

Definity Financial Corporation

First Quarter 2023 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Definity Financial Corporation First Quarter 2023 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 need assistance, please press *, 0 for the Operator. This call is being recorded on Friday, May 12, 2023. I would now like to turn the conference over to Dennis Westfall. Please go ahead.

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thanks, Joanna, 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 definity.com under the Investors tab. As a reminder, the slide presentation contains the 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 Digital Channels; and Fabian Richenberger, EVP of Commercial Insurance and Insurance Operations.

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

With that, I will hand it over to Rowan to begin his remarks.

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

Thanks, Dennis, and good morning. Last night, we reported results for the first quarter of 2023 that represent a solid start to the year.

Operating net income of \$63.4 million, or \$0.54 per share, benefitted from solid overall underwriting results, robust net investment income, and an increasing contribution from our recently built broker distribution platform.

Our 95.3 percent combined ratio was in line with our financial target. It reflects the benefits of diversification in our business, as strong performances in our personal property and commercial lines largely offset personal auto results. Seasonal declines in auto underwriting income were also impacted by persistent inflationary pressures and a heightened incidence of theft.

As expected, personal auto normalized from last year's performance as claims frequency moved off pandemic-related lows and inflation continued to impact claims severity. We maintain our view that we can deliver an upper 90s percent COR in this line in 2023 as our rate actions begin to be reflected in results later in the year.

As previously indicated, we are committed to taking additional rate if inflationary trends warrant and have recently received approvals in Ontario, our largest portfolio, for rate increases of close to 10 percent in Vyne, our broker business, and 7 percent in Sonnet. These are in addition to rate increases we obtained earlier this year of 3.5 percent in Vyne and 15 percent in Sonnet.

Our actions demonstrate our top priority is defending our profitability in personal auto during this challenging period for the industry.

Turning to the top line. We reported a robust 11.4 percent increase in premiums in the quarter. We continue to expect top line to increase at an upper-single digit to approximately 10 percent pace for 2023 as we manage growth in auto with an eye to protecting our margins.

On a per share basis, book value was 12.2 percent higher than a year ago when including the estimated impact of the conversion to IFRS 17, while our operating ROE at the end of the first quarter was 9.3 percent over the past 12 months.

We continue to hold a significant amount of excess capital, which when combined with untapped leverage capacity, puts us in a strong position to fund our strategic growth initiatives for the coming years.

Turning to the industry outlook on Slide 6. We expect firm market conditions in personal property and commercial lines to persist over the next 12 months, particularly given the dynamics of the reinsurance market, while conditions in auto lines will continue to firm as insurers aim to keep pace with the combined impact of normalizing claims frequency and lingering inflationary cost pressures.

As anticipated, industry results began to normalize in 2022 following very strong results in 2021, which had benefitted from unusually low claims frequency in auto portfolios. Overall, we expect the industry's return on equity to trend closer to its long-run average of 10 percent over time.

Slide 7 illustrates our key financial metrics. Growth, combined ratio, and operating ROE were in line with or better than our targets, which are unchanged from the prior quarter.

As we have stated before, we believe we have the growth platforms to outpace the market, but we'll continue to defend company profitability along the way. We continued to diversify the earnings profile of the business.

Recall that we acquired a controlling interest in McDougall in October, thereby launching our efforts to build a leading broker distribution platform. Our partnership is off to a very successful start and positions us to benefit from a complementary source of income, one which is more repeatable by its nature.

Earlier this week, we welcomed McFarlan Rowlands to the Definity family and believe their partnership with McDougall not only establishes a leading broker platform in Ontario, but also provides a solid foundation for geographic expansion. We believe we have now built another platform that before too long can reach an annual premium base of \$1 billion.

And with that, I'll turn the call over to our CFO, Phil Mather.

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

Thanks, Rowan. I'll begin on Slide 10 with personal auto.

Premiums were up 5.3 percent in the first quarter of 2023 driven by an increase in average written premiums. This is particularly evident in Ontario, where we have been successful in obtaining rate increases in both our broker business and in Sonnet. In the Province of Alberta, we are proactively managing the business, which could include redeploying efforts and capital elsewhere.

Our reported combined ratio of 100.9 percent in the first quarter was 4.7 points higher than the result from a year ago and largely in line with our expectations. I will categorize the primary drivers of the change from a year ago into three themes: frequency, inflation, and theft.

As anticipated, we experienced an increase in claims frequencies as driving patterns continued to normalize to pre-pandemic levels. For reference, Q1 2022 was still experiencing pandemic-related lockdowns, which drove a strong comparative combined ratio.

Severity is also up from a year ago, driven primarily by total losses as inflationary cost pressures have proven to be persistent, but were relatively unchanged compared to the fourth quarter.

Finally, a factor that accounted for about a third of the combined ratio increase from a year ago, is the growing impact from theft. Although it's not a new occurrence, the increased frequency of it has

been quite severe, and we applaud the Ontario government's recent announcement on its commitment to invest in new measures to combat auto vehicle theft related to organized crime.

We continue to expect this line of business to operate in the upper 90s percent for the calendar year. We have taken meaningful actions across much of our auto book, which we expect will result in overall written rates reaching approximately 12 percent by year-end, close to double the current levels.

