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Definity Financial Corporation

First Quarter 2022 Financial Results Conference Call

Event Date/Time: May 13, 2022 — 11:00 a.m. E.T.

Length: 65 minutes

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Definity Financial Corporation First Quarter 2022 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 point in this call you require immediate assistance, please press *0 for the operator.

This call is being recorded on Friday, May 13, 2022.

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

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thanks, Annis, and good morning, everyone. Thank you for joining us on the call today.

A link to our live webcast and background information for the call is posted on our website at definityfinancial.com under the Investors tab. As a reminder, the slide presentation contains a disclaimer on forward-looking statements, which also applies to our discussion on the conference call.

Joining me on the call today are Rowan Saunders, President and CEO; Philip Mather, EVP and CFO; Paul MacDonald, EVP of Personal Insurance; and Fabian Richenberger, EVP of Commercial

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

With that, I'll ask Rowan to begin his remarks.

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

Thanks, Dennis, and good morning, everyone.

We reported results for the first quarter of 2022 last night that started the year off on a solid footing.

Operating net income of $64.6 million, or $0.55 per share, benefited from solid underwriting results and higher net investment income. Our 92.2 percent combined ratio was driven by solid personal property profitability and strength in our commercial business, bolstered by favourable industry conditions and low large loss and CAT activity. As expected, results in personal auto normalized somewhat from last year's performance, as claims frequency moved off pandemic-related lows and inflation continued to impact claims severity.

This robust underwriting performance gives us the confidence to maintain our growth ambitions, as was evident in our continued strong top-line growth in Q1. Prior investments in our digital platforms, Sonnet and Vyne, our expansion efforts in personal property and commercial insurance, and overall firm market conditions combined to deliver a 12.7 percent increase in premiums for the quarter. We continue to expect top-line to increase at approximately 10 percent over the next couple of years.

Operating results also benefited from an increase in net investment income, reflective of our larger portfolio size versus Q1 of last year. Our operating ROE remained robust at 11.2 percent over the past 12 months, but was down slightly from prior periods, reflecting the increased size of our equity base.

From a capital perspective, our solid operating results largely offset investment losses from fixed income yields moving higher in the quarter. That our book value per share was down only 1.3 percent from year-end is a testament to the resiliency of our business. We continue to hold a significant amount of excess capital, which combined with untapped leverage capacity, puts us in an enviable position. We maintained over $1 billion in financial capacity to fund our strategic growth initiatives for the upcoming years.

Turning to Slide 6, I'm proud of the Company we’re building together and I'm confident that we’re well-positioned for long-term success. I've spoken before about our belief that the significant investments made in our growth platforms and to improve talent companywide position us to be a leader in the industry for years to come.

We continued to push the innovation envelope in the first quarter, announcing a strategic partnership with APOLLO Insurance Solutions, and a new relationship with Google Cloud. These concrete examples illustrate that we’re not satisfied to rely solely on past investments, but rather that we’ll continually seek avenues to innovate.

Growth in our digital direct business, Sonnet, remains robust, with premiums up nearly 23 percent in the quarter. The business is now over $300 million in annual premiums for the first time and

benefiting from continued scale efficiencies. As we continue to improve our segmentation, pricing, and fraud prevention capabilities, I'm confident the business can develop to become a contributor to overall Company profitability over the next couple of years.

More generally in personal insurance, we recently announced a new relationship with Google Cloud that will allow Definity to collaborate with the company and leverage Google's advanced data, analytics, artificial intelligence, and machine learning technology.

We reinforced our commercial insurance business in recent years, with a growing focus on small business and expanding into specialty segments to better position ourselves as a one-stop shop for key brokers. Our latest results illustrate the success of these efforts on profitability and the continued impact of our increased appetite and capacity for growth.

In March, we further enhanced our commercial offering, announcing a strategic partnership with APOLLO, a leading Canadian digital insurance broker and MGA specializing in commercial insurance. APOLLO's scalable platform, combined with our track record of digital innovation and strong underwriting, will help strengthen our distribution reach to relevant customer segments and provide certain customers with a full suite of products. This innovative partnership aligns with our commercial insurance strategy, an important part of which is growing our small business portfolio.

Turning to the industry outlook on Slide 7, we expect market conditions to remain conducive to solid industry results, but we don't believe the industry will be able to deliver the ROE outperformance that it did in 2021. We expect firm market conditions in property lines will persist over the next 12 months, while conditions in auto lines should begin to firm as claims frequency normalizes and/or

inflationary cost pressures persist. We expect the combination of normalizing auto claims frequency and higher severity related to inflation to bring the industry's return on equity closer to its long-run average. For Definity, we expect our operating outlook to support a upper single-digit to below-teen operating ROE. We continue to expect these results to be driven by double-digit top-line growth and mid-90s underwriting profitability.

Our current capital structure, with elevated levels of excess capital and no debt, reflects our operating history as a mutual Company. As a still relatively new public Company, we're putting the tools in place to enable future balance sheet optimization, which should result in a capital structure more in line with our publicly-listed peers over time, enabling us to target an operating ROE in the low teens.

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

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

Thanks, Rowan.

I'll begin on Slide 10 with our largest business line, personal auto.

Premiums were up 6.4 percent in the first quarter of 2022, driven by improved new business and continued growth in Sonnet. Our focus remains on driving profitable growth by leveraging our digital assets and strong broker relationships.

Our reported combined ratio of 96.2 percent in the first quarter was six points higher than the unusually strong results from a year ago. We experienced an increase in the core accident year claims

ratio, driven by inflationary cost pressures, combined with higher claims frequency, although still below pre-pandemic levels. Severity is up from a year ago, but up only slightly from the fourth quarter, driven primarily by total losses and thefts. We also experienced a more normal level of favourable prior-year claims developments compared to the 4.6 points in Q1 of 2021. Although results may remain in the mid-to-upper 90s in the coming quarters, we are confident that we can sustainably run this line of business in the mid-90s longer term as Sonnet reaches breakeven.

