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IAG.TO - Q2 2022 iA Financial Corporation Inc Earnings Call

EVENT DATE/TIME: JULY 28, 2022 / 6:00PM GMT

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PRESENTATION

Operator

Greetings, and welcome to the Industrial Alliance Second Quarter Earnings Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded on Thursday, July 28, 2022.

I would now like to turn the conference over to Marie-Annick Bonneau, Head of Investor Relations. Please go ahead.

Marie-Annick Bonneau - *iA Financial Corporation Inc. - Head of IR*

Good afternoon, and welcome to our 2022 second quarter conference call. All our Q2 documents, including press release, slides for this conference call, MD&A and supplementary information package are posted in the Investor Relations section of our website at ia.ca. This conference call is open to the financial community, the media and the public. I remind you that the question period is reserved for financial analysts. A recording of this call will be available for 1 week starting this evening. The archived webcast will be available for 90 days, and a transcript will be available on our website in the next week.

I draw your attention to the information on forward-looking statements on Slide 2 and on non-IFRS and additional financial measures on Slide 3. Also, please note that a detailed discussion of the company's risks is provided in our 2021 MD&A available on SEDAR and on our website.

I will now turn the call over to Denis Ricard, President and CEO.

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

Good afternoon, everyone, and thank you for joining us on the call today. As usual, I'll start by introducing everyone attending on behalf of iA. First, Jacques Potvin, Chief Actuary and CFO; Mike Stickney, Chief Growth Officer; and responsible, among other things, for US Operations; Alain Bergeron, Chief Investment Officer; Renee Laflamme, in-charge of Individual Insurance and Savings; Sean O'Brien, responsible for mutual fund business and wealth management distribution affiliates; Francois Blais, in-charge of Dealer Services, Special Markets and iA Auto and Home; and Eric Jobin responsible of our group businesses.

Earlier today, we released our second quarter results. These are very good results with core earnings above guidance, positive core experience, continued sales momentum and strong organic capital generation. As we move forward, the transition to IFRS 9 and IFRS 17, our outlook remains positive, even more so than at the beginning of the year. Indeed, based on preliminary estimates, the impact of the macroeconomic variation of the first 6 months of the year, including rising interest rates would be favorable for iA under the new accounting regime. More specifically, as Jacques will explain in the next few minutes, while we expect at transition a significant increase in solvency ratio and a nearly neutral impact on the book value. The impact of IFRS 17 on book value at June 30, 2022, would have been favorable.

Move to Slide 7 for some comments on Q2 key financial metrics. We're reporting core EPS of CAD2.37 for the second quarter. This result is just above the guidance and is largely due to good EPIF growth, combined with positive core experience. As for core ROE over the last 12 months at 14.1%, it confirms our solid profitability as it is slightly above the middle of our target range of 13% to 15%. Our financial position is robust, as evidenced by our solvency ratio of 130%. This is the result of our sound and prudent management and our long-term vision.

Noteworthy is our strong organic capital generation of approximately CAD160 million during the second quarter. Organic capital generation is an important metric that takes into account both profitability and the impact of risk management on capital requirements. As such, it will continue to be a key measure of our performance under the new accounting regime. Our strong capital position allows us to focus on growing the business, moving towards thoughtfully and confidently with the execution of our digital transformation and growth strategy. This is all the more important when the macroeconomic environment is volatile as it is this year. In some respects, this volatility can be good for us. For example, among the macro volatility factors in the first half of the year was the rise in interest rates, particularly long-term rates, which has a positive impact on our long-term value.

On another note, I would like to comment on employee experience as in today's environment, it is more than ever a key strategic focus for iA to attract and retain talent. Our strong commitment to our employees has always been rooted in iA's values. We recognize the importance of employee well-being through initiatives such as flexible work model, allowing employees to choose the workplace that will allow them to be the most effective while achieving a better work-life balance. We continually strive to provide a first-class employee experience that foster both professional development and fulfillment.

In conclusion, in addition to the good results disclosed this morning, we're pleased to announce an 8% increase in the dividend paid to common shareholders. This dividend increase, together with our active buyback program demonstrates our commitment to returning value to our shareholders. This ends my remarks. I will turn it over to Mike, who will comment further on business growth. Following Mike, Jacques will provide more information about Q2 results as well as an update on the IFRS 17 transition. Mike?

