading supply chain capabilities, this business is very well positioned. While we've averaged sub-90s performance over the last 5 years, we, of course, remain vigilant about volatility in natural disasters. We're committed to operating personal prop at a sub-95 combined ratio even when losses are elevated. In Commercial Lines, premiums grew 36%, which included 13 points of organic growth. At 88.5%, the combined ratio remained robust, reflecting strong rate actions in a hard market. We expect market conditions to remain favorable due to elevated CAT losses, inflation pressures and rising reinsurance costs. Our Commercial Lines business is well placed to sustain low 90s or even better performance in the long run.

Moving now to our UK&I business, which delivered a combined ratio of 98.9% despite a particularly heavy cat quarter in the U.K. and personal lines, severe windstorms in February drove nearly 14 points of CAT losses for the quarter. Normalized for extreme weather, the combined ratio was in the high 90s in line with Q1 expectations. Momentum in our pet insurance business continues to be solid. Market conditions remain quite competitive in both home and motor in part due to the U.K. pricing reforms that went into effect at the beginning of the year. We've maintained pricing discipline given the market backdrop as we're determined to see improved performance in this segment. We're supplementing this discipline by applying our core competencies in risk selection and AI.

In Commercial Lines, performance continues to be very strong with a combined ratio of 90%, driven by our pricing actions in the hard market conditions. We're continuing to optimize our footprint, prioritizing strong regions and specialty businesses. Overall, the UK&I business is in a good position. We're focused on building out performance. And intend to share more details on our road map in the coming months, including at our next Investors Day on September 22.

Our U.S. commercial business is growing at 19%, driven by hard market conditions, policy growth and new products. The combined ratio was very strong at 86.8%, improving nearly 10 points from the prior year quarter, which itself was impacted by the headline-grabbing Texas winter storms. During the quarter, we decided to exit the U.S. public entity space as the operating environment has fundamentally changed in recent years. However, the remaining lines in our U.S. portfolio are very healthy, and we're well positioned to deliver sustainable low 90s performance or better as we remain focused on portfolio quality while market fundamentals remain quite compelling.

Turning to the RSA acquisition, which is closing on its 1-year anniversary next month, the integration is very much on track. In Canada, policy conversion in the broker channel continues to progress very well. Approximately 50% of policies have converted to Intact systems so far. That's very good traction with our broker and affinity partners and retention levels are largely in line with expectations. We've also made significant strides in our efforts to optimize our footprint. In the past few weeks, we closed on the sale of Codan Denmark for close to 4x book value. We announced the sale of RSA's Middle East business and took steps to reduce our earthquake exposure by approximately 40%, which includes winding down the CNS operation of RSA Canada.

In addition to RSA integration, our teams are making significant progress on other strategic priorities. In fact, we executed on several initiatives during the quarter to transform our competitive advantages and expand our leadership position right here in Canada. We launched a fourth-generation usage-based insurance program for customers in Ontario and Quebec and modernized our broker portal. And on the distribution side, BrokerLink, again, was active on the M&A front, completing 4 more acquisitions, including its largest ever transaction in Alberta.

Last month, we also released our 5-part climate strategy, taking the next big stride towards a more sustainable future. First, we've made a firm commitment to achieve net 0 emissions by 2050 with an interim target of halving emissions across our global operations by 2030. Second, we're doubling down on helping society adapt to extreme weather impacts of climate change. We've been very active on the adaptation front for over a decade, and we think we need to do more. This includes investing $8 million in a new partnership with the Nature Conservancy of Canada to conserve wetlands in addition to increasing our support for the Intact Center on climate adaptation.

Third, we'll incentivize green behavior by our customers create green products and source green materials within our supply chain. Fourth, we'll enable the transformation of existing industries and support the creation of new ones in building a sustainable future through products, services as well as investments. And finally, we'll calibrate closely as we've done in the past with governments to accelerate climate action, building on our track record of sharing our expertise in climate change.

Overall, we're off to a strong start in 2022 with a lot of momentum across all the businesses. Organic premium growth is in the high single digits, NOIPS is up 13%, book value is up 32% year-over-year, and we produced an operating ROE of more than 16% for the last 12 months. We've achieved this despite an unprecedented period of upheaval in the world around us, thanks mostly to our people. Over the past 5 years, we've compounded NOIPS at 20% a year and beat the industry ROE by 670 basis points on average. That's close to 700 basis points. With a robust balance sheet, strong momentum in our business and the RSA integration very much on track, we're well positioned to meet our financial objectives in the years ahead.

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

Louis Marcotte
Executive VP & CFO

Thanks, Charles, and good morning, everyone. Before I get into our results for the quarter, let me comment on our position in the face of global macroeconomic and geopolitical uncertainty. We have little or no direct exposure to Russia or Ukraine, whether in our insurance operations or in our investment portfolio. We are monitoring inflation trends closely and we are well placed to manage changes given our current rate position, our prudence in reserves and our ability to leverage a well-integrated supply chain. Our book value exposure to rising interest rates is limited as our claims liabilities are discounted and offset most of the interest rate risk on the asset side. Finally, our investment portfolio is slightly underweight equities and our capital margin provides a substantial buffer against the ongoing volatility in capital markets.

