Definity Financial Corporation

Fourth Quarter Results

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Definity Financial Corporation's Fourth Quarter Results Conference Call.

At this time, all lines are in the listen-only mode, but following the presentation we will conduct and a question-and-answer session. And if at any time during this call you require immediate assistance, please press *, 0 for an Operator. Also note that the call is being recorded on Friday, February 11, 2022.

And I would like to turn the conference over to Dennis Westfall, Head, Investor Relations. Please go ahead.

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thanks, Sylvia, and good morning, everyone. Thank you for joining us for our call today. A link to our live webcast and background information for the call is posted on our website at definityfinancial.com under the Investors tab.

Please note that today's comments contain forward-looking information. Please refer to the advisory regarding forward-looking information included in the presentation, which outlines the risk factors and assumptions relevant to this discussion. Additional information is available in Definity's annual MD&A, which is available on SEDAR, and on our website.

Certain financial measures referred to in the discussion are non-GAAP measures. For a further description of these measures, please see our news release and MD&A.

Joining me on the call today are Rowan Saunders, President and CEO; Philip Mather, EVP and CFO; Paul MacDonald, EVP of Personal Insurance; and Fabian Richenberger, EVP of Commercial Insurance.

We'll start with formal remarks from Rowan and Philip, followed by a Q&A session where Fabi and Paul will also be available to answer your questions.

With that, I'll ask Rowan to begin his remarks.

Rowan Saunders — President and Chief Executive Officer, Definity Financial Corporation

Thanks, Dennis, and good morning, everyone.

I'm pleased to be speaking with you today on our first quarterly call. I very much enjoyed meeting with investors and analysts as part of our IPO process and look forward to continuing the conversation.

We reported fourth quarter and year-end results last night that capped off a very successful year for Definity. Operating net income of $46 million or $0.42 per share was driven by a resilient combined ratio of 94.6 percent in the quarter, inclusive of elevated cat levels driven by flooding in British Columbia, as well as reserve strengthening to recognize recent inflationary trends in auto. Our proactive approach to inflation was essentially offset by our past prudence in the form of favourable prior-year claims developments.

This solid underwriting performance was delivered in conjunction with continued strong top-line growth, strategic investments in our digital platforms, Sonnet and Vyne, our expansion efforts in personal property and commercial insurance, and overall firm market conditions, combined to deliver a 12 percent increase in premiums for the quarter.

We continue to expect top line to increase at a double-digit pace in the next couple of years. For the full year, premiums increased 14.8 percent, while our combined operating ratio of 93.1 percent improved from 2020, reflective of our past efforts to improve the business as well as continued lower-than-normal claims frequency related to COVID-19.

Overall, our financial performance led to an operating ROE of 11.5 percent.

As we begin 2022, I'm confident that we're well positioned to deliver on our growth and profitability targets while navigating the elevated uncertainty in the current environment.

From a capital perspective, our solid results and proceeds from the over-allotment bolstered our financial position. Book value per share increased 18 percent from a year ago. We continue to hold a significant amount of excess capital, more than three quarters of a billion dollars, which puts us in an enviable position.

Including untapped leverage capacity, we have over $1 billion in financial capacity to fund our strategic growth initiatives.

Last night, we declared our inaugural dividend and we anticipate being able to grow our quarterly dividend over time along with company profitability.

Turning to Slide 6.

I'm proud of the Company we're building together and I'm confident that we're well positioned for long-term success. Furthermore, I believe the significant investments made in our growth platforms and to improve talent company-wide, position us to be a leader in the industry for years to come.

Growth in our digital direct business, Sonnet, remains robust, with premiums up 22 percent during the year. The business is now approaching $300 million in premiums and showing underwriting improvement.

As we continue to improve our segmentation, pricing, and fraud prevention capabilities, we believe Sonnet can transition into a contributor to overall company profitability over the next few years.

We've also made a substantial investment in the broker channel via our Vyne platform. Its ease of use for brokers has provided a growth engine for our business while its advanced analytics and sophisticated underwriting capabilities have improved our underwriting results.

Our commercial insurance business was reinvigorated in recent years. We've invested in new talent and capabilities and expanded into specialty segments to better position ourselves as a one-stop shop for key brokers.

Our latest results illustrate the success of these efforts on profitability and the continued impact of our increased appetite for growth. The relationship with Uber, fostered in 2020, is evidence that we're moving in the right direction.

Turning to the industry outlook on Slide 7.

We anticipate performance in the next 12 months will continue to be influenced by the severity and duration of the pandemic, in addition to the persistency of recent inflationary trends.

We expect firm market conditions to continue in commercial insurance and personal property, while conditions in auto are likely to firm as claims frequency reverts to pre-pandemic levels and/or inflationary trends persist.

Slide 8 illustrates our stated financial targets over the next two to three years.

We expect our operational outlook, combined with the current low-yield investment environment, to support an upper single-digit to below-teen operating ROE. We expect these results to be driven by double-digit top-line growth and mid-90s underwriting profitability.

Our current capital structure, with strong levels of excess capital and no debt, reflects our operating history as a mutual company. We plan to evolve our balance sheet over time, resulting in a capital structure more in line with our publicly listed peers, and ultimately, enabling us to target and operating ROE in the lower teens.

With that, I'll now turn the call over to our CFO, Phil Mather.

Philip Mather — Executive Vice-President and Chief Financial Officer, Definity Financial Corporation

Thanks, Rowan. I'll begin on Slide 10, with our largest business line, personal auto.

Premiums were up 4.8 percent in the fourth quarter, driven by new business and growth in Sonnet. For the full year, top-line growth was solid at 6.8 percent, despite the benign rate environment.