Michael Stickney - *iA Financial Corporation Inc. - Executive VP & Chief Growth Officer*

Thank you, Denis, and good afternoon, everyone. Our good sales momentum continued in Q2, particularly in individual insurance in Canada where sales were again very strong. The wealth management sector supported by segregated fund sales recorded net inflows amidst declining financial markets. Also, sales in both our Dealer Services divisions outpaced vehicle sales and demonstrated resiliency, especially in Canada despite the persisting shortage of new and used vehicles.

Now please refer to Slide 10 as I will comment on business growth in the second quarter. Premiums and deposits totaled more than CAD3.6 billion in Q2, a good result to which all lines of business contributed showing year-over-year growth with the exception of the individual wealth management sector, where the industry is facing a difficult environment. Assets under management and administration of CAD194 billion at the end of the quarter compared to CAD211 billion a year earlier due to the unfavorable market conditions and rising interest rates.

Growth of AUA and AUM for the remainder of the year may continue to be tempered by the volatile macroeconomic conditions. In Individual Insurance, second quarter sales totaled CAD98 million, building on the strong momentum of recent quarters and resulting in a sizable increase of 34% year-over-year. Once more, growth was supported by the strength of all distribution networks, our superior digital tools and our comprehensive range of products, including our PAR products. In addition to these key growth drivers, the increase in average premiums per policy sold also contributed to the significant increase over last year. Note that according to the latest industry data, iA remains the leader in terms of number of individual life policies issued in Canada.

Turning to Slide 11 for Individual Wealth Management. The company continued to rank first for gross and net segregated fund sales, solidifying its position in the industry. Gross sales amounted to CAD924 million and net fund inflows of CAD390 million were recorded despite a challenging context for the industry as a whole. In this environment, mutual funds results were unfavorably impacted by gross sales of CAD375 million and net outflows of CAD237 million recorded for the quarter.

Lastly, Guaranteed products amounted to CAD230 million, up 5% year-over-year. In group savings and retirement, total sales of CAD695 million in Q2 were up 3% year-over-year, driven by the growth of both accumulation products and insured annuities.

Moving to Slide 12. Group Insurance Employee Plans premiums increased by 11% year-over-year, primarily due to good retention of in-force business. As for sales during the second quarter, they amounted to CAD12 million. In Dealer Service Canada, sales of CAD355 million were up 14% from a year earlier, driven by P&C insurance sales and car loan originations. This is a strong performance, especially given the vehicle inventory shortages mentioned earlier. In the Special Markets division, the pickup of travel insurance sales continued and resulted in a significant increase of 57% over the same period last year. As for iA Home and Auto, our P&C affiliate, direct written premiums continued to grow steadily and increased by 4% year-over-year.

Now to Slide 13 to comment on U.S. operations. Good sales in individual insurance of CAD38 million were up 3% year-over-year, mainly from the growth in the family and government worksite markets. In the Dealer Services division of our U.S. operations, sales amounted to CAD266 million compared to a very strong result of CAD285 million for Q2 2021. The 7% decrease in sales compares favorably to the new and used light vehicle sales, which were down 17% over the same period. Overall, we are pleased with the sales results for Q2, which ends the first half of 2022 with some areas of strong growth and other areas showing resiliency.

I will now turn it over to Jacques to comment on earnings, capital strength and IFRS 17.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Thank you, Mike, and good afternoon, everyone. Today, we are quite happy to report strong second quarter results and positive core experience. This, along with solid expected profit growth resulted in core EPS being above guidance, as shown on Slide 15. As for core EPS for the first half of the year, it is well within guidance. Core ROE for the last 12 months is just above the middle of the guidance and all other metrics are in line with or better than guidance. In this context, we remain confident of achieving our 2022 guidance, but given the low level of the market as of June 30 and their impact on wealth management profitability, we now expect 2022 core EPS to be in the lower half of the target range.

Slide 16 reconciles core earnings with reported earnings. Noncore items adjusted for Q2 reported earnings include charges related to recent acquisitions, which were lower than expected, in addition to CAD0.31 for unfavorable market-related impacts. These charges were offset in large part by the exclusion of a CAD0.25 tax gain for prior years, resulting in strong core EPS of CAD2.37 for Q2.

Slide 17 presents the source of earnings for the second quarter on a core basis. Expected profit was 11% higher than a year ago on a reported basis and 9% higher on a core basis. Core experience was positive with a CAD0.05 gain during the quarter from favorable policyholder experience, particularly for insurance business in Canada and in the U.S. and for group insurance. The impact of new business was also favorable, resulting in a gain of CAD0.08. As guided on the Q1 earnings call, we factor into the Q2 strain calculation, a portion of the interest rate increase that has occurred since the beginning of the year to reflect our view that some of this increase should persist through the end of the year. higher sales than expected also contribute to this gain.

