Definity Financial Corporation

Second Quarter 2022 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and thank you for standing by. I would like to welcome everyone to the Definity Financial Corporation Second Quarter 2022 Financial Results Conference Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press *, 0 for the Operator. This call is being recorded today, Wednesday, August the 3rd, 2022. And I would now like to turn the conference over to Mr. Dennis Westfall, Head of Investor Relations. Please go ahead, sir.

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thanks, Michelle, and good morning, everyone. Thank you for joining us on the 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. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call.

Joining me on the call today are Rowan Saunders, President and CEO; Philip Mather, EVP and CFO; Paul MacDonald, EVP of Personal Insurance; and Fabi Richenberger, EVP of Commercial Insurance. We'll start with formal remarks from Rowan and Phil, followed by the Q&A session. Paul and Fabi will also be available to answer your questions during the Q&A.

With that, I will ask Rowan to begin his remarks.

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

Thanks, Dennis, and good morning. We reported results for the second quarter of 2022 last night that continued our strong start to the year.

Operating net income of $48.8 million, or $0.42 a share, benefitted from solid underwriting results and a 31 percent increase in net investment income.

Our 95.8 percent combined ratio was driven by solid personal auto profitability and strength in our commercial business and includes the impact absorbed from the sixth-largest catastrophe event in Canadian insurance history. These types of weather events are reminders of the importance of delivering on our purpose to support our clients and communities.

I'm proud of the way our claims team responded with on-the-ground support to help our customers and broker partners rebuild their communities and recover rapidly. This resilient underwriting performance gives us the confidence to maintain our growth ambitions.

Prior investments in our digital channels, Sonnet and Vyne; our expansion efforts in personal property and commercial insurance; and overall firm market conditions combined to deliver a 12.6 percent increase in premiums for the quarter. We continue to expect top line to increase at approximately 10 percent per year on average.

Operating results also benefitted from a larger than expected increase in net investment income, reflective of our larger portfolio size, but also from a significant increase in fixed income yields. Our operating ROE remained robust at 10.7 percent over the past 12 months.

From a capital perspective, our solid operating results were offset by investment losses from fixed income yields moving higher and equity market declines in the quarter, leading to a quarter-over-quarter drop in book value per share. Despite this, we maintained over $900 million in financial capacity comprised of excess capital and untapped leverage capacity, which puts us in a strong position to fund our strategic growth initiatives for the coming years.

Turning to Slide 6. I'm proud of the Company we've built together, and I'm confident that we're well positioned for continued success. These 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.

Midway through the year, we remain on track to deliver on our financial targets as an innovative, digitally focused industry leader.

Our personal lines broker offering combines modern technology with a focus on superior service. In fact, the ease of use for brokers has provided a differentiated growth engine for our business, with premiums increasing well above the industry level.

Our advanced analytics and sophisticated underwriting capabilities have improved our underwriting results and give us the confidence to continue driving significant growth in segments we have targeted for expansion.

Growth in our digital-direct business, Sonnet, continues with premiums up 17 percent year to date. While the pace slowed somewhat in Q2 as a result of lower consumer shopping in auto, property growth remained robust at nearly 20 percent in the quarter.

Our Definity strategy continues to perform well and constitutes a higher proportion of our new business. The Sonnet business is now over $315 million in premiums and benefitting from scale efficiencies. As I've previously indicated, I'm confident the business remains on track to become a contributor to overall company profitability.

We've established an industry-leading commercial insurance franchise in recent years with growing focus on small business and an expanded specialty lines offering, which now positions us as a one-stop shop for key brokers. Our latest results illustrate the success of these efforts on profitability and the continued positive impact of our increased appetite and capacity for growth. The innovative digital

SME pathway capability launched last year, together with our expanded business development activities, support growth of the small business segment, which is an important part of our overall commercial strategy.

Turning to the industry outlook on Slide 7. We expect market conditions to remain conducive to solid industry results. We expect firm market conditions in property lines will persist over the next 12 months. And we're seeing evidence in the form of rising industry rates that conditions in auto lines should firm as claims frequency normalizes and inflationary cost pressures persist.

We expect the combination of normalizing auto claims frequency and higher severity related to inflation to bring the industry's return on equity closer to its long-run average.

For Definity, we expect our operational outlook to support an upper-single digit to below teen operating ROE. We continue to expect these results to be driven by an average of 10 percent top-line growth and mid-90s underwriting profitability.

Our capital structure currently, with elevated levels of excess capital and no debt, reflects our operating history as a mutual company. We continue to put the tools in place to enable future balance sheet optimization, which should result in a capital structure more in line with our publicly listed peers over time, enabling us to target an operating ROE in the low teens.