That being said, our operating performance continues to be solid. Underwriting income grew 33% over Q1 last year, driven by RSA and with strong performances across the business. The overall combined ratio for the quarter was 91.7%, 2.4 points higher than last year due to elevated CAT losses. Favorable prior year reserve development was strong at 4.7% of net earned premiums, slightly below last year and in part driven by reduced uncertainty around claims patterns during the pandemic. While PYD is typically higher in Q1 compared to the rest of the year, we continue to expect that it will be favorable and in the 1% to 3% range annually, though at the upper end of the range in the short term.

Net investment income increased 45% in the quarter, largely driven by the addition of RSA's investment portfolio. For the full year, we expect investment income to grow approximately $135 million compared to 2021. Any increases in interest rates from current levels would represent additional upside to our expectations. Distribution income grew a solid 48% in the quarter, driven mainly by variable commission revenues and growth in our on-site home restoration business. For the full year, we still expect distribution income to surpass $400 million, supported by continued momentum in the business, and growth of on-site earnings. Future acquisitions would be incremental to these expectations.

Let's now turn to our underwriting results. In Personal Auto, the underlying loss ratio increased 4.5 points on higher claims frequency from increased driving activity and more severe winter conditions. Although up from the prior year, frequency remains below pre-pandemic levels. We remain vigilant on claims severity even though the impact of the inflation continues to be relatively muted so far. In Personal Property, the 87.6% combined ratio was solid despite 6 points of CATs. In addition to relatively mild non-CAT weather, our profitability actions over time continue to drive robust performance in this business.

In Commercial Lines, the combined ratio was very strong at 88.5%, thanks to our profitability actions in hard market conditions. We saw a strong prior year development again this year, not too far from historical averages. Overall, this line is performing very well, particularly in a seasonally adverse quarter. The overall expense ratio in Canada improved 2.6 points compared to last year. This was driven by RSA's higher mix of direct distribution business and lower commission expenses from last year's elevated level. We expect the expense ratio for the full year to be roughly 1 point higher than the Q1 level. In our U.S. business, the Q1 combined ratio was very strong at 86.8%. While underlying performance was certainly robust, this also reflected our exit from the public entities business. With robust top line momentum and strong profitability levels in the remaining lines, we are confident that the U.S. business can operate in the low 90s range sustainably.

Turning to the UK&I. Underwriting performance in the first quarter was ahead of our expectations at 92%, normalizing for excess CATs. In Personal Lines, the FCA price reforms that went into effect at the start of the year resulted in particularly competitive conditions in the home and motor markets, muting top line growth in the quarter. We will maintain our pricing discipline and track inflation closely to support pricing adequacy. In Commercial Lines, the combined ratio of 90% was strong despite 8 points of CATs, most of which was offset by favorable PYD for large losses.

On the RSA acquisition, I'm pleased that we are delivering on both our strategic and financial objectives. On the sale of Codan Denmark, we will record a gain of approximately $400 million in our second quarter financial results. Most of the $1.2 billion in proceeds has already gone towards paying down debt and reducing the debt to total capital ratio to our 20% target. On the sale of our Middle East business, this business has been moved to exited lines, but is not material to our overall financial results. We secured $125 million in run rate synergies at the end of the quarter, up from

$85 million at year-end. The increase was driven by an acceleration of claims internalization and real estate synergies. We are on course to achieve the $250 million target inside our 36-month timeline. This exclude anticipated loss ratio improvements from pricing and risk selection. Finally, we delivered 12% accretion in Q1. And for the 10 months since the RSA acquisition closed, exceeding our high single-digit target for the first 12 months. We are very confident that we will achieve upper teens accretion in the first 36 months. Overall, the IRR of the RSA transaction is expected to exceed 20%.

Moving to the balance sheet. We ended the quarter in a strong financial position with a total capital margin of $2.6 billion, despite the redemption of Tier 1 notes in the U.K. and adverse market movements, which reduced the margin by approximately $300 million in the quarter. Last quarter, we launched a share buyback program in light of our financial position and the anticipated proceeds from the sale of Codan. So far this year, up until today, we have now repurchased over 200,000 shares for a total consideration of approximately $40 million. Should the need arise, we have the ability to fully fund buybacks up to the approved amount under our current program. The strength of our results over the past year has led to an operating ROE of 16.6% and book value per share grew 32% year-over-year. With the RSA integration on track, strong momentum across our businesses and a robust balance sheet, we are well positioned to capture the opportunities in front of us and continue delivering mid-teens operating ROE. We remain firmly focused on executing our strategic priorities and in driving outperformance this year and beyond.

With that, I'll give it back to Shubha.

Shubha Rahman Khan
Vice President of Investor Relations
Thank you, Louis. [Operator Instructions] So Anas, we're ready to take questions now.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Paul Holden with CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

Charles, in your prepared remarks you referred to perhaps new economic headwinds as least potential for. So I guess what I want to ask as we think about the strong organic growth, you're putting up across multiple geographies. To what extent might that come at risk if these do -- of these economic headwinds to materialize?