Income on capital was near expectations during the quarter as higher investment income was offset by higher financing costs and unfavorable experience at iA Auto and Home. The latter can be explained in part by the severe storm in May in Quebec. Finally, on a core basis, the tax charge was a little bit higher than expected, higher taxation from the company's multinational insurer status more than offset the favorable impact of our tax position refinement for 2022.

As shown on Slide 18, mortality experience during the second quarter was better than expected in the U.S. and higher than expected in Canada. The extra mortality in Canada was recognized in the result as an experience loss, whereas the excess provision in the U.S. is carried forward. This favorable impact was therefore not recognized in the Q2 results. As for the additional protection for policyholder behavior, it remains intact.

Moving to Slide 19. Our solvency ratio stands strong and comfortably above our target range at 130%. The solvency ratio continues to be supported by ongoing organic capital generation, which totaled CAD160 million in the second quarter. The strong capital generation adds to the company's financial strength and lead to future value creation. Our solid solvency ratio, combined with the different metrics presented on Slide 20, such as our leverage ratio below 24% are indicative of our robust and flexible overall financial position.

As for our NCIB program, 1.2 million shares were redeemed and canceled during the second quarter. Our capital flexibility allows us to keep buying back share and thereby return value to our shareholders in addition to the increase in the dividend to comment shareholders announced today.

Now please refer to Slide 21 for an update on the transition to IFRS 9 and 17. As the company transitions to these new standards, it continues to be managed with a long-term vision to protect the strength and quality of the balance sheet. Among other things, under IFRS 4, the company has kept action protection in the reserving process has provisioned prudently for financial guarantees and has positioned assumptions to limit gains on new business. This sound approach puts us in a favorable position at transition. And today, we are pleased to reinforce our positive outlook for the transition to IFRS 9 and IFRS 17. Based on information available today, we still estimate a near-neutral impact at transition to our book value. In addition, we expect that our CSM at transition will be greater than CAD5 billion. Furthermore, our solvency ratio at transition should increase significantly by more than 20 percentage points, having a very favorable impact on the level of capital available for deployment.

As for the most important profitability metrics shown on the slide, based on our preliminary estimates and after 2 quarters in 2022, we still anticipate near-neutral to favorable impacts tax. I will conclude by detailing that we are satisfied with the result after 6 months with both core EPS and core ROE well within guidance. The level of organic capital generation is strong, just like our balance sheet and our capital position. Therefore, we have a stable foundation to increase our dividend to common shareholders and to pursue our growth strategy in this environment of high macroeconomic variations. This completes my remarks. Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from Meny Grauman with Scotiabank.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Just a question on capital available for deployment. Despite the fact that you're generating a good amount of excess capital, it's continuing to go down 550 at the end of this quarter with 700 in Q1. And if you go back a year CAD950 million. So I'm just wondering what's driving that? And if we look towards the rest of the year, could that still go lower? And then as a follow-up, under IFRS 17, you're talking about you mentioned very favorable impact on capital available for deployment. So what could that look like once we transition?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Meny, Jacques speaking here. 2022 is a transition year for us. You know that we have decided to get exposed to IRR moving our investment strategy to prepare for IFRS 17 because under that future regime, we will improve the value to shareholders, we will reduce the volatility of our earnings as well as reduce the capital required to support the business. So this is a transition year. So what you've seen into the reduction of capital available for deployment this year is really because of that, the rising interest rate has negative impact. If you look at the solvency ratio, it's 7% since the beginning of the year that has reduced our capital ratio. So this is really because of that. And like you mentioned, under IFRS 17, it would be a completely different ball game because our solvency ratio will increase. There's 2 other elements considered as well for deployment of capital under IFRS 17. First one is presently in the current regime it is the core ratio that is our main constraint. And our core ratio will improve significantly also under IFRS 17. This is important. However, as the fact that we expect our earnings to be more volatile, we will have a higher target operating ratio. But all it now on a net basis, the capital for deployment will increase significantly next year.

Meny Grauman - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

So are you able to give us a range relative to the CAD550 million that you reported for the end of Q2? Could that be double? Or how should we think about that?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

I will say much more than that actually. Maybe just rough estimate you can do, you can use that we mentioned the 20% solvency ratio, you multiply that by CAD70 million. So it gave CAD1.4 billion. So this is just an approximation. Like we said, we're still working with estimate. At this point, we are confident into our estimate, though, to be able to give that, but it will be significant.

