Intact Financial Corporation

Virtual Fireside Chat with Charles Brindamour, CEO of Intact Financial Corporation & Mario Mendonca, TD Securities

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TRANSCRIPT

Mario Mendonca — TD Securities, Intact Financial Corporation

Good morning or afternoon to everyone listening in, or when you're listening to the recording. This is Mario Mendonca, TD Securities.

Today, I'll be having a conversation with Charles Brindamour, President and CEO of Intact Financial. I think these are obviously very trying times for everyone, and I'm finding these calls with the CEOs of the insurers and other companies, I'm finding them very helpful myself and I hope you're finding this helpful for you as well.

Charles, thank you very much for doing this. I sincerely appreciate you taking the time.

Charles Brindamour — Chief Executive Officer, Intact Financial Corporation

No. Thank you. Thanks for doing this, Mario. I think that it is unsettling for many people and communication is very, very important, and so I appreciate and support your initiative there.

Mario Mendonca

Thank you. Let me get started by asking a more—a broad question about how you think the COVID-19 virus is impacting your business. Let's stay away from the big macroeconomic issues right now and just think about the business and how you run it.

Charles Brindamour

Yeah. Thanks. So dealing with COVID-19 and the crisis that results from it is clearly our number-one priority. And given the nature of our business, we can mobilize, at lightning speed, when faced with a crisis, because that's the business, the environment we're used to deal with. I'd say, high level, the trains are running on time and we're there for customers. And we've been focused on this, Mario, since early February.

Our focus is twofold. First, the safety and well-being of our people. And second, to be there for customers and brokers when they need us. So as of today, 98 percent of our 16,000 people are working from home. We have less than 300 people in the Intact office on Friday, and we're preparing for an even stricter lockdown. And if it were to happen, we have plans to operate the business without our offices.

Our employees, I personally keep informed on a daily basis. There's a good degree of engagement. The managers are very much in touch with employees to make sure people understand what's happening broadly, what's happening within Intact, what it means for them, but also what we expect of them. This is an environment where we need to make this work for customers, now that employees are safe.

You won't be surprised; we're not relying on public health to monitor the contagion risk, and we've developed our own monitoring mechanism where we track symptoms, as well as actual cases. And I'd say, it's fair to say, overall, the team at Intact is healthy. So when I look back in the past month, I'm pleased with what people have accomplished in a very short amount of time.

So despite the very different work environment and despite the disruption, I'd say, I just zoom in on service, which really matters now, and it's very solid across all business units in North America. Service levels are at or above target on all phone queues.

We've been leveraging our digital tools. As you know, we've made big investments on that front in the past four, five years, and these come in very handy now to make sure there's no interruption in our services. Because insurance is an essential service, and we see a strong pickup in those tools.

Electronic claims payment offered to about 95 percent of customers. No major delays in the supply chains, and we're closing files and getting Canadians back on track, as well as our clients in the US, as quickly as we were before the crisis.

The IT infrastructure is robust. Performance is really good. And one of the things we've done, Mario, a few weeks back, is to activate our cyber defenses because we've seen activity pick up on that front, but doing well.

We know that this is really tough for families across North America, as well as small businesses. And let me give you a bit of a recap of the actions we're taking on the front lines to help our customers.

First, we've engaged into payment deferrals, fees elimination, and just overall financing relief for those that are most impacted by the crisis. Second, we're adjusting risk profile for customers, where it might lead to premium relief. In other words, you don't drive to work, if sales in your businesses are down dramatically, if you're parking fleet and so on, we'll adjust your risk profile to make sure that we take into account this environment. And we've been involved in a fair bit of community support as well.

Insurance is an essential service. This was widely recognized by governments, in particular in Ontario and Quebec, last week, which means that we can operate effectively and maintain customer service, which is now our main objective.

So I think overall, Mario, we're in good shape to keep doing what we do best, and it's help people be resilient in bad times.

Mario Mendonca

That's helpful. I guess the last thing you want to worry about is your insurance claims right now—or rather, monthly insurance. You sort of just take that for granted right now.

Charles Brindamour

That's exactly right.

Mario Mendonca

If we could now speak to the individual business units. Because I can certainly see businesses that might even function better in this environment—personal auto, for example. But then maybe there are others, some offsets to that. Could you help me think through, in your individual business lines, how the current environment might be impacting them positively or negatively?

Charles Brindamour

Yes. Because you're right, the impact is uneven by line of business, and it's also uneven by quarter, if you look at how the year will unfold. So, clearly, this is an important source of pain for many economies around the world, and we're focused on managing the business to help, while keeping operating performance on track.