Charles J. G. Brindamour
CEO & Director

I think, Paul, if you look back in time, the overall performance of the organization, including its growth has not been overly sensitive to the economic environment, right? I mean, there's the insurance cycles that overlay the economic environment. And the fact that we're quick to price what we're seeing, the fact that we're outperforming has meant that over time, the aggregate performance and the growth of the organization has not been overly correlated to the environment in which we're operating. There's lots of growth opportunities in the markets where we're operating. Now either as a function of the state of the market, as you can see, for instance, in the U.S., as you can see in Commercial Lines.

And then you have a number of elements in the toolbox, Paul, such as new products, new presence in parts of the U.K. where I think there are growth opportunities as well as specialty lines. So I think the point I was making is that despite the headwind, you can clearly see resilience. And in periods of turbulence, I would say that we're sort of on the front foot trying to capture the opportunities in the marketplace.

We need to be on top of inflation, which I think we are. But there's a lot of organic growth opportunities in my mind, even if we saw GDP contracting would be my perspective. Keep in mind, some insureds are going up. These are opportunities for us. And I think risk is going up globally as well. And I think that these are also opportunities for us. Risk is booming, but risk is our business. So I think growth is not something we're concerned about and the earnings momentum is very clear in the results this morning.

Paul David Holden
CIBC Capital Markets, Research Division

Second question is related to personal property in UK&I, obviously impacting the quarter from CAT losses and then you have these reforms taking place. I guess what I'm curious about, is there anything in the reforms that would hinder your ability to reprice that product over time in light of CAT losses?

Charles J. G. Brindamour
CEO & Director

No. Not at all. In fact, if there's one thing I'd say that what I love about the U.K. market and personal lines is your ability to react very quickly in pricing is much greater than it is in the Canadian context. So the team is certainly on the front foot in the U.K. Pricing for inflation on a monthly basis with a fair bit of rigor, we spent a fair bit of time on that and rolling out new segmentation tools this fall and this spring, again, it's actually from a regulatory point of view, the move that the regulators have done is a good one, which is to make sure that your levels of prices between new business and renewal are largely in line, which makes complete sense to us. But in terms of your ability to price up or down or in terms of expanding your segmentation, it's much easier to do in the U.K. than it is in the Canadian marketplace, actually.

Operator

Your next question comes from James Gloyn with National Bank Financial.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Yes. I guess I'll start in personal auto. And it looks or it appears that the inflation risk that we're seeing in the U.S. still remain muted here in Canada. And so I'm not looking for an explanation again of the structural differences in Canada versus the U.S. I think you did a good job last quarter. But is there anything that has shifted or changed incrementally in any of the drivers of inflation from the Q4 conference call to today?

Charles J. G. Brindamour
CEO & Director

Thanks, Jaeme, I mean, inflation is clearly something we're on top of, and we've been on top of inflation for a number of years. And maybe Patrick -- not that many changes, a few changes, we'll put the spotlight on that. I think it's worthwhile going over the key elements, though, of the product in Canada. I think it's worth talking about the difference with the U.S. because people ask the question still, even though we talked about it last quarter as you say. And then maybe it's worthwhile spending a bit of time on what we're actually doing about it in practice and there is a bit and Patrick can share their perspective. But Patrick, why don't you share your perspective?

Patrick Barbeau
Executive VP & COO

Thanks, Jaeme, for the question. Just briefly, you were mentioning the breakdown of the CATs so 40% is coming from injuries liabilities, 30% from total losses, including test, which represents about 5%. And then the 30% of car repairs. So the total severity in Q1 was just under 5%. You remember, it was 4% in Q4. So a bit of an uptick there, but no real change in the main indicators of inflation. The 40% of injuries and liabilities still shows no increase in severity, same as Q4. If I look at total losses, the repair part, the total loss outside of test, same as Q4. So yes, an increase in the market value of cars, but we still see that fully offset by the recoveries we get from salvage. Test is on the rise, same in Q1 as in Q4. It creates 1 point of total increase in severity. All of the remainder is coming from the 30% of car repairs. If I look at labor, the cost of parts, they have increased in Q1 at the same level as in Q4. So no change there. The 1 additional thing we've seen is longer delays to get OEM parts. And that has created a bit of an uptick on the cost of rentals while the cars are being repaired. And this is what has created that close to 1 point additional uptick in Q1. But all the other indicators are still in line with what we discussed in prior quarters. This is fully reflected in our pricing, and we have some key competitive advantages in the supply chain that we continue to push forward to mitigate the impact on our costs.

Charles J. G. Brindamour
CEO & Director

Isabelle, maybe a bit of an update on what we're doing from a pricing and risk selection point of view to make the most of this environment.

Isabelle Girard
Senior Vice President of Personal Lines

Yes. So in terms of pricing, we are reacting quickly to inflation and make sure it's reflected in our pricing. As we did in the past, a few years ago when we adjusted our rates to account for the new technologies in cars that were increasing repair costs. So we're really close to Patrick's team and really disciplined to react in our pricing to adjust for the inflation. So I think we're well positioned from a pricing point of view. In terms of risk selection and underwriting actions, we're putting in place some measures that are specific to new trends we see. And I think test is a good example of this. So as an example, we've put in place a program to pay for installation of some tracking device for high-risk vehicles in target areas. So that would improve the customer and insurance outcomes even if test is an increasing factor. So on both fronts, pricing and underwriting, I think we're well positioned today to face inflation and we're ready to react if inflation was to accelerate.

