

Definity Financial Corporation

Third Quarter 2023 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Definity Financial Corporation Third 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, November 10, 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. 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 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 Digital Channels; and Fabian Richenberger, EVP of Commercial Insurance and Insurance Operations.

As usual, we'll start with formal remarks from Rowan and Phil, followed by a Q&A session, where Paul and Fabian will join to help answer your questions.

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

Rowan Saunders — President and CEO, Definity Financial Corporation

Thanks, Dennis, and good morning, everyone.

Last night, we reported third quarter earnings that reflect a resilient performance in an active catastrophe period for the industry. Severe storms and wildfires affected communities across the country this summer, and our catastrophe response team stepped up for our customers.

While these events had a significant impact on underwriting income, we continued to leverage our strong broker proposition to drive overall premium growth of 9 percent.

Our efforts to diversify and strengthen the earnings profile of the business were evidenced by strong commercial insurance results and a growing contribution from our insurance broker platform.

Overall, we delivered a solid underlying performance which, combined with robust net investment income, resulted in third quarter operating net income of \$17.6 million or \$0.15 a share. Our 102.5 percent combined ratio included 13.5 percentage points of losses from CATs, more than double what we would expect for a third quarter. Other results reflected continued normalization in frequency, elevated claim severity arising from theft, and persistent, but now stable, inflation.

Results in commercial insurance represent another strong underlying performance, in addition to lower-than-expected level of CAT losses.

On a consolidated basis, underwriting results benefitted from a 2.4-percentage-point decrease in our expense ratio, which Phil will expand upon in just a moment.

Turning to the top line, growth of 9 percent was driven by commercial insurance and personal property, as our strategy to diversify our mix of business away from regulated auto has been successful. We continue to expect top line to reflect our disciplined approach to managing growth through the cycle, and for our significant rate actions in auto to return more balance in personal insurance growth in the coming quarters.

On a per-share basis, book value was 9.6 percent higher than a year ago. Continued strong operating results, outside of CAT losses, drove an operating ROE of 8.8 percent over the past 12 months, illustrating the benefits of our diversification strategy.

Although we've been successful in actively deploying capital in our broker distribution business, we continue to have a significant amount of financial capacity, putting 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 both personal property and commercial lines to persist over the next 12 months, particularly following another active period of severe weather events and the dynamics of the reinsurance market. We believe conditions in auto lines will continue to firm as insurers aim to keep pace with underlying cost trends.

Slide 7 illustrates our key financial metrics. Growth, combined ratio, and operating ROE were largely in line with our targets on a year-to-date basis, though unusually high cat losses in the third quarter pushed our combined ratio above expectations. We are confident that we have the growth platforms to outpace the market over time and will continue to protect and improve company profitability along the way.

You'll see on Slide 8 that we continue to diversify and strengthen the earnings profile of the business. We closed the acquisition of the Drayden brokerage in early October. In 12 months, we have built an insurance broker platform approaching \$1 billion in annual premiums, with repeatable distribution income which complements our underwriting operations.

The addition of Drayden provides immediate scale and market-leading presence outside of Ontario, where McDougall and McFarlan Rowlands have well-established operations. Each of these brokers have experienced management teams, highly valued brands, and generate robust operating

margins. I'm confident the additional distribution income from this platform will support growth in our operating ROE in the coming years.

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

Philip Mather — EVP and CFO, Definity Financial Corporation

Thanks, Rowan. I'll begin on Slide 10 with personal auto. Premiums were up 4.6 percent in the third quarter of 2023, largely driven by an increase in average written premiums, which reflect the multiple rate increases we took earlier this year in both our broker business and in Sonnet.

We're committed to taking a disciplined approach to growth and have taken further rate increases in Sonnet Ontario, and expect to maintain our pause on all Sonnet marketing activities in Alberta for the foreseeable future. Now we are focusing on other areas of the business where we see opportunity for more profitable growth.

A reported combined ratio of 98.9 percent in the third quarter was 2.6 points higher than the prior year, but in line with our expectations.

Severity was up from a year ago, though inflationary cost pressures are now stable and were down slightly from the first half of the year.