Turning to personal property on Slide 11, I'm pleased to report robust top-line growth of 17.1 percent for the quarter, benefiting from continued firm market conditions and higher retention levels. You'll notice in the chart on the right that we've now grown this business by $269 million, around 41 percent over the past two years. We expect growth in property to continue given the organic growth potential of our digital platforms and the continuation of the firm pricing conditions prevalent in the industry in recent years due to the volatility of weather events and elevated cost pressures.

Focusing on the bottom line, we reported a strong combined ratio of 91.9 percent compared to 91.5 percent in the same quarter a year ago despite 5.4 points higher catastrophe losses. Our results benefited from the proactive positioning we took on inflation last year and favourable prior-year claims developments related to 2021 catastrophe losses that came in below initial estimates. We continue to target a mid-90s combined ratio for the personal property line of business on an annual basis. To accomplish this, we continually review our loss trends to refine our segmentation, and have undertaken several measures and initiatives to mitigate our exposure to catastrophes and weather losses.

Moving on to Slide 12, you will see that our momentum in our commercial business continued, with premium growth of 19 percent in the first quarter. This growth rate benefited from our expanded underwriting capabilities, higher retention, and strong rate achievement in the context of firm market conditions. While we expect growth to ultimately slow from the pace of recent quarters, we believe that we can sustain it in the low double-digit range as we continue to scale.

The commercial line's combined ratio for the quarter was a strong 85.5 percent, improving by 7.5 points compared to last year aided by earning rate above loss cost inflation, low levels of large losses, benign catastrophe losses, and favourable prior-year claims development. While inflationary pressures continue and the offsetting COVID frequency benefit normalizes, our past and current rate actions within the context of firm market conditions have allowed us to protect our margins. We continue to expect the commercial insurance business to deliver combined ratios in the low-90s.

Putting this all together on Slide 13, consolidated premium growth was a strong 12.7 percent in the quarter, while profitability at the consolidated level remained robust at 92.2 percent, less than a point higher than the strong first quarter of 2021.

The combination of solid underwriting and net investment income enabled us to generate operating net income of $64.6 million, which was $4 million higher than Q1 of last year. Our operating ROE of 11.2 percent over the past 12 months was slightly lower due to the dilutive impact of the large increase in equity year-over-year.

Slide 14 shows our investment portfolio in greater detail. Though rising fixed income yields led to investment losses in the quarter, our portfolio is positioned to generate improved net investment

income going forward. Our net investment income increased by nearly 13 percent from Q1 of 2021, driven by higher interest income. We expect the combination of higher book yields and overall growth in the portfolio to maintain a similar pace of growth in the coming quarters.

As you can see on Slide 15, our financial position remains strong. We are well-capitalized, with over $1 billion in financial capacity under our current legal structure, and subject to the continuance of Definity under the CBCA, could add an additional $500 million in leverage capacity. Despite capital market volatility, our book value per share was resilient at $20.41, down only 1.3 percent quarter-over-quarter and 12.9 percent higher than a year ago.

Slide 16 demonstrates a number of proactive capital management actions we have taken as we continue to move the Company to a more capital-optimized and flexible position.

Notably, during the first quarter, we returned $400 million of capital from Definity Insurance to the parent Company, Definity Financial. This transfer did not impact our overall excess capital levels, but did have the desired effect of reducing our MCT in the operating insurance business to 215 percent. By doing this, we have more efficiently positioned the excess capital within the holding company and moved our insurance business to a more optimized operating capital level.

As an additional proof point of the more flexible capital position we now find ourselves in, effective January 1, we chose not to renew the 5 percent quota share structure we had in place on our personal line's intermediated business. This structure was put in place as a mutual company in order to support our growth ambitions while access to capital was more limited. The change also contributes to the higher net premium written growth in the quarter.

We paid dividends for the first time in the quarter, and are pleased to announce that our Board of Directors declared a dividend of $0.125 per share payable at the end of June. We will continue to proactively monitor and aim to grow our dividend payouts over time.

We also announced the approval of an NCIB of up to 3 percent of shares outstanding yesterday. We see buybacks as a flexible capital management tool, and the approval of the structure is another indication of our work to effectively transition the Company from a mutual structure to that of a public company. While we have approval for the NCIB, I'd remind you that we see buybacks at the bottom of our priority list for capital deployment actions, hence the relatively modest size of the structure.

While these actions continue to mature and build out our capital management capabilities and toolkit, our development priorities remain unchanged. We are focused on deploying capital in support of our robust organic growth strategy and making investments in our core business, sustaining and growing dividends over time, and pursuing strategic acquisitions which support our financial targets and market position.

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

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

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

Thanks, Phil.

In summary, I am proud of the way our Company has navigated change in the last few years to successfully emerge as a strong Canadian public company. To reach our goals, we intend to continue diversifying and strengthening our Company through acquisitions and partnerships, building on our digital leadership position, sustaining our underwriting profitability, and consistently demonstrating disciplined financial management. These strategic objectives are born out of our purpose; building a better world by helping our clients and communities adapt and thrive, and our ability to deliver on this purpose is made possible by our success at attracting and retaining top talent to complement our already high-performing and engaged workforce, and our efforts go beyond attaining certain financial metrics.

In our role as a leading Canadian P&C insurer, we come face-to-face with the real consequences of climate change and its increasing frequent and severe impacts on Canadians. Earlier this year, we committed to achieve net zero greenhouse gas emissions in our operations and investment portfolio by 2040 or sooner. We recognize the role we can play in reducing emissions to mitigate climate change and support Canadians and their businesses to be more resilient to the effects of our changing climate.

