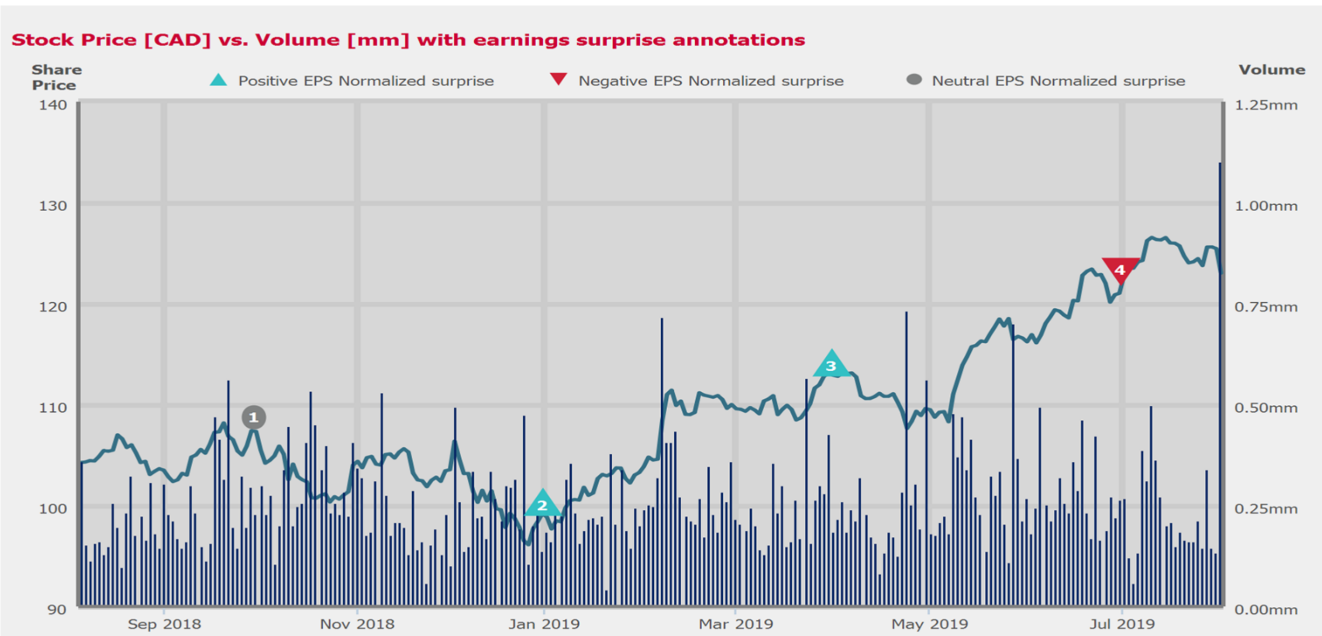
S&P Global
Market Intelligence

Intact Financial Corporation TSX:IFC
FQ2 2019 Earnings Call Transcripts
Wednesday, July 31, 2019 3:00 PM GMT
S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.76	1.44	(18.18 %)	1.79	6.13	7.96
Revenue (mm)	2513.86	2500.00	(0.55 %)	2637.00	10214.48	10828.14

Currency: CAD
Consensus as of Jul-31-2019 12:00 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	1.62	1.62	0.00 %
FQ4 2018	1.74	1.93	10.92 %
FQ1 2019	0.60	0.73	21.67 %
FQ2 2019	1.76	1.44	(18.18 %)

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EXECUTIVES

Alain Lessard
Senior Vice President of Commercial Lines

Charles Brindamour
CEO & Director

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Kenneth Anderson
VP of Investor Relations & Treasurer

Louis Marcotte
Senior VP & CFO

Patrick Barbeau
Senior Vice President of Claims

ANALYSTS

Brenna Phelan
Raymond James Ltd., Research Division

Brian Robert Meredith
UBS Investment Bank, Research Division

Doug Young
Desjardins Securities Inc., Research Division

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RBC Capital Markets, LLC, Research Division

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Mario Mendonca
TD Securities Equity Research

Meny Grauman
Cormark Securities Inc., Research Division

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Michael Wayne Phillips
Morgan Stanley, Research Division

Paul David Holden
CIBC Capital Markets, Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning. My name is Sheryl, and I will be your conference operator today. At this time, I would like to welcome everyone to the Intact Financial Corporation Q2 2019 Results Conference Call. [Operator Instructions] Thank you.

Ken Anderson, Vice President of Investor Relations and Treasurer. You may begin your conference.

Kenneth Anderson
VP of Investor Relations & Treasurer

Thank you, Sheryl. 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.

Before we start, please refer to Slide 2 of our deck for cautionary language regarding the use of forward-looking statements, which form part of this morning's remarks; on Slide 3 for a note on the use of non-IFRS financial measures; an important note on adjustment, terms and definition used in this presentation.

Joining me here in Toronto today are Charles Brindamour, CEO; Louis Marcotte, CFO; Darren Godfrey, SVP of Personal Lines; Alain Lessard, SVP of Commercial Lines; and Patrick Barbeau, SVP of Claims. We will begin with prepared remarks, followed by Q&A.

With that, I will turn the call to our CEO, Charles Brindamour.

Charles Brindamour
CEO & Director

Good morning, everyone. Thanks for joining today.

Last night, we announced a 4% increase in the second quarter net operating income per share to a $1.44 with strong investment and distribution results. The combined ratio in Canada was 97.4% and included 4.3 points from an increase in personal auto reserves for prior years. While this was disappointing, the fundamentals in all lines of business remained strong and hard market conditions are driving significant rate momentum across the country. U.S. commercial performance was solid at 94.8%.

In the second quarter, as anticipated, top line growth accelerated to 8% with strength on both sides of the border. Our Canadian business grew 8% led by double-digit growth in commercial lines and accelerating growth in personal lines at 6%. In the U.S., premiums grew 10% on a constant currency basis driven by new business, strong retention and rate increases.

In Canada, the hard market is not a surprise on the back of 3% industry ROE in 2018. When we compare ourselves to the industry at the end of the first quarter of 2019, we're outperforming by close to 10 percentage points, almost double our target of 500 basis points. While we are far exceeding our outperformance target, we remain focused on returning ROE to the mid-teens.

