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IAG.TO - Q3 2020 iA Financial Corporation Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Industrial Alliance Third Quarter Earnings Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded on Wednesday, November 4, 2020.

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 third quarter conference call. All our Q3 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'll 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 forward-looking statements at the end of the slide package. A detailed discussion of the company's risk provided in our 2019 MD&A available on SEDAR and on our website with an update in our Q1 2020 MD&A.

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. I will first introduce everyone attending the call on behalf of iA. First, Jacques Potvin, Chief Actuary and CFO; Mike Stickney, Chief Growth Officer and responsible of our U.S. operations; Alain Bergeron, Chief Investment Officer; Renée Laflamme, in charge of Individual Insurance and Annuities; Sean O'Brien, responsible for our mutual fund business and wealth

management distribution affiliates; François Blais, in charge of our Dealer Services, Special Market Solutions and iA Auto and Home; and Eric Jobin, responsible for our group businesses.

We are quite pleased with our third quarter results, which are very strong for a second straight quarter. As shown on Slide 3, profitability was particularly good with reported EPS up 18% year-over-year. For the first time since iA became a public issuer 20 years ago, our quarterly reported EPS is above \$2. Core EPS is also up at \$1.83, a 5% year-over-year increase. Several factors support these solid results, including favorable policyholder experience, such as the excellent performance at iA Auto and Home. Indeed, the performance of this subsidiary continues to be outstanding.

Our sales results are also noteworthy as they were strong in almost all business units, including in more mature markets such as Individual Insurance Canada where we continue to see growth potential for iA. Our Q3 results, with 14% growth in Individual Insurance together with 11% year-over-year growth, clearly demonstrate that the disciplined execution of our strategy focused on consumer and distributor experience enables us to continue to grow in this market.

I also want to comment briefly on our Dealer Services businesses. In Q3, following the reopening of car dealerships, there was an upturn in car sales, which positively impacted our Canadian and U.S. Dealer Services sales. This shows that the challenges that may arise from the pandemic in this sector are only momentary and that the potential for growth in this capital-light business remains just as interesting.

As for our financial strength and capital position, it remains sturdy with a sound leverage ratio and a 125% solvency ratio, up 1% from the previous quarter, with low sensitivity to macro variations and ongoing capacity to generate organic capital.

To conclude my comments on our Q3 results, I would like to say a few words on our vision and strategy. We manage iA with a long-term vision of sustainable growth and financial strength that aims to provide peace of mind to our clients. The strong results that we reported today show that prioritizing the well-being of our clients allows us to best grow our business and create value for our shareholders.

These good results are also the outcome of our smart choices in technology. For instance, part of our success in Individual Insurance and seg fund sales is due to EVO, our high-performance platform, which is used by 100% of our carrier network and close to 90% on the MGA channel. In Canada, about 93% of individual life insurance applications have been submitted through EVO since the beginning of the year. As for the United States, for the last 6 months, about 88% of new life application, insurance applications, have been done electronically. These and other decisions that we have made when investing in technology has served us well since the beginning of the pandemic.

Over the next months, we will continue to focus on the well-being of our clients as well as our employees and distributors and facilitating their work. This will enable us to continue to deliver high-quality service to our clients and create value for our shareholders. We will also continue to support our communities affected by the pandemic as the second wave is underway. In addition, we will, of course, keep up working on our positioning in the new normal that will follow the pandemic as well as on the integration of IAS.

I will now let Mike comment on business growth. Following Mike's remarks, Jacques will provide more information on our earnings and financial strength. On that note, I'll pass it over to Mike.

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

Thank you, Denis, and good afternoon, everyone. In continuing with the very good sales results since the beginning of the year, business growth during Q3 was robust in almost all business units.

Please refer to Slide 4 as I will comment on sales results by line of business. In Individual Insurance, sales totaled more than \$53 million during the third quarter, which constitutes a significant 14% year-over-year increase. Many factors explain these good results, including the strength of our diversified distribution networks, our digital tools and attraction of new products, namely a new YRT universal life product and a participating whole life insurance product.