In that regard, we were pleased by the recent proposal by the federal government to amend the mutualization regulations, which should enable an earlier transition to a CBCA company structure than might otherwise have been the case.

And with that, I'll 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 8.7 percent in second quarter, driven by strong retention in our broker business, higher average written premiums, and continued growth in Sonnet.

Our focus remains on driving profitable growth by leveraging our digital assets and strong broker relationships. Our combined ratio of 92.7 percent in the second quarter was 4.3 points higher than the unusually strong results from a year ago.

As expected, we experienced an increase in the core accident year claims ratio driven by higher claims frequency, although still below pre-pandemic levels, combined with inflationary cost pressures. Severity was largely unchanged from the first quarter, but up from the prior year driven by total losses, vehicle repairs, car rental costs, and car theft.

We experienced favourable prior-year claims development of 4.1 percent, down slightly from the 4.7 points in Q2 of last year, reflective of our prudent approach in establishing our claims reserves.

We expect the combined ratio to trend into the mid to upper-90s range as inflationary pressures persist and claims frequencies continue to normalize.

Turning to personal property on Slide 11. We reported strong top-line growth of 13.4 percent for the quarter, benefitting from continued firm market conditions and higher retention levels, partly offset by our ongoing efforts to improve underwriting results.

We expect growth in property to continue given the organic growth potential of our digital platforms and a continuation of the firm pricing conditions prevalent in the industry in recent years.

Focusing on the bottom line, losses from the May 21 storm in Ontario and Quebec came in within our preannounced estimates and drove the impact of catastrophes 12.5 points in the quarter, 6 points higher than the cat impact in Q2 of last year. As a reminder, we expect roughly 70 percent of annual cat

losses to occur between Q2 and Q3, though this year the second quarter impact was slightly higher than expected.

Comparisons for both core accident year claims and prior-year claims development reflect the proactive inflation provision we took last year. Adjusting for this 2021 provision, the core accident year claims ratio improved by a few points, largely driven by rate and underwriting actions.

We continue to target a mid-90s combined ratio for the personal property line of business on an annual basis.

Moving on to Slide 12. You will see that our momentum in our commercial business continued, with premium growth of 17.9 percent in the second quarter. This growth rate benefitted from our expanded underwriting capabilities, higher retention, and strong rate achievements in the context of firm market conditions.

While we expect growth to ultimately slow from the pace of recent quarters, we believe that we can sustain growth in the low to mid teens for the next several quarters as we continue to scale.

The commercial lines combined ratio for the quarter was a solid 92.5 percent, 3.6 points higher than last year, but inclusive of close to 7 points of catastrophe losses.

While inflationary pressures continue and the offsetting COVID-frequency benefit normalizes, our past and current rate actions have enabled us to protect our margins. We continue to expect the commercial insurance business to deliver combined ratios in the low 90s.

Putting this all together on Slide 13, consolidated premiums reached nearly $1 billion in the quarter, representing a strong growth of 12.6 percent, while profitability at a consolidated level remained in our target range at 95.8 percent despite elevated catastrophe losses.

A combination of solid underwriting and increased net investment income enabled us to generate operating net income of $48.8 million, or $0.42 per share, with operating ROE of 10.7 percent over the past 12 months.

Slide 14 shows our investment portfolio in greater detail. Our net investment income increased significantly in the quarter, up $7.6 million from Q2 of 2021, driven by higher interest income from the combination of higher book yields and overall growth in the fixed income portfolio.

In the absence of significant changes in fixed income yields, we expect net investment income should continue growing at around its current pace into 2023. For 2022, we now expect full year net investment income will exceed $120 million.

Rising fixed income yields also led to investment losses in the quarter, as did volatile equity markets. We reported $19 million of equity impairments, predominantly in the information technology sector. I'll remind you that these are mark-to-market adjustments where we still own the shares and are not concerned with the fundamentals of any of the specific companies.

As you can see on Slide 15, our financial position remains strong despite one of the most volatile six months for capital markets on record. We remain well capitalized with over $900 million in 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.

Capital market's volatility negatively impacted our book value per share, which at $19.51 was down 4.4 percent quarter over quarter, although still 3.4 percent higher than a year ago. It's clear that the conservative positioning of our portfolio helped mitigate the market impact.

Slide 16 shows that we continue to take steps to move Definity toward an optimized and flexible capital position.

First, we upsized and extended our existing $150 million unsecured bank facility and introduced pricing adjustments that are linked to meeting certain sustainability targets. This facility automatically increases to $600 million when the Company is continued under the CBCA.

Second, we completed an internal transfer of certain non-insurance assets under the holding company, thereby increasing future flexibility.