Operator

Our next question comes from Tom MacKinnon with BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD & Analyst*

The strain in the second quarter was better and you cited interest rates and volume as contributing to that. So if we looked at, say, if interest rates were unchanged in the third quarter versus what they were in the second quarter and your individual insurance sales volumes and mix was identical in the third quarter as it was in the second quarter. Would we expect strain to be the same in the third quarter as it was in the second quarter?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Hello Tom, Jacques speaking, yes. Yes, we can. Like I said on the Q1 call, I mentioned that I will recognize that high interest rate. Actually, for the strain calculation, there is a limit to the provision and the conservatism I can get into my IFRS 4 reserve. And that high interest rate is just improving the profit of our business. So for sure, that we have not recognized it in Q1, Q2 is really the impact of sales of Q2. So for Q3 and Q4, with that rate of interest, you can expect similar impact.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD & Analyst*

Okay. And just with respect to your comments about guidance. Was that for the second half of 2022 that you were talking about being in the lower half of the target range, I was unclear as to what you said. I don't think you would talk about prior results. So is it just the second half of 2022 that you would expect to be at the lower end of the target range? Or I was clear on that.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Okay. Jacques speaking again. Yes, that was what I was referring to. And maybe to give some color, there are other elements that are posted that are negative. And when I look at that, and this is my opinion, okay? I don't have any crystal ball like any of us. But the thing is that if you look on the positive side and you look at the group insurance, actually the dealer business, we have that benefit because of the value of used car. As long as there will be that inventory shortage, we could expect that used car value will continue to be high. So we'll expect benefit from that. We just spoke in your first question about the strain that we expect it to be positive. And when I look on the negative side, for sure that asset under management in the wealth division will be on the low side as well as the dealer business in U.S. because of the inventory, we are making our money with administrative fee there. So that's a direct impact. And the third one is expenses where we expect them to be slightly negative in Q3, Q4.

Operator

Our next question comes from Scott Chan with Canaccord Genuity.

Scott Chan

I'll start with Sean and maybe I have a question for Jacques after. Sean, just on the wealth management side, obviously, a difficult and challenging market in Q2. Yes, I think you have disclosed the Wealth Management sales were up 5% year-over-year. Maybe if you can give us an update just on your Wealth Management segment, net advisers in terms of retention improvement? And any progress on that AUA/AUM conversion on your previous target.

Sean O'Brien - *iA Financial Corporation Inc. - EVP, Wealth Management*

Yes. Thanks, Scott. It obviously started as a tough year, but our strategy continues. The adviser experience has been the focus, and we have a number of sort of tech projects I guess that we're really focused on to drive that experience between the client and the adviser. We're executing on a couple of those so far this year, so getting some good feedback for advisers. Retention on the private wealth side in particular has been very strong, which is good, something positive. Recruiting started slow for private wealth, but it's been good on the MFDA side. And the AUA to AUM strategy continues. The affiliates, in particular, in these tough times are definitely outperforming the outside advisers. So it's a tough year, but the teams, I think, is executing on the plan.

Scott Chan

And any gaps in your product lineup on the asset management side you got to fill?

Sean O'Brien - *iA Financial Corporation Inc. - EVP, Wealth Management*

Nothing immediate. No. No. There are a couple of we're exploring, but with the current markets and some of the stuff on the, we're not launching anything immediately.

Scott Chan

Okay. And Jacques, just a follow-up on the solvency ratio, the greater than 20 percentage points. Is that all due to the capital deployment comment you made in terms of being much bigger? Or is there something else involved in that as well?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. Actually, the capital ratio at transition there will be different elements, but the 2 main elements. One is really the macro protection that we've built holding for years. Actually, the transition is on January 1, 2022. If you look at our Q4 slide deck, you will see that the macro protection were worth 11% on the solvency ratio. And the other aspect as well is that the regulator gets rid of the scalar, so the scalar is really a 5% that is applied to the solvency buffer. So it has to be removed. So those 2 by themselves will explain 18% of the increase in ratio. And also, we were provisioning like it's written on the IFRS 17 slide. We have prudently provisioned for future financial guarantee, and those reserves under IFRS 17 will be a bit lower. So this is another element that held in the solvency ratio.