Turning to personal property on Slide 11. We reported top-line growth of 12.4 percent for the quarter inclusive of our ongoing efforts to improve underwriting results.

We expect a continuation of the firm pricing conditions prevalent in the industry in recent years and strong broker relationships to help maintain our growth above that of the industry.

Focusing on the bottom line, we reported a strong combined ratio of 91.1 percent compared to 92.6 percent in the same quarter a year ago. Actions to improve results are paying off, as core accident year results improved 2 points from the first quarter of 2022. We continue to target a mid-90s percent combined ratio for the personal property line of business on an annual basis.

Moving on to Slide 12, you will see that strong growth momentum in commercial lines continued in the first quarter as we benefitted from broad support from our broker partners across Canada.

Gross written premiums increased 20 percent in the first quarter of 2023, driven by strong retention and rate achievements in firm market environments and further scaling of our specialty capabilities. We expect current growth levels to moderate somewhat in the coming quarters.

The commercial lines combined ratio was also strong at 90.9 percent in the first quarter compared to 85.9 percent in the same quarter a year ago, which benefitted from an unusually low level of CAT losses and lower auto claims frequency related to pandemic lockdowns.

CAT losses normalized this quarter driven by two individually large commercial property losses. We continue to expect the commercial insurance business to sustainably deliver annual combined ratios in the low 90s.

Putting this all together on Slide 13, consolidated premium growth was a strong 11.4 percent in the quarter, while profitability at a consolidated level remained solid at 95.3 percent, bolstered by the improved performance in personal property and strong contributions from commercial lines.

Slide 14 shows our investment portfolio in greater detail. Our net investment income again increased significantly in the quarter, up nearly 60 percent from Q1 of 2022. This was driven by higher interest income from the combination of our proactive actions to capture yield in an increasing rate environment, together with higher reinvestment rates.

We expect double-digit growth to continue in 2023, resulting in expected full year net investment income of \$160 million, recognizing a solid start to the year while also taking into account the impact of cash outflows for our investment in McFarlan Rowlands.

As you can see on Slide 15, our financial position remains strong. We are well capitalized with almost \$850 million in financial capacity under our current legal structure, and subject to the continuance of Definity under the CBCA, we could add close to another \$600 million in leverage capacity.

These figures are prior to our most recent broker investments, which had a total impact on financial capacity of approximately \$190 million.

The estimated impact of IFRS 17 did not change our view of the business. This includes our underwriting performance, how we operate the business, and our allocation of capital.

You'll notice that we now measure excess capital above 190 percent as compared to 200 percent previously. The change recalibrates our target operating range to the new capital guidelines that were

implemented in conjunction with IFRS 17. While IFRS 17 did not materially impact our results, its implementation was felt throughout our business, and I want to thank the teams involved for their tremendous efforts in this regard.

Slide 16 shows recent capital management actions and longer-term priorities. While our capital management priorities remain unchanged, you will see we continue to make strong progress in our execution.

As we continue on our journey to the optimization of our capital structure, the acquisition of McFarlan Rowlands represents another concrete example of our ability to deploy our financial capacity in a strategic and accretive manner.

The transaction will utilize approximately \$190 million of our financial capacity, of which \$75 million relates to debt financing; the balance being the deployment of excess capital.

As we prepare for our transition to a CBCA, which we continue to target for the summer, you will note that we have successfully renewed our debt facility and upsized its capacity to \$700 million immediately upon conversion.

And finally, yesterday, our board approved the renewal of our expiring NCIB of up to 3 percent of shares outstanding subject to regulatory and TSX approval. I'll remind you that we see buybacks at the bottom of our priority list for capital deployment actions, hence the relatively modest size of the structure.

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

Rowan Saunders

Thank you, Phil. We've been clear that we believe we can build the Company into a top-five player in the industry.

This requires continued inorganic growth, which will include both insurance carriers and distributors.

Following McDougall's announced partnership with McFarlan Rowlands, we have meaningfully accelerated our path to \$1 billion in premiums in our broker distribution platform. In aggregate, our broker operation in the province is approaching \$750 million in premiums, which should generate approximately \$60 million in annual operating income before finance costs, taxes, and minority interest.

This level of earnings contribution is possible as McDougall runs with excellent operating margins, while benefitting from access to more than 50 insurance markets. Both McDougall and McFarlan Rowlands will continue pursuing organic growth in addition to their track record of bolt-on acquisitions.

Beyond Ontario, we believe there are further opportunities, and we feel McDougall now has a solid regional platform from which to execute their expansion strategy.

While we've been successful building our distribution platform, we remain focused on our top-five objective. Carrier acquisitions remain very much part of the strategy, and our team continues working to identify actionable opportunities.

In terms of focus areas, we're interested in continually expanding our commercial insurance expertise and capabilities, particularly as it relates to specialty. That said, given our investments in technology, our platform is well positioned to take advantage of any scale opportunities in personal insurance.

In closing, I'm pleased with our solid performance in the quarter. There is excellent momentum in the business, and our strong balance sheet will enable us to continue executing on our strategic vision.

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

Dennis Westfall

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

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session.

Should you have a question, please press the *, followed by the 1 on your touch-tone phone.

You will hear a three-tone prompt acknowledging your request.