So let's take a look in more detail at our results by line of business starting here in Canada. Personal auto premiums grew 6%, a significant increase from the 1% growth last quarter. Growth was driven by rate increases and a slowdown in unit declines as our competitive position continues to improve. Premium growth is now accelerating month-to-month and portfolio quality remained strong. The combined ratio of 99.5% included 10 points of unfavorable prior year development. In recent months, we observed more activity than anticipated on older files and considered it prudent to bolster reserves for those years, and we will provide a bit more color in a moment.

At the same time, our actions in auto are working well. The underlying performance was very strong, the best in 5 years, on the back of lower frequency and substantial rate increases. The environment in which we compete, continues to harden with capacity constraint and rates increasing. The industry in auto grew at an upper single-digit level in the first quarter and we saw further rate increases across the country in the second quarter. So I think we're well positioned to grow that line of business at a mid-90s combined ratio going forward.

In personal property, we saw strong growth at 6% with rate increases and a favorable environment and a return to unit growth. The combined ratio of 99.6%, included over 9 points from catastrophes and elevated weather and fire losses. The actions we've taken over time in property have been very successful. So while we anticipate some quarterly fluctuations, we expect this line of business to run at low 90s or better performance over time, consistent with our 5-year track record. The industry grew 8% in the first quarter in that segment, and we expect mid- to upper single-digit growth in property this coming year.

Looking to commercial lines in Canada, all segments contributed to the top line growth of 11% in the quarter. We saw mid- to upper single-digit rate increases as well as strong new business and renewal. The combined ratio of 92.8% was solid, despite elevated large losses. The fundamentals remain strong and rate increases are continuing to flow through the system.

The industry outlook for Canadian commercial continues to improve and we expect the current hard market conditions to drive upper single-digit -- low double-digit industry growth over the next year. This environment is very supportive of our rate and segmentation actions. We're positioned for strong growth and expect to run this business at our historical low 90s combined ratio moving forward.

Turning to our U.S. commercial segment. So premium growth was a strong 10% with mid-teens growth in profitable segments. Overall, I'm pleased with the progress on U.S. commercial. The combined ratio of 94.8% reflects strong performance in the core segments of the business, tempered by weak results in lines undergoing profit improvement. We continue to work on improving underperforming segments with pricing and claims action, and we're well on our way to achieve our goal of a sustainable low 90s combined ratio by the end of 2020.

Market conditions are evolving favorably in the U.S. with improving upward trends in a competitive environment. We expect the U.S. commercial industry to grow at a mid-single-digit rate in the coming year. We expect strong growth to continue in the profitable segments of the portfolio.

Turning to strategy. So over the past decade, IFC has delivered on its financial objectives. On average annually, we've grown our net operating income per share by over 10%, and beat the industry ROE by 650 basis points. This has translated into an average annual total shareholder return up over 15% in the past decade, almost twice that of the S&P/TSX 60 Index.

So as we look forward to the next decade, my team and I are working to beat this performance. The first priority is returning the operating ROE to our historical mid-teens level. A sustainable mid-90s auto performance is key to getting us there. Then bringing our U.S. operation to low 90s combined ratio on a sustainable basis will solidify that performance.

To expand our ROE outperformance, we will continue to invest in our risk selection and claims advantage. So to stay ahead in risk selection, we want to become the best insurance AI shop in the world. So we currently have over 60 machine learning applications in the field. In claims, we'll go deeper in the supply chain to improve customer experience and capture the margins embedded and getting our customers back on track.

To grow our net operating income per share in excess of 10% yearly over time over the next decade, we'll create a fortress position in Canada and build the leading specialty insurer in North America. In Canada, we'll continue to transform our customer experience, add scale to our distribution and continue to consolidate the Canadian market both in manufacturing and distribution. Specialty lines will expand our product range and our distribution footprint across North America. And at the same time, we'll continue to invest heavily in our people, the most important element in our success over the past decade.

In conclusion, while results in the quarter were tempered by auto PYD, the fundamentals are strong and continue to improve in all lines of business. We expect to take advantage of the substantial rate momentum we see in the current market, and we'll continue with our segmentation and claims initiative. We are committed to returning to our historical mid-teens ROE level and we'll get there.

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

Louis Marcotte
Senior VP & CFO

Thanks, Charles. Good morning, everyone.

Net operating income was up 5% to $212 million or $1.44 per share in the second quarter driven by lower cat losses, strong underlying performance in personal auto and solid profitability in commercial lines on both sides of the border. Results were, however, impacted by the $0.49 per share prior year reserve increase in personal auto. I will elaborate on that shortly. Cat losses of $70 million, which included the severe floods that took place in Eastern Canada in April, were below last year's elevated levels but largely in line with our expectations. We are not changing our cat guidance at this time.

Operating income was bolstered by strong performances in our investment and distribution activities. Net investment income of $148 million was particularly strong and grew 8% over last year, reflecting our portfolio optimization initiatives in the first half of 2018 as well as in higher invested assets. We still expect full year net investment income to grow at a mid-single-digit level over 2018.

Distribution EBITDA grew 16% to $72 million, but included some nonrecurring favorable items. Excluding these items, growth was solid at 11% driven by commission growth and margin improvements. 2019 has also been an active year on the acquisition front so far which will lead to additional earnings in the future. We are now expecting to deliver high single-digit growth for the full year.

Let me provide some additional color on our underwriting results beginning with Canada. In personal auto, hard market conditions are continuing to support strong rate increases across the land. In Q2, both written and earned rates were up 8%. Earned rates will grow at about 8% for the remainder of 2019, driving strong momentum for our auto business. The underlying current year loss ratio improved close to 3 points over last year to 66.8%, the best current accident year performance since Q2 2014. This is clear evidence that our actions are effective.

With respect to the 10 points of prior-year development, the level of claims activity on older years primarily 2015 and '16, observed in recent months has led us to increase our reserves in personal auto. 2/3 of the reserve increase is for Ontario AB and the rest is for Alberta BI.