Operator

Our next question comes from Doug Young with Desjardins Capital Markets.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Jacques, can I just go back to that comment on the LICAT benefit? And I think you, sorry, may have missed this, but a good chunk of the LICAT increase, and this ties into the CAD5 billion CSM as well. But how much of the LICAT increase in the CAD5 billion CSM relates to that market protection and partially relates to the equity market protection for equities vacuum liabilities because it does feel or it does seem like in your disclosure that since the end of Q4 of last year to this quarter, that protection has come down quite a bit as a result of the equity market decline. So I'm just trying to kind of piece a little of that together.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. That's a good observation, Doug, on that. What is really happening though a transition, you can use the number I just provided in the answer I gave to Scott. When you look since the beginning of the year, what is happening, there are 2 elements, you're right that the stock market protection is reducing for NFI. But at the same time, the long-term interest rates are rising big time, and this is certainly helping on the position with the reserve calculated using IFRS 17. So this is the element that is helping the ratio during 2022. So that's why we are really confident that the ratio is improving. Our estimate is really that ratio is improving in 2022 under the IFRS 17 basis.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

So the equity market side is actually a negative, but the interest rate side is becoming quite a bit of a positive once the adoption goes through, that's the way to think about this. And if it continues to go in that direction, then net-net, you're still comfortable with what you're suggesting?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Exactly. In fact, the correlation is, the ratio is positively correlated with rising long-term interest rate and positive market movement. So that's really what it's simple to remember.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Yes, okay. And then just on the CAD5 billion CSM transition, I mean, I just from the comments I've heard it just seems it's a big number. And can you maybe give a little bit or unpack where this is sitting right now. Can you give a little bit more disclosure around that?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. I may give some, but it would be easier to provide more details when we'll do an investor event. We were planning to do something in November and to provide with the slides and more information there. What I can say about the CSM is we've always mentioned over the years, over the quarter that we are very confident and very pleased with the profitability of our different products. Also, CSM is supporting economic risks. It's supporting nonattributable expenses, operational risk and also profit. And when you look at our portfolio, I would say, we have a huge legacy long-term guaranteed product in individual life. That business is very profitable, is capital-intensive business. So we have great profit to support that business. So that contributes a lot to that CAD5 billion.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

And maybe if I could just ask another way, how much of that CAD5 billion is a result of you not taking new business gains over the years and having that conservatism built into your reserves. Is that 75%? Is that the vast majority of that CAD5 billion? I don't know if you can give a sense of that.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. Actually, it's really depends angle, you want to look at it. What you're referring to is really the impact of not having taken gain on new sales is really that we have no it on book value at transition, okay? This is the consequence, it's a very positive consequence because we've not taken those profits in the past. The CSM is really a calculation in regard of what is the profit that we use the cost of capital to establish our risk adjustment. We use a market valuation to establish the CSM. So it's really a different construct. So my answer is really based on the construct we have to do. It's not because we didn't take a strain that we have a big CSM is really CSM because we apply IFRS 17 standard. That's the reason why we have that.

Doug Young - *Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst*

Okay. And then just one last one. Just on the LICAT post-IFRS transition. Can you give specifically where your range is going to go to? I know what your target range is now, but can you give a specific like where is that range going to go to next year?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Not yet. I cannot provide that. I really expect to be able to give more color in November on that.

Operator

Our next question comes from Paul Holden with CIBC World Markets.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Yes. So with the numbers Jacques provided on the additional CAD1.4 billion of estimated capital, does that prompt you at all to rethink or reimagine M&A strategy, i.e., does it open up new opportunities for you, you would have considered in the past simply because of the size?