We’re also committed to developing products and services that help to reduce the impacts of climate change and to the ongoing management and disclosure of climate risks and opportunities for our business. To this end, I'm proud to say that we’ll be publishing our inaugural ESG report next week.

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

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

Dennis Westfall — Head, Investor Relations, Definity Financial Corporation

Thanks, Rowan.

Annis, we are now ready to take questions.

Q & A

Operator

Thank you, sir.

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

Geoffrey Kwan – Analyst, RBC Capital Markets

Hi. Good morning.

I had a question around the movement of capital from the insured regulated entity up to the holdco. I know you mentioned it helps to optimize MCT, but what's the other—is there some other practical angle for it? I don't know if it's something that helps from a corporate perspective in M&A or whatnot. I'm just trying to understand the rationale for it.

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

Yes. Thanks, Geoff. It's Phil. I'll take that.

Yes, so the two key considerations there; one is that flexibility for deployment, so having the excess capital levels positioned within the parent Company, particularly once we do the transition through to a CBCA, it's just more effective from a deployment consideration. Moving it up requires various approval processes, and so having that behind us is important, so that's the primary rationale.

I think the second one, too, is we now move the insurance core operations to that target level operating position, and that's really, again, about continuing to train the business to effectively manage itself on a more optimized basis, so that's a skill set we want to get into as we manage the underlying operations more capital efficiently.

Geoffrey Kwan – Analyst, RBC Capital Markets

Would it be fair to say that your point is you need to get these approval requirements to pull capital out, but it's probably a lot easier to put capital back in?

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

Absolutely, yes, and it's all part of the maturation of how we see the corporate structure unfolding, so you'll see a few more of these items. I call them plumbing and wiring in terms of more efficiently positioning the overall balance sheets and the capital.

Geoffrey Kwan – Analyst, RBC Capital Markets

Okay. On the investment income, you talked about the growth rate. I think you were saying you might see that sustained in upcoming quarters, so do you have guidance on where you think the

investment income will be for 2022, because if you extrapolate the growth rate, I get to maybe about $110 million investment income for 2022?

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

Yes, I'd say that's not unreasonable. That is the guidance that we're seeing, that low teens rate continuing throughout the rest of the year, and I think what we'll see happening is we'll start to get a capture of those fixed income yield increases as we go throughout.

Geoffrey Kwan – Analyst, RBC Capital Markets

Okay, and just maybe if I can get just one last question in there, was just the Ontario government had in their budget just all these things about wanting to reduce the cost of auto insurance, increasing options for consumers and cracking down on fraud, and whatnot. There weren't a lot of details, but just wondered what your assessment of what was in there in terms of how they plan to achieve those objectives.

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

Hi, Geoff. It's Rowan here.

I think that, through the industry, we've had lots of discussions over the past couple of years with the government, and everyone is trying to continually optimize the industry. I think some of the recent changes that we now see is people starting to drive more of that or drive some frequency, and as we talked about, a little bit of inflationary pressures, and so we continue to do—think that the environment

is an attractive one for automobile, but we also continue to advocate working on continually updating and modernizing the product going forward. I think our sense is that there's some constructive changes that the government would—has proposed in their budget, and I don't think it would, let's say, be a very material change to our outlook for the province of Ontario's structure.

Geoffrey Kwan – Analyst, RBC Capital Markets

Okay, great. Thank you.

Operator

Thank you.

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

Doug Young – Analyst, Desjardins Capital Markets

Hi. Good morning.

First question on the commercial lines, obviously, growth was strong, and it sounds like you've expanded into new product areas. I'm hoping you can just elaborate a bit on that.

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

A couple of points just before I pass it over to Fabi there, Doug.

I think what I'm pleased about is that over the last couple of years, we've spent a significant amount of time reshaping that portfolio, building the team out, and we really like the portfolio that we've got, so very focused on high retention in the portfolio, and now putting that new capability to work, and I find that the broker market is very supportive of our teams, and there's a number of factors in there; certainly, a firm market condition, which is supportive for rate and retention, but as you have indicated, we do have broader capacities and capabilities than we've had in the past.

Maybe, Fabi, you could provide a bit more insight into the sources of product and your outlook.

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

Yes, certainly. Thank you, Rowan. I appreciate the question, Doug.

Obviously, we are really pleased with the momentum that we have achieved in commercial insurance in Q1. We would like to think that our value proposition in terms of expanded product range and service standards is now among the market leaders, and we do enjoy really strong support from our broker partners. As Rowan mentioned, we benefit from strong retention. We like the portfolio that's in place now.

We have also strong rate achievement, and we are really pleased with the new business success that we have, but it's really not concentrated in one particular segment, but we do enjoy good, new business success across all of our regions and across all of our lines of businesses, having said that, we do put an emphasis on growing our small business ahead of the curve, and as we mentioned on our last

call that we would like to grow our small business at twice the market growth rates, and we are achieving that, and then the same applies to specialty.

Small business benefits from the new digital capability that we put into the marketplace last year. We rolled it out across Canada. Our broker partners now are available to underwrite small business and quote and bind small business up to 50 percent in an automated and digital manner, and that has really led to the doubling of our new business volume, and our specialty segments are doing well as well.

We created new underwriting capabilities in D&O, E&O, in specialty property, in surety, and our specialty segment is benefitting from the volume that we with Uber normalizing to pre-pandemic levels as well, so overall, we do like the momentum, and we are quite confident that we can continue to grow commercial insurance in that low double-digit range.

Doug Young – Analyst, Desjardins Capital Markets

If I can, just a quick follow-up, the APOLLO agreements and MGA, and I'm just curious, does that MGA have the ability to bind risk and handle claims, or is that something that stays with Definity? Just curious as to your approach.