If you are using a speakerphone, please lift the handset before pressing any keys.

One moment, please, for your first question.

First question comes from Doug Young at Desjardins. Please go ahead.

Doug Young — Desjardins

Hi. Good morning. Thanks for the detail on personal auto. So you talked about written rate getting about 12 percent or up to 12 percent by year-end at close to double the current levels. What about earned? Can you talk about the evolution of the earned rate? And can you kind of weave in a discussion about loss cost trends and inflationary pressures and where you think that will be relative to that 12 percent and the earned premium growth?

Rowan Saunders

Yeah. Thanks for that, Doug. A couple points I would make around there. Firstly, on the severity side or the inflation side, it still is an elevated level from where we've been. So when we look at this on a year-on-year basis, it is up. But we've also seen kind of a flattening and a positive trend on the last few quarters.

So we feel that that inflationary period has really peaked in Q4 and now flattened. And if you go back and look at the big driver of that, which is the APD, or the auto physical damage, several quarters ago that was running in the high teens or around 20 percent. And when we get to the first quarter of this year, it's running at about 8 percent year on year, albeit flat quarter on quarter. So that's kind of what we're seeing on the loss-cost side.

You heard about the very strong pricing action that we've had in our major markets, but the earned lag does take some time. But we are seeing that now starting to pick up.

If you recall at the end of last analyst call in Q4, Paul had mentioned that our written rate was about 7 percent. So what that's translated in your questions about earned rate is we had 4.5 points of earned rate in the first quarter, and that keeps steadily building through the year. So by the time we get to the fourth quarter of this year, our earned rate is going to be 8.5 percent.

And as we then roll forward into 2024, we're actually into the double digits from an earned-rate perspective. So really pleased with the powerful rate filings that we've been able to get through, and we're starting to see that earned come through. And of course, as we've guided, it really is going to feature more strongly in the results in the second half of this year as it builds each and every quarter.

Doug Young

But that wasn't my question. I guess I was going where do you see that kind of to the earned increase in the inflation sort of like, I guess, the earned increase surpassing inflationary pressures? Is that more of a just third quarter, fourth quarter type of event? Is that how to think about it?

Rowan Saunders

Yeah. Go ahead, Paul.

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

Thank you. Yeah. Just to give a bit of further detail to that, as Rowan mentioned, in the quarter it has reduced year over year down to about 8 percent as a year-over-year number. However, it's still elevated relative to pre-pandemic.

What gives us a bit of confidence, to answer your question, is that it appears to be reducing quarter over quarter, and at this trend we expect that to continue on for the remainder of the year.

That then makes us look at that earned and written rate, as we've just discussed, and say, when do we expect the earned rate to essentially cover that inflationary trend. And from our projection and currently we are thinking toward the end of the year. Of course, that is highly dependent on market conditions up to and including what's happening with the Alberta rate pause. But that's our current view of the situation.

And as Rowan indicated, we have very, very strong, even stronger written and earned performance into 2024.

Doug Young

Okay. And then just second, Sonnet wasn't really talked about in your discussions. And I guess two questions around Sonnet. Can you talk a bit about your expectation on breakeven in terms of top-line growth? And then when you talk about pressure on personal auto from theft, is there more pressure related to your Sonnet business? Is that theft pressure coming from all your businesses? Or does it more kind of lean into the Sonnet business? Just hoping to get some colour on that.

Rowan Saunders

Doug, the first point I would say on that one is, so Sonnet continues to grow at about 6.3 percent. That's our direct business growth rate and that has been slowing for a while. And we expect that given this automobile environment and our focus on the path to profit, we're definitely prioritizing rate adequacy over unit count growth.

A bit of a unique part of Sonnet's portfolio is the business that we have in Alberta that Paul just commented on. Whilst it's not material at a Definity level—it's only about 2 percent of our total portfolio—it is about \$80 million or just under \$80 million, so quite important part of Sonnet's business. And in that area, we really are slowing new business growth. We know that there's about a 70 percent retention rate.

And so that's going to be a fairly big headwind to Sonnet's growth, but something we're very committed to not deploying capital into a line of business where there is a rate freeze and we're not rate adequate. So I think that's the point that we have there.

I'll let Paul talk about theft in just a moment. And your final question was—I think you led with it—which is any updates on the breakeven guidance. Really, there's no change there. There's nothing more to report than what we've already of said.

I think if we look at it, you got a couple of headwinds in places like Alberta where we know we're not rate adequate. And that's why we are slowing.

On the other hand, we've got a couple tailwinds. We're taking more rate than we had thought we'd be able to take and we're having great traction in the affinity book. And so that's our focus area. It's over 25 percent of the policies and new business, and we're getting super traction there.

So nothing really to update on that story, other than I think consistent with what we said before, we really are focusing on rates over unit count in the near term.

Paul, do you have any comments you want to add to that and touch on theft?

Paul MacDonald

Yeah. Just a couple points on affinity in terms of supporting why we believe this is a focus area for us. So, our affinity portfolio has grown 37 percent year over year, and as Rowan says, it represents now a full quarter of our entire PIF count.

And just from a quality perspective, we've got about a 14 point better multiline penetration rate relative to retail. Retention is higher. Credit score is better. Driving record is better. Payment rate is better. So this is why we want to continue focusing on that area.

