Definity Financial Corporation

Second Quarter 2024 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Definity Financial Corporation Second Quarter 2024 Financial Results Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded on Friday, August 2, 2024.

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

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

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

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

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

Thanks, Dennis, and good morning.

We reported strong second quarter results last night that were well ahead of our key financial targets. In the quarter, robust underwriting income, healthy levels of net investment income, and seasonally strong contributions from our insurance broker platform resulted in record operating net income of $109.1 million or $0.94 per share. Our second quarter combined ratio of 90.1% reflected strong performance across all lines. The benefit of higher earned rates flowing through the business, low levels of catastrophe losses, and ongoing operational expense efficiencies combined to generate a substantial increase in underwriting income.

Though we did not face the expected level of catastrophe losses in the second quarter, the events in July, from flooding in Southern Ontario to the wildfires in Western Canada, are reminders of the importance of delivering on our purpose to support our clients and communities. Our thoughts are with the families coping with the devastation from the Jasper wildfire and the realities of their path to recovery. I'm proud of the way our claims team are responding with on-the-ground support where that's possible to help our customers and broker partners rebuild and recover rapidly.

Our proactive rate actions in 2023 have put us in a strong competitive position to grow our personal auto book of business in what remains a firm market. The continued firming of conditions in auto, ongoing favourable conditions in commercial insurance, and our strong broker proposition combined to generate significant growth momentum in the quarter as gross written premiums increased by 14.2%. Operating results again benefited from growth in net investment income, driven primarily by

higher interest income that was enhanced by our active management of the portfolio in recent quarters. Combined with ongoing contributions from our expanded broker distribution platform, our financial performance led to an operating ROE of 10.8% and strong book value per share growth of 11.7% from a year ago.

Turning to the industry outlook on slide six, we believe the operating environment is one that remains conducive to sustaining favourable market conditions overall. We expect conditions in auto lines to remain firm, as insurers aim to keep pace with the combined impact of elevated theft, ongoing cost pressures, and regulatory uncertainty in Alberta. We also expect firm market conditions in personal property will persist, particularly following two consecutive years of industry cat losses above $3 billion, the move to higher reinsurance attachment points, and continuing elevated inflation. In commercial insurance, we expect the market to remain firm overall as carriers focus on ensuring long-term profitability and sustainable availability of capacity, though some commercial niche segments started to see more competition in the second quarter.

Slide seven shows our key financial targets for 2024. As you can see, both top line growth and underwriting profitability are better than target midway through the year while the robust results from Q2 propelled our operating ROE into double digits, reaching 10.8% for the past 12 months. We are focused on continuing the progress made in the quarters ahead with the objective to move toward the higher end of our target range before capital optimization.

Slide eight illustrates the composition of our national broker platform. We've made great progress in recent years to develop it into a vehicle to diversify and strengthen the earnings profile of the business

with repeatable distribution income that complements our underwriting operations. Looking ahead, we expect continued M&A activity and the organic growth potential of the business to result in $1.5 billion of managed premiums in the next three to five years. We continued our recent momentum with several additional deals in the first half of the year and maintain our expectation for 2024 operating income from this part of the business.

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

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

Thanks, Rowan.

I'll begin on slide 10 with personal auto. Gross written premiums were up 19.5% in the second quarter of 2024, driven by a double-digit increase in written rates, improving unit count growth, and the benefit of portfolio transfer activity. We expect our broker business to benefit from strong retention, portfolio transfers, and the inherent scalability of our Vyne platform, combined impact of which should support a mid-teen pace of growth for the remainder of 2024. We will continue pursuing additional rate and segmentation actions to maintain our target profitability.

Focusing on our direct business, Sonnet, we made the decision to exit the auto business in the province of Alberta. With no visibility to near-term profitability, it was a necessary decision. Given the loss-making nature of Sonnet's Alberta auto book, withdrawing from our business there reinforces our confidence for the remaining Sonnet portfolio to reach our run rate breakeven target by the end of the year.