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

Yes. No, so we retain full underwriting pricing and control, so very much in line with the comment I've made about our small business capability that we have put in the marketplace last year that allows brokers to quote and bind business subject to our own pricing and underwriting rules. We are making the same capability available to APOLLO, which acts both as a MGA and as a broker as well,

and I think the main motivation for our strength through this partnership with APOLLO is really to benefit from the digital trends that we have seen over the last few years.

As a big picture data point, in Canada, less than 10 percent of the 1.2 billion small businesses are buying insurance in digital channels. As a point of reference, the same number in U.K. is over 30 percent, so we felt the need to develop an interim digital solution with an aligned broker partner that would allow us to benefit from those trends going forward, so we've been now in this partnership with APOLLO for two or three months and we really like the digital capability. They are a very agile, very hard-working team, and we do expect that this partnership with APOLLO will allow us to gain more market share in small business through digital means.

Doug Young – Analyst, Desjardins Capital Markets

Perfect, and then just secondly on Sonnet, Phil, is the intention or is the belief still that you can hit breakeven by the end of 2023, and then secondly on Sonnet, I think not long ago, 25 percent of the personal auto policies just are personal property coverage, and there's a huge opportunity there to deepen that relationship and bring that 25 percent? Just wondering if there's any additional numbers you can provide in terms of the penetration there.

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

Just in terms of the outlook, yes, that's unchanged, so our view is still trying to move that—the Sonnet business to standalone profitability by the end of '23, and then, Paul, I don't know if you want to comment on the property.

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

Yes, we've moved the penetration of the multi-line policies up by a few points and continue to target that aggressively as we scale the business out across the country. As we've said before, multi-line policies do provide us a couple of points of improved performance from a loss ratio perspective, tend to be longer-tenured clients, and at incremental benefit to the portfolio, so that is very much a focus area for both the Sonnet and the book of business.

Doug Young – Analyst, Desjardins Capital Markets

Good. Appreciate it. Thank you very much.

Operator

Thank you.

Your next question comes from Tom MacKinnon with BMO. Please go ahead.

Tom MacKinnon – Analyst, BMO Capital Markets

Yes. Thanks for taking my question, and good morning.

Just want to start with the NCIB here. You announced you're starting with a 3 percent NCIB here, and you put it at the—priority at the bottom. Does that mean you're not going to be active in the NCIB? Do you not think your shares are attractively priced? Just getting some of your thinking as to why you put the—this in place, but have it as a bottom priority.

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

Yes, Tom. It's Phil. I'll take that. Thanks for the question.

Yes, so I think when we look at—first of all, from a priority standpoint, I think we'd always look at ourselves more as a capital deployment story than a return story, so there's nothing really changed there in terms of the way we look at it. It's the organic growth strategy first. We put the dividend structure in place. We'll look to grow that over time. Inorganic is the key area that we see as the method to optimize the Company's overall position, but we still—we do see buybacks as a supportive mechanism.

It is at the lower end of the range, as we've said, and that's really because of that focus on deployment, so the actions that you're seeing are very consistent with how we plotted this out over time. It is a useful toolkit to have in place. We do want to have it available for deployment, and hence the approval mechanism we went through, and then just in terms of usage, I think what we'll do is we'll look at it continually. We'll be cognizant of the market conditions, but also where it sits in the overall strategic view of how we utilize the capital that we do have.

Tom MacKinnon – Analyst, BMO Capital Markets

Okay, understood.

Then if we look into personal auto, I was just wondering if you can give us what you're seeing in terms of loss cost trends, severity trends, in particular. How are they trending with respect to, say, bodily injury or car repairs or total losses, and how do you see things unfolding with respect to that?

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

Thanks for the question, Tom, and this is a—there's a broader question around inflation that we're spending a lot of time on, and so maybe it's useful to give you a bit of context and then we'll move into the more specific product line, but I think a couple of points I'd like you to know.

One is this is a real focus of us. There's a number of actions in flight, but for context, I think it's important to know that P&C players, first of all, are used to inflationary environment, particularly when it comes to the automobile line. We continually are used to periods of severity trend ahead of CPI, and at the big picture, as we do get inflation, we're now seeing interest rates kind of move up.

We need to also remember that, actually, that's positive for an insurance company. As Phil has indicated, we're already starting to see better reinvestment rates of our bond portfolio, which will drive further investment income, and when we think about the scope of that change in inflationary trends, we've got about 40 percent of our overall portfolio in personal auto, and then the other 60 percent is 30 percent property, 30 percent commercial lines where quickly we've been able to adapt and pass on these costs, as we've seen.

The other point I'd make is that I think we've been early to pick up on this compared to many of our peers and been proactive, and you'll recall last year as early as Q2, we did make some reserve provisions, and then a bit later in Q4 for the auto, and we continue to be prudently reserved through this year.

There's a lot of actions in flight that we could certainly touch on, but I think as we go back to the big picture, I do feel—we think this is very manageable, and we're certainly comfortable when it rolls back up to the targets we've given to the marketplace, but I think it would be useful for you to just give a little bit more colour on that and then we'll narrow into the auto component.

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

Yes, sure. Thanks, Rowan.

Yes, just to build on a few of those comments, as Rowan has said, firstly, we were very proactive from a reserving standpoint in terms of the auto book. You'll know that we put up about $30 million. The large part of it was towards personal auto in the fourth quarter as we saw those severity trends really start to emerge, but we were also very proactive on the property side as far back as the summer of '21 and we put up just under $40 million of reserve strengthening in the second quarter of Q2, when, at that time, the common sentiment was that inflation was going to be a transitory issue, so we're very pleased we took those steps early and reserving is really standing up well, so we're not seeing any bad news coming from the past, as evidenced by the favourable prior-year development that we've had come through, and we are making sure that we reserve with the current severity levels in mind and taking that continued prudent approach.