It does come with a slightly lower AWP because of the inherent quality of that business, but we believe it provides a better long-term return on our investment.

In terms of your question related to theft, not a material difference between the two portfolios, but there is a slight difference in the fact that Sonnet has a more urban population than our overall broker portfolio. And as a result, we tend to have a slightly higher frequency of theft in the urban centres, but curiously a slightly lower severity, and that's likely reflective of the value of the cars in that portfolio.

Doug Young

Appreciate the colour. Thank you.

Operator

Thank you. The next question comes from Geoff Kwan at RBC Capital Markets. Please go ahead.

Geoff Kwan — RBC Capital Markets

Hi. Good morning. Just wanted to ask on the impact from the wildfires in Alberta and the storms in Quebec how that—your sense of that impact and how that compares to what you would expect for a normal Q2, given it tends to be a high seasonally quarter for CAT losses.

Phil Mather

Yeah. Thanks, Geoff. It's Phil here. So I think it's pretty early to say. Obviously, those events, if they transpire into being loss events, are pretty early in their genesis.

Q2 and Q3 are normally where we'd see a higher level of CAT events. The biggest one we've seen so far in the quarter was an ice storm in Eastern Ontario and Quebec, but nothing unduly unexpected there.

So I think at this moment in time, we're still pretty comfortable with how things are transpiring, but we're watching those events pretty closely.

Geoff Kwan

Okay. And just my other question was going back on the auto theft. Paul may have answered this already, but like how much would that in a normal quarter be in terms of the impact of theft on the loss ratio and basis points or however you want to do that? And is it something that at some point that may change how you think about underwriting, whether or not it's incentives or how you price the product?

Paul MacDonald

Yes. Absolutely. I'll start with the latter question first. It is absolutely something that has already impacted our underwriting and pricing.

And so much of the filed rate that Rowan mentioned is targeted at the comprehensive component of it to address theft specifically. We've taken repeated and continue to take additional actions in underwriting, particularly with high-theft vehicles. There are certain types in certain provinces that are worse than others, so we'll surcharge those.

And of course, we continue to take additional actions working with our brokers and our customers with anti-theft tracking devices, et cetera. And again, repeat what Phil mentioned earlier,

delighted to see the Ontario government's commitment to investing \$51 million in combatting theft in the marketplace. So we have confidence that theft overall will continue to improve over the next few quarters.

In terms of how much it represents, theft is approximately 7 percent of the loss of our auto portfolio. And although it's elevated, the quarter over quarter has actually improved. The year over year is still quite elevated relative to pre-pandemic levels. And we've seen a lot of that in the press.

So we'll continue to focus on this as a matter of priority. But we have some confidence that we, together with the governments and the regulators, will be able to address this in the near term.

Rowan Saunders

So really if you think about the composition there, it moved the loss ratio about 2 points in the quarter from the prior-comparison period. And that's why, as Paul said, there's a lot of activity underway to address that.

Geoff Kwan

Okay. Great. Thank you.

Operator

Thank you. The next question comes from Paul Holden at CIBC. Please go ahead.

Paul Holden — CIBC

Thank you. Good morning. Lots of useful information and discussion on personal auto, but I just want to bring it back to a high level and ask the question, has your outlook for the year changed at all versus when you talked about the outlook on the last conference call. Have things gotten worse? Or is it kind of shaping up as expected?

Rowan Saunders

Paul, thanks for the question. Look, this is not a surprise to us. These results are kind of falling into place largely as we've expected, given the auto environment that we've had.

So if you kind of just step back, look at the big picture here, we know that driving mobility has largely returned to pre-pandemic level. There is a bit of frequency that are still lower because of the driving patterns, but year on year it's up pretty significantly.

So when we look at the comparison period of this quarter versus Q1 2022, remember, we were still in lockdown period in that particular quarter with the resurgence of the Omicron. So that was one of the drivers that went up. We talked a bit at length already around the severity, which is now starting to flatten.

We can't forget that our Q1 is seasonally affected. It's the Canadian winter. And so that actually drives a couple points of higher loss ratio just because of the seasonality.

And you may also note that there's less PYD than we had, a little bit, though, than the last year, or limited I should say, and that really is kind of normal for us. If you go back and look at our trends for Q1, we like to be very prudent early in the year. I think Phil has guided in the past that our overall company, favourable development is 1 to 2 points a year, but it's much higher than that in automobile. And so we certainly expect to see some of that later.

So stepping back, you look at that, our full year guidance is not changed at all. It's unchanged. We said there would be upper 90s. We still believe it's going to be upper 90s. We did say that 2023 would be the trough year of earnings for the personal auto portfolio. We expect that 2024 will have better earnings than '23, and '23 was obviously less than last year because of those issues.

We're confident in that because there's increasing evidence that inflation has peaked last year. We've seen that now kind of flattened. It's really been the APD story that we've watched come down

quite favourably. No change or anything to comment on for AB/BI. That's very consistent. We think most of the frequency is really up and that should kind of normalize going forward.

And then you just do the math of the rates that Paul talked about, those are really significant rates and apply to the vast majority of our portfolio. So stepping back, we're comfortable with the auto guidance we've given.