Again, Mario, you won't be surprised. We've modelled a number of scenarios, ranging from mild to severe. And our view is that the underwriting performance should overall be on track, maybe not even throughout the year, but be on track under most scenario. And then, on the top line, one could expect an impact ranging from low single-digit to low double-digit, depending on the duration of lockdown and the severity of the economic downturn.

The top-line perspective itself is driven by three economic scenarios; coverage adjustments as risk profiles change, as I mentioned earlier; and temporary pricing relief in the SME space for sectors that have been most affected by the environment.

If you look at expenses, there's no doubt that the crisis will lead to additional expenses, potential for increase in bad debt. But then we're managing resources to ensure that our expense base moves commensurate with the level of business activity. And we're also put a plan in place to make sure that the one-time shocks that we have to absorb will be upset by a number of expense reductions that either

happen naturally as a result of the slowdown, or our discretionary calls that we've made in the past couple of weeks to make sure that the expenses don't become a burden. I think we have a good plan on that front.

On the underwriting performance front, or call it bottom line, it indeed very much varies by line of business and by quarter. In aggregate, I expect this to be fairly neutral in both mild and adverse scenarios for 2020. One would expect to see some mild benefits in early months as a result of sharp reduction in activity, while pressure will likely build in commercial lines as the economy stagnates.

So if I take it line by line, Mario, in auto, because of the slowdown in driving, which we see on a daily basis through our deep UBI penetration, we're likely to experience a temporary reduction in frequency. We're starting to see that in our claims call centre. Also true in commercial automobile. Now given we're adjusting risk profiles, adjusting premiums for most-impacted customers, for the year in aggregate, we think that the impact there is likely to be marginal.

Personal prop, we don't really expect an impact. You've got offsetting factors. People are at home and, therefore, could catch claims maybe faster. On the other hand, you have moral hazard building up. We don't expect much on the personal property side of things.

I think commercial lines is maybe more complex. And let me unpack commercial lines per se. So in what I would call our *Main Street* operation, that is our standard commercial lines operation, in general, there's no business interruption coverage because you need an insured peril to trigger a coverage. And the business we're in is getting businesses back on track after a physical damage. So think fire, theft, flood, natural disasters. We're not in the business of pandemic.

And so, in the Main Street operation, there's two risks that we're watching for. One is vacancy of buildings and the increased emergence of fires as a result, as well as, over time, if the economic slowdown persists, moral hazard, which is something to watch for.

Specialty lines is the area where we might see more direct impact of COVID-19 as opposed to indirect impact, because you have custom coverage in those lines of business. So think of lines like entertainment, for instance, with event cancellation, as well as tuition reimbursement. These are two examples of specific lines where one could expect to have some exposure. Beyond that, you could think of a potential for liability claims on the employment front, as well as through director and officers.

Overall, we think the impact to IFC across all lines is expected to be fairly neutral from an operating point of view. We think our product is resilient throughout economic cycles, and we've proven that in previous economic downturns. And we're working with customers to make sure that we're providing as much financing relief as they need in the context of the coverage we provide. And then where profiles are changing for an extended period of time, and then we're adjusting those profiles as well.

Mario Mendonca

That's helpful. Going into this, the business was functioning well. A very firm market across the board. This fairly meaningful drop in rates and maybe investment income, does it have the potential to extend the firm market conditions a little longer than what you originally contemplated?

Charles Brindamour

I think this will indeed take it a little further out, because I expect certain areas of the market where there'll be temporary pause. Where relief needs to be given, I think it's responsible to pause there and make sure that we help customers in that environment, in particular in the SME space.

There is indeed investment return has an impact, but there's a possibility of that. I mean, if you go back in late '19, the industry indeed was firming up, both here and in the US. And this was primarily driven by the fact that closing '19—and the numbers came out last week, Mario, at the industry level—the ROE was 5.5 percent in '19, and 4 percent before investment gain. So this will need to be corrected over time. And if there's pressure on the investment income front and there's a slowdown because of relief for a number of months, it's clear to me that this corrective action that started in '19 is likely to extend further out.

We're clearly in a different environment now. And as an organization, we want to support the Federal and Central Bank action to ensure that most vulnerable businesses will go through this crisis and come back online quickly when health concerns subside. That's in our interest. And that's why, beyond financing relief and coverage, I think there'll be a bit of relief for a few months; at least these are the actions we're taking. But past that point, the industry will need to self-correct.