We reported a combined ratio of 94.9 percent in the fourth quarter, a slight improvement from the comparable quarter a year ago. Underpinning this result were two offsetting factors. Our core accident year claims ratio increased 10.0 percentage points, with seven points attributable to reserve strengthening related to recent inflationary trends and physical damage. The impact in the quarter was magnified by the fact that we reflected these trends in outstanding claims reserves for the full year. Largely offsetting this was favourable prior-year claims development, which benefited our combined ratio by approximately 9 points from a year ago.

Although the fourth quarter often sees higher levels of favourable prior-year development, this year's increase was largely the result of our prudent approach taken in 2020 as we navigated the pandemic. As Rowan mentioned, our reserving philosophy has been to remain prudent given the elevated level of uncertainty in recent quarters related to COVID and inflation. We believe this approach serves us well over time.

In 2021, personal auto reported a strong 91.2 percent combined ratio as lower claims frequency during past COVID-19-related reduced driving levels benefitted the full year.

We expect the normalization of driving patterns and potential headwinds from inflation could combine to drive our combined ratio back to the mid- to upper-90s in this line of business. A return to rate activity, ongoing claims actions, and an improving Sonnet book, should act to mitigate these trends.

Turning to personal property on Slide 11.

I'm pleased to report robust top-line growth of 17.9 percent for the quarter and 19.2 percent for the full year, benefitting from our Sonnet and Vyne platforms. You'll notice in the chart on the right that we've now grown this business by more than $260 million over the past two years. We expect growth in property to continue given the organic growth potential of our digital platforms and the continuation of the firm pricing conditions prevalent in the industry in recent years.

Focusing on the bottom line, we reported a combined ratio of 93.2 percent compared to an unusually strong 78 percent in the same quarter a year ago.

Personal property results this quarter reflect several catastrophe losses, including the flooding events in British Columbia, whereas the fourth quarter of 2020 experienced relatively benign weather.

We have taken additional actions to address increasing cost trends in certain areas of our personal property book, which includes rate and segmentation changes that were implemented in 2021, updated flood mapping, and several product and policy changes.

Our goal is to position this line of business to run sustainably in the mid-90s and the proactive steps we are taking should help us deliver this.

Slide 12 outlines the highlights in the quarter for our commercial business, with premium growth of 17.8 percent in the fourth quarter and 24.9 percent for the year.

Growth in commercial lines benefitted from improved retention, new business, and strong rate achievement in the context of firm market conditions and our expanded underwriting capabilities.

Our relationship with Uber has bolstered growth and is part of our wider strategy to diversify our book of business and complement our regular commercial P&C lines business with new specialty products.

Our combined ratio for the quarter of 95.5 percent increased by 6.7 points compared to last year. This reflects the impact of inflationary reserve strengthening recorded in the current quarter, lower CATs, but elevated weather-related losses and lower favourable claims development.

We expect global supply chain volatility to continue in the near term, which we believe could continue to add inflationary pressure on indemnity costs.

For the year, the commercial insurance combined ratio of 91 percent was 5.4 points improved over 2020 due to our underwriting initiatives, lower catastrophe losses, and lower claims frequency as a result of the COVID-19 pandemic.

We continue to expect our commercial business to generate a strong underwriting performance in the current environment, with combined ratios targeted in the low 90s.

Pulling this all together on Slide 13.

Consolidated premium growth was a strong 12 percent in the quarter and almost 15 percent for the year, while profitability at a consolidated level remained robust at 93.1 percent for the year, a full 1.5 points better than 2020.

The combination of solid underwriting and net investment income enabled us to generate an operating ROE of 11.5 percent over the past 12 months, despite a large year-over-year increase in equity.

As Rowan alluded to in his remarks, we believe we're on track to sustainably deliver on our operating ROE aspirations in the near to midterm.

Slide 14 shows our investment portfolio in greater detail.

Net investment income for the quarter increased $1.4 million from Q4 2022, but was $3.5 million lower on a full-year basis due to lower yields and increased investment expenses. Looking ahead, we expect full-year 2022 investment income to be modestly above 2021.

Lastly, you can see on Slide 15 that we ended the year with total equity of close to $2.4 billion and a book value per share of $20.68, representing an increase of 18 percent from last year.

We are proud to announce our inaugural dividend, which includes a quarterly amount of $0.125 per share, in addition to $0.05 per share reflective of the stub period from IPO to the end of the year.

We already have significant financial capacity under our current legal structure and, subject to the Continuance of Definity under the CBCA, we could add an additional $500 million in leverage capacity.

Overall, I believe our strong operational performance and capital level positions us well to deliver value to shareholders while continuing to support our customers, brokers, and employees.

With that, I'll turn the call back over to Rowan for some final thoughts.

Rowan Saunders

Thanks, Phil.

Transforming one of Canada's oldest mutual insurers into a public company was an incredible journey. We have made significant investments to reshape our business and to build market-leading digital capabilities that'll allow us to confidently compete in a dynamically changing industry.

We have focused on modernizing our technology, diversifying our portfolio, enhancing our customer experiences, and building exceptional talent. Our award-winning digital platforms are adapting to meet the evolving needs of our brokers and customers and have advanced our reputation as a digital leader in the P&C insurance market.

I'm extremely proud of the milestones we achieved in the fourth quarter, becoming a public company, securing our cornerstone investors, and celebrating our 150th anniversary. These were made possible by the tremendous efforts over many years of our dedicated employees and strong broker partners.

I look forward to delivering on our stated strategy to become a top-five player in the Canadian market by maintaining our digital leadership, growing profitably, and deploying our capital in a disciplined manner.

And with that, I'll turn the call back over to Dennis to begin the Q&A session.

Dennis Westfall

Thanks, Rowan. Sylvie, we're now ready to take questions.

Q&A

Operator

Certainly. Ladies and gentlemen, if you would like to ask a question, please press *, followed by 1 on your touch-tone phone. You will then hear a three-tone prompt acknowledging your request. And if you would like to withdraw from the question queue, please press *, followed by 2. And if you're using a speakerphone, we do ask that you please lift your handset before pressing any keys. Please go ahead and press *, 1 now if you would like to ask a question.