Paul Holden

Okay. Okay. That's great. So I also did want to ask a specific question on PYD. Just prior to the IPO, or around the time of the IPO, you added some additional reserves for this type of environment specifically for higher severity. How much of those additional reserves are left? And assuming there is still some left, like why didn't you use more in this past quarter?

Phil Mather

Yeah. Thanks Paul. I think we don't specifically look at individual components like that. We look at the overall kind of strength of the balance sheet position, so. And it's obviously been a decent amount of time since we've established those.

I think what I'd say, just a big picture comment on prior-year development, we're still continuing to see favourable developments run off from prior years from last year and the year before. So we're not seeing anything in the underlying numbers at this point that gives us undue concern.

We do tend to start the year a little conservatively out of the gates as we look at that. But we continue to have good confidence in the overall balance sheet position that we have across all our lines of business, including auto.

I think historically, we've had about 1 to 2 points at a company level of prior-year development. Under IFRS, we're still reporting on a consistent basis as we did before. So that 1-to 2-point historic level

reflective of the approach that we take from reserving we think is still a good proxy for expectations going forward, and we're still very comfortable that we have a robust and solid balance sheet.

Paul Holden

Okay. And then last one for me. Just in terms of thinking about acquisition potential, and I guess particularly in commercial and specialty, as you highlighted, Rowan, like when I think about the current environment it's obviously very good. Right? It's very good for you in terms of your margins and the growth, and that's obvious in the results and I think that's probably broadly true for the industry.

So does that make it a tougher environment to find a willing seller because they're earning great ROEs on that business? Or maybe does it make it easier because they're more happy to extract the acquisition multiple that might come at a favourable time?

Rowan Saunders

I think there are a couple things that are happening in the market and one is, overall, there are a couple drivers in commercial lines that are relevant for companies. Some companies are more dependent on reinsurance capacity than others, and that sometimes has to do with the size and scale of your business and balance sheet.

We know that the reinsurance market was really firm and that is a substantial change from previous years. We saw that one on one. And we expect that to be a firm market going forward. So that certainly puts some pressure on some commercial/specialty companies.

And then the other thing is that brokers are really raising their expectations. We're seeing consolidation of brokers. Brokers are getting bigger. They're looking to consolidate their business, and they have higher expectations in terms of interactivity and service levels with their various markets. So there's a big investment required to step up and do this.

So in a time like this where I think there is some pressure with this reinsurance, inflation, natural CAT kind of losses, not everybody is willing to make big investments in their business. And I think that may bring some more opportunities to the marketplace.

That's certainly part of the thesis that we have, and I think when we sit back we look at our platform, which is built out, we look at the fantastic broker support that we're getting, and a very strong balance sheet that looks to participate in any of these opportunities.

So I'm going to just ask if Fabi's got anything to build on that because I think one of the points that we're also seeing is not just, hopefully, more M&A opportunity, but very strong support for our channel.

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

Yeah. Certainly. As you know, from prior conversations, we are focusing our growth plans in commercial insurance on three main segments. It's the small business, middle market, and specialty. And we have now built a value proposition for each of those three segments that is market leading in terms of product range, service standards, and underwriting capabilities as well.

In small business, for instance, we launched a digital capability recently that allows our broker partners to quote and bind more than half of their small business opportunities in an automated manner. And that results in us writing more than twice the amount of new business than we did a couple of years ago.

In middle market, which we are executing through our regional operations, we are benefitting from very strong relationships that we've built with our broker partners locally.

And then in specialty, we are now the market leader in Canada in the sharing economy segment, which includes accounts like Uber and Turo, and we have also built a very strong offering in the D&O, E&O surety, and large property segments.

Overall, I would say that we are now able to provide an insurance solution to more than 90 percent of Canadian businesses, and that has resulted in, as Rowan mentioned, tremendous support from our local partners. Very much in line with our strategic aspirations that we conveyed to you earlier on, we have now been growing our small business and specialty segments above market growth rates, and in Q1 those two segments grew by more than 30 percent.

And I think what is also important to consider when you look at our growth rates, is about 40 percent of our growth is coming from rates and inflation indexation adjustments, and that gives us the confidence that we'll be able to sustain our profitability in that low 90s percent combined ratio range.

In terms of our growth outlook for the rest of the year, very much in line with what Phil mentioned. We do expect that our growth rate will sustain itself in the mid-teen range as a result of firm market conditions, our strong value proposition, and then the strength and the support that you're getting from our broker partners.

Rowan Saunders

And so to kind of put a pin on that, I think that we're having great organic growth opportunities, and some of the strong domestic insurers are now encroaching on space that was typically done by foreign insurance companies.

And so we think that's going to potentially create some more opportunities in the marketplace because a lot of these brokers are saying, if I have an option of placing my business with someone like Definity and other leading Canadian insurers who can do all the specialty, but also do my mid-market, also

do my auto, also do my personal insurance, that's a more strategic relationship to me. And I think some of that will be a headwind to their growth. And that combined with my earlier comments, we think may be a thesis for some more opportunities ahead.

Paul Holden

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

Operator

Thank you. The next question comes from Mario Mendonca from TD Securities. Please go ahead.