Now looking at Group Insurance businesses. Employee Plans recorded sales of more than double those from the same period last year, standing at \$26 million. The addition of a large number of new groups during the quarter contributed to this good result. In Dealer Services, rapid growth recovery following the reopening of car dealerships led to total sales of more than \$309 million, up 3% from 2019. As for sales of Special Market Solutions at \$40.3 million, they were lower than last year, mainly due to the decline in travel insurance sales.

In our U.S. operations, sales momentum remained strong in Individual Insurance with a 30% increase year-over-year. In the Dealer Services division of our U.S. operations, sales totaled USD 249.1 million, a significant increase over the sales for the corresponding quarter 2019. This is mainly due to the addition of the IAS sales since May 22, 2020. In Q3, sales results in this division were supported by the recovery of car sales following the reopening of dealerships. Conversely, automobile inventories in the U.S. reached their lowest levels in 7 years, which may have tempered growth during the third quarter. The integration of IAS led by Kristen Gruber, the Head of our U.S. Dealer Services division, is progressing well as planned. The ongoing integration has a wide scope in order to maximize efficiencies and synergies between IAS, DAC and IAS Corporate Services.

Now turning to Slide 5 for Individual Wealth Management. Let's start with the guaranteed products, which sales continue to be excellent, totaling more than \$208 million. Segregated funds sales were also very strong with gross sales of almost \$725 million, up 26% year-over-year. iA remains #1 in the Canadian industry for net sales with nearly \$376 million for the quarter, more than double year-over-year. In addition, the company currently ranks second in the industry for segregated fund sales, close behind the #1 position.

Moving to mutual funds. Gross sales were up 17% year-over-year to nearly \$545 million. Net sales recorded inflows of nearly \$48 million, and we're, therefore, positive for the second quarter in a row. This performance was supported by the contribution of our affiliate networks.

Now turning to Group Savings and Retirement sector where sales were significantly higher than a year earlier, totaling \$1.2 billion. The signing of groups with substantial assets of both accumulation products and insured annuities explains this good result. Finally, direct written premiums in our P&C affiliate, iA Auto and Home, continued their steady growth and increased 14% year-over-year.

Overall, these sales pushed premium and deposits to a quarterly record of over \$3.9 billion for the third quarter, an increase of 43% year-over-year. As for assets under management and administration, while they slightly decreased over the last 12 months mainly due to market downturn, they increased 3% during the quarter driven by net cash flows and growth in financial markets.

In summary, again, this quarter, our distribution networks, supported by high-performance digital tools and our comprehensive range of products and services, have proven to be key success factors of our growth story. Our efforts are now focused on maintaining the strong momentum.

I will now turn it over to Jacques to comment on Q3 earnings.

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

Thank you, Mike, and good afternoon, everyone. We are very happy to report today excellent Q3 results.

Starting on Slide 6. Reported EPS was \$2.03, which is 18% higher than a year ago. On a core basis, EPS was also very solid at \$1.83 for Q3, and also for the first 9 months of 2020, core EPS is higher than last year. Core ROE for the last 12 months is 12.3%.

Now digging into results, please let's move to Slide 7. Policyholder experience was again favorable in most business units, including the Individual Insurance and Group sector. It was even more positive at iA Auto and Home, our P&C subsidiary, which continues to have results above expectations. Macroeconomic variations also add a positive net impact of \$0.12 EPS on the result.

Strain was in line with expectation as increased premium in Individual Insurance offset the negative impact of the first quarter drop in interest rates. Income on capital generated a \$0.04 EPS loss, mainly due to lower investment income. On the tax side, the company's status as a multinational insurer was the main factor supporting the gain of \$0.12 EPS.

Finally, 2 other specific items are noteworthy. First, we incurred a loss of \$0.11 EPS, mainly due to a software writedown. On the other hand, the sale of our residential mortgage portfolio generated a gain of \$0.06 EPS.