In Ontario, the push for cat determination has not diminished as we expected. As a result, we changed our view of ultimate payouts. However, it is important to note that actual payouts on these files continue to show no inflation and cat concession rates are in line with expectations. In Alberta, our action plans are showing signs of tempering inflation, but the level of claims activity on older years was higher than expected in the past few months, leading us to update our view of ultimate payouts.

All in, we concluded that bolstering reserves by $93 million was the prudent thing to do. Although I cannot offer certainty, I am confident these additional reserves are sufficient to offset future prior year activity based on the activity observed. Although it is a significant hit to this quarter's result, I believe it is more appropriate to look at it on an annual basis where it represents approximately 2% of the auto premiums. When combined with hard market conditions, 8% rate increases and solid underlying results, we remain well positioned to grow and sustain a mid-90s performance moving forward. That's it for auto.

On expenses, the 28.5% expense ratio remains low and we saw improvement across all lines of business. We remain diligent and continue to lead the industry in expense management. At the same time, we are continuing to invest in digital and artificial intelligence to enhance the customer experience. We still expect the annual expense ratio in 2019 to be consistent with 2018s.

Now turning to U.S. commercial, strong top line growth of 10% in constant currency reflects a mix of rates, strong retention levels and new business. Pricing trends are improving across most lines at OneBeacon. Similar to last quarter, growth continues to be driven by our profitable lines of business. We reported a solid 94.8% combined ratio driven by a healthy underlying current year loss ratio of 57.8% and favorable prior year development. The expense ratio of 38.6% for the quarter was slightly higher versus last year's, but it's largely due to quarterly fluctuations. We still expect the expense ratio to remain steady at around 37% for the full year.

Now looking at our balance sheet. We ended the quarter in a strong financial position with a total capital margin of $1.3 billion and an MCT at 191%. Our debt-to-total capital ratio was 21.6% and we're on track to reach our 20% by the end of the year.

Our Canadian results, if we exclude the reserve increase for a moment, were solid. The underlying loss ratio in personal auto continues to improve and reached an attractive level. Commercial lines are doing well despite some large loss activity, and we're currently growing written premiums at a pace of 8%, mostly from rates and only half has been earned. And this is happening while market conditions remain favorable across businesses. Overall, we feel good about Canada.

In the U.S., we're making steady progress at OneBeacon and executing well with strong top line growth and improving underwriting performance. Our capital position remains strong and we are ready to capitalize on growth opportunities that may arise in manufacturing or distribution across North America. With a talented team, robust operating platforms and solid fundamentals, I'm confident we can continue to meet our financial objectives and deliver increased value to our shareholders.

With that, I'll turn it back to Ken.

Kenneth Anderson
VP of Investor Relations & Treasurer
Thank you, Louis. [Operator Instructions] So Sheryl, we're now ready to take questions.

Question and Answer

Operator

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

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

On the M&A front, so you guys talked a little bit earlier this year potentially looking at something in the U.S., but I'm just wondering given the rally in the valuations in the U.S. P&C insurance as well as the brokerage space year-to-date, has that changed at all kind of the appetite that you have? Or has the -- also the improvement in your valuation maybe help to -- tempers any concerns that you might have had?

Charles Brindamour
CEO & Director

Geoff, we've laid out a 10-year road map. I think the first thing we want to see in the U.S. is sustainability towards low 90s combined ratio. We're making really good progress. We're not there yet, and therefore, we're open to mid-sized transaction, but there'll be no large capital deployment in the U.S. until we feel comfortable we found the sustainable low 90s. I think our priority is to build the fortress in Canada by consolidating both manufacturing as well as distribution. We feel that the environment in which we operate, the industry with a 3% ROE in 2018, are excellent conditions to deploy capital in the current Canadian market and to use our ROE outperformance to create value, and I would say we'll be focused on that at this stage.

Geoffrey Kwan
RBC Capital Markets, LLC, Research Division

Okay. And just the other question I had, was on the personal auto PYD. My recollection was in the past, you've talked about just kind of bigger picture, ideally kind of having about 3 points favorable on an annual basis. Is that still the way to think about that? And do you have a sense as to what type of timeframe you'd like to get that back to?

Charles Brindamour
CEO & Director

Yes. If you look, in aggregate, the -- our historical track record has been slightly above 4%. Our guidance like last quarter or a couple of quarters ago, has been moved to 1% to 3% to take into account, and particular, the fact that the higher interest rate environment will lead to slightly less PYD going forward. And I think we've said in the near term, in automobile per se, I think we're likely to be seeing 0% PYD until the sustainable mid-90s and the older years on with -- there has been activity become more mature.

Operator

Your next question is from Meny Grauman of Cormark Securities.

Meny Grauman
Cormark Securities Inc., Research Division

Charles, you talked a lot about hard markets all across Canada, both on the personal and the commercial side, and it doesn't sound like you think that's going to change anytime soon. But I'm wondering, to kind of reach into your experience in history, how do you expect this all to evolve? Do you expect a backlash to come? And just -- at what point does it become too much?

Charles Brindamour
CEO & Director

So if I go back to my own experience, I would take us back to about 16 years, 17 years ago in 2002, '03 and '04 where there was pressure at that point in time primarily in automobile insurance and to a lesser extent to commercial lines. The industry's ROE was back at those sorts of level. And at that time, we've seen a meaningful increase in rates, we've seen reforms taking place to slow down inflation, and we've also seen a fair bit of consolidation in the Canadian marketplace.

If I look at where we are today, one difference is that automobile is hard pricing conditions; home insurance on the back of changes in weather patterns is hard market conditions; and commercial lines, even though we had in fact have increased our rates for close to 6 years, we're now seeing a meaningful pickup and tightening of that environment. And by tightening, I mean rates are up meaningfully. In our case, we are in the upper single-digit range. We're also seeing less capacity in the marketplace.

In other words, our competitor is showing less desire to grow in a far more defensive stance. Given where the industry ROE is at the end of '18, our view is, you've got a good 18 to 24 months of strong market conditions in most lines of the business. So very favorable I think to grow, to expand the margin and to consolidate the industry. And that's certainly even more true given the size of the outperformance at the end of the first quarter.