Mario Mendonca — TD Securities

Good morning. This might be best suited for Paul. In the personal auto business you talk about the move in earned rate and getting approvals in Ontario and throughout Canada. I want to look at the question from a different perspective. Do you think insurers see things the same way you do?

I guess what I'm getting at is I often hear people compare the Canadian market to the US market. And I think there are some different dynamics from a pricing discipline perspective. I want your perspective on how you view your competitors from a pricing discipline perspective in personal auto.

Paul MacDonald

Yeah. Thank you. Difficult for us to comment on our competitors, but I can certainly comment on our strategy and philosophy.

And the idea for us is, we are in a highly regulated environment. Many of our provinces are regulated. And so there's always a focus on ensuring that we're well aligned with the regulator and the jurisdiction to ensure that we get broad support for recognizing the trends in the marketplace.

We're delighted by the support that we've been given, particularly in Ontario. And as Rowan called out, we've been getting lots of support from the Ontario regulator in terms of recognizing the

inflationary trends, particularly the theft trends. And this is an important health metric to ensure that we can cover the escalating trends.

Of course, even with that strong support there's still a delay. There's a lag in between you seeing inflationary trends and the rate burning through the portfolio.

So from a pricing perspective, our philosophy is absolutely to cover the trend, make sure we stay ahead of that trend in the long run, and ensure that we focus on the profitability of the underlying portfolio. And we also look at this in the context of our entire portfolio and diversification strategy.

So it's not just regional diversification. It's also diversification into personal property. I mentioned previously that we would focus on extracting a bit more profits from property to offset this, and we've been successful in getting at least 2 points of improvement.

Fabi and his team have done an incredible job in getting profitability and growth on the commercial side. When we net it all out, we believe that we're well priced for the future to meet our guidance.

Rowan Saunders

Sorry, Mario, I was going to—just one add to that is I think you were asking a bit about regulators and peers or competitors. And I think that what we are seeing on the competitive side of things is consistent pricing increases as well.

And if you look at Ontario, which is the main market where we've got 70 percent of our total portfolio, we're now seeing the market at about a 10 percent written rate. And so I think that gives you good evidence that everyone's seeing the same story. Everyone's leaning into it. The regulators are recognizing and approving that.

So we feel very good about the price changes that we're putting through our portfolio and fully expect solid retention to continue, given the whole market's moving at about 10 percent price increase.

And then more recently, another part of evidence of that is we are starting to see some more shopping activity coming up. And that's normal as customers start seeing bigger price increases. So when we put that together we do see some discipline in the marketplace, and we do know it's starting to flow through because customers are starting to once again do a bit more shopping.

Mario Mendonca

Sort of a related question. In response to Paul's question, Rowan, you said that you weren't really surprised by the results in personal auto. So maybe I'll ask it this way.

Definity became a public company at a very odd time. The pandemic and the results in personal auto during that period are not in any way indicative of what we can expect from this company going forward.

So maybe, let me ask this. Is it reasonable for this company in more normal environments, if there is such a thing, to generate underwriting losses in Q1? Is that a normal occurrence for a company like Definity, an underwriting loss in personal auto in any given Q1? Is that normal?

Rowan Saunders

I don't think so. I think when you step back, we've got a couple of parts to our portfolio. Right? And one part is the Sonnet business, which is, as you know and would expect, generating underwriting losses. And you've got the broker business, which is generating underwriting profits.

So we put it together in this particular quarter, we're right on that 100 percent area. But whilst we don't get into the details of each of those segments, that's generally the view because Sonnet still isn't breakeven. It's on the path to breakeven. So that part of our business, which is steadily improving on the

path to where we think it would be, on a normalized basis that wouldn't get you to an underwriting loss in any particular quarter for the personal auto business.

I think the other thing is that inflation is not normal. I mean, this is a complete mismatch in timing between rapid elevated inflation and then the lag of rates. And in a more normal environment, you don't get inflation this high and it doesn't take so long to get your rates to catch up. So that would not be an expectation of ours.

And I think longer term, as we've guided and were asked about this on the road show, I think that we think this is more like a mid 90s percent line of business and not the elevated high 90s percent we're talking to now. That's a point in time for us, and we're confident we'll get over that.

Mario Mendonca

And sorry, just one final thing. When this company became public when you demutualized, one of the big storylines behind it was just how the top line is growing a lot faster than the industry, and that's still true today.

Do you envision a time in the near future, as in possibly next year, where Definity's top line just sort of looks like the industry? Or do you really see this persistent?

Rowan Saunders

We definitely see it persistent, Mario. I think we're very comfortable with the growth engines we've bought with the opportunities we see in the marketplace that we'll continue to grow roughly twice the pace of the industry. So we do not see in the next several years that we will normalize to industry growth. We continually see we will be able to outperform that.

Mario Mendonca

Thank you.

Operator

Thank you. The next question comes from Brian Meredith at UBS. Please go ahead.

Weston Bloomer — UBS

Hi. This is Weston Bloomer on for Brian Meredith. My first question, you highlighted some non-rate actions within personal auto that you're taking on the theft side. Are there other non-rate actions that you're currently taking across your book to improve the profitability of the business? Or is it more just rate exceeding trend at this point away from theft?