And lastly, we filed a base shelf prospectus, which us allows us to support future capital raisings of up to $2 billion.

A few additional thoughts on the draft regulations to allow for earlier conversion to a CBCA. The comment period for the government’s proposal to amend the demutualization regulations ended on July 18th. The amendments would come into effect on the date when final amending regulations are registered as legislation and published in the Canada Gazette. We intend to reply to continue Definity under the CBCA shortly after that happens.

We believe we are well positioned from an implementation perspective, but we’ll know more once the federal government resumes after the summer break.

When it comes to deploying our capital, the primary focus is in support of our robust, organic growth strategy by making investments in our core business which supports our financial targets and market position. We’ve also been clear that we believe we can build the company into a top-five player in the industry. This would require inorganic growth, which could include both insurance carriers and distributors.

We also intend to have a sustainable and growing dividend per share that is proactively monitored. On this, we are pleased to announce that our Board of Directors declared a dividend of $0.125 per share payable at the end of September.

As for our NCIB, we've not been active to date, and I'll remind you that we currently see buybacks at the bottom of our priority list for capital and deployment actions.

Overall, I believe our strong operational performance and robust capital level positions us well to deliver value to shareholders by growing profitably and deploying our capital in a disciplined manner over time.

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

Rowan Saunders

Thanks, Phil. In summary, I believe the Company's done a great job of navigating the volatile environment over the past few years, successfully emerging as a strong Canadian public company.

Our prudent approach during these uncertain times has served us well. We were early to spot and proactively address pressures from inflation, initially in property a year ago and subsequently in auto at year-end; our earnings remain robust; and we're well positioned to execute on our strategy in the current environment.

To reach our goals, we intend to continue diversifying and strengthening our company through our positions and partnerships to become one of the five-largest P&C insurers in Canada, maintain our digital leadership position, consistently deliver disciplined financial management, and position Definity as a purpose-driven sustainability leader.

Paul mentioned our new credit facility, which has been converted to a sustainability-linked loan structure. We continually look for opportunities to align our financial objectives with Definity's purpose of building a better world by helping our clients and communities adapt and thrive. This credit facility demonstrates that commitment and will strengthen accountability across the organization for these climates and diversity goals.

I believe this is great momentum in our first year as a public company as it follows the release of our inaugural ESG report in May and further demonstrates our ongoing commitment to these important strategic objects.

And with that, I'll ask Dennis to start the Q&A session.

Dennis Westfall

Thanks, Rowan. Michelle, we are now ready to take questions.

Q&A

Operator

Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. If you would like to ask a question, please press the *, followed by the number 1 on your telephone keypad. If you would like to withdraw your question, please press the *, followed by the number 2. Please standby for your first question.

Your first question comes from Geoff Kwan, RBC Capital Markets. Please go ahead.

Geoff Kwan — RBC Capital Markets

Hi. Good morning. Just wanted to follow up your comments on the Government of Canada and the change on demutualization and the CBCA. I know you talked about it's the summer break and what not, but just wondering if you have any sense on timing of when the formalization of these potential new rules might come out? And then also too, you mentioned you'll reply shortly after. Any sense on how long that process is until presumably you'd get approved?

Rowan Saunders

Phil?

Philip Mather

Yeah. Thanks, Geoff, I'll take that. So no, I'm not going to speculate on the timing. Although, obviously, the proposal of the draft regulations was an important step forward. And from the comments we made, that public consultation period is now over. And we're not aware of any new information, or new comments that came through that process. So that is a useful step forward, I think, from our perspective.

And in terms of our application, as you'll know, we've been preparing the Company in a number of ways to move towards a CBCA as soon as we possibly can. And so we're very well equipped to make that application as soon as those regulations are enacted.

So what I'd say, Geoff, is good progress has been made. We're very supportive of the content of those draft regulations; are well aligned with the advocacy that we've put out there. But I won't speculate on the government's timing itself as it works through that process.

Geoff Kwan

Okay. On the net investment income, just given where rates are today, like how much higher would your annualized net investment income be today if you were to take full advantage of where market yields are in the market right now?

Philip Mather

Yeah. I mean, certainly, we've seen a significant increase in the quarter. It was about 30 percent year on year. And that kind of came from a couple of places. It's not just the rise in yields that we've seen, which have been pretty dramatic, but also the significant cash that we deployed into the portfolio throughout the prior year.

We had about $0.5 billion in the second half of last year that was deployed into the portfolio. So it's coming from both of those places. And certainly that large a size should be quite sustainable.

When we look at the full year now, we're projecting about $120 million-plus for 2022. And that's premised on a continuation of this yield environment. And we'd see that—we're up about 30 percent. We see that carrying on into the first part of next year until we start lapping the size of the portfolio increase.