Charles J. G. Brindamour
CEO & Director

Yes. No, I think it's a very good point, Isabelle. It's important to keep in mind that we've been cautious from a reserving point of view as well. And so we're keeping an eye on that. There are big differences with the U.S., and I think some are indeed structural, Jaeme, some though are driven by our competitive advantages in the supply chain. We've talked in the past about injuries being a difference about the fact that we sell salvage. The other big difference is that if you go back to how we think about claims and our role in society, we're there to get people back on track. And what it means in practice is that we're managing 100% of the claims ourselves. We're using our supply chain. We're not quick to do a cash settlement. We much rather get people back on track and take care of the repairs. And I think that's a massive difference between how we operate and the rest of the industry and the U.S., which is probably in the 50% range in terms of cash settlement. Patrick, maybe just a few points on what we're doing from a supply chain management to mitigate the inflation pressure that others might be seeing.

Patrick Barbeau
Executive VP & COO

Yes. You mentioned the fact that we don't have a ton of cash settlements that allows us to leverage really our Rely network. So 70% of all the car repairs that we are doing are done through our preferred network, which means that we get visibility on their capacity, we get involved in the supply of parts and get a better outcome from a cost perspective as well as a customer service aspect. We also leverage AI and data. We have been doing that within claims for many years. And in a period like this, it means that we have deployed models to the front lines and claims that allow them to take much better decisions on declaring a car to a loss or repairing it and where to guide our clients in the process, minimizing costs like storage, rental and towing, which is important. Yes. And you mentioned the salvage recoveries. This is due to the fact as well that we use more recycled parts in Canada and the U.S., partly because of that lower use of cash elements, and that is structural in nature. We've seen it very much correlated to the increase in the market values of cars that we have observed in the past few quarters. So we think this is really structural within our business. Thanks.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. Thank you for the comprehensive answer there. My second question is on capital. Codan proceeds are now in your back pocket, $1.15 billion. And then there's also the capital margin of $2.6 billion. I was wondering if you could give us a bit of color on how much dry powder you'd say you have today? And the ability and resources both financially and from a management team perspective to execute a transaction?

Louis Marcotte
Executive VP & CFO

Sure. So on the proceeds, so $1.2 billion has been received and is more than our back pocket. It's in our bank accounts. And we've already used it to repay debt as we suggested in earlier quarters. So of the $1.2 billion, we had targeted $600 million to bring us back to 20% debt to total cap. So that was executed. We also redeemed a Tier 1 note that was outstanding in the U.K. in the quarter for a net cost of around $300 million there. And the remainder is available. So that's $300 million. And then of the $2.6 billion capital margin, we estimate that there's probably $200 million to $300 million here that is available for deployment. So the 2 together, you're in the $600 million range. And then once you apply all the debt reductions and what remains in terms of debt capacity, should we want to do a transaction or deploy capital, we think there's $1 billion of capacity that we've basically created with the application of the proceeds. So that takes us in the 1.5, 1.6 range to come back to a debt ratio that we typically see on a transaction. So that's a bit the -- where we are on capital.

Charles J. G. Brindamour
CEO & Director

Yes. And I think, Jaeme, if I go into management capacity to deploy capital and then create value deploying it, I would say there's no doubt that the Louis Gagnon's team in Canada is very much focused for the next 4, 5 months to complete the integration of the RSA business. That's the first point. But then if you look at distribution, both in Canada and in the U.S., there's a lot of bandwidth to deploy capital in distribution today, and we're doing it. Then if you look at Mike's team in global specialty lines, but in particular in the U.S. The performance of the U.S. business is excellent from my point of view, the rigor and the improvement in sophistication in pricing is excellent. We've shown outperformance in the U.S., and I would say we're ready and we have the bandwidth to deploy capital should we find a good opportunity in the U.S. And so I'd say right now, in terms of capital deployment, there's a good degree of readiness in a number of areas, and I would say 5 months from now, broadly speaking, the North American platform will be ready to step up if there's a good opportunity that presents itself pretty much anywhere we operate.

Operator

Your next question comes from Geoff Kwan with RBC Capital Markets.

Geoffrey Kwan
RBC Capital Markets, Research Division

Just wanted to start on the U.K. personal side. You talked about being disciplined and just kind of seeing, I guess, subdued premium growth. What do you need to see to be more active underwriting new business? And also, are you seeing any attrition in that segment from customers switching to competitors if they are being maybe a little bit more aggressive on rate?

Charles J. G. Brindamour
CEO & Director

Geoff, I'll ask Ken to give a bit of a perspective and then I'll share I guess, what we need to see to be more on the front foot in the U.K.