To your question, how much is too much. Well, the industry's ROE is 3%, so there is a fair bit of work left. In the lines that are regulated, there is only 1 and it's automobile insurance. And the degree of regulation varies by province. What I would say clearly as rates go up and capacity tightens this can become more political. We've seen that in the early 2000, and this is where to restore insurance companies' appetite to grow reforms are needed, to restore capacity and restore affordability. I think that if you take Ontario being the biggest province in the budget of the new government, they've laid out a road map of reforms, which we think were -- are quite good and we're encouraged by that. But clearly, the state of the market should give momentum an impetus to government to modify the product to tame inflation.

Meny Grauman
Cormark Securities Inc., Research Division

And just as a follow-up in terms of the hard market-creating opportunity for you on the M&A side, I'm wondering if you could just expand on that? Are you suggesting that maybe foreign players will start to leave or how do you expect those dynamics to work in your favor?

Charles Brindamour
CEO & Director

So we've laid out, 7 years, 8 years ago, the perspective that 20 points to 30 points of market share would change hands, and half of -- more than half of that has taken place already. Our perspective now is, probably a good 15 points to 20 points of market share that will change hands. And clearly in an environment where the average return of the industry is just not cutting it in terms of return, many people are thinking about the way forward. The difference between now and 20 years ago is, scale is making an even more important difference.

I think you're seeing the cost of investing in technology for smaller players being a drag, the cost of generating response and promoting one's brand name is more expensive than it was historically. So I'd say the difference between this cycle and 20 years ago, is that it's not just about performance issues, it's about strategic positioning and your ability to finance your growth as a smaller player. And so if I look out -- you can look at every segment of the Canadian marketplace, ranging from private Canadian companies to foreigners to banks to mutuals, and one can easily see potential action in each of these segments. So I do think that if you look out in the next 1 year to 2 years, it would be very surprising if we didn't see consolidation activity taking place from a number of the segments I've just highlighted.

Operator

Your next question comes from Paul Holden of CIBC.

Paul David Holden
CIBC Capital Markets, Research Division

I want to ask a couple of questions on auto QID, and I guess, starting with Ontario and they get a better sense of, from our perspective, future potential risk around PYD. So you know all the open files. So there is no risk of higher volume per se, but really the risk is in claims per file. So are you -- or help us then compare what the risk is, and what you've reserved for every open file that still remains? Have you reserved to the point where it matches prior claim payouts?

Charles Brindamour
CEO & Director

Yes. I think we're probably reserved above what the past payouts have been. I'll let Patrick share his perspective on the Ontario marketplace, and accordingly lead the reserving position.

Patrick Barbeau
Senior Vice President of Claims

Right. So your point on the new claims coming in is right, that we don't have new claims coming in. So these developments in Q2 on pre-reform is really the ones that were already open there to develop. And as we mentioned, payments are continuing to push to try to get access to cap limits. We were expecting that to slow down faster and it hasn't slowed down as fast as we thought in Q2, and we have reserved for that new observation. I think a few important points that Louis pointed out that I want to come back, like the payback.

The amount in average that we pay on the file that we close, continue to show no inflation. And that has been the case for now at least 18 months. The number of cats that actually are considered or that get access to the limit, is also in line with our projections that we talked about in prior quarters. So it continues to develop in the settlement as planned. We also...

Charles Brindamour
CEO & Director

That's an important point, Paul, because the activity comes from demand forecasts, which drive an increase in case reserves in the field by our adjusters. The amount of actual payments or the amount of cats considered, agreed upon, is in line with expectation. It hasn't shown much inflation.

Patrick Barbeau
Senior Vice President of Claims

That's right. And the last point that I would add is, the rate at which we close those files that remain open on pre-reform is also in line with our expectations. So there is no slowdown in our ability to close those files. Now if we look at the future, there are a few reasons, 3 main reasons why we can feel confident with the current level of reserves.

First in both Ontario and Alberta, actually the activity that we have seen is on older years and the risk on these years really diminish at current prices and as files are closed. And for example, in Ontario, Alberta, if I take the 4 pre-reform accident years that -- where there is still some significantly open files or a number of open files, so 2012 to 2016, 95% of those files are not closed.

Secondly, why we increased the reserves? As I said, the paid activity shows almost no inflation and that's true not only for IB, but across the board now. So the average pay-per-file that closed are flat compared to a year ago.

Charles Brindamour
CEO & Director

And lastly, maybe on the Q2 in particular, for every dollar of actual incurred loss activity that -- which we've seen, we've added on top of it an additional $2 to reflect and to be prudent in our reserving approach.

Patrick Barbeau
Senior Vice President of Claims

So to your point 95% of the claims for those accident years have been closed at this stage.

Paul David Holden
CIBC Capital Markets, Research Division

That is a very helpful color. And then I just want to understand the specific situation in Alberta a little bit better as well. So -- because when you refer to Ontario, you say, pre-reform. So if something changed in the regulations in Alberta as well, that means that, that eventually will bleed down or is there potential for ongoing reserve development in Alberta based on current trends?

Charles Brindamour
CEO & Director

Sure. I think in Alberta, the inflation stems from the number of court decisions that took place in 2012, '13. We've talked about that in the past, we've done lots since. But I'll let Patrick comment on what we're seeing in Alberta, what we've done, and how we feel about the marketplace in general.

Patrick Barbeau
Senior Vice President of Claims

Yes. So there was -- there were no new court decisions. It's linked to those same older court decisions that back in 2012 and '13, have opened the door for injuries of chronic pain to get between the trend, and access to outside of the minor injury guideline. So this is linked to that same trend that we've been discussing. When we look at the PYD for the past few years, it has been fairly benign in Alberta, but we have seen a bit more activity on those older years in the claims, so there's development than we anticipated during the last few months.

But part of that activity could actually been -- could actually be caused by the fact that the new accidents in the past 2 years is going down significantly. So that might trigger more actions on the other open file by the different stakeholders in the market. We have also implemented that quite a few actions since back in 2014 on the claims side, trying to focus our actions on keeping those claims within the minor injury and trying to close them fast and we're seeing some signs in the more recent accident years of benefits from it, but there's kind of the mix forces or signals in the reserve during the quarter that made us be prudent on the total reserve. And, Darren, do you want to add to the perspective in Alberta?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

The only other thing I would add is that really, we identified this trend back in 2016 in Alberta. And if I look at our activity since that time, we have taken 30 points of rate, and as Patrick said in our more recent accident years, we continue to see that impact, we continue to see declining frequency in the last couple of years. So that's also very, very encouraging. So I would say that our actions really are paying off in the last 3 years to 4 years and we're quite comfortable with our position in Alberta.