So $120 million-plus, I think, for this year. And we do expect that rate of increase will continue on into the first part of next year.

Geoff Kwan

Okay. And if I could sneak in one just last question is on M&A, if anything's changed in the landscape in terms of things that you're looking at since we talked last quarter?

Rowan Saunders

Hi, Geoff. It's Rowan here. I wouldn't say anything's particularly changed. I think just to remind everybody our objectives of becoming a top-five company in Canada do call for us to participate in inorganic growth as well. And so we continue to build out our platform, and I think there's some really good news stories there so that we can participate, we can be a better owner of the business.

And I think the environment has certainly changed to see impact of inflation in the environment. But I think organizations are still looking ahead and saying, look, there's a big investment required in technology to have a modern technology stack to stay relevant to our customers and our brokers. I think we increasingly feel scale, particularly in personal lines, products are very important; access to data. And that may unlock some further opportunity.

So I would say it's still a significant objective of ours. And we're active, but nothing to obviously report at this stage.

Geoff Kwan

Okay. Thank you.

Operator

Your next question comes from Tom MacKinnon of BMO Capital Markets. Please go ahead.

Tom MacKinnon — BMO Capital Markets

Yeah. Thanks very much. Good morning. The first question with respect to personal auto. We've got 4 points of favourable reserve development. It seems a little bit elevated. What perhaps has been driving that? And how sustainable is that?

And with respect to your mid to upper-90s range for personal auto, what could make you come in higher or lower than that going forward? Thanks.

Rowan Saunders

Hi, there, Tom. It's Rowan. Just giving you a couple kind of context there. So for sure, I mean, I think that we've seen this inflationary environment continue. And I would say that whilst there is inflation in the system, it is impacting loss cost trends in the automobile portfolio. But I'd also say that what we're starting to see is that trend levering off quarter by quarter.

I'd remind you that we have been very prudent in terms of responding and reacting, as well as reserving through this different environment. And last year in the fourth quarter, we strengthened our provisions for automobile. And I think that that is proving to be a good decision. I think we feel the risk in the back book is not there. We are seeing some favourable development. So you asked about the 4 points of favourable development. It's down a little bit from what we had last year, but I think it's indicative of the fact we are being prudent in our reserving in these uncertain and inflationary times.

So whilst that's a little elevated from what we normally see, it's not unexpected for us. And I think we would say that we're rolling forward into 2022 equally being conservative and prudent in our reserving for the current year exodus. So I think expecting some favourable development, prior-year development in the automobile line is a feature of the results, and I don't think it would go away.

Your second question, which is about our guidance. And I think, again, we've been very clear here that we are expecting, over time, the strong profitability that we've had in automobile lines to normalize because we are seeing driving normalizing, frequencies coming up, and there is sort of this inflationary environment despite the number of actions that are being taken for that.

I guess you asked about what would surprise to the upside, and that would really be if inflation continues at this trajectory much longer and a more elevated level and we were inadequate, or unable to adjust our pricing increases. So that's not something we're anticipating. It's not something we're seeing. We actually are able to pass on costs. We've started to unwind our COVID relief and got other price increases across the country. So we think that would be there.

And on the flip side of that, what would surprise to the positive, that really is about assumptions around frequency. And so what we have seen is that driving has started to normalize.

The patterns are different, particularly the return to work is still below where would expect it and certainly below the pre-pandemic levels. We have seen it starting to trend upwards, but if it didn't get back to normal levels, or further reduced, that would be something that would be positive to our expectations.

Tom MacKinnon

Okay. And if I could just squeeze one more in here. With respect to Sonnet, I think your word was on track to overall profitability. I think the line before was that you saw it breaking even from an underwriting perspective by the end of 2023. Is that still the case? Thanks.

Rowan Saunders

Yeah. Tom, that's still the case. There's no change in our guidance on Sonnet. In fact, we're more than pleased with how the business is continuing. We did mention in the comments that there's been very strong year-to-date growth.

It did slow a bit in the second quarter, largely because of the environment and some of the temporary factors that we're seeing there: less new vehicle sales creating less customer shopping; the fact that the industry hasn't really fully unwound its COVID reliefs that started to move rates higher, so it's generally very low-to-flat rate increases in the industry; there's less shopping. We see that. The evidence we look there is Google traffic search trends are down, as well as higher broker retention. So we think this is kind of some more temporary market factors that are influencing that.

But I'd also say that what we are seeing is some tremendous success on shifting that portfolio and a couple things we're doing. We're focusing heavily on personal property. Personal property has a lower average premium, so policy counts still very strong as we grow there.