Industry pools impacted the composition of our Q3 auto combined ratio compared to a year ago. While only a small drag in the quarter overall, pools negatively impacted the change in core attritional results by approximately 2 points, while benefitting prior-year development by a similar amount.

Lastly, personal auto wasn't immune to CAT losses, with a 2-point impact in the quarter. As we discussed in recent calls, theft continues to be a challenging issue for us and the industry, accounting for approximately 10 percent of our total auto loss costs and 6 points of loss ratio points over the last four

quarters. In response, we're continuing to implement both underwriting and claims initiatives aimed at addressing theft and auto recovery.

We've taken meaningful rate actions across much of our auto book, which we expect will result in earned rate improvements that will more fully benefit both top- and bottom-line results in 2024. That said, we continue to expect this line of business to remain in the upper 90s percent for the next two quarters, reflecting anticipated levels of winter seasonality.

Turning to personal property on Slide 11. The story this quarter is clearly one of catastrophe losses, which accounted for nearly 40 points of our reported combined ratio of 123.3 percent.

As we previously communicated, we experienced 10 events that reached our definition of a catastrophe.

Wildfires in BC represented the largest of these and was the only event to breach our reinsurance retention threshold of \$40 million.

Our results were helped by our multiyear aggregate reinsurance treaty, which is designed for periods such as this, where multiple smaller events occur, and reflect the full utilization of the treaty limits for 2023. We will again have this protection in place in 2024 as the final year of our three-year arrangement.

Beyond CATs, ongoing actions to improve the underlying results are paying off, as core accident year results improved four points from third quarter of 2022. This improvement gives us the confidence to target a mid-90s percent combined ratio for the personal property line of business on an annual basis.

We reported strong top line growth of 11.8 percent for the quarter, benefitting from firm market conditions driving increases in average written premiums and the continued success of winning portfolios of business in the current market environment.

In the upcoming couple of quarters, we expect our actions to improve and protect profitability, including the short-term impact of having slowed new business in CAT-exposed regions during the recent events, will somewhat dampen our current pace of growth. Beyond this, we remain confident in our ability to outgrow the industry over time, supported by strong broker relationships and scalable platforms.

Moving on to Slide 12, you will see that double-digit growth in commercial lines continued in the quarter, with gross written premiums up 13 percent versus the prior year. Growth was driven by strong retention and rate achievement in a firm market environment, and further scaling of our small business and specialty capabilities. Believe that we can maintain growth at a similar pace into 2024.

Commercial lines combined ratio was very strong at 86.6 percent in the quarter, compared to 93.9 percent in the same quarter a year ago. Result was driven by an improved core accident year claims ratio and lower catastrophe losses. Continue to expect the commercial insurance business to sustainably deliver annual combined ratios in the low 90s.

Putting this all together on Slide 13, premium growth was 9 percent in the quarter, while profitability, at a consolidated level, reflected the unusually high impact of catastrophe losses, resulting in a combined ratio of 102.5 percent.

Our expense ratio decreased by 2.4 points from last year due to a couple of factors: first, the negative impact of CATs on our loss ratio had a corresponding favourable impact on expenses in the form of lower quarterly accruals of both contingent profit commissions and variable compensation; second, expense management initiatives, including the reduction in Sonnet marketing expenses from our targeted actions in Alberta.

More sustainably, a reduction in commissions from the consolidation of our insurance broker platform benefitted the expense ratio by about half a point. Continue to focus on disciplined expense management and leveraging our growth momentum to become more efficient overall.

Operating income was down but resilient, benefitting from the expansion in net investment income and a growing contribution from distribution income, leading to an operating ROE of 8.8 percent.

Diversified earnings profile gives us confidence that we can more sustainably generate operating ROEs that are inherently less volatile and with the expectation to grow over time.

Slide 14 shows our investment portfolio in greater detail. Our net investment income again increased substantially in the quarter, up nearly 29 percent from Q3 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 now expect full year net investment income of approximately \$170 million, recognizing the strong first three quarters of the year, while also taking into account the impact of the recent cash outflow for our investments in Drayden.