Personal auto generated a very solid combined ratio of 95.2% in the quarter, 2.4 points better than a year ago. The performance reflects the benefits of our active expense management and an improvement in the core accident year claims ratio, which continues to benefit from higher earned rates but was again impacted by heightened, though diminishing, levels of theft. Favourable claims development amounted to 0.5 point of loss ratio inclusive of adverse development of pools of about a point. We maintain our expectations for personal auto to generate a mid to upper 90s combined ratio in 2024.

Turning to personal property on slide 11, growth momentum continued to build, reaching 7.1% in the quarter, and benefited from continued firm market conditions, driving increases in average written premiums. This was partially offset by ongoing actions to address risk concentration in geographies with a higher propensity to peril events. We expect this line to grow at a mid to upper single digit pace for the full year given the firm pricing conditions prevalent in the industry. Focusing on the bottom line, we reported a combined ratio of 86% in Q2, significantly better than the 102.5% from a year ago. The unusually low level of catastrophe losses in the quarter was a key contributor to the strong underwriting performance. That said, July was an active month, flooding in Ontario and wildfires in Western Canada. Though the inherent volatility of cat losses makes the timing of them difficult to predict, on a year-to-date basis to the end of July we are in line with the expected level of losses companywide from weather-related catastrophes. We continue to target a mid 90s combined ratio in personal property on an annual basis.

Slide 12 outlines the highlights in the quarter for our commercial business as double-digit growth in commercial lines continued with gross written premiums up 13.8% versus the prior year. Strong growth momentum was driven by targeted growth across strategic segments with strong retention and rate achievement in a firm market environment in our core segments and further expansion of our small

business and specialty capabilities. We expect commercial insurance to maintain growth of double digit to low teen pace in 2024. Commercial lines benefited from a continued focus on underwriting execution with a strong combined ratio of 86.6% in Q2 of 2024 driven by a 2.7 point improvement in the core accident year claims ratio. The reported increase from last year's 84.3% was a function of a COVID-19 release that benefited favourable development by 4.8 points in Q2 of 2023. Normalizing for this release, our commercial business reported a 2.5 point year-over-year combined ratio improvement. We continue to operate our commercial insurance business with the intent to sustainably deliver an annual combined ratio in the low 90s.

Turning to slide 13, consolidated premiums increased 14.2%. The purposeful nature of our growth through our underwriting expertise, pricing strategies and product expansion, along with the continued focus on expense management and the benefit of favourable weather conditions resulted in a second quarter combined ratio of 90.1%. This marked the strongest quarterly combined ratio we've reported since going public in late 2021. Our expense ratio of 30.1% was 1.5 points better than the prior year, benefiting from the investments we've made to improve productivity along with our disciplined expense management. As there were some benefits from timing, we view our year-to-date expense ratio as a better indication of our expectations for the full year. Focusing on distribution income, the seasonally strong second quarter contribution of $17.2 million reflects both the ongoing inorganic expansion of the platform and continued strong organic commission growth across the business. As we mentioned on past calls, the full impact from our national broker platform also includes a benefit to consolidated expenses in the form of the commission offset. In aggregate, we maintain our full year target of $75 million before finance costs, taxes, and minority interests and expect it to have a roughly 70-30 split between distribution income and commission offset.

Slide 14 highlights the components of our investment portfolio. Our net investment income again increased meaningfully in the quarter, up more than $7 million from Q2 of 2023, due to higher interest income from increased book yields captured through active management of the fixed income portfolio. Growth is expected to slow from double digits to single digits for the full year 2024 as book yields and market yields have converged. We maintain our expectation for full year net investment income to exceed $190 million.

As you can see on slide 15, our financial position remains robust with shareholder equity surpassing $3 billion for the first time and nearly $1.4 billion in financial capacity. Strong operating income supported growth in our capital in the second quarter and generated year-over-year growth in book value per share of nearly 12%.