But also in the affinity business. And that line of business has really been quite pleasing to us. The quality of business is better. Policy count is significant. It comes with a bit of a lower average premium, but also we expect to have better margins from that.

So when you kind of put all that together, we're still very comfortable with our trajectory to get to profitability by the end of 2023.

Tom MacKinnon

Thanks.

Rowan Saunders

You're welcome.

Operator

Your next question comes from Doug Young of Desjardins Capital Markets. Please go ahead.

Doug Young — Desjardins Capital Markets

Hi. Good morning. Just on personal auto if I look at the current accident year, the division's combined ratio was—or on the current accident year, the division combined ratio was about 96 percent. I guess what you're saying is you still do expect to see some further deterioration on this. Just want to confirm that's the case.

And then can you dig into in terms of what you're seeing from an earned premium in place? And how that in terms of price increases that's already in place that's being earned through? And what are you expecting over the coming year in terms of rate increases in addition to that? And if you can compare it to loss cost trends, that would helpful as well.

Rowan Saunders

Yeah. Let me just kind of start that and pass it to Paul. I think your comment is, yes, we are expecting, as we've guided to, some deterioration in that loss ratio. And if you looked at the personal auto core accident claims ratio, you see about 4 points of deterioration year on year from very a profitable prior-year comparison period. And so we do think that as the quarters roll forward, some of that deterioration is likely to continue. And that's where we've kind of guided to.

So nothing different than we've signalled before. It's still within the guidance range.

With respect to what's in the system from a pricing or what we expect and earning through, Paul, do you want to add some comments on that?

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

Yeah. I'll just add a little flavour to the conversation. So when we talk about the 4 point deterioration year over year, approximately one-third of that is the frequency increase that Rowan mentioned earlier around return to driving. We expect that to stabilize around this level and be somewhat persistent for the next couple of quarters.

In terms of the remainder, two-thirds of it was around severity. And we've previously mentioned this in the last quarter. So I'll give a couple of additional data points to show trending. Whereas we previously were talking about a 20 percent physical damage frequency or severity increase year over year, now we're seeing that drop a tiny bit. So we do believe that we are seeing potentially a peak in the severity pricing of the product in Q1.

The two data points I had pulled out last time specifically where theft, which was in the mid-20s range. That's dropped significantly down to about 13 percent, reflecting, I think, police intervention and insurer action around this. That's a positive improvement because, of course, those are equivalent to total losses.

And the other element that I quoted was total loss. We're seeing a couple point reduction on that as well, again, giving us a bit of a sense that potentially we may have peaked at these levels.

The two areas that are starting to see a tiny bit of an increase quarter over quarter are in the non-drivable and drivable sections. And essentially, what we're seeing is a slight elevation in parts, parts supply, and in labour rates. Net-net, it's still coming down quarter over quarter. And so we expect that to run into the next quarter.

What we are seeing from a pricing perspective to offset that is approximately about a 2 percent, 2 to 3 points of price flowing through the book. I will remind everyone that we are still under the COVID-relief regime. We did unwind that beginning in April and so that has to earn through the remainder of the portfolio. And in June, we unwound the 5 percent specific to Ontario.

And so when you combine those, we've got about 2 percent of rate flowing through the portfolio now. We expect that to move up to about 6 percent countrywide by the end of the year. That's a very positive movement.

So in addition to that, frequency is a bit stable. We're starting to see the severity flatten. We expect rate to come up. And we have a number of underwriting and segmentation and actions underlying the portfolio to improve performance.

Doug Young

Perfect. Thank you. And then just second, on the financial flexibility down $100 million quarter over quarter, I think that's mostly as a result of higher rates on the AOCI, but you can correct me if I'm wrong, Phil. But how quickly—if that's the case, how quickly does that come back into capital as instruments mature like the duration there? And then what is the minimum cash balance that you do want to maintain at the holdco just to get a sense of flavour of what's deployable?

Philip Mather

Yeah. Thanks, Doug. So yeah, you're absolutely right. The impact on capital is essentially being driving by those mark-to-market losses on the portfolio. So that's really what's reduced that level. They are mark-to-market losses, so you'll see that there was an impairment charge in the quarter. But we still own those assets. That's really reflecting the market valuation. And all of that current valuation at the end of June was reflected fully in the book value.

In terms of where we go from here, well, the first half of the year has been pretty active, both in terms of capital equity markets and also fixed income. So we'll follow those trends dollar for dollar. To the extent that portfolio valuation comes back, that goes immediately into kind of capital recapture.

So it's pretty hard to speculate on where that's going, given how dramatic the actions have been in the six months. And it was a very unusual period where all asset classes effectively trended down.