As you can see on Slide 15, our financial position remains strong. We are well capitalized, with over \$580 million in financial capacity under our current legal structure and, subject to the continuance of Definity under the CBCA, could add close to another \$600 million in leverage capacity.

These figures do not include our acquisition of Drayden, which closed in early October and represents a capital outlay of approximately \$200 million.

Substantial financial capacity and the regulatory approval process for our planned CBCA continuance nearing completion, there's significant flexibility available to support our ongoing reinvestment in and growth of our business.

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.

To continue on our journey to the optimization of our capital structure, our recent broker acquisitions represent concrete examples of our ability to deploy our financial capacity in a strategic and accretive manner.

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

Rowan Saunders

Thank you, Phil.

Before moving to Q&A, I wanted to provide my view on the situation in Alberta. We mentioned in the past that the province represents approximately 14 percent of our auto business, but more than a quarter of Sonnet's auto premiums.

In response to the government-mandated rate pause announced earlier this year, we've essentially turned off all Sonnet marketing activities in the province, given rate inadequacy.

While the rate pause will expire at the end of the year, the government has now introduced new measures that allow it to continue to control rates and profit margins. I believe these measures threaten the attractiveness of the personal auto market in Alberta, while the government's actions to intervene in the market require us to consider how we deploy capital in the province.

As we assess our go-forward response for Sonnet in Alberta, we've committed to work with the government on regulatory improvements to the auto products so that further intervention is not needed in the future.

In closing, I think the resilience of our operating model was illustrated this quarter, and I'm confident in the inherent momentum of the business. We delivered strong revenue growth in the quarter and year to date, and we are pleased with the strength of our underlying insurance performance.

Distribution income is building nicely and provides a new, more stable income stream. Net investment income again benefitted from our proactive actions to capture yields. Putting this all together, we move forward with a strong and growing balance sheet, which enables us to continue executing on our strategic vision.

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

Dennis Westfall

Thanks, Rowan. Joanna, we are now ready to take questions. And I'll ask that everyone please limit the number of questions to two before then re-queueing.

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.

First question comes from Geoff Kwan from RBC Capital Markets. Please go ahead.

Geoff Kwan — RBC Capital Markets

Hi. Good morning. Just wanted to follow up on your comments on Alberta. I just wanted to get your sense there. Like how would you describe the likelihood we see measures introduced aimed at reducing claims costs to hopefully help ensure adequate competition in the province?

Or do you think we may see some capacity getting pulled out of the province if the current rate regime persists?

Rowan Saunders

Thanks for the question, Geoff. Rowan here. Yeah. Look, I mean, I think that this is recently new breaking news, and so we do need to understand the details from the government. And we have been, through the industry, in touch with the Alberta government and the regulators as well, who also are waiting for some of the details to be outlined.

I mean, I think when you step back, you could look at this and say, well, the fact that the rate freeze or the rate pause has been lifted is a good-news story. But unfortunately, there is now a cap that will be imposed for some definition of a safe driver, which will be a substantial part of the portfolio.

One of the concerns we have is that, when you think about that percentage of 3.7 percent, which is meant to reflect CPI trending, what we do know is that over the long haul, the loss cost trends in automobile are higher than that. And so that's why we think that that's going to be inadequate over time.

Of course, there are other things that are happening as well in the province. And as an industry, we have suggested reforms to the government. They have put reforms in place in the past, and that would be, certainly, helpful if product reforms go forward.

One of the more short-term impacts are that, generally, the product reforms that you put in place tend to address accident benefits and bodily injury claims and not automobile physical damage. And

really, where the short-term pressure reflecting this inflationary environment is on, is on actually the short-term claims and the accident physical damage.

So I think, as you step back, this just—it can't be seen, I believe, as good news. And I do think that there will be some views that the market is, at least in the short term, less attractive than other jurisdictions across the country. And that's why I think people will have to decide what they want to do.

When I just step back for a moment, for us, both the broker business auto and Sonnet auto represents about 6 percent of Definity's premium. We feel that our broker business, being so much more mature, is clearly in a different position than the Sonnet portfolio. And the Sonnet portfolio, in the grand scheme of things, is still less than 2 percent of Definity's premium, but it's material for Sonnet.