Kenneth Anderson

Sure. Yes. So I mean, Jeff, as we know, the reform came into effect on Jan 1, impacting both home and motor. From a motor perspective, which is about 1% of overall IFC premium, we've seen the market lower rates in 2021. And since the reform on Jan 1, we've seen about a further mid-single-digit market decrease. But given inflation pressures, we would expect there to be some catch-up on rates in the remainder of 2022 in mover. In home insurance, that's less than 5% of IFC volume. There, we have a profitable back book, which we're aiming to protect, and we're taking moderate rate reductions on renewals there. And of course, raising new business rates. We're seeing good retention on the home, albeit it's slightly down compared to the pre-reform levels, which we expected.

So to get a gauge, I guess, on 2022, UK&I personal lines, top line, I think a good starting point is what we reported for Q3 and Q4 in 2021 time to -- now remember, we've exited the Middle East, which represents about 8% of the UK&I. So we need to remove that. So then on that base, we would see the reform impacting by about 4 points on top line in personal lines in the U.K. on a full year basis. The approach we've been taking has been very much focused on pricing discipline and pricing adequacy. So therefore, in terms of margins, as the reforms are playing out, we don't see we see a negligible, I would say, impact on underwriting profit.

Charles J. G. Brindamour
CEO & Director

Thanks, Ken. And Jeff, there's 3 things I want to see before we can be on the front foot in growing the U.K. Personal Lines portfolio. The first one is I want to make sure that the inflation is actually fully baked in, in our price position in all the lines of business in which we operate. I'm pretty confident it is the case. But as you know, in the U.K., the inflation is changing at a somewhat greater clip than in the rest of the world. The second thing I want to see is advancing further the exercise whereby we're rationalizing the footprint and where we play in personal lines. And the third thing and the most important 1 to be able to grow in that market is that we up our game from a risk selection point of view. And we've deployed a number of things in the field last fall. We've taken advantage of the reforms to deploy a few improvements in risk selection. We've got a big agenda on that in 2022. But for me, until I'm convinced that the science is in the field and we're not at risk of being selected against, we'll be very cautious in growing that portfolio.

Geoffrey Kwan
RBC Capital Markets, Research Division

That's helpful. And just my second question was you talked about in the quarter looking to reduce earthquake exposure in part on against CNS and in the U.S. exiting the public entities. Are there other business lines that you're looking at either rehabbing right now or things that might be moving on to a watch list?

Charles J. G. Brindamour
CEO & Director

So I would say that if I start with the U.S. There's not that many areas in the U.S. at the moment where I would say there's a red flag, quite frankly. And I think public entities was at the top of the list, and we've shut it down in the quarter. All the other lines of business are sustainable, profitable and in a position to grow. I think the Canadian platform broadly speaking, is an excellent shape as well. Our focus is very much on U.K. first lines at the moment and making sure that the relationships we have with distributors are economically sound for us as a firm in our position in the 3 product lines. As I mentioned, are on a footing where we think we can earn a reasonable return on the capital we're putting in the U.K. Whether we paid for that capital or not in the acquisition is a secondary debate. It's not so much about whether financially it makes sense. It's far more about strategically, does it make sense? And I would say that's our #1 area of focus at the moment. But there's not that many hotspots. I mean there's strong momentum across the platform. Patrick, you're quite involved with me in trying to pre-identify so to speak, where things can go wrong. What else would you add?

Louis Marcotte
Executive VP & CFO

No, I think it's really within the lines of business that remains in the UK&I, focusing on the models and agreements that we feel we can get the upside from our actions in pricing and segmentation. So I think see anything else.

Charles J. G. Brindamour
CEO & Director

No, that's it. It's a very high degree of strong performance across the platform.

Operator

Your next question comes from Tom MacKinnon with BMO.

Tom MacKinnon
BMO Capital Markets Equity Research

Yes. Let's start with the expense ratio. I think the guide here is for 2022 overall to be 1 point higher than what we see in the first quarter of 2022. What about if we look forward to 2023? Presumably, you get a few more synergies coming in. Would we look at 2023 as being probably flat at best compared to 2022, in terms of the expense ratio? Or would it be higher as a result of possibly higher commissions or something like that? So any color on that is appreciated.

Louis Marcotte
Executive VP & CFO

So on the commissions front, if that goes higher, I will assume it would be with variable commissions driven by better underwriting results. So there would be sort of an offset here. At this point, that's not the premise I would work with. I would say, though, directionally, I would expect an improvement. It won't be necessarily a huge needle mover. But directionally, I would expect a move downwards. But would I put 0.5 point there, maybe not necessarily more. Keep in mind, we are reinvesting in technology. So this is what -- we haven't totally determined those plans for next year. But directionally, clearly, we want to harvest the synergies and leverage the size of the group and the scale to reduce the ratio.

Charles J. G. Brindamour
CEO & Director

Yes. And I think the -- on synergies, we talked about $125 million run rate, which is half of what we talked about when we closed the deal. There's a fair bit of tailwind on this front, I would say, and synergies are materializing a bit sooner than what we anticipated. And so I certainly feel good about that and it's definitely a tailwind for the expense ratio over time. It is -- some of them are in the loss ratio as well, so it's not the full amount that is expenses, but it is a tailwind, and I think we're in good shape there.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And if I look in Canada, Personal Auto, the underlying loss ratio up about 5 points year-over-year. Now we've got certainly a different market here in terms of degree of which we're in the pandemic. But to what degree with seasonality in the first quarter of 2022 worse? I mean, it seemed to be a tougher winter for driving. Did that play into it as well? And then as a follow-on that one, if you look at your lower end of mid-90s for the year in personal auto, how much PYD is in that? And what would make that number higher or lower than you would have anticipated? And any thoughts on 2023 as well? So if you could tackle that one, please, that's great.