In terms of the cash levels, I mean, we traditionally run somewhere in the kind of 3 percent to 5 percent range for the total company portfolio. That's kind of what we'd see as a normal operating range.

Doug Young

Okay. Great. Thank you

Operator

Your next question comes from Paul Holden of CIBC. Please go ahead.

Paul Holden — CIBC

Thanks. Good morning. Most of my questions have already been answered. I have a couple additional ones. I guess, first off, just in terms of thinking about the positive insurance rate cycle, what is the risk, if there is a risk, that it's disrupted by higher investment yields? We typically see a negative correlation between investment yields and premium rates. Are you seeing any evidence of that today? Or do you expect any of that in the future?

Rowan Saunders

Well, I think my view on that one would be that's a ways off, and we would need even more elevated investment returns to get that. I think that's somewhat supported by the discipline and the consistency we're seeing in the marketplace today.

And whilst Phil has kind of guided to higher net investment income, so relatively year over year that's a nice significant change, the absolute returns are still relatively modest and nowhere near, I think, what would cause us to reprice the product in the market. And I think that both Paul and Fabi would say that they're seeing no signs of a change in peer group behaviours on that perspective.

I think we're in an environment today where there is inflation going through the system in all lines of business. It is more elevated. We're seeing more weather losses, and I think the discipline and the pricing seems to be pretty firm. And so that's why we're comfortable with kind of our pricing guidelines outlook for the next 12 months or so. So we don't really see pressure on the combined ratio driven by better investment returns.

Paul Holden

Got it. Okay. That's good. And then second question is maybe you can give us a sense of how economically sensitive your premiums might be. And I'm thinking primarily on the commercial lines business, are there any particular lines you write where you think there might be a more cyclicality to it based on GDP growth?

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

Thank you, Paul. This is Fabian Richenberger answering your questions. So overall, we're not overly concerned about that topic. We have about $1 billion in commercial premiums at this point in time. That is very well diversified across different segments and across different regions.

And then on top of that, we've built a very strong value position. And I would say that our overall value position in terms of cross-range and service standards is now among the market leaders. So even if there were a little more pressure on the industry overall, we are quite confident in our capabilities to drive above-industry average growth with the capability and the people that we have in place now.

So we continue to be comfortable with our guidance of low to mid-teens growth rate over the next several quarters.

Paul Holden

Okay. So you'd be comfortable with that type of growth rate even if we were to go through a recession in 2023?

Fabian Richenberger

Yes.

Paul Holden

Okay. And then just final question for me. I didn't hear—well, I heard combined ratio guidance on personal auto and commercial. I don't think I heard it on personal property, but maybe I just missed it. Can you just fill us in on the outlook for combined ratio on personal property?

Rowan Saunders

Well, that one, it's the mid 90s, which is where we're guiding on the personal property. Obviously, this is going to vary a little bit quarter by quarter. And as Paul mentioned, 70 percent of our cat losses happen in Q2 and Q3. So expect a bit of pressure in those quarters. But the actions are in flight and our kind of run rate expectation is around mid 90s for the personal property.

Paul Holden

Got it. Okay. Thank you very much.

Rowan Saunders

You're welcome.

Operator

Your next question comes from Jaeme Gloyn of National Bank Financial. Please go ahead.

Jaeme Gloyn — National Bank Financial

Yeah. Thanks. Good morning. I just want to start off by just clarifying the severity commentary. I believe I understood that you were seeing increases at a rate or growth rate of around 20 percent, and that seems to now have dropped into the mid-teens when we're thinking about theft and total loss-driven growth rates. And then it sounded as well like the parts supply and labour rates are still accelerating into the mid-teens now. Did I understand all that correctly?

Paul MacDonald

Almost. Let me just clarify. So just as a reminder as well, approximately 50 percent of our portfolio's on the auto physical damage side, so that's the impact that we're referring to. On that side we are seeing the drop, as you mentioned, for quarter over quarter from the overall physical damage category.

There's a little in and out in between those categories. What I mentioned was theft, which was one of our major contributors to loss-cost severity, has come down significantly relative to last quarter. But what you mentioned, the non-drivable and drivable, those have gone up only a couple of points. And so we believe this is sort of the early indication off a little bit of labour rate increase.

But we are also hopeful that we are seeing some input cost reductions. Some parts are getting a bit cheaper and also the availability of shipping and other elements are giving us some hope that this is stabilizing at this level.

Jaeme Gloyn

Okay. That's helpful. A couple more questions. Just looking at the cash flow statement, I noticed there's a small outflow for business acquisitions. Is there anything you can share as to what that cash flow is for? Is that work on a potential acquisition? Or maybe something else?