And that's why we have reduced our marketing expenses dramatically there. The portfolio is actually contracting as you have a normalized retention ratio. And so for us, we've got to just understand the details and then decide how we move forward. And I don't think we're going to be unique, quite frankly, in that approach, Geoff.

Geoff Kwan

Okay. That's helpful. Thank you. And just my other question was just on the CBCA approval. Just any updated thoughts on timing, why it's taking so long?

But also, in terms of pursuing major, or just call it transformative acquisitions, do you feel like you can only try to pursue those after you get approval? Or have you been willing to pursue it if it did or has come up prior to getting the approval to convert?

Philip Mather

Yeah. Thanks for that, Geoff. I won't estimate at a specific timing, but we do believe, at this point now, we're nearing completion of the process. So if I was to use a sporting analogy, I'd say we feel like

we're in the bottom of the ninth at this point, and we're looking forward to getting that process completed. And as I've said before, we don't control the outcome or the timing, but we're very confident at this point that we're at the late stages, and that process is coming to an end.

In terms of the acquisitions and looking at transformative opportunities, obviously, the nearer-term impacts of the ICA restrictions is on leverage. It wouldn't restrict us on preference shares or equity raises.

But also, if you think of the time horizon to actually complete a deal, once you go through regulatory approval, we'd estimate that the CBCA process will be out of the way long before we'd be through that. So we haven't seen it as a hindrance to any of the current deals. Obviously, you've seen we've been very successful on the broker side, and it hasn't inhibited our views of pursuing any strategic opportunity.

Geoff Kwan

Okay. Thank you.

Operator

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

Paul Holden — CIBC

Thank you. Good morning. I want to talk a little bit more about the margin outlook for personal auto. So, I think you mentioned sort of high-90s percent for the next two quarters because of seasonality. I don't know if there's any data points you can give us to help us sort of think through the entire 2024. Maybe some updates sort of on where premiums earned versus premiums rates sit and also claim inflation trends; just kind of help us think through what kind of margin improvement we might be looking at for next year.

Rowan Saunders

Yeah. Thanks for the question, Paul. I mean, I think, if you just sit back for a moment, we're definitely feeling much better about the personal auto environment than we were over the last couple of quarters. And what we have seen is that, essentially, the normalization has occurred, and we're seeing now flattening trends in severity, for sure. And then whilst there's still a little bit of a tick-up in frequency, particularly if you look at it year on year, that is now getting to be quite marginal.

And so I think, when you think about those trends, looking at slightly higher frequency and kind of flattening but still elevated severity, you get a loss cost trend, which is in that kind of middle-single digits.

Now when you then say, how do we think about that, you know we've taken a significant amount of pricing and rates. And so in the third quarter of this year, our written rate is now in the 13 percent-14 percent range, and that will continue into the fourth quarter, of course.

And the earned rate has been building all year, and it's now at about 6.5 percent. And so we're getting very close to that crossover period. And as we've kind of called before, we think in Q4, we will have actually crossed over, where the earned rate will be outpacing the loss cost trend in margin and, therefore, you start developing a margin contribution. And everything looks pretty solidly trending into that direction.

Our guidance has been that we'll be in the upper-90s, and that continues to be the case because as you got more power from this earned rate, we actually do go into a seasonal period where Q4 and Q1 are seasonally higher. So that's probably why you don't see a faster margin improvement. But then as we get into the rest of 2024, that mathematics kind of work its way through.

So I think that would be the kind of high-level trending we're seeing. And it feels like it's now normalized. We're comfortable and confident that the inflation has stabilized, and so that's important.

And then the other point that I might just ask Paul to touch on, with these significant rates that have gone through, we know the mathematics is going to work for us. It then just depends on what the more competitive market looks like and retention ratios and things like that. So any colour you could add on, on that point?

Paul MacDonald — EVP, Personal Insurance & Digital Channels, Definity Financial Corporation

Yeah. Thank you, Rowan. And so as we've called out before, we felt we were a little bit ahead of the market in taking such significant rate on our auto portfolio. And what we've seen is a response in the marketplace where double-digit rate is flowing through many of the markets.