Charles J. G. Brindamour
CEO & Director

Yes. Why don't you take a shot at that, Isabelle, and then I'll give a perspective on PYD.

Isabelle Girard

Senior Vice President of Personal Lines

Perfect. So looking at Q1 personal line underlying this ratio. You're right. I think we need to remember first that looking at the absolute number, Q1 is a quarter where we see unfavorable seasonality in personal to due to wintertime. So that's looking at the overall number. And of course, when comparing to last year combined ratio, we see a bit of an increase. It's driven by an increase in frequency, mainly from 2 drivers. The first one, as you mentioned, the winter weather was a bit higher than expectation this year versus last year and versus historical levels, as well as a bit of increased driving due to the pandemic versus the last quarter. So those are the 2 main drivers of the increase year-over-year. And on top of it, Q1 is a quarter that is unfavorable from a seasonality point of view.

Charles J. G. Brindamour
CEO & Director

And let me just take PYD, and I'll talk about PYD for auto, but I'll talk about PYD more broadly because there is a tendency sometimes to exclude PYD and then talk about the rest of the results. And I think we have to be careful to do that, quite frankly, because for me, PYD is a complement to current accident year. And let me explain what I mean by that. If you're in a period whereby there's a fair bit of dislocation. So dislocations would include shifts in profile because of M&A, would include reforms or would include other big events such as pandemic, inflation and other trends. Tom, you're an actuary, so you'll understand that. When there are swings, you actually take a cautious approach. And the cautious approach you take starts with the current accident here, you'll play it more cautiously in booking the IBNR for the current accident year. And you'll definitely keep an eye on the prior accident year as well.

Now when you see a year where there's more prior accident year than there was in the past, you can implicitly assume that the last time you booked the current accident year, you were cautious. And if you're still in a period of dislocation, like we are now, that we're also cautious from a current accident year point of view. I do think it's tricky to strip the PYD and say the underlying current accident year is deteriorating because quite frankly, those 2 things are part of the same equation. And I would say at the moment, we're cautious because there are many moving pieces. There's a fair bit of dislocation. That caution turned out to play in our favor in the past year, certainly, my expectation is that it will likely be the case in the near to midterm as well. And so I would be careful, I guess, to strip those 2 things. I certainly look at our results with 2 things. I look at current accident here and PYD together, and then I really focus on rate adequacy and that's kind of how we're managing the business as opposed to stripping PYD. I think it's important to understand.

So if you look at auto, specifically, at least when I look at auto, Q1 last year, you had a couple of points of PYD. This time around, you have 4-ish points of PYD. I would say, it is a reflection of what we've talked about in the past. In the pandemic, there were lots of moving pieces. As Patrick mentioned earlier, 40% of the cost equation is injuries. And so we took a fairly cautious -- very cautious stance on injuries. And I think that this is sort of what we're seeing system. And we're very much still in that position. We're also cautious on inflation. And so all else being equal, I do expect a healthy level of PYD in that segment in the near to midterm. And that's why we're guiding towards the upper end of our overall range certainly in the near to midterm.

Tom MacKinnon
BMO Capital Markets Equity Research

Do you mean when you said upper end, I think you said the lower end of the mid-90s?

Charles J. G. Brindamour
CEO & Director

No, no, sorry. The upper end of PYD range. And the lower end of our mid-90s.

Tom MacKinnon
BMO Capital Markets Equity Research

Yes. And what accident years was this PYD applicable to? Is it largely just last year? Or was it any kind of prior years? There were some in the commercial lines, too. So anything to add to that?

Charles J. G. Brindamour
CEO & Director

It's pretty much spread, Tom. Clearly, the most recent years are always the most influential on your PYD because this is where you go from greater uncertainty to certainty faster because they are more recent. But I don't know, Patrick?

Patrick Barbeau
Executive VP & COO

In auto, in particular, it's mostly the 2 years of COVID, the prudence that was taken there. There was a bit of pre-reforms. That we had some reforms in Canada, in both Ontario and Alberta, there was a bit of pre-reforms, but it's mainly the development of the patterns of the claims during the 2 COVID years that makes us a bit -- gave us positive or favorable development in Q1.

Louis Marcotte
Executive VP & CFO

But in commercial, so we had very strong PYD in commercial for 2 years in a row. Historically, commercial has been a strong PYD business. We're slightly above historical averages, but I don't think there's something specifically to point to why it's elevated. It's -- we're sort of expecting higher PYD share there. It's been 2 good years here, and I think the pandemic environment has helped, but...