Philip Mather

I think that's predominantly the APOLLO transaction that closed in the quarter. But there's often some kind of other additional activity that goes around that area as we continue to get active, but I think that's probably the main component part.

Jaeme Gloyn

Great. And then this might be a little bit more nuanced. We can take this one offline, but I'm looking at claims paid as a percentage of claims liabilities, and I see that percentage ratio increasing from last year to this year. And if I compare that to your closest publicly traded peer, they're seeing more flattish-type ratios on that basis. Is there anything in terms of like your book where you'd be paying out more claims relative to your peers? Any detail you can share on that?

Philip Mather

Nothing obvious springs to mind, to be frank. I mean, we've been focused on responding proactively as we've enhanced our claims capabilities over the last couple of years. So making sure we've got good kind of customer service. I mean, the faster you're able to respond is beneficial to everyone. It's beneficial to the customer, but it's also beneficial to us in terms of overall claims management.

And then the only other thing that springs to mind is in relation to some of the elevated cat activity, we were very proactive and early to get boots on the ground with respect to the ever-large storm that we saw. And that was a big Ontario storm. So as you know, we've got a good concentration versus the overall industry in Ontario. And so those are the only things that spring to mind off the top of my head.

Jaeme Gloyn

Great. That's helpful. Thank you very much.

Rowan Saunders

You’re welcome.

Operator

Your next question comes from Lemar Persaud of Cormark Securities. Please go ahead.

Lemar Persaud — Cormark Securities

Yeah. Thanks. Most of my questions have been asked and answered. But just to start off here with a modelling kind of question, the effective tax rate was a bit lower than kind of I was expecting in Q2. Can you talk to us how should we think about that for the balance of the year and maybe into 2023?

Philip Mather

Yeah. Sure. So what I guide you to is the operating tax rate. We definitely had some noise in the quarter because we had the various investments kind of losses moving around. So what you actually saw when you look at the effective tax rate was a bit of an exaggerated impact of Canadian dividend income compared to what we’d normally see.

So where I guide you to is that operating tax rate. And so the kind of low 20s is a good range and a go-forward on a normalized basis.

Lemar Persaud

Great. That’s helpful. And then on to my more substantial question. I just want to circle back to some of the comments about the active rate environment in personal auto. Like where do you think Definity is relative to the market in terms of pursuing rate increases? Like what I’m trying to figure out is is there going to be a period of time where Definity might see a reduction in units as it kind of incorporates more rates versus peers? Or does it feel like you guys have been on the more proactive side in terms of rates in personal auto?

Paul MacDonald

I think part of the answer is related to the period over the last couple of quarters where a variety of different insurance companies have been employing a variety of different mechanisms for both giving and unwinding COVID relief. So it's a bit difficult to evaluate the rate environment purely on what's posted.

Underneath that, when we look and do some work relative to the market and also relative to quote bind ratios, we're actually seeing quote bind ratios—our bind ratios improve. So that's a good sign. And we are, as I said before, unwinding that 5 percent in Ontario. That's the big movement.

We aren't seeing as a result of that unwind in June and July material negative impacts to our quote and bind rates. So we feel that we're comfortably positioned relative to the market from an overall premium perspective.

But as I did mention earlier as well, we are starting to see both ourselves and the competitors starting to take proactive rate action. And we're seeing regulators begin to grant that countrywide, which is a positive reflection of the rate need.

Lemar Persaud

Great. Thanks. That's it for me.

Operator

Your next question comes from Brian Meredith of UBS. Please go ahead.

Brian Meredith — UBS

Yeah. Thanks. Rowan, just to pivot over to the commercial lines a little bit here. There's been a lot of chat down in the US this earnings season about kind of the rate environment in commercial lines moderating and then also loss-cost trends and what's happening and those are actually kind of picking up a little bit. What are you all seeing in your business?

Rowan Saunders

I mean, I'm going to ask Fabi to jump in a second, but I think that our macro view is we solely see the environment as a very positive trading environment. We are seeing in discipline. We are seeing the industry still moving prices forward. Our view would be, the macro statement would be we're achieving rates at or better than loss-cost trend. And we feel we've got a very attractive portfolio, one we've spent a number of years refining and reshaping. So we'd like to maintain and retain it. And all of that is going very well with high retention rates.

But, Fabi, do you want to give a bit more colour in terms of loss-cost trend in the industry and pricing power?

Fabian Richenberger

Yeah. Maybe a couple of additional data points, Brian, to your conversation. But from a commercial perspective, I would say that our loss trend overall has probably increased to the tune of 3 loss ratio points as a result of the inflation that we've seen across all of our segments and across all of our lines of businesses.