That has reflected in our results, where we're starting to see a tick-up in new business and in retention rates which, essentially, gives us some confidence that the market as a whole is being rational and flowing through the loss cost into the need for additional rate. We expect that to continue, to be quite firm or, definitely for the rest of this year and into most of next year, we expect that those hard market conditions to continue.

Paul Holden

That's very helpful. Thank you. And then my second question is, with respect to the investment portfolio and income flowing off of that. Can you just provide us what the market yield is versus the book yield?

And I know Drayden's going to have some impact in terms of the potential investment income there. I guess what I'm really trying to get at is, if the entire book rolls over at current market yield, what's kind of the upside?

Philip Mather

Yeah. Thanks, Paul. So current market yield is about 5 percent on the portfolio, and current book yield is about 4 percent. So we're still maintaining about a 100 basis-point gap between those current market values. So I would say there is still opportunity, as we move forward into next year, to capture some additional yield in that rising rate environment.

Now obviously, that's where current yields are, and they've been pretty volatile. And as you've seen, we've been pretty proactive in deploying capital into some of the broker acquisitions. And so the pace at which we deploy cash out of the portfolio may impact the accumulation of future interest income. But certainly, we still believe that the rate environment is supportive right now, the capturing additional opportunity and generating that higher level of return overall for the Company.

Paul Holden

Okay. Helpful. Thanks for that.

Operator

Thank you. The next question comes from Jaeme Gloyn from National Bank Financial. Please go ahead.

Jaeme Gloyn — National Bank Financial

Yeah. Thanks. I just wanted to dig in on the Alberta portfolio a little bit more. Could you give us a little bit more detail on how the broker market is performing in Alberta in 2023? Like is this a—has this been a profitable business for you so far, year to date?

And obviously, if that's the case, the view is that you would sort of maintain your share or continue to grow it slightly in the 2024. So a little bit more colour on how that Alberta portfolio and the broker segment is growing and how profitable?

Paul MacDonald

Yeah. Jaeme, that's a great question. And actually, it's a good description of the situation for us in Alberta. So the broker portfolio is far more mature, as Rowan mentioned earlier. And we were fortunate to get the rate approved that we needed in advance of the most recent rate pause. And so we feel that it's progressing well and generating a required profit.

The challenge, of course, is how long will the rate pause continue and how much will it impact. And so there are loss cost trends that continue, as we have mentioned. And so the long-term aspect is one that we'll continue to look at very closely, but in the near to medium term, we're quite comfortable with our positioning in that marketplace with that portfolio.

Jaeme Gloyn

Okay. So prospects for growth in Alberta in the broker market are still present?

Paul MacDonald

We still strongly believe in the Alberta province in terms of investments. And as we've mentioned, we've recently closed that Drayden acquisition. We continue to be a strong participant in that marketplace, and we are actively working with the government and the industry to look at solutions for making that a rational marketplace. So we'll continue investing in that space and the broker—based on the back of our success on the broker side.

Jaeme Gloyn

Okay. Got it. And then just a clarification question in personal auto. Did I understand from the prepared comments, pools had a negative impact on the core by about 2 percent, and then PYD by 2 percent. So was it a 4 percentage points combined impact from industry pools? And can you describe a

little bit more about what was within those pools and driving that outcome? And it seemed like you took a bigger share than, maybe, your overall market share would imply.

Philip Mather

Yeah. Thanks, Jaeme. No. Maybe I'll step back and just provide some clarification. So think of it in two ways. What did it do to the actual quarter itself? And then what did it do, or what did the pools do, to the year-on-year comparison?

So if you actually look at Q3 distinct and the 98.9 percent combined ratio for the quarter, there's about a one-point drag from pools in that number. So excluding pools, the core portfolio was just under 98 percent. So there's one point drag in that.

When you look at the year-on-year comparison, the overall drag itself isn't that different. But where it does show up is some geography between core accident year claims ratio and then prior year claims development. So if you look on Slide 10, you'll see that the core accident year claims ratio year on year went up 4.6 points. Of that number, 2 points was pools.