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

It's Denis here. Thank you, Paul, for the question. It's a very relevant question. Obviously, I mean, the IFRS 17 transition is something that is pretty new. We're discussing internally exactly the question that you are bringing to the table because this is going to be a very centerpiece to our plan that we are trying to build right now. And certainly, we have an ambition going forward. We have also areas where we believe where is it that we want to invest that excess capital. At the end of the day, we're putting more attention to acquisition, obviously. But at the end of the day, if we are not able to grow organically or by acquisition, to the extent that we want at some point, shareholders will get the money back to some extent. But our role here is really to grow the company, and we have specific areas where we want to grow.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Got it. That's helpful. And then second question related to that. What we've heard from other life insurers is that the reg capital ratio under IFRS 17 should be less volatile. So the reason I ask is just that would give me more confidence that, that CAD1.4 billion estimate between now and actual transition is unlikely to change materially. Would you share a similar view?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Okay. It's Jacques. I will answer that one. Actually, it's all relative. What they've said is compared to what they are leaving through with under the current regime. Our comment has always been that we expect our solvency ratio to be more volatile than what we have experienced over the past few years. And the reason is simple. We have had market protection that have absorbed volatility under the current regime. And you can see the evolution of that absorption, I will as a term by looking at the number we're providing at every conference call. So this won't be there, those protection won't be there. However, at the same time, we are working, we're implementing an investment strategy that will reduce our economic risk, our accounting risk, and it will also help in the ratio. So bottom line, net-net, we will have a higher volatility and our target operating ratio will increase because of that. But I can tell you that the 1.4 is very strong. If I'm telling you today that number is because I strongly believe in it, even if we're working with estimate.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Got it. Okay. Yes. That's helpful. And last question from me is just on individual insurance. There was a bit of a step function Q-over-Q and expected profit on in-force, just wondering if there are particular factors that explain that Q-over-Q change in sort of the annualized growth rate?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes, it's a good observation. Actually, it was in Q1. It was a seasonality factor. Actually, it's an improvement in our modernization. There are some bonuses on the compensation side that we are paying in Q1. And the actuarial model doesn't model it by quarter. So that's why we have adjusted the expected profit for that. There are a few other things you expect business to grow quarter-over-quarter as well. So overall, for the year, we're expecting the life to be around 7%. So pretty close to what we have in Q2. So Q2 is more reasonable, but that's really what happened during that year quarterly guidance.

Operator

Our next question comes from Lemar Persaud with Cormark Securities.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

My first question is probably for Jacques. So just maybe I'm misunderstanding one of your earlier answers, but it sounds like to establish a CAD5 billion CSM that's not coming out of equity because you didn't take the gains in the past. So if that's the case and it's not coming out of equity, hence, the near neutral impact to book value, then where is it coming out of?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Okay. Okay. Sorry for that. I'm trying to be as more concise as possible, but it's a tough one. Actually, the system is calculated under the IFRS 17 with the IFRS 17 standard. When we migrate from IFRS 4 to IFRS 17, they are impact on book value, EPS and all that kind of stuff. So when we say that the past equity protection, okay, our macro protection, they are helping to finance the CSM. Actually, what we're seeing is that at transition, we don't have a hit on book value because under IFRS 4, we were conservative with that macro protection. That's really what we mean by that. But I don't want people to understand that the CSM has been calculated to be equal and it's the addition of that margin. We have followed the IFRS 17 rules, we have calculated according to the standard. I just want to make sure that it's to distinct element. Maybe I'm too technical, but I thought it was important to mention.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

And then just on the CSM. I appreciate the CAD5 billion figure at transition. But I wonder if you could talk about if you were to freeze time, how would that CAD5 billion kind of amortize into income?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Okay. It really depends on the business it's supporting. So you can expect that for Individual insurance, the portion that is related to the life insurance will be amortized actually over the life of the different businesses, so according to the standard. So that is the way it's calculated. And for shorter line of business, the CSM will be amortized over the shorter period.

Lemar Persaud - *Cormark Securities Inc., Research Division - Research Analyst*

Yes, that makes sense. So there is no estimate then like if you were to free sign of that CAD5 billion could come in like maybe CAD500 million a year sort of thing. That's probably tough to boil it down to.

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

I think what you're trying to do and maybe I'm wrong here, but is to try to, let's say, model or rationalize, let's say, the amortization of the CSM and how it translates into profit over time. But keep in mind that the CSM is only part of the future profitability of our organization. So it's a good indicator. And the reason why we are showing the CSM today is because we wanted you analysts and investors to realize that the size of the CSM is quite significant based on the size of the organization. That's the reason why we are disclosing it today. But keep in mind that it's only part of future profitability.

Operator

Our next question comes from Gabriel Dechaine with National Bank Financial.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

I just want to go very high level, stupid even in terms of how we kind of think about the CSM under the current accounting, the policyholder liabilities, the best estimate and then a PFAD and then under IFRS 17, we'll have best estimate risk adjustment thing and a CSM. So it's just a change of label, basically, and the proportion of the liability that's future profits, which was PFAD before just has different labels on it, but it's basically the same proportion. Is that anywhere close to reality?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. You're right, Gabriel, okay? You have this estimate assumption, you have risk adjustment for any actuarial decrement. And after that, everything goes to CSM, you are not allowed to front-end profit on the IFRS 17. So you put the rest in the CSM. And that CSM will, like Denis mentioned, will flow through profit as well as risk adjustment down the road. So those will be the two sources of expected profit.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. But the proportions of expected future profit of the total liability is not changing that much, is it?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