Just for some context, Alberta represents 7%, personal order represent 7% of IFC in Alberta and the particular longer-tail coverage of BI is only 3% of IFC. So it is a small piece of the total IFC portfolio. But as I said, we're quite comfortable from our position in Alberta and we're in very much in a prudent quality growth mode right now in Alberta.

Charles Brindamour
CEO & Director

Yes and I think just -- how do you feel about the current accident year in Alberta. Darren talked about 3 points of rates, frequency year-to-date in Alberta is down 17%, just to put things in perspective. So that's in part why our sense is one of growth, but quality growth we want to make sure that because capacity is tight in the marketplace and the market has been slow to react, we want to make sure that we're growing in the right segment of the marketplace, but we have the tools to do that.

Operator

Your next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Charles, could you comment what current loss trend kind of looks like in personal auto, the severity frequency?

Charles Brindamour
CEO & Director

Yes. So the sort of -- if you break down current accident year, what you're seeing is frequency is down about 7% year-to-date in auto. So it's really starting to gain some traction. That's why if you look at the underlying combined ratio in Q2, it's actually sub-90. If you adjust for seasonality or probably in the 94%-ish range and it's on the back of meaningful drop in frequency and meaningful increase in rates. You're picking up -- in terms of drift in auto right now, you're picking up 1 point of drift.

And the severity, including some of the changes we've made to the reserves, which also touch the current accident year, is mid-single-digit to which you should subtract the point of additional sum insured that we're picking up. So let alone rate increases, you're getting at current accident year, improvement in loss cost and you're getting rates at the meaningful clip here. So we like what we're seeing in the current accident year in automobile insurance and that's why our growth, despite the adjustment we've made to the prior year, is certainly one of growth, but quality growth.

Brian Robert Meredith
UBS Investment Bank, Research Division

And then on commercial lines in Canada, you talked about a good pricing environment there. Is rate an excessive trend? And then can we expect improvement in combined ratios in date of commercial?

Charles Brindamour
CEO & Director

I'll ask Alain to share his perspective.

Alain Lessard
Senior Vice President of Commercial Lines

So just to give you a bit of perspective, rates right now are in the tone of about 8% to 9%. In fact, in the quarter, average rate increase were about 8.5% and at the end of June, we were closer to 9.5%. And with what we have currently in the pipeline, we expect the rate to be closer to 11%, 12% by the end of Q3. So that gives you a bit of perspective on the rate.

Charles Brindamour
CEO & Director

That's IFC.

Alain Lessard
Senior Vice President of Commercial Lines

That's IFC. The net loss trend we're seeing are in the range of about 3% in auto and about 2% in P&C. So you can see that there is a solid gap between the trend and in the -- in rates and loss trends. Currently on the earned basis, we're earning rates at about 5%. So we've got a lot in the pipeline coming up through the next month.

Charles Brindamour
CEO & Director

Brian, I would say I listened to Alain's comments and I'm -- that's very much what we observed. The thing we've seen in commercial lines in the last 9 months is a number of large losses that have taken us away from what I think the underlying performance should be. We're keeping an eye on those to make sure that this is random stuff as opposed to tweak in the portfolio. I don't think it's the case. But there is lot of momentum in the marketplace to grow opportunistically our quality portfolio.

Operator

Your next question comes from Mario Mendonca of TD Securities.

Mario Mendonca
TD Securities Equity Research

Just -- I think the comment was made about -- you've added $2 reserves for every dollar you've seen of, I believe, higher claims activity. Could you put a little bit more behind that? I'm not so sure I entirely understand what you mean.

Charles Brindamour
CEO & Director

Yes. So we've basically not only reflected in the PYD the actual activity in the field, we've deteriorated through a number of assumption changes, our view, the ultimate payouts. And that was done by a factor of 2:1.

Mario Mendonca
TD Securities Equity Research

So let me ask in a slightly different way then. If the level of activity in those troublesome years, 2015 and '16, if the pace with which people or claimants are pursuing the catastrophic limits were to increase in subsequent quarters, would you then have to go back and strengthen reserves again?

Charles Brindamour
CEO & Director

Well, the changes we've made in this quarter is in anticipating of increased activity in the coming quarters, Mario.

Mario Mendonca
TD Securities Equity Research

So it reflects greater than the level of activity you are -- you've seen in Q2?

Charles Brindamour
CEO & Director

Yes.

Mario Mendonca
TD Securities Equity Research

And how much greater, 5%, 10%?

Charles Brindamour
CEO & Director

That's a hard one. I don't want to put a number on that -- on the sly like this at all.

Operator

Your next question is from Brenna Phelan of Raymond James.

Brenna Phelan
Raymond James Ltd., Research Division

So one more question on the prior-year development within auto. As you look at the government initiatives and specifically in Ontario, but also in Alberta, is there any sort of legislative understanding that there should ultimately be an end to this? Is -- do you foresee a stage where enough is enough, and the door is shut either in the courts or through some sort of regulation?

Charles Brindamour
CEO & Director

Yes. So Brenna, I think the answer, of course, varies by province, but overall you take the biggest province, Ontario, actually reforms took place in 2016 to deal with that and the activity we're seeing is people are going back on the older years, because the gravy train is over. And so the activity we're seeing in a province like Ontario is increased representation on open claims, trying to take what was seen as a basic claim, claiming psychological injury, which was really the center of the reforms in 2016 and trying to get a cat designation. This has led to more activity than we anticipated. That's what our adjusters are seeing in the field.

The payments were making, as a result, or the actual amount of conceded tests were making, once the assessment and the negotiation, is done is not out of line with what we expected, but because there is more activity, we've strengthened reserves. The reforms that took place in 2016 appeared to be effective so far. So I think the government gets that and they have a number of ideas to further strengthen the inflation in the Ontario automobile environment.

In the other jurisdictions it depends, it varies based on the nature of the problem and we certainly have been working with the government in Alberta and are renewing effort with the current government in Alberta to bring the slight modification that are needed to the minor injury guideline to tame inflation further.