Slide 16 shows recent capital management actions and longer-term priorities. When it comes to deploying our capital, the primary focus remains in support of our robust organic growth strategy. We also intend to continue growing our dividend over time. With an objective to build the company into a top-five player in the industry, we are actively pursuing inorganic growth, including both insurance carriers and distributors. Flexibility to leverage short-term debt in support of organic growth increased in the quarter as we upsized our credit facility by $100 million to $800 million. Following our initial build of the platform via our partnership with McDougall, recent broker acquisitions have been more programmatic in nature. We expect this to continue and have successfully deployed almost $100 million year to date.

With that, I will turn the call back over to Rowan for some final remarks.

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

Thanks, Phil.

While favourable weather bolstered the performance in the second quarter, on a trailing 12-month basis we've experienced cat losses somewhat above expectations and still delivered a 10.8% operating ROE. This gives me confidence in the strong underlying fundamentals of the business. We've taken the actions we believe are required to ensure our success is sustainable, from last year's focus on auto rate adequacy to the management of our property portfolio to address potential cat exposure to our work with the Alberta government and eventual withdrawal of Sonnet from the auto market in the province. At the midpoint of this year, we are in an excellent position to continue building on our profitable growth momentum. We are realizing the benefits of the operational leverage of our digital platforms and remain active in our efforts to further our track record of success. And we have the right team in place to deliver on ambitious plans. In fact, one of our key strategic pillars is being an innovative, high performing, and inclusive culture. Great Places to Work Institute has recognized our efforts on this front and has recently named Definity as one of the Best Workplaces in Financial Services and Insurance in Canada for 2024.

And finally, I'd like to welcome the latest addition to our Board of Directors, Sonia Baxendale. Sonia brings over three decades of experience as an executive and board member in the financial services industry. Her appointment will further strengthen Definity's ability to navigate the opportunities ahead in a dynamic industry and market environment.

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

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

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

Q & A

Operator

Thank you. Ladies and gentlemen, if you would like to ask a question, please press star followed by one on your telephone keypad. If you would like to withdraw your question, press star two. If you are using a speakerphone, please pick up the handset before pressing any keys. One moment please for your first question.

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

Geoff Kwan — Analyst, RBC Capital Markets

Hi. Good morning. My first question was on personal auto, just the comments around kind of mid single digit physical damage inflation. Just wondering, do you see it staying at this level for a while? Do you see it eventually coming down into the low single digit? And really, if it does get to that level, what would be the key drivers that would get you there?

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

Thanks for the question, Geoff, and just maybe a quick comment before I ask Paul to give you some details on that. I think that we are watching the trends very carefully and are generally seeing some favourable momentum. I think that when we look at our overall auto portfolio, we're pleased with our positioning and we're outperforming the industry. We're pleased with the trending. As we've told you in

the past, we're very focused on cycle management, and the last couple of years was not the type to grow without focusing on quality and rate. We've moved past that trough and are now quite comfortable with the environment and you've seen very strong kind of growth of the personal auto portfolio. A lot of that is still rate in the portfolio. But the reality is we are comfortable and seeing some stability in the loss cost trends and that's why we're leaning into the growth.

But Paul, do you want to add a bit more colour to that?

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

Yeah. Thank you, Rowan. So, Geoff, you asked specifically about APD and what we've noticed is that it seems to be stabilizing at about that mid single digit range. Of course, the theft component still remains a little elevated. We mentioned previously frequency is down and we're seeing a further reduction in frequency, but the actual cost of the vehicles being stolen is still quite elevated. So, although it's stabilizing, just as a reference point, pre-pandemic it was about 2% of loss costs, now it's still almost 5%. So, more work to be done on that component, but APD as a category, it does seem to be stabilizing around that mid single digit level.

You asked do we think it's going to get much lower than that and I think the answer is likely not too much lower. If you think even pre-pandemic, the cost of vehicles, the content in the vehicles, cameras, technology, the increasing percentage of EV vehicles in the fleet, all contributed to a mid single digit trend and we expect that to continue on in the near future.