On the actions, it wasn't just about reserving. As Rowan said, we were very proactive on this. We've been really managing our business for the last nine months with a view to this inflationary environment. On the property side and commercial side, we adjusted the inflation factors we have embedded in our pricing considerations as far back as the summer of last year, and certainly, the firm

market environment has been supportive of that, and on the auto side, we’re now starting to see a return to some modest rate activity, but Paul and his team have also been active with segmentation changes and filings and a view on risk appetite in this environment, and the last point on actions, we spoke last time just around a large focus on claims management and how we try to mitigate some of these pressures.

Then just looking forward, just before I pass it to Paul, I’d say how we think about inflation overall, certainly, from the personal property and commercial lines' standpoint, we see that as really supporting an extension of the firm market conditions we’re operating under today. On the auto side, you'll see in the outlook, we’re calling for this environment to bring back some modest rate activity, and in Ontario, in particular, Sonnet has achieved some rate approvals in the first quarter, and you'll note the customer relief actions on the Ontario auto broker portfolio expire at the end of May, and I think a return to a rate environment is good news for us given the Sonnet and broker combined platforms that we have in place.

Then the last comment, just to reinforce Rowan's point around diversification, if you go back as recently as 2019, just over half our book was in personal auto lines, less than a quarter was in commercial lines. We've really shifted that, and if you look at the first quarter, just over 40 percent of our book now is written in personal auto and CI is almost 30 percent, and there's an earnings lag yet to come through that, so to reinforce Rowan's point, I think in summary, we say we’re on this topic, we've moved early, and assuming severity stabilizes, at this point, with the actions that we've taken and with some of that rate starting to flow, we think it's a manageable environment, but we’re watching it very closely.

I'll just pass it to Paul for some—any detailed observations.

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

Thank you, Phil.

Just to give a few more specifics around auto, you will recall that about 50 percent of our auto portfolio is on the AB&BI side. There, we're seeing trends probably in line with annual inflationary increases, so nothing overly concerning. On the physical damage side, which is the other half of the portfolio, the two areas that are of concern to us are theft and total loss where we are seeing approximately a 25 percent increase year-over-year in loss cost. Now, intuitively, this makes sense, because these are the two categories where we have to replace a vehicle, either a new or used vehicle, and these are the areas where we're seeing dramatic escalations in market price.

Taken together, these are contributing a few points of loss ratio. Now, where is this moving? Frequency, while slowly increasing as per our previous expectation, may be tempered in the near term due to the rising gas prices which may change consumer behaviour toward avoiding some driving behaviour.

Secondly, we are starting to see some positive signs out of wholesale prices, which are a leading indicator for retail car prices. We're starting to see week-over-week slight reductions in wholesale prices and a flattening in their retail prices. I'll also remind you that Q1 is typically a worse quarter for the auto industry due to winter weather driving conditions, and we would expect that to improve over the summer months, and finally, just another reminder that we do have plus five flowing through our auto

portfolio in Ontario starting—it started in April and will be earning through our portfolio for the remainder of the year.

Tom MacKinnon – Analyst, BMO Capital Markets

If 50 percent of the claims are benefits and the other 50 percent is physical damage, is that just entirely theft and total loss? Isn't there just things that aren't total loss or theft, just minor car repairs? I'm just trying to get a handle on the breakdown of your personal auto claims.

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

Yes, very good question. Of the physical damage side, that is indeed split up into items like comprehensive and collision, made up of a number of categories, including general, theft, total loss, non-drivable, drivable. Just to give you a sense of the areas that I mentioned earlier in terms of theft and total loss, taken together, they represent about a-quarter of that physical damage component.

Tom MacKinnon – Analyst, BMO Capital Markets

Okay. Thanks. All right. Well, thanks for that detail, and just with respect to the reserve you built up last quarter, did any of that unwind into the PYD? The personal auto reserve you built up last quarter, did any of that unwind into the personal auto PYD that you had in this quarter?

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

Yes. It's Phil. We did see a little bit left, so overall, though, we're still maintaining the prudent approach, so if we step back from it, if we look at the overall prior-year development across the

business, there's a few factors in there. We saw a little bit on some CAT losses in the property side of things that unwound favourably. Large losses both on the auto side and on the property side have been pretty benign in the first quarter; in fact, impacted a couple of our expectations, but we're also seen a little bit of positive flow from the inflation adjustments that we made last year. I will say, though, that it's—we're continuing to take a prudent approach to that. We only just put up a pretty significant reserve in Q4, so we're a little tentative to draw it down, but certainly, what we're seeing from an experience standpoint is that the reserves that we put in place are settling at lower levels in that first quarter.

Tom MacKinnon – Analyst, BMO Capital Markets

All right. Thanks for the great detail.

Operator

Thank you.

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

Paul Holden – Analyst, CIBC World Markets

Thanks. Good morning.

You've already given us a lot to chew on in terms of personal auto, but I'm going to ask one additional question here, so just thinking about that $10 million of premium relief that came through this quarter, an additional amount expected to come through next quarter, and then that rolls off, I

guess really with the idea in mind that frequency normalizes, I think there's a very plausible scenario today where frequency doesn't necessarily normalize because of hybrid work arrangements, so in that kind of scenario where frequency doesn't get back to pre-pandemic, how should we think about that $10 million? Does that just simply flow to the bottom line, or maybe because now margins are more attractive, you decide to dial up the growth a little bit more? Help us walk through that a bit.