Charles J. G. Brindamour
CEO & Director

I think that's right. I mean if you look at commercial lines in Canada, we've been cautious on the current accident here because there's been a lot of things happening in the past few years. And so far, so good. The other thing is we've seen growth in specialty lines in Canada, small segments with not as much credibility as the main lines of business. So clearly, again, took a cautious stance from a reserving point of view. And I think that it's materializing in PYD now. So I certainly don't see this as noise, Tom, when I look at the quarter, or the performance of the organization right now. For me, it's part of the underlying performance.

Operator

Your next question comes from Doug Young with Desjardin Capital Markets.

Doug Young
Desjardins Securities Inc., Research Division

Just on Canadian Personal Auto and Property and just back to inflation. Can you quantify what you've built into your reserves and pricing related to inflation? And where I'm going with this is I do understand the preferred Body Shop in preferred provider angle, but I also understand that these preferred shops are pushing through quite significant price increases. And so I'm just curious as what you're seeing on that front? And how often do those agreements come up? Is it every year that these are repriced? Or maybe you can give a little color with that as well.

Charles J. G. Brindamour
CEO & Director

So I think, Doug, it's important to understand that the inflation is taking place in the short tail lines at this stage. So while we're cautious in reserves. This is not so much a reserving issue in the case of short-tail lines, what's going on in the body shops. But Patrick, why don't you share a bit of color with Doug on supply chain.

Patrick Barbeau
Executive VP & COO

Yes. Well, Doug, we price for prospectively for the next 12 months. So not only is our pricing reflecting the current observation on inflation, but also a cautious approach on where we could see additional points of pressure. From a labor perspective, we have seen about 2 points increase versus what we would normally see. If I look at the past 2 years, Body Shop's labor rates have increased by about 2 points every year, 2, 3 points in the last 2, 3 years, and it's up about 5 at the moment. These agreements are looked at on a regular basis in the preferred network. We work closely with the shops to find efficiency opportunities, concentration with our volumes, and we'll look at it overall together. This is why it is a significant advantage for us. We have many of these firms that are actually concentrated with just intact volume. So we have good visibility on how they operate the points of pressure they see. And we also have good capacity. So if frequency was going back up, like we've seen in the states. We don't expect we would face capacity pressures that we see in many parts of the world, given our approach with our preferred network, if that helps.

Doug Young
Desjardins Securities Inc., Research Division

No, it does. So this isn't really a reserving issue. It's more of a pricing and it doesn't seem like you're overly concerned. And the second question -- sorry, go ahead, Charles.

Charles J. G. Brindamour
CEO & Director

No, no, go ahead. I think you have.

Doug Young
Desjardins Securities Inc., Research Division

I'd rather hear what you have to say than what I have to say, so.

Charles J. G. Brindamour
CEO & Director

Well, no, I think in the supply chain, Doug, I mean, there's service and there's inflation, right? And service is really important. And the sort of deals we have include making sure that our customers are ahead of the queue ensure that we have access to capacity first. And those 2 things are really important to keep cost in check beyond and above the deals we have on cost per se. And yes, we have deals that will get repriced over time. We have a fair bit of leverage on buying automobile parts. And as such, we do have an edge, but it's not just about pricing, it's about the speed at which repairs get done, the speed at which our customers are back on the road, and that's a big element of our advantage, and it's an important element of the cost equation as well.

Doug Young
Desjardins Securities Inc., Research Division

I mean you've talked about being able to reach through to the client on saving the body shops on paint costs and on repair costs. Is that something that's unique to you intact, that's giving you a bit of an advantage relative to peers because of the volume that you do?

Charles J. G. Brindamour
CEO & Director

I think that I'm not sure what peers actually is, but let's pass beyond that point. I think people have different strategies that are far more fragmented than ours. I think ours is wall to wall and we've been working on it for 20 years. And the good thing with supply chain management is that it's not super intellectual, it's just really hard to do and you need to keep at it for decades, if you want this to actually make a difference. The other thing is that it certainly helped when you're 2x, 2.5x bigger than the next player in the marketplace. And then when you have the intelligence in the field, and you use that data to help customers find the best body shop. And so I think it's a real massive advantage actually. We're not the only one who has a supply chain management strategy, but I would stack our supply chain management strategy against the best insurers in the world, and would not be embarrassed because in fact, we've done that a few times.

Patrick Barbeau
Executive VP & COO

So one additional data point I would point to is in Canada, if we look at our cycle time, and we have some benchmarks that we can look at in terms of average time of rental, for example, and it's a full week better than the average in Canada because of a combination of factors we just mentioned.

Charles J. G. Brindamour
CEO & Director

So our point, Doug, is that if you're not insured with us, maybe you should look into it.

Doug Young

Desjardins Securities Inc., Research Division

The second question, just on the UK&I personal lines had a negative PYD. It was small, but we're not used to necessarily seeing this with Intact. And so I'm just curious, is there's a particular issue that you foresee? Is this something that was unique to this quarter? Or is there something that you're trying to address there?

Charles J. G. Brindamour
CEO & Director

I think it's a quarter-specific issue. Ken will give you the perspective on that.

Kenneth Anderson

Yes. Again, we talked a lot about the inflation. I think there was a bit of prudence taken in the first quarter in the prior year, provisioning in relation to inflation, which was about 5 points that was largely offset with regular favorable PYD that came through, which is why you're seeing a small -- less than 1 point overall of adverse PYD in the quarter.