Geoff Kwan — Analyst, RBC Capital Markets

Got it. Thank you for that. And just my second question is just any updates in terms of the CAT Aggregate cover policy have kind of, ah, what's the, I guess, usage or how to think about it on a year-to-date basis? And then also, two, is it still fair to say that it may not necessarily be cost effective to get a new CAT Aggregate cover policy when the current policy expires later this year?

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

Geoff, thanks for that question. Yeah, so in terms of where we are on a year-to-date basis, I mentioned that July has obviously been an active month and we saw pretty large events for us in the GTA area, but overall the year to date at the end of July is very much in line with our overall expectations. And the Agg-only really you want to use it in outsized years like Q3 of last year as an example. So right now, the way the Aggregate works, you know, each event above $3 million will contribute a certain proportion into the accumulation, because we've had a reasonably in line year to date. We're not at a point yet at which the Aggregate is switched on is the way I'd kind of describe it. So, there would still need to be some additional loss activity to get that to a point where it's going to respond. But like I said, that's really reflective of overall to the end of July, pretty much in line CAT experience.

In terms of the renewal cycle, we certainly think volatility protection, there's a role for reinsurance to play in there. The Aggregate is the best example of that. But since we put the original three-year contracts in place, the reinsurance market hardened significantly. You've seen it move up in attachment points around that. We would definitely have an appetite for a renewal of an aggregate style structure as part of our reinsurance strategy, but it has to be on terms that are effective for both counterparties. So,

it's something for sure we'll explore, and if the opportunity is there on an appropriate basis, we'd certainly have an appetite, but we have to be kind of cognizant of the market conditions that have changed somewhat since we put it in place the first time.

Geoff Kwan — Analyst, RBC Capital Markets

Okay, great. Thank you.

Operator

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

Doug Young— Analyst, Desjardins Capital Markets

Hi. Good morning. So, the announcement that you're taking the Alberta Sonnet business out of operating and putting it in exited lines, I'm hoping you can just give us some colour in terms of what the impact that will have on underwriting profit, on operating earnings, any metric you can, just to give some context of how to think about that.

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

Doug, thanks for the question, and maybe before Phil gives you a little bit more insight I think it's kind of worth pausing on for a moment, because I think that we step back to the context there, I think we've signaled this for some time, that unfortunately, in the Alberta environment, the regulatory changes there have made it difficult for a start-up company like Sonnet. And as you recall, I mean the government had an auto freeze that went to a cap at the level of general inflation, which just isn't enough for a business

like Sonnet that was rate inadequate, but even considering the trends that are currently happening in Alberta. So, there is certainly some concern we have with that marketplace where the cap of rates is just not going to keep up with the loss cost trends.

We've worked closely with the government over the past year. We were looking for an exception for the Sonnet brand. Unfortunately, that did not happen. We, therefore, could not see a path to breakeven or profit in the foreseeable future. And I think as we've shared before, this is a material portfolio for Sonnet, it's 25% of Sonnet's auto portfolio and 19% of total Sonnet, but it's really not that material to the group with less than 1.5% to Definity. And I think the way we look at it is that this portfolio would have continued to deteriorate. And as you know, we were focused on getting Sonnet to breakeven by the end of the year, and if that portfolio continued to build up losses that would have been very difficult to do. So that was the kind of rationale. We filed our exit. We will still be issuing policies until the end of the year and then there'll be that $65 million decision. So, I think that's the main message of kind of what we've done and how we've done it.

And perhaps, Phil, you can add some detail to the rest of Doug's question.

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

Absolutely. So, as Rowan has said, in the context of the business overall, it's a relatively small portfolio, and in the context of Sonnet it's much more so. So, the actions that we're taken are really about preserving our confidence in our ability to achieve those go-forward financial targets. And the impact on this historically has been relatively modest overall given the size of that portfolio. So, if I look forward to the kind of expectations for auto as a whole and for Sonnet in terms of kind of breakeven run rate view

achieving that by the end of this year, we aren't changing our views on that. So, the announcement to exit the Sonnet Alberta auto was more about preserving those views and we reiterate kind of our guidance on that point.