And your first question will be from Geoff Kwan at RBC Capital Markets. Please go ahead.

Geoff Kwan — RBC Capital Markets

Hi. Good morning. Just on the reserve strengthening in auto, you talked about seeing more recent developments there, which we have also seen for a number of years now. Just wondering if you can give some detail around what you're seeing recently. But also, is it a bit of prudence to ensure that you're properly reserved when we start to see accident frequency probably increase, obviously, more from here as the economy reopens more?

Rowan Saunders

Sure, Geoff. Thank you very much for that question. I mean, just a little bit of kind of context there. I think I'd start off by saying that we were really pleased about our Q4 results and we feel that in aggregate there, or a certainly solid set of results, just under a 95 percent, when you think about it, there's about 5 points of net CATs in there as well.

You're right as you pointed it on the auto portfolio. And we are a significant auto underwriter, and as such, watch this line very, very cautiously. We know that the pandemic continues to impact our industry and so there's a number of things that we're observing.

Driving is starting to normalize and frequency is coming back up, but it's still well below pre-pandemic levels. But we have seen some inflationary changes kind of later into the year, and we've reacted to that. We're seeing it in the auto physical damage side. We wanted to be early. We wanted to be prudent and actually, this has been largely offset by some favourable development as we were prudent last year, the first year of kind of COVID.

So let me pass it to Phil to kind of comment a bit more on that reserve movement and what we actually saw and booked.

Philip Mather

Yeah. Thanks, Rowan. So I'll comment on both the prior-year development we've seen in the auto lines as well as the inflationary reserve strengthening we undertook in the fourth quarter as they're both really related in terms of the approach and philosophy we take to reserving, albeit the underlying drivers are a little different.

For the prior-year development, what you're really seeing here is the unwind of the prudent approach that we've taken throughout the pandemic, reflecting the heightened levels of uncertainty

we've all experienced and as time's passed and our loss estimates have refined, what you're really seeing here is an unwind of that prudence, particularly in respect of 2020 longer tail liabilities.

For this quarter, we've been monitoring auto cost inflation closely. And as you say, we saw it increase towards the end of the year, together with some increased macro uncertainty, but I would say, particularly in respect of supply chain disruption.

And so, really, in keeping with that prudent philosophy, we've strengthened the 2021 accident year short-tail reserves for auto to reflect these trends, but I think also to recognize the increased level of uncertainty in the operating environment today.

And I'd say like this approach really mirrors the actions we took earlier in the year on the property side when we reacted very quickly to then emerging cost pressures there, and that really positioned us well as the rest of the year played out.

So, overall, I would say we should look at both the prior-year development and the inflationary reserve strengthening in Q4 really as flip sides of the same coin. And overall, I'd tell you we feel as confident in our closing balance sheet reserves as we do in the opening.

Geoff Kwan

Great. Thanks for that. And just my other question was, I'm wondering if you can kind of give an update in terms of—with your excess capital position, if there's anything even kind of generic that you can talk about, you know, potential for acquisitions, but also too, any discussions that you may be having with the government about being able to try to transition to the CBCA faster.

Rowan Saunders

Phil?

Philip Mather

Yeah. Maybe I'll just take the second point first in terms of the CBCA. So no update there, Geoff. As you know, the base case for that period is two years post demutualization under the regs. I mean, we certainly continue to advocate for changes there to help us accelerate, but that is a government decision; it's not ours.

And in the meantime, as our reporting shows, we do have a very significant excess capital position, and the transition to a public company stature has increased that flexibility. So we think we're very well positioned to execute on our overall strategy.

And just in terms of how we think about the use of capital, I think the first point we'd make is that prioritization to support the organic growth strategies of the organization, reinvest in the core business, I think that's the number one priority.

You'll see we announced our inaugural dividend yesterday, so that's an important part of our thought in terms of deployment of capital. And we do have a plan to grow that over time.

And then thirdly, in terms of M&A, that's certainly part of our overall thesis as we look to pursue a top-five strategic position in the industry. So that's kind of how we think of it. We will look at buybacks as a capital management tool, but that's lower down the rung, I'd say, Geoff, and we'd use it up from a capital management perspective, and it'd be relatively modest if we do activate that tool.

Geoff Kwan

Okay. Thank you.

Operator

Thank you. Next question will be from John Aiken at Barclays. Please go ahead.

John Aiken — Barclays Capital

Good morning. Phil, a follow-on to the reserve strengthening. I get what you're trying to do with the 2021 accident year, but do you have a sense in terms of what this might do in impact moving forward in terms of the claims ratio for 2022? And how much of a nullifying impact could price increases have on that?

Philip Mather

Yeah, thanks for that. Just as we close out the year, I think, certainly, the level of drawdown we've seen is reflective of that prudent stance in 2020, and is reflected equally as we've looked at the 2021 position. And I will say that reserve strengthening is a bit magnified in the quarter. So you'll see there's about 4 points overall of strengthening that we've taken in the quarter. Just under half of that really relates to the earlier accident quarters, and about half of it relates to accident quarter four. So that is a little magnified in terms of the overall impact.

I think as we look forward, there's a number of things we think about, on auto in particular. Rate is definitely part of those considerations, and we are seeing some rate activity in the marketplace more generally.

But beyond that, there's also cost management actions in terms of how we control the costs that we incur. There's some embedded offsets on things like salvage against the auto inflation cost that we've seen, and a lot of actions that we've undertaken in recent years to enhance our claims activities and a lot of focus in recent years on some of the contracts that we have in place.

And then the last piece I'd say, John, looking forward is in those auto results, we also have the Sonnet business, which continues to improve. So I think when we step back from it, that mid to upper 90s

percent guidance on auto lines feels comfortable and supportive of the overall financial targets that we've just reaffirmed.