No, actually. We expect we've mentioned it over the different quarter. We expect our EPS level. actually, we said this on the EPS level, it's near-neutral favorable and all that kind of stuff. So it's audience considering CSM release, all that kind of the investment gain as well that has to be factored into the total profit of the company. We have also to consider the other businesses that are not under IFRS 17.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Perfect. Good enough for me. Now as far as just looking at the numbers this quarter, so I understand them a bit better, expected profit was up 11%. And then the explanation of one of the explanations is the impact of high net fund entries in recent quarters, is that just I guess you had strong inflows and AUM growth in prior quarters. So you kind of preprogrammed the expected profit, but then that gets netted out in the experience losses, is that maybe the 11% expected profit growth is a little bit of a not really 11% if you factor in the experience losses by the market performance?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Yes. Actually, when you look at the expected profit on in-force you have to consider its year-over-year were comparing Q2 2022 over Q2 2021. If you recall, last year was simply wonderful in regards of our net sales in both mutual funds and seg fund division. So this is part of the growth in that. And I will encourage you to look at Q1 expected profit on that division. It was around 16%, 17%, if I recall well. If you look at it, the fact that market has decreased in Q1, the AUM has decreased. So that's why the growth, it's still a growth because year-over-year, last year was so great, but it's a lower growth than in the first quarter because of the negative market.

Gabriel Dechaine - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And the last one, just you were talking, it was very helpful given what you're seeing as positive and negative drivers for EPS growth as we move into the second half. On the negative side, I didn't see or write it down here, but unless I missed it, you didn't have expense inflation listed. And then you didn't list P&C business because obviously, there's a bit of a shortfall, but I guess in reverse order, the P&C, you're treating this quarter, the shortfall is a bit of a one-off and then expense inflation, what's going on there because I know that will topical in Q1.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

So Gabriel, I mentioned expense as being a source of probably negative pressure on the EPS for Q3, Q4. So certain inflation is part of that. About now, there will be the expense side because we are starting a digital transformation there to improve customer experience. So this will be a factor in there. But about the experience of our iA Auto and Home, if you look at the claim experience, that was the big storm in Quebec during Q2. We expect the remainder of the year to be pretty much in line with, our best estimate is still the guidance actually for this one.

Operator

Our next question comes from Darko Mihelic with RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets, Research Division - MD & Equity Analyst*

My questions are all related to IFRS 17 Jacques, so bear with me. I guess the first question is you decided to sell us the contractual service margin. Why did you opt not to tell us what the risk adjustment?

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Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Because nobody are speaking about risk adjustment, but actually, nobody has had the question. So this is a good question, Darko. But overall, they are pretty much in line with the, I would say, the PFAD, we already have over the actuarial decrement. But what we're providing usually, when we say that on the core ROE, the core EPS level, the core EPS growth is favorable, it factor in everything that we expect as being released from CSM investment return, risk adjustment, growth of the business. So for us, it was all in all, net-net. And I think that was the best way to convey say to the market.

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

And it's Denis here. I would add also to that, that we received comments that the fact that we had some positive development in terms of the book value at transition, meaning i.e. no real impact. I mean there were comments that it could have been that the CSM of the organization would be small. And that's one of the reasons why we are showing it because that's not the case. I mean we have a strong CSM. And by the way, the transition has been quite positive development for iA.

Darko Mihelic - *RBC Capital Markets, Research Division - MD & Equity Analyst*

Okay. That's fair. I mean, I guess it harbors a lot of questions though, right, because the contractual service margin at CAD5 billion as a proportion of your year-end liabilities is extremely high. It's like 13.7%. And I don't think any of the other life will have something similar. And you actually mentioned it, Jacques, you said a portion of the CSM is a legacy product. So I think optically, the fear I have is that if you have a legacy proportion of CSM, then the growth of your CSM going forward may be difficult and may in fact, I mean, I don't know I'll open the door, I'll open the question up and say, is it possible that, that CAD5 billion will actually be in runoff or decline over a period of time because you'll have to sell an awful lot of the other products to make up for the CSM that's running off of the legacy block.