So in other words, if you exclude the impact of the pools, the underlying accident year went up only 2.5 points year on year. That's actually a very positive story for us because it shows that the rate actions that we've been taking are starting to earn through, and they're starting to close the year-on-year gap from an accident year performance.

Because the pools' impact year over year wasn't that much, what happened the opposite way is that the prior-year favourable claims development moved not quite 2 points, but more or less the other way. So the positive—so the impact of that negative variance on core accident year was more or less offset on prior-year favourable claims development. So you basically, if you want to exclude it, you'd knock two points off both of those numbers. It's a bit of a wash overall.

So key takeaways, about a one-point drag on the distinct quarter; the underlying book more like 98 percent for the Q3 of this year. And then, year on year, the core accident year claims ratio, tighter than you'd see on that representation, the 2.5 points year-on-year variance, improving trend, and starting to close in on what we'd seen in earlier quarters.

Jaeme Gloyn

Understood. I appreciate—yeah. Yeah. Go ahead.

Philip Mather

And just a bit of colour. If we look at the full year on the pools, it's pretty much a wash. So this is a bit of Q3 timing going on. It's creating some noise in the individual numbers. But on an overall basis, we don't see anything unusual opposite market share or anything like that.

Jaeme Gloyn

Okay. Understood. That's good colour on the underlying core accident year too, so thank you.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press *, followed by the 1.

Next question comes from Mario Mendonca from TD Securities. Please go ahead.

Mario Mendonca — TD Securities

Good morning. I don't normally spend a lot of time on the tax rate, but they're obviously—it stood out this quarter. And I think I understand your explanations as it relates to CATs and dividends received from Canadian corporations.

What I'm asking you to think through now with me is, if we look forward a year and we tax the Canadian dividends in a different way, in line with the budget, the '23 budget, what would the tax rate have been? Would it have been materially higher in a quarter like this?

Philip Mather

Thanks for that, Mario. Not materially, no. So if you just think of it from a dollar perspective, if that change happens and all of those dividends become taxable, it's about an \$8 million impact on an annual basis. So it's about \$2 million a quarter. It usually impacts, on a more normalized quarter, a couple of percent. That's the overall tax rate.

It looks weird this quarter because you've got, obviously, the impact of the CAT losses consuming the contribution from underwriting results. So I think the step back is, if that change happens, it would be about \$8 million on an annualized basis, about \$2 million a quarter, so not material at all to the overall numbers.

But certainly, that number bounces along each quarter, based on just the contributions of operating income come from the different sources.

Mario Mendonca

I see your point about the quarter tends to exaggerate the effect a little bit, but the two points are relevant.

Philip Mather

Absolutely.

Mario Mendonca

Let me move on to something a little different. I always look at this company, Definity, as having a ton of excess capital and capital flexibility. That's sort of the whole point of the demutualization. But I

did notice that this quarter was different. Your MCT was off about 12 points, and I think your presentation shows that a fair bit of margin was eroded this quarter.

Is there anything on the horizon that would make you—do you see a scenario where you'd have to slow the pace of growth, direct written premiums, just essentially slow the pace of new business, to accommodate a slower growth in your capital margin? Or is that really far, like not really plausible in the current circumstances?

Philip Mather

Yeah. Thanks, Mario. No. I don't think in the near term we'd have any concern around that. Really, what happened in the current quarter is you had two perfect storms coming together a little bit. Obviously, the catastrophe losses were very high.

So if you think about the current quarter, we had 13.5 points of cat losses. Normally, we'd only have about 6 points. So that's actually a meaningful impact on the current quarter. And at the same time, you saw those rising yields coming through the investment portfolio. So combination of both of those is what caused some of the compression.

On the MCT, the 200 percent you referenced, that's what we leave down in the operating company. That can move around a bit. Our natural kind of level there is maybe like 190 percent to 200 percent operating range.

So we actually usually dividend out excess capital into the current so that it's available for deployment. And obviously, you saw we did the Drayden deal post quarter-end. So there is a bit of a disconnect between making sure the operating company is well capitalized, which we obviously focus on, and then the overall financial position of the Company.