John Aiken

Yeah. That's great, Phil. Thanks. And if I can just ask one follow-on, because you did broach the topic in terms of the expenses. Fantastic result this quarter. I think it's one of the lowest that we've seen overall. Was there anything unusual driving the low expense ratio at the top of the house? And expectations are, obviously, that you're going to continue to grind down on costs, but what should we look for in 2022 in terms of would it—should we, obviously, expect a little bit of a reversion? Or are we going to continue to see this grind down?

Philip Mather

Yeah. Thanks, John. So yes, there are a couple of moving parts in this. So if you look at our full-year expense ratio, just over 32 percent, I think that's a bit more indicative of the run rate. If you break down the expense ratio, you'll see the commission ratio came down around 1 point. There's some true-up going on in there. We accrue—it's really the contingent profit commissions that we pay. So, as we've estimated through the year and we've kind of refined that final picture for the closeout of the year, that's run at a slightly lower rate, alongside with some of the cat events that we had kind of impacted some of the overall expected levels of payout.

So I would say that's a little low for the year—sorry, for the quarter. I think the longer-term view is more like the year.

Offsetting that, there's about 0.5 points of upward pressure in the operating expense ratio, which is also a little bit one-time-ish, just again, as we've closed out some of our staff accruals and some

actions we took in the fourth quarter. So that longer-term picture, I'd say, the full year gives a more indicative position.

And the only other comment I'd make just as you look to next year, you'll know that we have a quota share structure in place, which effectively rolled off at the end of the year. That will actually inflate a little the expense ratio next year because we do get some commission income on that, but offsetting that, we'll have a higher net earned premium base coming back. So that'll work to offset itself nonetheless.

John Aiken

Thanks for the colour. I'll re-queue.

Operator

Thank you. Next question will be from Stephen Boland at Raymond James. Please go ahead.

Stephen Boland — Raymond James

Hi. Just one question. When I look at your 10 percent premium growth goal, I break down the components, and personal property and commercial are up 18 percent year over year. I think that's about 58 percent of your total premiums, which implies that personal auto would be in the very, very low single digit to achieve that 10 percent.

Can you provide a little bit of outlook in personal auto, what your thoughts are on market share pricing in Ontario, and why, if it's true, that you're kind of at the low end maybe of what you've just delivered in terms of growth?

Rowan Saunders

Sure. We're happy to kind of provide some comments there. So one of the things that I would say is firstly, our strategy is to continue to keep diversifying the overall portfolio, and so we intend to grow

our commercial business and our personal property business at a rate faster than our automobile portfolio.

Overall, 44 percent of Definity's portfolio is in personal auto, and so we do think that that will reduce as a component over time. So that's what we intended to do. And in fact, when you look at the quarter, that's exactly what is happening. We are growing very strongly the commercial business, almost 18 percent, and the property business, again, is very strong.

The auto business, while there is, I think, reasonable growth there, what I would point out is that in this environment, where we still have customer relief flowing through the portfolios, it's all about unit count. So, at a full year basis, we're getting that a little above the mid to upper-single digits, and that's—about 80 percent of that is unit count. So there's very little growth there.

As we go forward, I think the general theme of we are going to continue to try to diversify the portfolio and grow property and auto—property and commercial lines at a faster rate. But we do anticipate that one, you'll see the customer relief measures falling off. And I can remind you that we have a 5 percent rate relief on Ontario auto, our biggest portfolio, that expires at the end of May of this year. So we're not very far away from, effectively, getting a 5 percent increase on our largest portfolio, which is two-thirds of our total auto portfolio.

So I think you will start to see more growth, partially, as we start reintroducing rate on top of unit count growth. So that should start to increase a bit as you look forward in the next couple of years.

Stephen Boland

Does that imply your premium growth goal is very conservative, then?

Rowan Saunders

Well, I think what it implies is that we're comfortable in our growth targets. And what we've kind of said and guided the market is that on average, we'll be growing at about 10 percent in the next couple of years. We have been doing a bit better than that in terms of this year.

I think that there's a view on what happens to auto pricing in the next couple of years. If frequency doesn't come back to pre-pandemic levels and this inflationary environment is more transient, then there won't be a significant amount of price in the auto portfolio other than normal inflationary trends, which happens persistently in the business. But if you do get a bit of an elongated or less transitory inflationary perspective, I think we can count on more rates coming into the auto portfolio and then in which case, that would drive higher-than-expected top line.

Stephen Boland

Okay. Thanks very much.

Operator

Thank you. Next question will be from Tom MacKinnon at BMO Capital. Please go ahead.

Tom MacKinnon — BMO Capital Markets

Yeah. Thanks very much and good morning. We talked about some of the reserves strengthening you did with respect to inflationary pressures in the personal auto book. But the release also notes some inflationary reserve strengthening in the commercial lines. And it also notes that you did some proactive reserving actions with respect to inflation in personal property.

Maybe you can quantify the amounts of which those were and how they impacted the fourth quarter and what your thinking was behind those. Thanks.

Philip Mather

Yeah. Thanks, Tom. So, in the fourth quarter, we referenced strengthening on the personal auto portfolio. On commercial lines, it's about 3 points. But that's also really reflective of the auto book within commercial lines. So same overall kind of underlying concerns and kind of cost trajectory, but it's 3 points or so on commercial lines overall in the quarter. Similarly again, that's been applied to all open reserves. So it's a little magnified in the fourth quarter itself.

And just in terms of personal property, when we look at the full-year impact of inflation, it's about 3 points. About 2 points of that came from property, and that was taken earlier on in the year. So you'll recall at the half -year point, we've seen pressures on parts, lumber costs, and we reacted pretty quickly there to lean in and kind of prudently react to that. So that's really the driver of what we're seeing on the property side.