Charles J. G. Brindamour
CEO & Director

That's exactly right. And then you could say, well, how can this be substantial given inflation really impacts material and short tail. And it's one type of property claim that is longer term in the U.K. called subsidies -- subsidence, still have to work on the pronunciation, but we understand it anyways. And that's a one shot, I think.

Operator

Your next question comes from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

A couple of them here for you. First one, just curious, if I look at the Canadian Commercial Lines segment, the underlying loss ratio, up on a year-over-year basis. And I know you explained it as frequency-driven. I'm just curious if you can dive into a little bit more what exactly that was? Because I would have thought given the favorable market conditions we've had for a long time, even with maybe a little bit adverse frequency, you still see improvement on a year-over-year basis.

Darren Christopher Godfrey
Executive Vice President of Global Specialty Lines

Yes, Brian. I mean I think if I look at the current accident year, I would probably highlight 3 things for you. First of all, on frequency. When you think about Q1 of 2021, being at the sort of the bottom of the curve, from a frequency standpoint. So as driving gets back to closer towards pre-pandemic levels, we got a lift in frequency there. However, I would say, though, that, that lift in frequency is coming from smaller claims. And again, that's obviously the opposite of what we saw as frequency was going down. It changed the mix of claims as well, too. So we're seeing some of that reverse will take place. A tougher winter in Q1 of this year versus last would be the second point.

And then thirdly, a little bit of noise, I would say, in the quarter due to some large loss activity. No underlying trend concerns, just noise in the quarter. I mean, I think as Charles said before, you got to be careful to disconnect the current and the prior. And when I look at the business today, now again, Q1 is a tougher quarter from a seasonality standpoint. Our overall performance of the portfolio that we see in Q1 is quite reflective of our view of the current performance of that portfolio moving forward. So yes, a bit of deterioration in the current accident year. We've still got strong rates earning through the portfolio. But I think when you look at the complete picture here, that sort of operating performance is very indicative of where we see this portfolio moving forward.

Charles J. G. Brindamour
CEO & Director

Yes. So a portion of that, Brian, is auto. But if you look at -- on the P&C side of things, we're seeing rates north of almost 10% still running up. So we feel pretty good about that line.

Brian Robert Meredith
UBS Investment Bank, Research Division

That's great. And my next question, Charles, I'm just curious, if I think about coming into the pandemic, you're really well positioned in the personal auto space with respect to your need to take rate versus your competition. And obviously, the pandemic kind of put that in different position now. I guess my question is, as we look forward here, do you think you're still in that kind of relative good position from a rate perspective so that we could eventually start to see market share gains? And the reason I ask is also look at your policies in force the last couple of quarters, it declined sequentially. And not sure if that's due to RSA or competitive conditions. So maybe a little bit on just what's going on in the personal auto business from a growth perspective.

Charles J. G. Brindamour
CEO & Director

Yes, I'll ask Isabelle share her perspective from a top line point of view in auto, and come back on broader market trends at towards. Go ahead, Isabelle.

Isabelle Girard
Senior Vice President of Personal Lines

So in terms of the growth in personal auto. Retention is still all in very, very strong. So our customers are staying with us. The challenge in growing the unit count right now is really driven by new businesses, and it's really because people are shopping much less than in the past few years because rates have been tempered by the release measure in the market as well as the decrease in new cars that are sold. This is really putting pressure on quotes. So it's difficult, even if you're well positioned from a rate perspective to attract new business these days. In terms of our pricing position, we still feel we're well positioned in the marketplace. Then the question is how can we put actions in place to attract more of the customers to come with us?

Charles J. G. Brindamour
CEO & Director

Yes. And I think that, Brian, something that might have clouded the unit count is our exit from British Columbia and per solar mobile last year. We exited British Columbia because the government is the main insurer, and they don't leave much room for choice or private capital.

Brian Robert Meredith
UBS Investment Bank, Research Division

Make sense. And then the competitive positioning, you're saying you're still in a pretty good spot. So eventually, we'll start to see the market share is kind of come back?

Charles J. G. Brindamour
CEO & Director

Yes, I think so.

Operator

Thank you. That is all the time that we have for questions. I will now turn the call to Mr. Khan.

Shubha Rahman Khan
Vice President of Investor Relations

Thanks, Anas, and thanks, everyone, for joining us today. Following the call, a telephone replay will be available for 1 week, and the webcast will be archived on our website for 1 year. A transcript will also be available on our website in the Financial Reports and Filings section.

I would like to point out that our Virtual Annual Meeting of Shareholders will take place shortly after this call at 1:00 p.m. Eastern time today, you may join the meeting via live webcast from our website. We will also be hosting an Investor Day on Thursday, September 22, with presentations by senior executives. Further details about the event will be posted on our website in the coming weeks.

And lastly, our second quarter 2022 results are scheduled to be released after market close on Thursday, July 28, with the earnings call to start at 10 a.m. Eastern on Friday, July 29. Thank you again, and this concludes our call for today.

Operator
Ladies and gentlemen, this concludes your conference call for today. We thank for participating, and ask that you please disconnect your lines. Have a great day.