And that financial capacity metric, we think, just gives a fairer representation. Sometimes, there's just—you're trying to manage your expectation of how the quarter will close before it actually has. So sometimes, you just—the level at which you draw out or even can bounce around a little.

But big picture, I think we're a long way off having the concern from a capital standpoint on anything in terms of our organic growth potential. We think that's a long way off.

Mario Mendonca

Sure. Thank you.

Operator

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

Tom MacKinnon — BMO Capital Markets

Yeah. Thanks and good morning. Two questions here. The first just really about Sonnet. I think you used to have a 2023 breakeven outlook, and then it moved out to 2024, given the Alberta situation. Is there any potential for this 2024 year-end breakeven for Sonnet to be pushed out any further?

Rowan Saunders

Good morning, there, Tom. It's Rowan. Look, I think as far as Sonnet's continuing, it's moving along the way we would have anticipated. We did—this was a year ago—kind of say that the targeted breakeven would be at the end of 2024. And that was really driven, at the time, mostly about the inflation period in the personal auto of where we were and the changes to the macro auto, kind of, cycle.

And so, I guess, that issue and the Alberta issue, which being 25 percent of Sonnet's auto portfolio—and it was actually larger percentage at the beginning of the year than that—is certainly not

helpful to Sonnet. But there's a number of actions that we are working with the regulator on as far as that product and province is concerned.

But outside of that, what we are seeing is Sonnet's still on its path to profitability. We're focusing on margin and overgrowth at this stage of the business, shaping the portfolio into higher quality segments, particularly all the work we've been doing on Definity.

An example is Definity in Q3 grew 27 percent year on year. So that shows you that, that traction—that is gaining a lot of traction. It's now, in aggregate, over 25 percent of the total portfolio.

And so there's no change in our kind of guidance there due to the Sonnet's kind of outlook at this stage that we have.

If there's any kind of caveat we have around that, it really just depends on our outlook for 2024 with respect to Alberta. If we can find a good solution to go forward, I think nothing changes, really, in our guidance. If we have to take a more extreme action, then we'll have to reflect the implications that, that has. But overall, it's still trending the way we had expected it to be, by and large.

Tom MacKinnon

Yeah. And then—thanks for that. And then the second question. Given that, I think, your tone was that the regulatory approval has not been any hindrance to looking at deals, I wonder if you can share with us what you're seeing out there with respect to broker acquisitions or the acquisition of an insurance company. Pricing trends within that? Suspect the broker acquisition, that those are becoming increasingly expensive.

Any flavour or any comments you can share with us with respect to what you're seeing in the marketplace in terms of pricing of potential deals? Or availability?

Rowan Saunders

Yeah. And look, we are active. You know, Tom, that's part of our strategy. And it probably wouldn't surprise you that there's more activity on the broker side than there is on the insurance carrier side. I think our thesis is that there will be more opportunities for consolidation or on carriers over time.

And we think some of the market's new pressures and things like a tighter reinsurance market, things like greater broker expectations for interfacing on technology, importance of scale, is all leading in to, we think, an environment where we will return to more of a normalized consolidation.

And as you know, over time, the industry typically trades a—consolidates by a couple of points of market share. So we're active. We have a very experienced corp-dev team, and we will see an update when we can on that one.

I think, on the broker side of things, this is clearly a big part of our strategy that we've deployed this year. We've been successful in deploying capital. We like this business because of the stable high-margin earnings. We also like it because it gives us access to a high-quality portfolio.

So as an insurance company, we get two streams of income, both the distribution income, plus the underwriting income. And you've seen that actually starting to help the stability of our earnings, so good earnings diversification.

In terms of your comment about pricing, I think it's pretty stable now from, certainly, what we've seen through this year. There doesn't seem to be a tremendous, deep difference direction up or down of these levels. I would say that the valuation of high-quality brokers is certainly elevated to what they would have traded for a few years back, but it certainly seems stable.