Tom MacKinnon

And how are you progressing in terms of the Sonnet top-line growth? It seems to be moving along nicely. But is there any colour you can give us as to Sonnet's profitability? I think the target is to break even sometime in 2023. Correct me if I'm wrong. But is there any more colour you can give us as to how that might be trending? And so any kind of update there?

And if—how Sonnet has been doing in terms of building out both in personal auto and in personal property?

Rowan Saunders

Yeah. Happy to provide some kind of insight in there. But firstly, I'd say that we're still very pleased with the trajectory of Sonnet. Both product lines, the automobile and the property, within Sonnet are growing really strongly. And so when you think back at the end of the year at 22 percent kind of

growth, it's a very similar growth rate between the two lines of business. So we're having success both in property and in auto lines.

With respect to the profitability, I think we would say similar to what we said on the road show is—or on the IPO is that this is a business that is going to take a couple of years to get to scale. It's going to take a couple of years for their portfolio to mature and start contributing from an underwriting perspective.

And so really, there's no change in our outlook there. We are seeing the efficiency ratio improve in this business. We are seeing the loss ratio come down, and, of course, the top line, that we do publicly share, it's pretty strong at 22 percent.

So I think as we look forward, so it's only been a couple months since the IPO, but no changes in that. We still are confident the business can double in the next couple of years. And we're comfortable that it will be able to contribute to an underwriting profit about two years out.

Tom MacKinnon

Is there any more kind of tweaking with the artificial intelligence algorithms, the use of third-party data that you're doing with Sonnet? Or is that just kind of always an ongoing tweak, if you will?

Rowan Saunders

Yeah. I mean I'll ask Paul to give you a couple comments on that.

Paul MacDonald — Executive Vice-President, Personal Insurance, Definity Financial

Yeah. I think you've accurately described it there when you say it's an ongoing part of our strategy. We continue to increase the capacity and capability of our analytics team, including fraud, and we deploy changes and upgrades on a biweekly schedule.

So that is an area of heavy investment for us, and we're seeing great returns out of that. So we're going to—you're going to hear me saying this every quarter. We continue to invest in improving the operation of Sonnet. And that's also providing knock-on benefits on our broker business because much of the learning and intelligence that's developed in Sonnet can be deployed on the broker side.

Rowan Saunders

And maybe one final kind of comment that I think has been encouraging for us. We've mentioned that we have opened our appetite and started to focus on the affinity segment. We know that the affinity segment is a very big and very profitable segment in the Canadian marketplace, and it is now representing over 25 percent of our new business growth. So we're making—it's early days, but we're making really positive inroads into that attractive segment. So we will keep pressing hard on that through 2022.

Tom MacKinnon

Thanks.

Operator

Thank you. Next question will be from Brian Meredith at UBS. Please go ahead.

Brian Meredith — UBS

Yes. Thanks. A couple of questions here for you. First, I'm just curious. The 5 percent rate relief that expires in Ontario, are you all thinking right now that that's enough to offset this kind of elevated severity that we're seeing as we look forward for the next six months?

Rowan Saunders

Go ahead, Paul.

Paul MacDonald

I think the short answer is yes. It is uncertain, of course. We can't predict with any level of certainty how long this pandemic will last. But certainly, early signs are pointing to the fact that various provinces are unwinding lockdowns, and that's a net positive in terms of the performance and, obviously, reducing the supply chain disruption.

Just as a reminder around that rate. As Rowan mentioned earlier, we did get approval for a 5 percent increase on Sonnet. That minus 5 is an automatic unwinding. We don't have to apply for it. So, as you mentioned, it's two-thirds of our personal auto portfolio, which is almost a 3-point positive impact on our entire personal auto portfolio, which will apply, as I mentioned, automatically in Q2.

Now, maybe add a little bit of colour around there. The inflationary costs to which you refer, really are disproportionately impacting the physical damage side of our claims costs. And so half of our portfolio is injury; the other half, that's personal damage. And we believe that, for now, including the reserve strengthening that Phil mentioned earlier, plus the increase that you mentioned, we are covered in the short to medium term.

Brian Meredith

Great. That's really, really helpful. Thank you. And then, Rowan, I'm just curious. Looking at Sonnet right now, great growth going on. I'm just curious. How do you balance or think about managing that growth call it in the near term versus perhaps some uncertainties in what's going on with the supply chain and the inflationary environment that we see right now and perhaps not wanting to put on the amount of new business right now?

Rowan Saunders

Brian, I think that's always a balance for us. And I think we look at—Sonnet needs to continue to scale in order to get to the right level of expense ratio. We're on that path. Of course, we want to do that with attractive business. And so one of the things that we have been doing is, and I referred to it in one of the early questions, is focusing more of the growth on higher-contribution segments, higher-quality customer segments like the affinity business.

One of the short-term consequences of that is your cost of acquisition, particularly in a search environment, is a little more elevated when you're targeting let's say a more desirable customer. And so I think that there's a little bit of cost pressures that we see. But overall, what we're really focusing on is building out the high-quality [new] portfolio in Sonnet.

The other thing that I would mention is that whilst the premiums are higher in automobile, our unit count is actually very similar between property and automobile, and we're continuing to grow quite strongly in that area. Initially, it tended to be condos, renters, and I'd say, for the last several quarters, we really are being quite successful in more the suburban homeowner policies. So that's another area we would grow.

At the end of that day, we are committed to scaling this business up but making sure that it does get to that underwriting contribution on the timeline we said. So we'll keep that balance in mind.

But I think we've been quite excited in the last several quarters with the quality of business improvements within Sonnet. So the segmentation approach seems to be working.

Brian Meredith

Great. Thank you. Real helpful.

Operator

Thank you. Next question will be from Jaeme Gloyn at National Bank Financial. Please go ahead.