And as you know from private sources, we've been very attractive last year when we started those inflation plans, we had increased our automated indication already back in Q2 of last year. And we have also amended our pricing and the underwriting approach.

And to apply your questions now, we actually have been able to add a couple of freight contracts as of June and we saw inflation remain in that 8 percent, 9 percent level overall economically. Again, that translates into a loss trend increase of about 3 points as a result of the means of business that we have.

So overall, I would say that we've marked with a firm market condition persisting, we continue to be quite confident that we can continue to generate single high-digit rate increases in the 8 percent, 9 percent, and that is quite effective in mitigating the impact of the inflation trends that we talk about.

So overall, with all of that in mind, we are confident in our guidance that we will be able to generate combined ratios in the low 90 percent range over the next several quarters.

Rowan Saunders

And, Brian, as you'd know, I think a couple of things that we also think about in that inflationary environment, that not our entire commercial portfolio is really directly impacted by that. About 35 percent of the portfolio is property. And so we're able to not only pass prices on, but move TIV, some insured values up substantially. And that's happened as well.

Brian Meredith

Great. That's helpful. Thank you.

Operator

Ladies and gentlemen, just a reminder if you would like to ask a question, please press *, 1 now.

Your next question comes from Stephen Boland of Raymond James. Please go ahead.

Stephen Boland — Raymond James

Thanks. Just one question. Maybe you could just talk about the personal lines. Again, very solid growth in the number of policies in auto and property. Maybe you could just provide some segmentation in terms of what's driving that. Is that coming through the broker channel? Is it coming through Sonnet? If you could provide a little bit more detail, that'd be great.

Rowan Saunders

Let me start with that. I think so firstly, I think what we are seeing is continued really strong growth in our personal property accounts. And I'd remind you that that's part of our strategy. We are looking to diversify in provinces outside of Ontario and in the property lines. And so that's where we've had really good traction for a number of quarters now and that continues.

We're seeing strong growth on the broker side and close to 20 percent growth in policy accounts in the Sonnet side there. So I think that's what's happening in the personal property.

On the auto, as Paul said, really, there hasn't been a lot of rate strength as it's going through the system. And so we've actually had that relief, which slowed the revenue growth in personal automobile, that's now shifting around. So finally, we're going to get some rates assistance to the policy account growth.

One point that I made a little earlier, but I think it's worth repeating, on the Sonnet side of things, we are growing both in the retail business, but also in the affinity business. And I think the affinity business is something that's a segment that we have focused on the last little while. We've only been really focused on that for a little over a year.

And a couple really good statistics, I think, overstate our success. If you look at the percentage of new business that came from affinity and Sonnet in the second quarter, it's now 42 percent of all their new business written. So really good traction there. And that actually now totalled 20 percent of the total Sonnet portfolio. So there's an example of when we're focused on a particular, more attractive segment, how good traction is coming on.

And, Paul, do you want to talk a bit more about the broker business and which segments and where you're driving your growth from?

Paul MacDonald

Yeah. Just a couple of additional data to share with you. So our retention on the overall auto book has gone up. Rowan mentioned that earlier, and that has a net positive impact, obviously, on the portfolio because we have such a large proportion of our portfolio as a retained book.

On the rate perspective, quite a flat-rate environment. Last year, you'll recall me saying the last couple of quarters that last year most of our growth came from unit growth and that we were expecting to rebalance that this year. And so in Q1 of this year, we moved to about the 70/30 split from unit to rate and in Q2 it's about 60/40. So we're moving in the right direction in terms of adding additional rate on the auto portfolio.

On the property side, similar story last year in terms of it was mostly unit growth. And we're actually much closer in Q2 now to a 50/50 percent split between unit growth and rate growth, which is very positive for the future financial performance of this line.

Unlike the auto, there is already a mid-single digit rate flowing through the portfolio, and we expect to get close to double that by the end of the year. So that's quite positive.

Retention has remained fairly flat. You may recall me saying last quarter that we were going to give back some of our top line on the property portfolio in an effort to improve some of the underlying segments. There were a number of segments that were performing not as highly as we desired. And so we were taking proactive action to cleanse the portfolio. We felt we were ahead of plan in terms of our top-line growth, so we were comfortable with giving some of that back to improve the overall loss ratio.

Stephen Boland

Okay. That's all I have. Thanks very much. That's helpful.

Rowan Saunders

Welcome.

Operator

There are no further questions. At this time, I would like to turn the conference back to Dennis Westfall for closing remarks.

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 August 10th, and a transcript will be made available on our website.

Please note that our third quarter results for 2022 will be released on November 10th.

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

Operator

Ladies and gentlemen, we'd like to thank everyone for participating. You may now disconnect your lines.