In terms of how exited lines will shape out, under the terms of the withdrawal, we'll still be required to underwrite business for the next six months through to the midpoint of December, so you'll still see, written premiums will show up as part of the exited lines presentation. We'd estimate there's about $50 million worth of earned premiums to come through over the next six quarters. That will take us through to the end of 2025. Maybe half of that comes in the next couple of quarters and half in the year 2025. And this is a loss-making portfolio, so we have taken that decision to exit, so you will see underwriting losses come through on a go-forward basis. Certainly, with the new accounting standards, as you write business, you have to put losses up against that, so it will be more front loaded. And so what we'd probably expect to see is we still expect to see some millions of dollars of losses come through on this portfolio overall, not tens of millions, and for the next few quarters we should expect to see a few million dollars a quarter come through in exited lines associated with that continued requirement to underwrite the business and earn it out over the next six quarters or so.

Doug Young— Analyst, Desjardins Capital Markets

I appreciate the colour. And then second, just on the commercial market, I mean we're hearing from a number of players about increased competition and you're talking more in the niche markets. Hoping you can dig a little into that in terms of what you're seeing and what do those niche markets, you

know, I assume in those niche markets you're seeing prices drop, and what do those niche markets represent in terms of your total commercial portfolio where you're seeing increased competition?

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

Thank you, Doug. This is Fabian Richenberger answering your question. So you're right, we've seen increased competition coming to the marketplace this year in those niche segments. I would say that large property and large fleet businesses would be a good example of that. But what would I say is that we are very proud of our front and online team as they've been executing our business plans that it allows us to sustain our strong margin position that we have across commercial insurance.

I think one data point that is important for you to consider is to look at our overall growth rate that we achieved in Q2. Our growth rate came in at 13.8%. And what is important to note is that over 40% of that growth rate is being generated through rate and inflation adjustment actions and that gives us a great deal of confidence that we continue to cover the loss trend that we have in our commercial portfolio and with that we will be able to sustain our guidance of low 90s combined ratio going forward.

To answer your question more specifically, kind of what helps us as well is that large account segment in our portfolio is the smaller segment. So we are, as you would expect, making appropriate decisions between sustaining our growth and protecting our profitability. And if a large account proposition doesn't make sense to us from a margin perspective, we are quite happy to let go. And given the fact that those segments are small, less than 15% of our portfolio overall, you don't really see the impact of those decisions on our portfolio overall. So, big picture is that we like the business, we like the

run rate profitability, and we are comfortable to sustain our guidance of low double-digit growth and low 90s combined ratios in the commercial space.

Maybe the other point to add as well, as we mentioned in prior calls, we built out this strong value position in our core strategic segments. We are focusing on small business and specialty business and we are very comfortable with our new business rate retention growth that we have in those segments and, more importantly, very comfortable with the margin position in those segments as well as our underwriting capabilities. In small business, we are benefiting from a market-leading digital capability that allows our broker partners to quote and bind in an automated fashion and that gives us good profitable growth opportunities. And in specialties that we are very comfortable with our margin position as well, we have very strong underwriting capabilities. And something that we're not talking about all that often, for five years now we've been the leader in the sharing economy in Canada. We've had those partnerships in place for five years, as I mentioned. Very comfortable with the market position, very comfortable with the partnership, and what people have noticed over the last few years is that those segments generate above-average growth as compared to the general economy, so what I would say is that this gives us a great deal of confidence that our growth guidance in that low double digit range is sustainable and is not hurting our profitability going forward.

Doug Young— Analyst, Desjardins Capital Markets

Appreciate the colour. Thank you.

Operator

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

Paul Holden — Analyst, CIBC Capital Markets

Thank you. Good morning. So, from some of the US insurers we're seeing increased negative PYD related to liability, the so-called social inflation. I know your PYD remains favourable, but just wondering if you're seeing, in any lines of business, any indication that liability trends are becoming more challenging. Are there any kind of early warning signs that it's something to keep a closer eye on, whether that's in personal lines or commercial?

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

Why don't you go first, Paul?