Jaeme Gloyn — National Bank Financial

Yeah. Thanks. Good morning. First question I wanted to just get a little bit more colour on was the unit growth. Personal auto came in around looks like just under 5 percent year over year; fairly flat, quarter over quarter. And personal property came in much more rapid than that, that looks like 15 percent—or 3 percent, quarter over quarter. So can you talk through what are some of the drivers that would—that's helping personal property grow units at a faster clip? And maybe a little more colour as to why auto was a little slower?

Rowan Saunders

Go ahead, Paul.

Paul MacDonald

Yes. Absolutely. Well, let me start with property first. I mean, first and foremost, I would say that the systems that we've developed in Sonnet and Vyne are very user-friendly and enable us to then make adjustments regularly and rapidly in response to changing market conditions. So we've been able to adjust those to take advantage of opportunities in the marketplace.

Secondly, on the broker side, we have great relationships with brokers, and the systems are easy for them to use and to transact.

Also, that I want to highlight on the property side, is I want to remind you that we are pricing to mid-90s and so we're comfortable, given the additional reserve strengthening and the elevated Q4 cat losses, with that performance. But it does allow us to achieve that outsized property growth.

I'd also like to remind you that three years ago, we were disproportionately weighted in auto relative to the market, and we've rapidly caught up in the last few years. And now, on an aggregate basis, we're about equal to the market in terms of property to auto weighting. We do like that, both to diversify our portfolio but in the long term, property tends to be a bit better at outperforming automobile.

On the automobile side, I know you mentioned reduced rate. But the reality is, at a combined 6.8 percent growth, 80 percent of which was unit growth, that is at the top of the market in terms of growth in the automobile space. Particularly during the pandemic conditions, we found that many customers have chosen to remain with their existing insurance companies, in part because of relief measures that have flown out.

We've benefitted from this in terms of our retentions being higher but we've also disproportionately benefitted from available business moving to us. So we are quite pleased around the auto growth and expect to continue that trajectory into the future, as Rowan mentioned.

Jaeme Gloyn

Okay. That's helpful. But just a follow-up on the property side, pricing to mid-90s and your comment that you're now comfortable with the mix. Is this—like have you reached a point now where you would scale back a little bit on your competitive pricing? It seems like it's a price-driven unit growth, where you're a lot more attractive than the market. And so would you normalize that pricing dynamic with the market and maybe target a little bit below that mid-90s? How are you thinking about that, going forward in '22?

Paul MacDonald

Yeah. I think, naturally, there'll be a bit of a normalization moving forward because 75 percent of our growth last year was unit growth. And we had—although we had 25 percent in rate—the remaining

25 percent in rate, it was a lower rate environment than typical, in part because we did not want to punish customers during the middle of a pandemic with property increases.

I think you've seen a hardening of the property rates across the marketplace, and we've increased our rates, including adding an automatic annual inflationary factor. So, as that increased rate flows through the portfolio, we would expect to see a slight tempering on the unit growth, but, of course, made up for on the AWP and premium side.

Rowan Saunders

And the only thing I could maybe add a little bit of—to that is there is good growth. It is part of our strategy. We've also been very successful this year at firstly, expanding our broker footprint. So we've appointed dozens of additional brokers that we'd—never used to represent economical. So that's also driving new business.

And we won a few portfolios that are fairly sizeable, and so that accelerates and maybe adds a bit of lumpiness to the quarters. All really good news and helping us build that portfolio.

But at a macro level, I'd just remind, really, what we're trying to do here is grow the business, average of 10 percent or so growth rate, at the mid-90s combined ratio. And as we think about, as Phil said, deploying that excess capital that we have, we think that's a really great way to compound—get compound growth of earnings.

And so when you say, would we look to optimize, we're always looking to say are we getting the appropriate margin? Are there opportunities to optimize? That totally makes sense. But the macro picture is really to outperform our growth and deliver that mid-90s combined ratio. That's the macro plan for the next three years.

Jaeme Gloyn

Okay. Good. Fair enough. Second theme is just in the commercial lines. Is there—are you able to break out performance for us of the Uber relationship versus, let's say, the core commercial lines portfolio? And are you seeing inflationary impacts affect one more versus the other?

Rowan Saunders

Okay. Fabi?

Fabian Richenberger — Executive Vice-President, Commercial Insurance, Definity Financial Corporation

Yeah. Thank you for your questions. So we don't disclose specific combined ratios at the segment level. But what I can share with you is that we think of our business in three main segments. One is commercial property; one is commercial auto; and then Uber. And all three main segments are performing in line with our expectations, and generating combined ratios in the low 90s combined ratio range.

So we're quite pleased with the profitability that we have in our portfolio, and with us expecting that the marketplace will remain firmer into next year as well, we are quite confident that we'll be able to sustain our combined ratios in the low 90s this year as well.

Jaeme Gloyn

Okay. Excellent. Thank you.

Operator

Thank you. Your next question will be from Mario Mendonca at TD Securities. Please go ahead.

Mario Mendonca — TD Securities

Good morning. Not to put too fine a point on it, but regarding the premium relief and how it rolls off, I think you said it rolls off in Q2 '22. Would it be more appropriate to actually see the benefits of that in Q3, as opposed to Q2? Or do you think it'll be evident to us when you report Q2?

Paul MacDonald

I can address that. So the—just to clarify, on the Sonnet side, we're having a plus 5. On the broker side of the business is the minus 5s that we were speaking about. And the minus 5s comes through from new business earlier in the quarter and renewing business later in the quarter. But given the earned pattern, we should start to see the impact of that more in Q3.

Philip Mather

Yeah. And maybe just—

Mario Mendonca

Okay. Then.

Philip Mather

—to add to that. So from a top-line perspective, as the minus 5 grows, you'll see the GWP kind of more instantly attach. But we'll actually have a crossover period where we're still unwinding the earned impact of current customer release on a go-forward basis, and then the new rates will start to accumulate after that. So there will be a bit of a crossover.