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

Paul, one of the comments I could make here is when we think about what's actually happening in the auto portfolio, there is more mobility, so when we start—when we track mobility trends, people are starting to drive more, and there was a very strong correlation between each wave of COVID, the government lockdowns, and people less driving. As we've now got to, let's call it—I think it's, in Ontario, the sixth wave, there is less correlation with lockdowns because we're just learning to live with it, so what we're seeing here is mobility—so driving is actually pretty close now to pre-pandemic, but the patterns have changed, and so you correctly point out the hybrid work.

What we're seeing is retail traffic pretty well normal, but commuting traffic to work places is still significantly down, and that added disproportionate frequency, so the intense rush hour; rush to work, rush home claims, so whilst we are seeing some frequency year-on-year increases, it's still well below pre-pandemic levels, so I think what we've kind of guided to and we initially anticipated is that we would get past this and frequency would normalize.

It's quite plausible that frequency doesn't get back to pre-pandemic levels, and in that case, there is certainly a bit of a tailwind for the results, and that could be favourable to the point that you're

making. I think the way at a macro level we’re looking at this is we’re seeing that in the short term, we’ve talked a little bit about some of those inflation trends that Paul gave you some statistics on. Those are being offset by the lower frequency that's happening, and over time, when the frequency normalizes, if it does, as the rate comes on, that's the next lever that starts to offset that inflationary environment, so that's where, I think, we get comfortable in our outlook for the pricing.

If, however, we do get sustainably and significantly lower frequency benefits, then I think that's something a little bit of—that's upside that we've actually modeled into, and we’re increasingly starting to believe that as businesses go back, it will be more and more in the hybrid model, and there will likely be some long-term benefit to frequency, but we’re watching that carefully, and we’re also aware that in the short term or let's say the medium term, some of that will be eaten by the increased loss cost trend.

Paul Holden – Analyst, CIBC World Markets

Got it. Okay. Thank you, and then maybe just some quick thoughts around sort of the temperature for M&A opportunity. A lot of market volatility, economic uncertainty, uncertainty on Ontario auto; is that driving increased opportunity, or maybe perhaps in the other direction as sellers become hesitant to engage today?

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

Well, as you know, we've got excess capacity, and part of our strategy is to be a top-five player, and based on how we anticipate our market share gains organically, we’ll still need to participate in

some form of inorganic activity, and that's roughly between half a billion and a billion dollars of applied revenue over the next couple of years to get to that level.

As we've said before, we built this platform for growth to be a bigger business. We do believe we can be a better owner of many portfolios, and there's significant synergies as we—we're able to put some acquired business onto our platforms, particularly Vyne, things like that. I do think that this is something we're active on. As we've indicated before, we like the personal lines business. We do believe that the Vyne platform's very scalable, and over time, we are very confident in the outlook of our returns in automobile, and particularly in commercial. Fabi and the team have done a tremendous job of building that infrastructure and growing the business organically, but we still see opportunity there for inorganic activity, so I think when it comes to your question, clearly, we're alert to a greater uncertainty in the economic environment, but we still are pursuing interest in inorganic activity.

We'd consider the risk profile of each and every one of those transactions as they come up, but I actually do think there might be some more opportunities because of this, and if you think about as the automobile portfolio starts to trend back to its normal levels and people look about—look at the huge infrastructure or technology investments they need to make to compete and to not be anti-selected against, that may cause people to think about it.

Then the other part is, as we all know, with rapidly changing interest rates, whilst it's generally good for P&C insurers as we roll over our investment income, there is mark-to-market impact, and if you're not well-capitalized that, again, could force some people to think about opportunities, so I think

on the margin, we think that the environment is a little bit more favourable for opportunities than it was a few quarters ago, but this is a key part of our strategy and we continue to work on it.

Paul Holden – Analyst, CIBC World Markets

Great. Thanks for your answers. That's all I had.

Operator

Thank you.

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

Jaeme Gloyn – Analyst, National Bank Financial

Yes. Hi.

First question is going back to the capital management side and the distribution up to the parent. MCT ratio at 215 percent at the insurance level; is that the right way to think about where you're, let's say, comfortable to operate as opposed to the 200 percent MCT internal target? Would we view the 200 percent more as a lower bound than just a simple target?

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

Yes, absolutely, so I think when we think about the operating range, somewhere between about a 195 percent to 215 percent, we'd say is a comfortable range, so you'll actually see, we've—as we've transitioned the capital, we're at the high end of that operating range, and that was done deliberately,

just recognizing the macro environment is a little more uncertain, so we've deviated towards the top end, but anywhere between that 195 percent to 215 percent we'd say is a good operational level, and it will move around over time just dependent on the overall market circumstances, and oftentimes, you just get some timing around quarter-end, but yes, we'd say anywhere between that range is a nice operational level, and we're probably just a little bit on the high side right now, recognizing the macro environment.

Jaeme Gloyn – Analyst, National Bank Financial

Okay, great, and second question is just on the commercial insurance or commercial line. One of the comments around improved combined ratio was improved mix, and I was just looking for a little bit of colour around which line, was it mid-market, small business or specialty, where the mix shifted and drove some of that combined ratio improvement.

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

Yes, Fabian Richenberger to answer this question, so I can provide a couple of data points in there. Overall, I think that the most important answer to your question is that we're very comfortable with our portfolio, feel very comfortable with all the segments and all the regional results that we have in our portfolio. As you know, we've worked very hard over the last three years to bring back sustainable profitability, and we have achieved that now for every segment and every province, and with the team that we have in place now, we do feel that we have market-leading pricing and underwriting and the risk selection capabilities not only on the technical side as well, but we have a very comprehensive quality underwriting framework in place as well where we measure the outcome of underwriting decisions on

the monthly basis by underwriter, and that gives us the comfort that we feel that we have a sustainable profitability in our portfolio in the low-90s range, and for Q1 for commercial property outperforms our expectations, mostly as a function of not having had any large losses and having had a fairly benign CAT season, but overall, as an answer to you, we don't see any dislocation needs in our portfolio and we like the run rate profitability that we have in each segment and in each region.