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

Thank you. So, Paul, social inflation is really a feature of the awards given to the plaintiff being inflated by jury awards. We don't really see that pressure in Canada. And so, on the casualty lines, we still have seen a fairly persistent mid single digit trend, which is in line with what it was pre-pandemic. That being said, we are starting to see a little bit of an increase on BI trending, specifically in Alberta. A couple of points higher than that mid single digit trend we're seeing elsewhere. But this seems to be specific to that territory and really focused on litigation costs. And by that I don't mean the awards going to the plaintiff or the injured party, we mean legal costs associated with carrying those cases through the court system. So, we're watching that carefully, but we're not seeing that in other parts of Canada.

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

And maybe just adding some colour from the commercial perspective, I think very much in line with what I just mentioned is that our portfolio is a portfolio of low-end exposures in the small lower end and middle market space, so we don't really have those global or scary liability exposures. And with that in mind, we are very comfortable with the liability trends that we're seeing in our commercial portfolio as well and, as I mentioned, we do expect that we're going to be able to cover those loss trends with adequate rate and inflation actions.

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

So, Paul, I think we feel pretty good about that. Not too concerned. And just a little bit of context to what Paul shared is, when we think about where there is a little bit of a slight elevation in Alberta, Sonnet's exiting and that was 4% of our auto portfolio and the only other part of the business there is the broker segment, which is just about 8% of the auto portfolio, so really kind of a small portfolio in the grand scheme of things.

Paul Holden — Analyst, CIBC Capital Markets

Okay. Okay. That's all helpful. Thank you. And my second question is related to personal auto specifically and I'm just wondering, given the expense improvements you've seen, I know look at more year to date versus Q2, but the expense improvements, the claims, the better claims management tools you're going to put in place, and then sort of the rates you've gotten, does that give you more confidence

that the combined ratio should be more in the low end of your mid 95 to upper 90s guidance range? And I guess most importantly to me, given those initiatives, is that kind of a sustainable guidance range going into next year?

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

I mean I think I'd just start that answer by saying, look, I mean I think, number one, when we think about ourselves compared to the industry, we're outperforming, and so I think we're in a pretty good position there. And what we are seeing is year-on-year improvement and we pay a lot of attention to that accident year, the attritional loss ratio. There, however, are still a couple of trends that we're dealing with. Paul talked about theft. That's still elevated. We think that will settle. Alberta we just talked about, and whilst it's not a big portfolio for us, it's going in the wrong direction. And then there is some offset from the industry pools that have kind of adapted to our profitability. So I think we've got to figure, you know, keep all those things in mind. But this is a regulated line of business, our kind of, let's call it, run rate target is more in the 95 kind of range, and as Sonnet continues its pleasing progress, we'll get there. So I think it's more about timing, Paul, for us. And so we're not changing guidance at this stage, but ultimately we've got a good level of confidence that we will be able to run that total auto portfolio in that the mid-95s area.

Paul Holden — Analyst, CIBC Capital Markets

Okay. Okay. That's great. That's all for me. I'll leave it there. Thank you.

Operator

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

Jaeme Gloyn — Analyst, National Bank Financial

Thanks. Just wanted to get a little more colour on the expense ratio improvement. Your guidance would suggest 50 basis points coming from distribution income. I'm just wondering, does that apply to this quarter on the year-over-year improvement? And how much would the expense savings initiatives around the real estate footprint and then scalability? Like if you could break down the contribution of those drivers to the year-over-year improvement.

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

Thanks, Jaeme. So, in terms of the national broker platform, you're right, it's about a 0.5% or 50 basis point structural benefit to the commission ratio at this point in time. Obviously, as that broker platform expands and as we continue to focus on winning business through that platform, that could increase, and certainly we'd have a goal and an objective to do so, but that kind of about a 0.5 point benefit is structural to this quarter. It's up a little bit from last year and we'd hope to grow it over time, but about 0.5 point basis point improvement is valuable.