Mario Mendonca

Okay. That's helpful. The second question is a bit of a broader question. It's very clear, I think you've articulated it plenty of times that you should all understand by now, that the strategy for this company is to grow the top line, maintain around a mid-90s combined ratio, and use your excess capital to get there. That all makes sense.

But the growth doesn't happen in a vacuum. So what I'm trying to get at here is what do you contemplate, from an industry perspective, in terms of property, auto, and commercial, what sort of

growth rates do you think, for the industry, that would be consistent with the outlook you have in each of those businesses, for your business specifically?

Rowan Saunders

Maybe you have a comment on that, so go ahead first, Paul.

Paul MacDonald

Well, I can start. And I'd like to break my answer into two components. On the property side, I think we've all experienced the rapidly increasing property values across Canada. And there's a real demand for increasing property ownership and values. So I think our growth will not only be commensurate with that rise of value, but we're going to leverage our Sonnet and buying capabilities to disproportionately win our share of the business. And we've shown that successfully to date.

On the auto side, it's interesting. We believe that there's a pent-up demand, and we saw that at the end of the lockdown that occurred in Q2 of 2020. There was a rapid escalation of interest in purchasing vehicles after that point. It's diminished a little again since this lockdown, and we believe that pent-up demand is occurring, which is, in fact, what's leading to the increased vehicle rates and used vehicle prices. And so we're well positioned to take advantage of that demand, once it unwinds, and once manufacturing and supply chain allows additional vehicles to come on the market.

Taken together with the hybrid approach to work, we also believe that there'll be increased use of vehicles throughout Canada as a result of a potential reluctance of people to use public transit. So all of these things, and our unit growth in particular, give us confidence that we can continue to take more than our fair share of that growth.

Fabi?

Fabian Richenberger

Yeah. Thank you. So on the commercial side, it was a function of the rate environment that we expect for this year. And I would say that we expect that the market growth will be in the high single-digit range. What that means for our own operations, and as we disclosed earlier on, we want to double down on small business and on specialty lines of businesses.

And what we have done is that we have expanded our value proposition in a quite material manner in those two segments. And we are quite confident that we'll be able to drive twice the moderate growth in those two segments.

And maybe giving you a little bit more background on small business, as to why we have the confidence that we can grow small business at twice the market range, is that just last year, we have introduced a market-leading digital capability that has been very well received by our broker partners. They are now able to quote up to 50 percent of their small business in an automated manner, and that has come through with us being able to double our new business production. And we do expect that this capability will allow us to gain further market share as well.

And then in specialties, as we disclosed as well, we have added new and experienced talent, and we have developed a number of expanded COVID solutions in the space of specialty property, D&O, and E&O shortly as well. The sharing economy would be an example as well. And we will actually have less than 1 percent market share a couple of years ago in specialty lines. And we do feel very comfortable that with the value proposition that we have in place now, and the team that we have in place now and the strong support that we get from our broker partners, that we can grow that line to a market share of 5 percent over the next few years or so.

Mario Mendonca

I see. Now so, Phil, with that background, what would you say, then, would be the spread between your businesses' direct written premium growth and the industry? Would you say like a good 500-basis-point spread in growth? Is that reasonable?

Philip Mather

I think if you look back over the longer term, the industry's grown kind of mid-single-digit range. It's been higher than that in that, more recently, it has—particularly given the high levels of rate action within commercial and that personal property lines in particular. And so we see that continuing. If you think about outlook, we do see a continuation of those firm market conditions.

I do think, though, our performance, so our expectation from our own outlook is that double-digit, 10 percent rate over the next couple of years. Maybe the industry's a little elevated on the historic average. But I think that's a good baseline for ourselves.

Mario Mendonca

Yep. Thank you.

Operator

Thank you. Next question will be from Lemar Persaud at Cormark Securities. Please go ahead.

Lemar Persaud — Cormark Securities

Thanks. My first—my first question here is just a quick point of clarification. I think I heard you suggest that a Continuance under CBCA isn't going to happen for, I guess, at least another two years. I guess I thought that in light of the purpose of the Minister's major shareholder restrictions, to enable a company to grow out, like why wouldn't they allow that to happen sooner rather than later?

Philip Mather

Yeah. Maybe I'll take that. So under the current regulations, there is a two-year period of time, post-demutualization, and so that's the base case. So I think the comment we've made is that's what the regulations say. It's up to the government if any change to that occurs. We're continuing to advocate that, ideally, that is a shorter period of time. But it will be up to government to make that change.

And our rationale is that one of kind of equal, level playing field. So we have significant financial capacity today on our own balance sheet and as a new public company. But with the ICA restriction, you'll see that there's a lot more flexibility available to us as a CBCA. So that's our argument and our advocacy, but it is a two-year period under the regs as it stands today.

Lemar Persaud

Okay. Thanks. So then, if I could just switch over to inflation. I want to look at inflation at kind of a 10,000-foot mirror, in your view here. It sounds like you guys think that you can adjust your rates pretty quickly if inflation remains high. So, first of all, is that a fair comment?

And then secondly, what's your view on inflation overall? Do you think it's more transitory in nature, so you don't need to necessarily price it in fully? Or is this going to be more permanent in nature; it is a cost that needs to be passed on to the end consumer? So just maybe some thoughts there on inflation would be helpful.

Rowan Saunders

I think a couple points to kind of offer there is we are seeing some changes, and the macro environment, I think, looks a bit different in the last month or so than it did even several months before that. Listening to the Bank of Canada, watching the news, there is activity happening, and so I think, as

Paul said earlier, what we've taken is a prudent and early approach to lean into that and I think that's appropriate.

It's difficult to speculate what will be transitory and what will be long term, particularly if things like wages really take off. I mean, that obviously will have a longer-term impact than some of the supply chain issues we've seen.