Paul MacDonald

So absolutely we continue to take significant non-rate actions to improve the profitability of the portfolio. First and foremost, remembering that Sonnet is on a path to profitability, year over year we've had significant improvements in the mix, in the underlying mix. And as I mentioned earlier in the call, one of those main focus areas is pushing more on to the affinity space, which has a better-quality profile.

For the overall portfolio, I mentioned already significant underwriting actions related to theft and some of the inflationary trends. And we continue to refine our segmentation and use advanced analytics to identify and remediate any fraud potential.

Of course, beyond all of that, we continue to focus heavily on claims, improving cycle times, improving pending levels, improving the amount of our claims that gets sent to our preferred vendors. And so this is an all hands on deck set of activities around continuing to improve the underlying performance of the portfolio.

Weston Bloomer

Great. Thanks. And a follow-up on the frequency discussion—I'm sorry if I missed this—did you quantify how much on a basis point perspective frequency was up on the loss ratio? I mean, it sounds like

you're expecting it to normalize closer to year-end, so should we expect a similar impact in the 2Q to 4Q normalizing for maybe winter weather?

Paul MacDonald

Yes. I think that's an appropriate view. We're expecting it to be relatively stable now from a frequency perspective, of course, seasonally adjusted, as you mentioned. It's the severity component that we're seeing reductions in certain input costs, and we're hoping to see those reflected in the overall trends as we roll forward through the end of the year.

Weston Bloomer

Great. Thank you. And the last one is just on the expense ratio. On the year-over-year improvement is mostly through claims or commissions ratio where other operating expenses generally trended higher. Is that more just inflationary pressures? Or are there other investments in the business that you're making? Just curious on overall expense ratio trends as you try to hit your target combined ratios.

Phil Mather

Yeah. There's a couple moving parts in the first quarter. On the commission ratio, we probably normally see that in the kind of mid-15 range. So there was some favourable outcome of the CPC accruals we put in for 2022 from an expense basis.

But then offsetting that on the operating expense side, you'll see that ticked up a little bit compared to this time last year. That's really timing of some talent acquisition and investments in technology we made in 2022. So you're seeing that bulge a little bit more from a comparative basis compared to Q1 last year due to the timing of when we were hiring some of that talent. That's more stable from hiring activity this year.

So what you'll probably see is that ticks down a little bit in the second half of the year as you get more to a like-for-like comparison. So if I step back around the 33, which we're very close to in the first quarter, is a good indication overall from our expectations on the expense ratio.

Weston Bloomer

Great. Thanks for taking my questions.

Operator

Thank you. The next question comes from Tom MacKinnon at BMO Capital. Please go ahead.

Tom MacKinnon — BMO Capital

Yeah. Thanks, and good morning. A question about I just want to compare the regulatory environment in Ontario to Alberta. I mean, you're jamming all this rate increase here in Ontario, and both Ontario and Alberta are having inflation issues. But one regulator says stop and the other one says keep it coming.

So like you've been in the business for a long time. At what point is a breaking point? I mean— and is it the last man standing that can't get the rate through? If you could put some context on that. And also compare why Alberta would say no and Ontario would say yes and what's the issue? What would drive Ontario to eventually say, enough's enough?

Paul MacDonald

Yeah. Good question. Rate pauses or rate freezes are nothing new in the Canadian context and in other contexts and, typically, are a political reaction to economic conditions faced by consumers.

Unfortunately, in Ontario, there was a period of rate relief that had flowed through, and then the inflationary trends are being recognized by the government and also by the regulator. And so we've got good support for that, as mentioned.

But you're absolutely right, the trends are similar. These are macroeconomic trends. These are not trends that are materially different in the different provinces. So Alberta is absolutely seeing the same inflationary trends as Ontario and indeed the other jurisdictions.

So what then is leading to the Alberta situation? It is completely related to the political context and the election that's coming up at the end of this month. And so I won't speak too much to the political party's platforms on this, but certainly this is why it's being communicated to the industry as a pause. And hopefully once the election has resolved, we can resume more normal operations.

It is a challenging context, obviously, for the industry. And ultimately, we believe it's going to be difficult for the consumer as the insurance industry has to react to these conditions.

So if there's no rate flowing through that portfolio and you're seeing very significant inflationary increases, the net result is profitability is going to suffer. And likewise, you would expect to see capital being redeployed out of that province into other provinces.

Rowan Saunders

And I think for your question relating to Ontario, which has been very positive, that we continue as an industry to talk with the government on solutions, which really are around product reform.

So at some stage, and we have a history of this, when you do see significant loss-cost trends that are followed by price changes or rate increases, at some point you do need to then move into some product reform to address those costs. And I think there's been some good examples of that happening in the past and that's something that the industry at large through the IBC continue to engage with the Ontario government with.

So my sense is what we're going to see here is some price movement in the short term, and then that'll be followed with some reform to provide some relief on the prices to consumers.

Tom MacKinnon

Okay. So just a less rich of a product and that would then alleviate some of the inflationary pressures?

Rowan Saunders

That's correct. And we've had to do that a few times through the decades. And I think the other issue is that fraud and you heard about earlier things like theft, but particularly the fraud there is a lot of activity and there's some regulation changes that'll help address that as well.

So not everything has to be completely done through just price alone, but there are other tools available to the product, and that discussion continues to occur with the province.