In terms of the expense initiatives going forward, what you're really seeing from us is a focus on discipline. So, what we're trying to do now is grow the operating expense base at a much lower rate than the earned premium pattern coming through. And I think you'll see that our operating expense ratio within the expense ratio overall is around 12%. That was over 13% not too long ago and we still think there's a good opportunity to drive that down maybe to 11% or below over time.

Now the real estate component itself, as an example, isn't a huge cost saving, but really what we're doing here now is we're able to grow the organization without adding additional cost to the base. So, it's a really good example now of leveraging the scalability of the organization. We do not need to grow the FTE at the same pace and therefore we don't need to grow the footprint occupancy costs of that either. So, I'd say that's a good example, not so much of a dollar out kind of perspective but our ability to kind of grow the scale of the organization going forward.

So, if I step back, the year-to-date view of just under 31%, we're really pleased with that. We're really pleased with the progress that we're making in terms of leveraging the scale efficiencies of the organization. We think that's a pretty good pick for the second half of the year. That's what we're focused on achieving. But we still think there's a point or so of additional opportunity to get out of the operating expense ratio over the next period of time.

Jaeme Gloyn — Analyst, National Bank Financial

Okay. Great. And then second, just on the distribution income, there's been a handful of smaller, I guess, tuck-in broker acquisitions so far this year that you're dedicating some capital towards. Is that the view going forward or do you still have…? I believe in previous calls you kind of talked about maybe doing another larger-scale broker acquisition. Like where would you say you are on that side of the M&A story?

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

I think that we're definitely very pleased with what we've built. And part of this is the opportunity. And so, over the last 18 months, we had the opportunity of adding three scale high-quality brokers, which

really created the bulk of the platform. If we could find or when we find something similar, we're absolutely happy to and lean into that and add it on, but I think what we're finding in the meantime are generally smaller, we call them more programmatic bolt-on acquisitions. The pipeline is pretty good. The McDougall's team have been active. We completed five transactions so far this year. So, as they come on board, that's obviously going to help going forward and the organic growth is still pretty good.

I think the main message here is that nothing too much is different. The market is consolidating, but we do believe there's going to be a healthy pipeline for really quite some time. But there really are not a huge amount of large, high-quality assets available. So those are much more kind of rare to get and we were just very fortunate and pleased that we've got off to such a good start. So, I think what we can count on is a healthy pipeline of smaller transactions as opposed to larger ones. But we wouldn't rule that out if we could find the opportunity.

Jaeme Gloyn — Analyst, National Bank Financial

Right. And just following on that, just given the transactions in place so far and the growth in premiums, as we think about future years for distribution, and I don't think you provided guidance, but thinking through that, I mean, at a minimum, like double-digit growth in future years would be kind of the expectations or something maybe more elevated?

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

I think we'll refresh the guidance as we obviously get through closer towards the end of the year, but certainly you've seen continued activity and I think we've certainly got an objective to grow that over

time. You've seen that we're hoping to get to $1.5 billion of premium scale over the next three to five years. That'd be a good proxy from kind of where we are today to where we think we could go. Timing of that is obviously dependent on the transactional activity. But we'd also say beyond that, the underlying business is in really good shape. They've got very good strong organic growth capabilities outside of transactional M&A and we're very fortunate there to have a strong leadership team in place. So, there's good opportunity outside of M&A to drive that forward as well, but we would refresh our 2025 views later on in the year, but certainly, you know, direction of traffic as we continue to scale the size of that organization, it should flow through beneficially into that distribution income component.

Jaeme Gloyn — Analyst, National Bank Financial

Great. Thank you.

Operator

And there are no further questions at this time. I will turn the call back over to Dennis for closing remarks.

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thank you, everyone, for participating today. The webcast will be archived on our website for one year. The telephone replay will be available at two o'clock today until August 9th and a transcript will be made available on our website. Please note that our third quarter results for 2024 will be released on November 7th. Please also note that we'll be hosting our inaugural investor day in Toronto on Thursday,

September 19th. Additional details will be posted on our website a bit closer to the event. That concludes our conference call for today. Thank you and have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect. Thank you.