Please refer to Slide 8 as I will now comment more specifically on policyholder experience, which totaled a gain of \$0.15 EPS in Q3. Starting with Individual Insurance, a gain of \$0.04 EPS was recorded, mainly due to favorable morbidity experience and lower expenses, partly offset by negative mortality. Individual Wealth Management reported a result close to expectation as commissions paid on mutual funds sales were higher than expected. Our Group Insurance sector recorded a gain of \$0.03 EPS, which can mainly be explained by lower expenses in the Dealer Services division and favorable experience in the Employee Plans division. The overall positive experience in Employee Plans is mostly due to positive long-term disability experience, which was partly offset by health and dental experience and mortality. As for Special Markets Solutions, experience was in line with expectations.

Group Savings and Retirement reported a gain of \$0.02 EPS due to favorable longevity and lower expenses. U.S. operations reported experience below expectations with a \$0.04 EPS loss. This is explained by adverse mortality in the Individual Insurance division, nearly half of which can be attributed directly to COVID-19. As for the U.S. Dealer Services division, favorable experience resulted in a small gain. Please note that the operating profit from the IAS acquisition for the period from May 22 to September 30, 2020, is included in our U.S. operations' Q3 results. IAS profit during this period was in line with management's expectation as specified during the second quarter conference call.

Finally, as already mentioned, experience at iA Auto and Home was once again much better than expected with a gain of \$0.11 EPS. This very good experience can be explained by lower claims, particularly in auto insurance as well as lower expenses.

Please refer to Slide 10 for our capital position. During the quarter, our solvency ratio increased by 1 percentage point due to organic capital generation. Indeed, we generated about \$70 million in organic capital during Q3 and \$175 million during the first 9 months of 2020. We are quite pleased with our continued capacity to generate capital organically as we consider organic capital generation to be the best source of capital.

Our resulting solvency ratio as at September 30, 2020, is very strong at 125%, well above our target range of 110% to 116%. This target range is more than adequate for iA due to the low sensitivity of our solvency ratio to macroeconomic variations.

The market protection that is described on Slide 11 provides a better understanding of some of the reasons for this low sensitivity. Indeed, iA has a distinctive market protection in the form of a margin embedded in our reserving process that protects against valuation of public and private equities matching long-term liabilities. More specifically, this margin increases or decreases based on market fluctuation. In practice, as this margin can sustain significant market drops, we normally don't need to adjust reserves intra-year. Most recently, the effectiveness of this protection was proven in the first quarter of this year.

In addition to decreasing the net income volatility, this market protection also decreases our solvency ratio volatility, which supports a lower solvency ratio target. This protection has a great value and is well aligned with our prudent and long-term approach. The current work of this protection, which is not recognized in the solvency ratio calculation, is equal to more than 7 solvency ratio percentage points.

Altogether, with a solid solvency ratio at 125%, the market protection equal to more than 7 percentage points, a leverage ratio of 25.1% and a high-quality investment portfolio, the company continues to be in a very strong financial position.

I will conclude my remarks by commenting on our actuarial review and year-end risk management strategy. Please move to Slide 13. First, we expect that our regular annual review of actuarial assumptions will have a near-neutral impact on fourth quarter earnings. More specifically, any assumptions strengthening, including for the URR, should be offset by investment gains and strategies to manage macroeconomic risks, most of which have already been completed to date.

In parallel, since the beginning of the fourth quarter, we have concluded new reinsurance agreements. As a matter of practice, we periodically test the reinsurance market. And this year, we decided to take advantage of the favorable reinsurance environment. And this reinsurance treaties are ROE accretive and will create value. At this time, we plan to use the gains from these agreements to take on additional protections against uncertainty

arising from the COVID pandemic. Overall, we are well positioned as we expect our year-end risk management strategy to have a neutral to positive impact on Q4 2020 results.

In conclusion, I will say that with our strong earning power and financial strength, all the fundamentals are in place to support our continued growth and to deliver value to our shareholders.

Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Tom MacKinnon with BMO Capital Markets.

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

Just 2 questions here. My first question relates to the new reinsurance arrangement you're speaking of, just a little bit more color here on what you're doing. Are you like replacing current reinsurance arrangement with a new one and, in the process, you're getting some more favorable terms in pricing? And does that mean you're getting some earnings gains going forward? Or is this like a new reinsurance arrangement that you're embarking into and you're getting capital and reserve release? And then maybe you can elaborate on what additional protections you're going to be taking here. Does that mean you're getting some relief in capital and reserve relief from reinsurance and you're going to strengthen reserves elsewhere? Just a little bit more color on that? And I have a follow-up.