Tom MacKinnon

Yeah. And presumably that would mean less profitability levels would be, on a combined ratio basis, would be around the same or maybe a little bit better, but the premiums written would be less. So the scale of the business would be less. Would that be safe to say if you took away some of the richer benefits in the product?

Paul MacDonald

Yeah. And it's Paul here. As Rowan said, typically the reform occurs on the casualty side of the equation. And so you're absolutely right that we'd start to see a reduction in AWP for that component.

Offsetting that potentially are the rising costs of automobiles. Just technology, even pre-pandemic, technology was getting more expensive. Cars were getting more complicated as we introduce electric vehicles into the system. You're going to see a slight increase on that. So we do expect to see sort of a net flattening of that.

And of course, regulators adding more choice to the consumers. They can evaluate how they can deploy their premiums.

Tom MacKinnon

Okay. That's great. Thank you.

Operator

Thank you. And the next question comes from Lemar Persaud from Cormark Securities. Please go ahead.

Lemar Persaud — Cormark Securities

Thanks. This one's probably most appropriate for Rowan. Is the bottom line on carrier acquisitions in some way linked to the CBCA conversion? So that once you have that additional financial capacity, then we can expect a bigger carrier deal. Is that fair?

Rowan Saunders

Well, I mean I think I would start by saying if you look at the current financial capacity, it's pretty significant. And as we've got it before, we're very confident that the CBCA process will unfold. And we're expecting that to be in the summer. That's well advanced. There doesn't seem to be any hurdles. So we're assuming that happens. That just gives us more financial capacity to look at that. So really, it depends on the size of an entity.

So I think, as we said today, we don't feel limited in terms of our ability to find opportunities in the marketplace, but it is scale dependent. If we wanted to pursue a larger target than being a CBCA company, it's definitely helpful for us. So but that's pretty imminent. So I think we're going to be in a pretty good shape there.

Lemar Persaud

Okay. And then just kind of linking that to one of your previous answers on outgrowing the industry over the next, I guess, couple of years, do you need a deal to—are you building in the expectations of a carrier deal to outpace the market on the top line? Or if we go through the next couple of years without a deal, could you still see yourself kind of doubling the industry on a top line growth perspective?

Rowan Saunders

Yeah. The comments we make and the targets we give, which is upper single digits to around 10 percent, that is all organic. So we really are pretty confident in our organic abilities to build up the product lines, keep retention, keep putting prices through. It's the organic story. And so, therefore, we don't need an acquisition to deliver that organic target of close to 10 percent. An acquisition would help us exceed that.

What we've talked about in the past is our objective to be a top-five player. And if you think about the path we're on, we're doing really well on an organic perspective, but there's a pretty significant gap between ourselves and getting into that top five at roughly \$1 billion. And so we, therefore, say, in addition to strong organic growth, we would need an acquisition of approximately \$1 billion of revenue that would put us into that top five position.

Lemar Persaud

Okay. Okay. And then kind of like trying this a little different way, what makes Definity special to, and I'm talking about a couple years down the road, absent acquisition, what makes Definity special such that you could continue to double the industry growth without, say, being more aggressive on price and rates?

Rowan Saunders

Well, I mean, I think that if you just step back and I look at this and I say, look, we've got solid growth and it's happening across our portfolios. We're shifting the mix of business. So our personal automobile is a smaller percentage of our total now than it was a couple of years ago and even more than that before. We've got really strong growth in commercial lines, around 20 percent in all of those segments.

There's capacity we're putting into specialty commercial, the talent pools that we've brought into the business, and our natural market share is still low there. So that's how we could move up.

In personal insurance, we really think that the technology advantage that we've got is what's going to help. Brokers are consolidating the number of insurers they deal with. They, of course, need good claims and good pricing, but technology interface is a bit of a game changer, a really big driver of differentiator for them, and that's where we stand out, which is why we're getting an excellent growth from that perspective.

So I think those are the points that give us good capacity. If I just step back and take a macro view, we've got very strong organic growth. We've got a solid combined ratio. We're targeting to be in the mid-90s percent. We've been consistently that or a little bit better than that. That's going to keep generating solid earnings for us.

We're now adding distribution income to that. Phil talked about higher investment income. We've got a bit of a higher book value, some benefit there. So we've got a lot of financial capacity, as well as the organic growth story.

So I think there's something unique about the broker support for our business model. And the fact that, quite frankly, even after being a public company our brand has gone up. We're able to retain

and attract more talent than we were when we were a mutual company and brokers are more comfortable concentrating more of their volume with us than they did before.

So that's really what's kind of—there's a number of elements in that I realize in my answer, but that's really what's fuelling our confidence in the strong growth ahead.

Lemar Persaud

Okay. That's it for me. Thanks.

Operator

Thank you. There are no further questions. I will now turn the call back over for closing comments.

Dennis Westfall

Thank you, everyone, for participating today. The webcast will be archived on our website for one year. Telephone replay will be available at 2:00 p.m. today until May 19th and a transcript will be made available on our website.

Please note that our annual meeting of shareholders will be held on May 19th. Our second quarter results for 2023 will be released on August 3rd.

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

Operator

Thank you, ladies and gentlemen. This concludes your conference call for today. We thank you for participating, and we ask that you please disconnect your lines.