And I think it is very much dependent on the quality of the assets. And the assets that we've been successful in adding to our broker platform are all top-line assets. They're all very profitable. They

have been very sizable. And of course, you have a scarcity issue around those quality businesses. So I think that, that trend is going to continue.

And I would say, we are pleased that our proposition is resonating. We have not been the high bidder in the transactions we've done, partly because it's a really unique solution that we bring into the marketplaces. And that continues to have a healthy pipeline.

And in fact, McDougall has done a couple small deals in the quarter, and that's going to continue. I think that programmatic, smaller, bolt-on trend is finding quite a bit of interest in the marketplace.

So I think we're quite optimistic in terms of continuing to build that channel out. We were really pleased of how much progress we've made this year. I mean, when we first acquired McDougall, we'd hoped to double that over a five-year period. We've pretty well done that faster than we thought, and we see good opportunities in that area.

And again, we think this is a—in a very—I mean, it's definitely accretive to us and very supportive to driving us into our targeted operating ROEs. So we like it. We'll continue with that. But of course, we're still very focused on insurance carriers as well, which we know we need to do to get ourselves up to that top-five ambition, so more to come when we can.

Tom MacKinnon

Yeah. Thanks for that answer. Appreciate it.

Operator

Thank you. The next question is a follow-up from Paul Holden from CIBC. Please go ahead.

Paul Holden

Thank you. Thanks for taking my last question. I just want to drill down a little bit more on the overall picture for personal auto. I think it's important, just given your commentary around Alberta and the obvious challenges there, particularly for Sonnet.

And I guess, really, what my question is sort of putting together, the premium rate earned you've highlighted versus the claims inflation for the total portfolio, and then the drag on Sonnet volumes from Alberta. Is it correct to assume that the overall outlook for underwriting income for all of personal auto is still positive, despite the headwinds in Alberta?

Paul MacDonald

Yeah. Thanks, Paul. It's Paul here. Yeah. I think, again, a pretty good description of the outcome, as Rowan had mentioned, with our earned rate increasing toward the end of this year and, actually, it continues to increase into next year. So not only does that crossover period occur at the end of this year, but then we expect that continuation of the earned rate to offset trend and make up a little bit for that Alberta drag.

Of course, as we've said before, the Alberta drag is not—it hasn't been finalized, the degree to which it may be or it may not be contributing, simply because the regulation or the direction that's come out recently hasn't finalized all the details.

So we're going to continue to work with the regulators and with the government in Alberta to understand the real implication to the portfolio, but this has been going on for the better part of this entire year. And what we've been doing is proactively managing our portfolio to adjust for that, so we haven't stood still. We've redirected assets and capabilities to other provinces, we've continued to focus very much on our commercial and personal property lines, and so we look at this as an entire portfolio.

You've asked specifically about personal auto, exact same thing. We have operations in most of the provinces, and we manage this actively throughout the provinces and with the inclusion of new products, such as our UBI Sonnet Shift product, which I've mentioned in previous quarters.

So we'll continue to actively manage this portfolio, adjust accordingly to the Alberta scenario, and maintain our guidance around profitability in this portfolio.

Rowan Saunders

Yeah. And thanks for that, Paul. That's great. And I think, the way I would kind of summarize that, Paul, is firstly, you take into consideration the size of Sonnet auto. It's not huge, but it is running at an underwriting loss. And so as we contract that line of business, effectively, the size of the loss reduces.

Then on top of that, you pulled up Paul's comments, which is rate earning and premium growth picking back up. It's clear to us that the question about will the earnings in the auto portfolio improve going forward, absolutely, it will. We're past the trough, and our personal auto will become a bigger contributor again to the portfolio.

Paul Holden

Thank you. I think that's—yeah. I think that's a very important point. Okay. Thank you for that.

Operator

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

Dennis Westfall

Thank you all for participating today. A webcast will be archived on our website for one year, a telephone replay will be available at 2 o'clock today until November 17th, and a transcript will be made available on our website.

Please note that our fourth quarter and year-end results for 2023 will be released on February 15th. That concludes our call for today. Thank you and have a great one.

Operator

Ladies and gentlemen, this concludes your conference call for today. Thank you for participating, and we ask that you please disconnect your lines.