We hope COVID-19 will be a short-term situation. We're out there for customers. But if you look out 18 to 24 months, when you look at where the industry was in '19, no doubt in my mind that there'll be continued rate momentum until the industry is back towards 9, 10 percent ROE, its historical level. So I think a bit of a slowdown but only temporary.

Mario Mendonca

That makes sense. Can we just now speak to maybe some of the macro impacts. When I look at the sensitivity that you provide in your MD&A, the equity market sensitivity, the interest rate sensitivity, I'm not seeing a material impact on earnings. And I'm talking about operating earnings. I'm not really—I know there could be impairments and that's something we should think about as well—but I don't see it a lot to earnings, primarily because of the hedging I see that you have in place. But what I am seeing is a

meaningful impact to the Company's book value. Am I thinking about this in the right way? Are there any goalposts you can offer us to think about book value and capital generally?

Charles Brindamour

Yeah. So I think, directionally, Mario, you're right. Your read is, in my mind, pretty much right. I think the net operating income per share, if you look at the comments I've made on the operating performance, I don't expect much, and it's not overly impacted by mark-to-market movement. So I think that side should be on track.

I think the book value per share then picks up indeed gains, realized or not, it picks up impairments, it picks up market value movements. So everything is in the book value per share.

We've given, over time, pretty clear guidance as to the sensitivity on our capital base, and obviously with significant declines in equity in a depressed market, one should expect some pressure there. And so if I just ballpark look at where we think the book value per share, given all the impact from capital and market movements in the first quarter will be when we close the quarter tomorrow, our assessment is book value per share will be down mid- to upper-single digit *(percentage)* in the quarter, pretty much all-in. And I think if you look at the sensitivity we've provided in the MD&A and in our disclosure in the past, you'd very much get to that conclusion indeed.

Mario Mendonca

It's interesting, because things are just so fluid. Before that really strong rally we saw last week, if you had tried to market just maybe two weeks ago, you would have got a different response. And I think that really speaks to how we have to really be careful with these calculations, because with this sort of volatility in markets and rates, it actually does change week to week. It's not something I'm used to seeing. But I appreciate that highlight and I understand that it really is contingent on how things play out, I guess.

Today is the 30th, so we have one more day, really. And normally I wouldn't care about a day, but it actually matters now.

Charles Brindamour

Yeah. It does, Mario. And quite frankly, we manage—I'm involved with the finance, treasury and the investment guys on a daily basis, where we keep an eye on movements. Our strategy is largely unchanged. We have some downside protection, but you're right, it swings every day. So I feel like we've got many tools in the toolbox to manage that, and we did activate a few of those in the past few weeks.

Mario Mendonca

Okay. Let's go to interest rates specifically. Now let's think about this more long term. Obviously, the level of the interest rates matter because it contributes meaningfully to your investment income. Are there any goalposts you can offer us now in thinking about how a prolonged period of very low rates might affect your investment income? And then, does it change your outlook? Does it change your strategy? Do you want to revisit how you manage your investment portfolio as a result?

Charles Brindamour

You know, Mario, we have not, and we're not in the business of changing the investment portfolio too much because we price on the basis of ROE. And so we're in the business of having strong processes in place and managing accordingly. And our investment portfolio is managed like the rest of the Company—it's managed for the long term. So no big change in investment strategy for short-term market volatility. We tweak things tactically from time to time, based on risk-return considerations, to either protect or take advantage of dislocation. And in that environment, we keep an eye on that frequently.

While government rates have declined in Canada and the US, the corporate spreads have widened significantly, so I think it's important to keep both in mind. We turn over about 15 percent of our

fixed income portfolio annually, so if yields decline, it would take a few years to roll into the income statement. Offsetting some of that pressure on the investment income is the strengthening of the US dollar in our US investment portfolio, which has been helpful in the past few weeks.

But at the end of the day, investment yield is just a factor in determining how we price for our product to achieve targeted ROEs, and that's what I've shared with investors for many, many years. And so while we don't expect an impact in the current year, past that, pricing remains ROE-driven and should absorb investment income weakness.

Mario Mendonca

That's very important. I guess it's relevant, particularly now.

If we could now get to a more broad question. Has this environment caused you to revisit capital deployment strategies or your overall enterprise strategy? Is there any sort of thinking, anything you can offer us there to think about?