Brenna Phelan
Raymond James Ltd., Research Division

Right. Understood. I guess more specifically, what I was asking, if there is an open claim that is for something smaller, and then suddenly that's adjusted to claims psychological injury and wanting to get a higher payout, is in your view, the court system aware of this? Is there any impetus to say it's fairly clear what the incentive is here and we're not going to allow this?

Charles Brindamour
CEO & Director

It's for the government to do that. I think the government in Ontario clearly gets it. Has done a number of reform in '16 and the current government also is keenly interested and focused on reducing cost and that goes through the incentives you're referring to. So I'm pretty comfortable that the government is thinking about this the right way and I think we've got a new government in Alberta, and it is on their list, though Alberta has a whole range of things to tackle.

Automobile insurance is something we're talking about with them and they understand where the problem is coming from. It's not so much for the courts to solve that problem. I think it's for the government who mandates a product, who actually gives clear direction to the court as to what is a minor injury and what is not a minor injury, and that's where there has been erosion. That's why we think it's for the government to go back and clarify the language.

They've done that over the years in a number of jurisdictions. Through regulation we think that more is needed and legislative changes is needed, and we're interacting with various governments across the board to do that. In the meantime though, we're not sitting on our hands. We're moving rates and we have meaningful claims actions across the board and we're seeing that we're able to tame inflation in that context.

Brenna Phelan
Raymond James Ltd., Research Division

Okay. That's helpful. Then switching gears to unit growth within auto, can you speak to how written insured risks trended throughout the quarter and post quarter, if you can, across your various geographies and how you expect those unit growth trends to play out over the next 18 months to 24 months?

Louis Marcotte
Senior VP & CFO

Yes. So first of all, we're not going to get into post quarter stuff, other than to say that we're seeing changes month-to-month as we have throughout the year and we were pretty clear in previous earnings call that we expect that the second half of '19 to look different from the first half of '19. I must admit that the second quarter of '19 was better than what we thought it would be and we're seeing a momentum building up. I'll ask Darren to give you a perspective on units in auto, and hopefully this will answer your question.

Alain Lessard
Senior Vice President of Commercial Lines

So Brenna, obviously when you look at the MD&A, you can see that we still experienced slight unit decline in the quarter. When I break it down to the month, in fact, in the month of June itself, we saw a slight increase in unit growth. So when we look at June compared to January, we see approximately a 5 point swing in our unit growth profile over that period. Now again, June is 1 month, so we are cautious in terms of extrapolating on that. But clearly we see a pivot in our growth profile.

We continue to see hardening market conditions that is supporting that growth. Now that growth has come from both an increase in new business levels, but also with retention ratios as well, and obviously, you put on top of that the right momentum that we've talked about before. Clearly, as we have a shifting growth profile, quality continues to be critical. So that's one thing that we continue to monitor extremely carefully on a regular basis and we have no concerns currently with our growth that we're seeing on the order side. So a lot of that hard work in the past 3 years is paying off and has positioned us quite well from -- with the current hardening market.

Charles Brindamour
CEO & Director

And Brenna, just to give you a sense of momentum in units, the first quarter of 2019, we shrunk the units by 4.7%. In the second quarter of 2019, we shrunk the units by 0.6%, and in June, units were growing by 0.7%. So you can see where a big company like Intact to have such change on a sequential basis by month, gives us a sense that we are about to start to see momentum picking up in units. Our job here -- we've been sort of predicting that this would be the case and that the market would move in that direction. Our job is to make sure that the quality of what we're growing with in terms of units, is top-notch. And I think in a tight market, this is something that is really, really important and we're focused on that.

Operator

Your next question is from Doug Young of Desjardins Capital Markets.

Doug Young
Desjardins Securities Inc., Research Division

Just wanted to make sure I understood just what you're saying about the Ontario -- auto prior-year reserve development. And I think you mentioned concession rates haven't changed, meaning the amount of people that are asking or the percent of those asking for the cap benefit hasn't changed, but because the amount of people asking for the cap benefit has increased, and the total amount, it increases. Is that really the pivot point? Am I thinking about that right?

Charles Brindamour
CEO & Director

We're not conceding more cats than what we expect.

Patrick Barbeau
Senior Vice President of Claims

The process is, now that we are past the 3 years, people will want to have access to the cap limits needed to file a cat application, that we call it. And from there, we can ask our own evidence and examination of the injuries or situation of the client. And after that process, that's where it's either conceded or not. That ratio of the ones and of all the requests we receive that are conceded, continues to behave that we were expecting and from what we were seeing in prior quarters. But the number of people on the remaining open files that continue to try to file for it, that piece has increased in the quarter compared -- will not increase from prior, but is higher than what we're anticipating because we were projecting that this would start to now slow down faster than what we've seen. I don't know if that's clear.

Doug Young
Desjardins Securities Inc., Research Division

So it's not like you're paying out more, right?

Patrick Barbeau
Senior Vice President of Claims

No.

Doug Young
Desjardins Securities Inc., Research Division

It's just the fact that more people are asking, so the -- that's probability of you having to pay out. So it's not -- so you're not actually having to payout, it's just the probability that you would, because more open files are coming and asking you if that's increasing, is that correct?

Charles Brindamour
CEO & Director

That's exactly right. Again, I think that the way we set up case reserves in the field, the probability you're just highlighting is actually a variable that is used to case reserve in the field and has been driving a bit of let's call this field reserving activity, paid as well as conceded taxes sort of in line with what we anticipated. But we feel like we need to react to the activity we're seeing in the field.

Doug Young
Desjardins Securities Inc., Research Division

But I thought that this was a message to you last year as well, that you didn't think there is going to be any further change or that you thought prior-year reserve developments would be nil going forward. So what's the quantum? Like has it changed that much in the last 3 quarters?

Charles Brindamour
CEO & Director

Yes, we thought that the level of activity that is, people trying to push themselves from basic to cat, would drop faster than it actually did, because we thought the passage of time should lead to within -- I think we said 24 months last time or 12 months at this level should drop meaningfully and the slope of decrease hasn't materialized as we anticipated.