Jaeme Gloyn – Analyst, National Bank Financial

Okay. Thank you.

Operator

Thank you.

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

Brian Meredith – Analyst, UBS Securities

Yes, thank you.

Rowan, I just want to follow up a little bit on the M&A question. I noticed in your slide on capital management, it mentioned distribution acquisitions, and I'm just wondering, what's your thoughts around that? Are you thinking that maybe there's an opportunity to actually start acquiring some brokers here and develop a broker channel?

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

We do think that there's an opportunity there, and I think one of the points we're trying to do is attract and acquire profitable portfolios, and so what we've said is that this interest in that activity is less about trying to build a broker for building a broker sake, but more as a means to accessing attractive portfolios that we can put onto our platform, and we do think that there's a lot of activity in the marketplace, and certainly, insofar as brokers are concerned, there's a significant amount of consolidation going on and brokers looking for scale and access to capital, so that's something that, as an organization, we have some investments. They're very modest at this stage, but it's certainly one of the options that we will consider, as well as I mentioned, personal lines and commercial lines portfolios over time.

Brian Meredith – Analyst, UBS Securities

Makes sense, and the $400 million, I assume that's available for those types of acquisitions?

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

Yes, it is. Yes.

Brian Meredith – Analyst, UBS Securities

That makes sense.

My second question, I'm just curious, you've seen some tremendous growth in your property portfolio; policies-in-force, as well as gross rate and premium. I'm just curious, how are you thinking about that with respect to managing your CAT exposure in those lines? A lot of growth, should we

expect more volatility going forward? You obviously got rid of the quota share. Are you buying more CAT cover? How are you thinking about that with respect to managing your CAT exposure as you grow that more CAT-exposed business?

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

Yes. I'll let Paul answer that in just a second, but I think one of the points that I would say, we've made the decision that we are looking to reshape the portfolio over time, and that's why you've seen us, consistently now for some time, growing our commercial portfolio at a rate faster than our automobile, and growing our personal property portfolio at a rate faster than the auto, and we felt that we were actually underweight a few years ago, and so consciously, we’ve made an effort to better diversify our portfolio by building commercial and personal property, and as we've done so, we've done so thoughtfully and carefully, reflecting things like net CAT exposure and that.

Our reinsurance treaties obviously protects us. We have been buying increased limits to do that. It's an area we've spent a lot of time on. We believe we’re quite sophisticated in doing so, and in building out a number of capabilities, including claims and CAT management as well, to make sure that as we shift the portfolio, we can achieve the targeted returns that we’re on, but I think we are seeing a number of opportunities, and I know that Paul and his team have been doing a lot of actions to ensure we do that.

Is there anything you'd like to add?

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

Absolutely.

One of the key areas, of course, is geographic diversification to ensure you're not overly concentrated in one particular area and be overly exposed, therefore, it's bad CAT, so we're pushing quite hard in the various different provinces to grow and right-size our portfolio.

Secondly, we've done very well relative to the market in certain types of CATs like hail CATs. That's reflective of the significant investments we've made in hail mapping and improving the underlying sophistication. Toward the end of last year, we did the same with flood mapping and upgraded all of our flood maps across Canada across all of our portfolios, and we're working on wildfire maps as well, so this is all about understanding where you could be most exposed to the types of CATs, ensuring that the product and the pricing and geographic distribution is aligned around that, and also making sure that you're not overly exposed from a total insured value or concentration risk.

Lastly, I would add that we've also taken great pains to remove a number of volatile aspects of our property portfolio and that could be overly exposed to those elements, and we're pleased with the results so far, so we're going to continue making these investments into the business, and I would add that the partnership with Google allows us to bring enhanced analytics and third-party data sets to continually improve our portfolio.

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

Brian, one final comment there. In terms of the significant revenue growth, a good component of that is us moving values up, indexation levels, as well as passing on and achieving pretty solid rate

increases, and what we say is a firm environment for both personal property and for commercial property, so we'll continue capitalizing on the firm conditions.

Brian Meredith – Analyst, UBS Securities

Makes sense. Thank you.

Operator

Thank you.

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

Lemar Persaud – Analyst, Cormark Securities, Inc.

Thanks.

My first question is just on the NCIB here. Sounds like we shouldn't expect you guys to necessarily execute on it. It's really just there to potentially support the share price rather than signaling a lack of organic and inorganic growth opportunities. Is that a fair characterization?

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

I'd certainly say you shouldn't see it as thinking there's a lack of opportunity. The way we look at it is it's a useful tool in the toolkit. It's one of a number of things like the $400 million, moving it up in the corporate structure, so you'll see us continue to do those activities to get ourselves well-positioned, but

no, you shouldn't read into it any view that it changes our prioritization, but also appetite for deployment of capital. We really do see ourselves as a deployment story more than a return story.

Lemar Persaud – Analyst, Cormark Securities, Inc.

Great, and then could you help us understand kind of the mechanics of the NCIB in light of HOOPP's ownership? Would they be forced to sell down to remain below the 20 percent interest, or could they decide they don't want to sell their ownership and prevent Definity from buying back stock?

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

Yes, so HOOPP has a mandatory requirement because of the 20 percent ownership restriction under the regulations, so when you look at the press release for the NCIB, you'll see there's explicit reference there to some mechanics, which was another part of us moving reasonably early to get it in place, because there is some additional complexity around the way that works, so essentially, if we do some buyback activity, they'll sell into that to stay at the—around the 19.9% that they have today.

Lemar Persaud – Analyst, Cormark Securities, Inc.