When you think about what our claims teams are dealing with, not only is there inflated used car parts, but it's the cycle time is taking longer. It might normally take five days for somebody to have a rental car whilst you repair their car; that's taking longer. So that is driving up costs in the short term, but we expect that will be solved over time as we come out of the pandemic and then that will revert to the norm. So it's difficult to say exactly what pieces are again, to be permanent or not.

With respect to the question about pricing, I think the answer is yes. We can take pricing actions. The vast majority, well the majority of our portfolio, subject to competitive pressures, we're able to step in and take prices and, in fact, we've shown we've done that. When we talked about the property inflation in the second quarter, immediately, the teams moved their indexation amounts up, they put price changes through the portfolios, and a number of other actions. So we've demonstrated we can do that, and we have been able to do that.

The automobile is the regulated line of business, and that's the one we will over time take further rate changes that need regulatory approval, but we have seen a constructive rigor for the environment. We have seen regulators observant of these unwinding of the COVID release as claims costs start to normalize, as driving begins its normalization. So I think we've got a good degree of comfort and confidence in that.

And the other thing I would just say is this isn't all about just taking price increases. There's a number of other actions that you could take to improve your loss-cost trajectory. So when you talk about pricing, rate changes are firstly for maybe moving the prices up, the rates up, but they're also about segmentation changes, and, in fact, there's several segmentation changes that the regulators have currently approved, and I think that that'll happen.

And then, as we'd mentioned earlier, there's a lot of things we can do in managing the supply chain. We have been quite successful in getting significant amounts of our customers into preferred suppliers. In those preferred suppliers, we have a portion that is fixed-price contracts. So all of those things help us going forward.

And then there's still other items that we could do to further improve the portfolio and, you know, Paul talked a little about Vyne and segmentation. We are growing in unit count there and we're growing in what we believe is high-quality customer segments. And so, there's a number of actions we could take to address that.

And that's why I think if you go back to saying, have we seen some inflationary trends? Yes, we have. Have we been early and prudent? I think Phil's taken you through that. We absolutely think we can. Does that change what our outlook is going to be in terms of our profitability? No, it doesn't. We feel very, very manageable.

In the event inflation is much worse or much longer than we've anticipated, we're confident that the regulatory environment will then adapt to that. Whether it's product change or whether it's future price increases.

And the final point I'd make about inflation, particularly when it comes to automobile, this is actually nothing new for us. I mean, our industry, for decades and decades, has dealt with this. There is

always inflation in your automobile portfolios. Every new model car year typically has more sensors and is more expensive than older vehicles, but accidents and bodily injury claims never get less expensive to fix, and so this is nothing new for us as an industry, and certainly as Definity. We're just kind of leaning into it to make sure we're in a good position.

Lemar Persaud

Thanks. That's very comprehensive.

Operator

Thank you. Last question will be from Tom MacKinnon of BMO Capital. Please go ahead.

Tom MacKinnon

Yeah. Thanks. A question just following up with the discussion we had earlier on excess capital. A billion dollars sitting at now, and I appreciate the dividend, but that's probably only like about 10 percent of that. And I think Phil's comments with respect to buybacks was—correct me if I'm wrong, but I think you said, as a capital management tool, it's further down the road.

So what do you want to do with this? I don't think investors want you just sitting on this excess capital. The dividend, you probably generate excess capital to the tune of the dividend that you're paying annually. Is it really just dry powder for potential M&A? And why not use a buyback as just a tool for flexibility? Thanks.

Rowan Saunders

Thanks for that, Tom. Again, this was a topic that certainly came up a lot on the road show coming to the IPO a couple of months ago, and as we said then, we do see that there's a great opportunity for a company like Definity to continue to grow and significantly. And so we do see strong organic opportunities, and we will need some of that excess capital to support the opportunities.

We do see as we haven't commercialized a larger addressable market that we typically have played in. So that will also support that. And we do think that the industry is going to continue to consolidate.

We have a stated strategy of being a top-five player and our strategy calls for leading in organic growth but also spending in M&A and what we've done is we've bought this platform that we think we can be a better owner of a portfolio and so that's why we're looking for opportunities to add scale to our personal insurance business where we think there'd be tremendous synergies as we put the portfolio onto our Vyne platform.

Fabi and his team have done a really good job; 25 percent growth last year involving our commercial business. We still have a low market share. We are getting tremendous support from our broker partners. We're becoming one of the go-to commercial players. So we think there's lots of opportunity there. But again, we would also prioritize looking for opportunities to add M&A at size and scale out and build expertise in our commercial business and potentially distribution opportunities that also give us access to high-quality portfolios.

And so that's the kind of the two paths that we're activating and kind of working on and I think more to come over the quarters ahead.

Tom MacKinnon

And just with respect to a buyback, I mean, it doesn't take much, and it does provide some flexibility, and it does give investors some of that capital back instead of you just sitting waiting for the opportunity to come along. How would you answer that question?

Rowan Saunders

I think as Phil said earlier, it's certainly one of the considerations that we have. We don't have anything to announce on that today, but we do see significant opportunities ahead. We'd like to have a little bit of time to kind of run those down and pursue them, but we're also cognizant of the interest in increasing our operating ROE. So we will be disciplined on how we deploy that capital, but we won't be lazy in terms of sitting on it for too long.

Tom MacKinnon

Okay. Thanks for that.

Operator

Thank you. Ladies and gentlemen, this concludes our question period for today, and I would like to turn the call back over to Mr. Westfall.

Dennis Westfall

Thank you, everyone, for participating today. The webcast will be archived on our website for one year. A telephone replay will be available at 2:00 p.m. today until February 18, and a transcript will be made available on our website.

Please note that our first-quarter results for 2022 will be released on May 12.

That concludes our conference call for today. Thanks, and have a great one.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines. Have a good weekend.