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

Okay. Okay. We'll answer it from 2 angles. The first angle is you can expect our CSM growth to be in a high single-digit number, okay? So for both new sales and for the total in-force, so we have no worries whatsoever in regard of our capacity to do good business in that industry. this is the first answer. The second part of it about CSM, at the end of the day, when we price products, we have to factor in what would be the capital required to support that business. And the profit goes according to the capital that is needed. So we are selling more capital-light. We have intentionally diversify our operation to be more capital light, but I don't mind at all because we're asking less capital to support that business, and it's profitable. So at the end of the day, it's pricing for each product, that is that matter. And that's what we're doing.

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

Yes. I just want to add, it's Denis here. I mean I mentioned it before, but it's very important. CSM is only part of the future profitability and organization. And for example, if we decided to go only in, I'm just saying distribution business just for the sake of the discussion here, that's not what we want to do, but just for illustration here. I mean, obviously, if we don't build the insurance business and there could be a runoff in the CSM over time but other businesses would strongly replace that business and then profitability would come from another source. So keep in mind that the CSM is only for a portion of the business. It is still strong. We still believe that it's going to go up significantly over time because we are in the core insurance business, but it's only part of the story. Just keep that in mind.

Darko Mihelic - *RBC Capital Markets, Research Division - MD & Equity Analyst*

Okay. Okay. That's fair. Jacques, what do you think of the approach of taking the contractual service margin and the risk adjustment and putting that as a proportion of total liabilities. That would give me a sort of a sense of, I don't know, maybe conservatism, maybe the profitability of the underlying product. Do you think that's an okay ratio?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

I think I will prefer really to look at the organic capital generation because in the 2 metrics you mentioned, this is an indication for sure, but you don't factor in what's the cost of capital for the business. So what's the business behind it? Is it capital intensive or not? When you look at the organic capital generation, you factor in the capital required for the business, which is really all inclusive. So that's what we prefer to look at.

Darko Mihelic - *RBC Capital Markets, Research Division - MD & Equity Analyst*

So when I think of a capital-intensive business, my spitty sense goes up, right, because capital-intensive might mean risky. And isn't it possible, for example, somebody's underwriting insurance in another jurisdiction that has a much lower capital requirement is not as risky but it has a high CSM. So am I thinking about it incorrectly? Do you think that just because it's capital-intensive, it's not necessarily risky?

Jacques Potvin - *iA Financial Corporation Inc. - Executive VP, CFO & Chief Actuary*

No. What I wanted to mean here is really that if you price a long-term guaranteed product, okay, you will ask for a great profit, higher profit that if you price a 1-year GIC, which you have less risk. So all proportion kept, you will target this for the same ROE, you will have a huge CSM because of the economic risk of that long-term product. So that's the only thing I want to convey here as a message is CSM by itself doesn't tell a lot if you don't look at the business behind and the risk behind. And there are different businesses, we are in the different businesses in different country and the profitability of each businesses could be different. That could be better ROE on certain business. So what you're saying is also true. You can have higher CSM on some businesses that have capital light because ROE is better, it may happen as well. But the message I want to convey is we prefer to look at the whole thing together. It gives us a better indication really on the way we use the capital of our shareholders.

Darko Mihelic - *RBC Capital Markets, Research Division - MD & Equity Analyst*

Okay. I apologize for diving into this, but I look forward to the event in November for sure.

Operator

Mr. Ricard, there are no further questions at this time.

Denis Ricard - *iA Financial Corporation Inc. - President and CEO*

Okay. Well, thanks a lot. Maybe the message to conclude. I think you realized that one of the big message today has been one that we've been able to deliver an EPS above our target range, and we're very, very pleased with that. And we see that going forward, there is a capability for this organization to really perform. Strong organic capital generation. I think it's a theme that is very important because at the end of the day, capital is king. And the last thing I would mention is the IFRS 17, and I just want to reemphasize one of the message that we've given here. And we are saying that capital is very important. Well, Jacques mentioned that on a net basis, our preliminary calculation implies an additional CAD1.4 billion in capital to be deployed. That's net of the increase in the target LICAT ratio. So that's quite an achievement. And I think one thing to remember is that we've been telling investors and analysts for years that we manage conservatively the balance sheet of this organization. And today, you really see the result of it with the very positive development under IFRS 17 because all those conservatism under that new regime has to be "released" and they are being shown in the book value, they are being shown in our capital, they are being shown in the future earnings of this company. So it's a very positive development for iA going forward. And at the end of the day, that's why we were very pleased to increase the dividend by 8%, probably more than what one would expect going forward. So with that said, thanks to all of you. Bye-bye.

Operator

That does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your line. Have a great day. Thank you.