Okay, thanks, and then my next question, just moving on to personal auto, I'm just wondering if you can comment on the competitive landscape in personal auto. It just seems like the industry's digesting the impacts of cost inflation and higher frequency, but then there's some commentary in the MD&A which suggests that some of your peers are holding on to their COVID-19 relief rates. This might suggest that some guys are being overly aggressive on pricing. Is that fair, and then could it drive a slowdown in premium growth for you guys moving forward?

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

Yes, I'll make a couple of comments on that.

We are actually seeing over the last few weeks a reversal of the pandemic relief measures, so while it is difficult to get full insight about every single competitive action, we are generally seeing the unwinding of those benefits, and in fact, in addition to that, we’re starting to see a slow increase of rate approvals occurring across Canada, so we do believe that this is the beginning of that slight tightening around the pricing of automobile insurance.

In terms of grabbing market share, we are seeing across the industry elevated levels of retention, which therefore, also means slightly less new business circulating in the marketplace, and we believe it's a bit of a natural cycle related to most consumers sticking with their incumbents with—because they've got higher-priority items for them to worry about. However, as we see those prices start moving up, we might expect to see a little bit more new business activity. This is a net positive for us, both on Sonnet and on our Vyne broker portfolio, because we have very easy to use systems that encourage consumers and brokers alike to get competitive quotes.

Just maybe one additional touch point I would add related to a previous comment I made, I want to make sure that we’re clear on that. When I referenced the theft and total loss combination was 25 percent, the clarification is it 25 percent of our auto loss cost.

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

Thanks, Paul, and Lemar, just a couple more comments that might be helpful on the auto. I think when we look at our portfolio, the broker intermediated business is growing in the low single digits, and really, it's the Sonnet portfolio that's growing a little bit over 20 percent, and as you know, it's important for us to kind of scale up Sonnet over time. I'm pleased with that growth in Sonnet, because one of the things we have seen is actually less customers in the market shopping over the last several quarters. This is part of what's happening with COVID and with supply chains and new—less new car shopping, and so the fact that we're able to grow in excess of 20 percent in, I think, a market with some headwinds, actually is quite encouraging to us, and our expectation is as this normalizes, as the customer leaf across the industry gets unwind, as we start moving into some more modest price increases in automobile, there will be more shopping, and this'll be helpful to both of our platforms; the Vyne platform, which is the intermediate broker platform, because it's just so easier for brokers to use, but also to the Sonnet platform.

The final point that I would make on Sonnet, which is encouraging to us, is that a good part of that growth is coming in the very attractive Affinity segment. Last quarter, we mentioned that about 25 percent of our new business, automobile, was coming from Affinity. That's actually up a few points, and so getting closer to 30 percent now, and we do know that it's resonating well for those attractive market segments, and that'll also help mature and improve the profitability over time of Sonnet, as the Affinity customers generally are more attractive customer than general retail, so that may be helpful context in the view of the revenue opportunities for personal auto.

Lemar Persaud – Analyst, Cormark Securities, Inc.

Great. Thanks. That's it for me.

Operator

Thank you.

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

Stephen Boland – Analyst, Raymond James

Thanks. I think this is a quick one.

Just looking at the number of policies in personal auto and personal property, you mentioned a number of factors why that—those are going up. I don't really know, you mentioned Sonnet (audio interference). Could you maybe just talk about the traditional broker channel and what you're seeing there and your penetration within that channel?

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

If I understand the question, you're asking about our growth rates on policies or unit growth relative to the market, and actually, interesting. As I mentioned in a prior quarter, last year, we were heavily focused on unit growth in the marketplace, predominantly due to the low rate environment, and this year, we're approaching a more balanced approach between unit growth and rate. As Rowan mention, we're pushing quite a bit harder on the Sonnet portfolio to gain market share year-over-year, so that has a higher unit growth, and we'll continue to have that into the future.

On the broker intermediated side, as Rowan mentioned, we are in the mid-to-high single-digit growth rate, but we are still gaining market share relative to our competitors at a higher than average rate, and we are looking to double the growth rate from that perspective, so leveraging the capabilities of both Sonnet and Vyne, we continue to promote ourselves as a growth opportunity.

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

The final point I would add...

Stephen Boland – Analyst, Raymond James

Sorry, maybe I'll just go quickly. How are you doing that in terms of doubling the market rate? Is that just more sales, more contacts? How is that being accomplished?

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

I think a big part of that is actually the Vyne system, which, it's being put into place. It's fully integrated with the brokers. Two things that it drives is it's just so easy. Literally, a click of the button to renew your policy, so we're finding record high retention rates, which are certainly very, very supportive to us. I also think that because of the less friction with dealing with our Vyne system, there's less price sensitivity for brokers, and so that's helping our new business.

Then the final point that I would say is that Paul and his team have been very successful in achieving a significant amount of portfolio transfers, and so particularly in the province of Quebec and the province of British Columbia we've had great success as we diversify out of Ontario in actually

winning other companies' business that brokers who aren't prepared to shift to us and put onto our Vyne platform, and we've built technology to make that very easy for our broker partners, so gaining share that way is certainly part of our strategy. We are a top-three insurer in about 50 percent of our broker offices, and we have an internal target to move that up to top 70 percent of our broker offices, and that's one of the strategies that we're deploying successfully, so that helps win business organically.

Stephen Boland – Analyst, Raymond James

Okay. Thanks very much.

Operator

Thank you. There are no further questions. Mr. Westfall, back over to you.

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. A telephone replay will be available at 2:00 p.m. today until May 20, and a transcript will be made available on our website.

Please note that our Annual Meeting of Shareholders will be held on May 19, and our second quarter results for 2022 will be released on August 2.

That concludes our conference call for today. Thanks, and have a great day.

Operator

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