Doug Young
Desjardins Securities Inc., Research Division

Okay. And then just Alberta, I mean what I've learned over the years is that once you start to have adverse developments, they tend to creep back in for a while before they start to move the other way. And so Alberta is relatively new in my view as to the prior-year reserve development. And I know you talked a bit about the rate that you're getting. How much slippage could there be here going forward? Like do you feel confident, you've got your handle on this, or is there the risk here that there is going to be further slippage as we've seen with the Ontario file?

Patrick Barbeau
Senior Vice President of Claims

Yes. So I think from a scale point of view, Alberta is much smaller. We've been on this for a number of years. I think the level of representation has gone up over time and as a result, the activity has gone up. We've responded by reorganizing our claims operation to be better equipped to deal with the higher level of representation. This has led to activity in the field as well, driven by us as opposed to the external environment. But I'll let Darren to share his perspective.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

I think that if you look at the activity that we see in the quarter, it is the older accident years where we see a little bit of this pressure. What gives me some comfort when I look at the more recent accident years, we see strong improvements through lower frequency. We see the evidence of the work that Patrick and team are doing to manage our payments early on within development. So early signs from the more recent accident years are quite encouraging. So as I said, the Q2 activity or the first half of this year activity, is obviously, further out into the tail. Obviously, that does have a finite time line and that risk will diminish over time.

Doug Young
Desjardins Securities Inc., Research Division

And Charles, when you say representation, you mean legal representation essentially?

Charles Brindamour
CEO & Director

Yes, yes, that's exactly what I mean. Yes.

Operator

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

Tom MacKinnon
BMO Capital Markets Equity Research

I'm going to go ask something about personal property for change here. In the MD&A you noted higher non-cat weather and fire losses in the quarter. Would you be able to quantify what those were, where those a couple of points or 2 points, 3 points, 4 points? What -- were those losses, higher than anticipated?

Charles Brindamour
CEO & Director

Yes. Will ask Darren to give you a perspective on that.

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. Both of them were a couple of points, Tom. We've taken a good close look at the fire losses, but we are seeing no evidence of concerns from an underwriting perspective, underlying trends, just a little bit of noise volatility in portfolio. As I mentioned, 2 points from the non-cat, that's really just a bit of a shift from cat to non-cat. We get a little bit of that from quarter-to-quarter. No overwhelming concerns there. I think what I would say from a property standpoint and which gives us further comfort is, on the right side, we continue to see strong momentum there.

So to the extent that we see a little bit of noise, a little bit of activity, we've got 4.5 points of written right flowing through personal prop less on the earned. So we've got some strong momentum there as well too. So again, no concerns from where we sit. Clearly, combined ratios today, they are higher than where we've been historically. But again, past 5 years, 90s or better, really -- and it's continued to be in a strong position from a personal property standpoint.

Tom MacKinnon

BMO Capital Markets Equity Research

Okay. So that's 2 for the -- points to the non-cat and 2 for the fire. So 4 points in total?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. That's it.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. And to what extent do you think on the PYD issue that we've talked here, that it's kind of an industry problem, not just strictly an Intact problem? Do you think this is just leading to -- to what extent do you think that will just lead to higher rates in Ontario and Alberta?

Charles Brindamour
CEO & Director

Well, I think that it will see the hard market for sure. I think we're a harder market for sure because those years go into rate indication. I think we've baked in the pressure on those years now for a few years ourselves in terms of pricing. As you've seen, we were way out there from the pricing point of view, shrinking our market share. And I think as this becomes more real for the industry, you will see further tightening in the marketplace. So no doubt that this will impact the state of the market.

Tom MacKinnon
BMO Capital Markets Equity Research

And in your slide show, you mentioned you expect minimal impact from PYD going forward in personal auto. And I get Ontario because anything that happened post the pre-reform is not going to be able to qualify in. As you mentioned, to quote you, "this gravy train is going to be over here." But in Alberta, what gives you confidence to say you would expect minimal impact from PYD going forward?

Charles Brindamour
CEO & Director

I'll ask Patrick to share his perspective on that.

Patrick Barbeau
Senior Vice President of Claims

Yes. I think it's the fact that the activity we've seen recently is linked to older years. We've seen the history in the past few years and if it's linked to older court cases that triggered this opening, our erosion in the minor injury, the activity we've seen is concentrated on older years. And we see signs that our actions since then and in more recent years are paying up. Some of the increased activities that we've seen in just the recent might be caused by the fact that we have less new claims. So more time to work by the different stakeholders and the legal community on the older file. So not all of it might actually be fully trend, but we're cautious in our reserves at the moment and not assuming that this is just in what different development -- developing pattern.

Tom MacKinnon
BMO Capital Markets Equity Research

And that 2:1 ratio that was mentioned, it is for the total personal auto across Canada PYD. Does it vary by what you've done for Ontario versus what you're doing for Alberta?

Patrick Barbeau
Senior Vice President of Claims

Very similar.

Tom MacKinnon

BMO Capital Markets Equity Research

Very similar, sir?

Patrick Barbeau
Senior Vice President of Claims

Yes, other kind of pattern.

Operator

Your next question comes from Meyer Shields of KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Two very quick questions. One, I was hoping you could share the assumed frequency and auto that was compared to the 7% decline that you've seen year-to-date?

Charles Brindamour
CEO & Director

I think Meyer is asking what did you expect the frequency to be versus what we're actually getting. I think if you look -- I mean there's a lot of moving parts here. Clearly, the underlying minor issue was slightly better than what we would have expected in Q2, and a big chunk of it would be frequency driven because we largely know what the rates earned would be. I don't know if you want to add to this, Darren?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes. I think it's difficult to quantify, Meyer, but what I would say is, a lot of the rate activity or all of the rate activity is heavily segmented. So that by its very nature should drive the risk selection process, which drives also the frequency that we're experiencing as well.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And I assume that that's a bias towards lower frequency customers as opposed to higher priced customers?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

Yes, and I think we're also doing a lot of work in the field in terms of quality of portfolio both in terms of, as I said, the new business that we're writing, but also in terms of the book of -- the renewal book as well too. So a lot of -- the field has a lot of quality indicators at their disposal to help ensure quality moving forward, and I think that's what you're seeing play off from a frequency standpoint.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

And can you give us a sense of maybe what a normalized annual loss trend is for personal property?