Charles Brindamour

Clearly, this is unsettling and there's lots of things coming at us and there's a lot of change but we've laid out, I think, a clear road map for the next decade that's built around four big ideas—strengthening our leadership position in Canada; building a leading North American specialty insurer; transforming our competitive advantage in data and supply chain; and investing in people to sustain strong culture and engaged workforce. And our focus remains on those four pillars.

And while we're very much focused on the short term at the moment, we always have an eye out for those big strategic pillars, and that's not changing. And so, as we manage this crisis, our workforce utilization is changing a bit, and we're trying to accelerate a number of strategies. So for instance, we've

invested in those digital tools now for a number of years. They're really helpful and timely now, so we're accelerating the usage of those. I think this is advancing our strategic positioning.

One of the exercises we're doing now, Mario, is we're redirecting resources that might not be fully occupied because they're at home and because the environment is changing, to accelerate strategic investments. We're accelerating the deployment and the advances we were making on flexible work arrangements. We're about to launch a big push on training while people are at home, and clearly, developing a very good understanding of the talent pool, where you see the true leaders stand out in this environment. So overall, the big strategic pillars are on track and we're tweaking as we manage, to make sure that we use resources that might not be fully utilized in this environment.

Now with regards to the capital base itself and whether this leads to change, we manage the capital to make sure that it's available in both good days, but be resilient in bad days, and there's no exception now. The capital priorities have not changed. We focus on maintaining a resilient balance sheet. We want to make sure that we have capital ready to be deployed for growth, both organic and true M&A, and return capital to shareholders over time.

We've been taking actions in the past few weeks to make sure that our financial position is strong. You might have seen, about 10 days ago, we, to enhance financial flexibility, issued 300 million of midterm notes at an all-in, after-tax cost below 3 percent. So we feel like if the environment improves, we have the capital to deploy into attractive opportunities. But if the environment worsens, we have a solid capital cushion to weather the storm. And so not a big change in strategy, but we remain alert in the current environment to opportunities both offense and defense.

Mario Mendonca

Okay. Let's actually follow that train of thinking just a little further and think about dividends and buybacks. You may have seen on Friday, late on Friday, in Europe, they are making a recommendation, the banking authorities there. It's not quite a directive yet but they're making a recommendation that banks in Europe not pay dividends. It could run 'till the end of October. So they're just deferring the dividends. And in Canada, we haven't gone there. In Canada, we're not seeing dividend increases or buyback. Can you talk about what your limitations are, if any, on buybacks and raising dividends?

Charles Brindamour

Yeah. So we're working closely with OSFI through the crisis, just to make sure they're informed of what we're seeing in the field and the broad implications for our industry, including capital. A few things to keep in mind, Mario. We review our dividend policy every year in Q4, and we've increased our dividend by 9 percent last month, which was our 15th consecutive increase. We don't intend to increase dividends and we're reassessing that in Q4 2020, ahead of 2021, so we're not there.

Our payout ratio is around 40 percent. So I don't see a risk to the dividend itself. And we don't have a share buyback program in place and probably won't have one in the near term, given the guidance, and our capital position remains solid.

Now the European banks are in a different spot, I would say, than financial institutions here in Canada, and certainly organizations like ours.

Mario Mendonca

Yeah. I've expressed a similar sentiment.

So that really covers everything I wanted to go through. Are there any broad comments you want to offer for investors in light of what we're dealing with today?

Charles Brindamour

Yeah. Well, look. This is unprecedented, and there's a lot of pain here and abroad, both for individuals and businesses, and we're there to help. I think that's the first important point. I think the response from government has been robust, and in my view this is encouraging. I think this increases the odds of returning to normal in the coming months.

But regardless of the timing here, the trains run on time at Intact, and we're prepared to operate on that basis for a sustained period of time. I think our platform will again demonstrate that it's resilient, but that we're there for customers and society broadly as we weather this crisis. And I think we'll get through this by working with communities, with government, and public health authorities. And frankly, the dialogue has been very good, very open, very constructive. It's all hands on deck. And that, for me, is a source of optimism.

In the meantime, we're open for business. The employees are safe, informed, focused, and doing an amazing job. And I want to thank them for that. It'll put pressure on revenues, but I think the overall performance of the organization will be on track. We're structured to be resilient, and we'll try to prove that again this year.

So in the meantime, all the energy is going to helping customers and communities be resilient like Intact throughout this crisis.

Mario, I thought that this call was very timely. I really appreciate doing that with you. And stay safe.

Mario Mendonca

Thank you. And thank you to everyone who listens to this. I hope you find it helpful. Thanks, Charles.

Charles Brindamour

Thanks, Mario.