Charles Brindamour
CEO & Director

Well, if you look at the expected increase in the value of the carpool, so to speak, year-end it will be single digit, value is not single digit. You're close to 1% to 2% increase in the insured value of the carpool, which we're picking up in premium. Is your question personal auto or personal prop?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Personal property, actually.

Charles Brindamour
CEO & Director

Sorry about that. I was going down a tougher answer here. So what's your perspective Darren, on personal prop?

Darren Christopher Godfrey
Senior Vice President of Personal Lines

I think obviously, similar to the auto, we do have a inflationary element in terms of exposure. So in terms of increasing amounts of insurance we see -- we pick up a couple of points there in personal property. From a loss trend, which would include that, we're in the sort of 4- to 5-point range. So net-net, [2% to 3%] is where we're looking at right now, Meyer.

Operator

Your next question is from Michael Phillips of Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

Yes. I think that's me. I didn't get the name. It's Mike, Michael. I wonder if you can quantify -- trying to get the quantification of -- on the U.S. commercial, kind of the impact of the accounts and the business that is ongoing on the profitability programs so if you look at the core loss ratio, that kind of went up a little bit this quarter. Can you back those guys out and see what that would have been without them?

Charles Brindamour
CEO & Director

Yes. Alain, why don't you share your perspective on that? The impact is really quite meaningful...

Alain Lessard
Senior Vice President of Commercial Lines

Yes. The impact is meaningful because if we would look at our commercial just in the U.S. and we want to split between lines undergoing profitability improvements and other lines, it's about 80%, 20%, 80% very solid and that 80% has been performing some 90s combined ratio regularly over the last quarters and years. So very solid improvement. The 20% is really where the drag is coming from and this has been performing above the 100% zone, okay. And this is where we're concentrating our efforts, okay.

A lot of that relates to PYD's past where we are in, adjustment there, but we're taking a lot of increase on those lines of business. We're doing a lot of selection exiting sub-segment, reviewing the portfolio. In fact, the retention on that portfolio is down meaningfully compared to the rest of the business. New business is down, and in fact, that portfolio is shrinking.

Charles Brindamour
CEO & Director

And the bottom line is the -- the portion of the book that is not undergoing profitability improvement plan is running in the 80%s.

Operator

Your next question comes from Jaeme Gloyn of National Bank.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

In the U.S. commercial business, looking at premiums written and net earned premiums, just a little bit divergence there. I wonder if you can speak to some of the dynamics at play between what you're writing in and what you're earning on a quarter-to-quarter basis?

Charles Brindamour
CEO & Director

Yes, the environment in which we operate has been improving, in particular, in the last few months and you're starting to see an increasing divergence. I'll let Alain share his perspective on the state of the market.

Alain Lessard
Senior Vice President of Commercial Lines

There is one business unit called [indiscernible] in our organization, that is really looking at covering tuition fee in school, and that business unit's earning pattern is way different. There is a bit of seasonality on that and that is really what's causing the discrepancy between the growth in written and the growth in earnings.

Charles Brindamour
CEO & Director

Was that your question?

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Yes, yes. Just the divergence between those growth rates and the gap between written and earned, if there was any reinsurance or anything like that at play, but it sounds like it's related to specific segment mix in the quarter-to-quarter basis.

Alain Lessard
Senior Vice President of Commercial Lines

Exactly, and seasonality in that segment.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

Okay. In terms of the broker distribution and distribution EBITDA acquisitions in that broker market are continuing to occur at a more rapid pace this year. Can you talk about multiples and the outlook for continuing to consolidate that part of the market?

Louis Marcotte
Senior VP & CFO

Sure. So in the state of the market as it is now, we're clearly seeing some rising activity. Hasn't triggered necessarily any meaningful bump in multiples, just more opportunities as brokers want to move on either exit the business merger to acquire other brokers. So we're clearly seeing some more activity than we did last year and this will accrue to us over time as we integrate those businesses into our own businesses. So we did the -- you saw the jump in distribution income in this quarter.

Most of it has come -- really comes from organic growth. In fact, the top line impact you're seeing at Intact is also trickling into our broker network. So that's the main growth engine there. The M&A will pan out, I think in future quarters mostly, and this enabled us to rise our guidance from 5% to 10% in terms of EBITDA earnings for the rest -- or for the full year, this year we will show 10% growth rather than what we had estimated at first.

Charles Brindamour
CEO & Director

And the environment in which we operate, is certainly conducive to consolidation and distribution as well, and to work quite keen to continue to deploy capital in that segment and build scale in distribution.

Jaeme Gloyn
National Bank Financial, Inc., Research Division

And how would you rank distribution in terms of capital deployment priority relative to either manufacturing or as a traditional manufacturing distribution combination like a CDI, for example or U.S. M&A?

Charles Brindamour
CEO & Director

Yes, I would say that's manufacturing in Canada right now would be at the top end of our appetite level just given the fact that performance in the market is not so good. And our outperformance is big. So I think that the opportunity to go beyond our target rate of return on manufacturing acquisitions at the moment is pretty good, I think. And then I would say distribution, consolidation opportunity there's big synergy potential there, given what we've done in distribution in the last decade.

And I would say that's the second area of focus in terms of capital deployment, followed by the U.S. The difference between manufacturing capital deployment and distribution capital deployment is on one hand, distribution is less risky. On the other end in manufacturing, you can move the needle much faster given the outperformance and the size of most opportunities. And that's why it's at the top of the list at this stage. But we like distribution because to keep things in perspective, I mean between investment income and distribution income now, and that's very different from where we were 10 years ago, we're coming to work on Monday morning with an 8% ROE before we start doing the insurance manufacturing business, which is what we're really good at. So we intend to add to our distribution and fee earning capability to solidify our ability to generate mid-teens ROE over time. Thanks a lot.

Operator

There are no further questions at this time. I will turn the call over to Ken Anderson for closing remarks.

Kenneth Anderson
VP of Investor Relations & Treasurer

Thank you all for joining us today. So following this 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 archive. Our third quarter 2019 results are scheduled to be released after market close on Tuesday, November 5. Thank you, again, and this concludes our call for today.

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