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

Okay, Jacques speaking. About reinsurance and I will mention right away that we have not finalized all the negotiations for that strategy, so I will be, I will keep some information to not lose some bargaining power because we want really to try to increase the shareholder value. But reinsurance, okay, we've already signed some of the deals and, for sure, they will provide positive value. That value is coming from 2 sources, okay? One is, like you said, we will no longer require because we will no longer bear the risks. So we will no longer need to have the margin in our reserve, and the capital ratio will be lower. The capital required to support that business would be lower, so it's ROE accretive.

But the good news is that -- the reason why we strike the deal because almost all year, we kicked the tire and we looked at the reinsurance market. But this year, we feel really that we have to take that deal because that was a very good deal on the street. So reinsurance is seeing more profit in the future business than what we are seeing. But like I said in my notes is that I'm not planning to release that profit in Q4 because I know that there will be some headwinds coming from the COVID situation. It's a situation that is very fluid. So far, so good. After 3 quarters, we've been hit a lot by volatility in Q1. Q2, Q3, COVID has been, I would say, neutral. But we don't know what the second wave will bring to us. We don't know if the government will continue with their same programs, so I will try to be cautious here and to keep those margin to manage that path.

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

The only thing I would add -- Tom, if you don't mind, I'll just add one thing here. Regarding reinsurance, we are not dogmatic about it, meaning that, like Jacques said, from time to time, we do check how the market is. And it also gives, for us, some comfort about our assumptions as well. And this time, we thought that the convergence of these good reinsurance deals and the fact that COVID, we need to be more, I would say, prudent in terms of some of the assumptions, so the convergence of the two, I think, was quite done at the right time. So we're trying to be forward-looking in the way we look at reinsurance and also not being dogmatic.

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

And is there any impact on earnings?

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

To complete, on your first question, it's new reinsurance agreement on business. It's not replacing an old reinsurance agreement. And the impact on earnings, it's too soon to say so. In Q4, I will be able to provide that.

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

Okay. And my follow-up is on the amortization of finite life intangibles related to acquisitions that you disclosed on Slide 22. So this noncash expense has essentially doubled from 2019 levels. And it's almost entirely due to the IAS acquisition. Now this expense is included in core earnings, and I get it, it wasn't particularly material in 2019 or in the prior years, it was only maybe about 4% of core earnings or so on an after-tax basis. But now with the IAS acquisition, it's essentially doubled, and it's over 8% of your core EPS. And as you know, the Canadian banks have the street focused on adjusted net income, which, in addition to excluding restructuring and integration expenses, also excludes expenses related to the amortization of finite life intangibles related to acquisitions. And these are probably about 2% to 3% of the bank's income. Intact Financial also presents operating earnings, which excludes these noncash expenses as well.

So can you help us understand why you have decided to include these noncash expenses as part of your core earnings? Because, like, the way I calculate it, the \$0.27 EPS 2021 accretion you talked about from IAS and the \$0.38 you guided to for 2022, these would probably be, like, \$0.28 higher, more like \$0.55 and \$0.66 if you had followed the same kind of reporting adjustments that the Canadian banks and Intact Financial make when they exclude these noncash earnings from their "core earnings". So maybe some color with respect to that, please.

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

Okay, Jacques speaking. Tom, you're making a great point. You know what, historically, in the life insurance industry, it's my understanding that we've always reduced the core earnings by the amortization of those numbers. But like you point out, it's not done in the bank industry, it's not done for Intact. So that's a really good point with the fact we just double it with the acquisition of IAS. So for sure, that's why we changed our strategy this quarter. We provide the information in the slide package, and that's a good information. But like I said, historically, insurance industry didn't recognize it. So it's a good point that we shall be compared on a level playing field.

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

So like, when you looked at IAS, you looked at it on an EBITDA basis. So I assume that when you looked at it, because you gave us some pricing metrics on an EBITDA basis, so I assume on that EBITDA basis, you're excluding these noncash expenses just the same way the banks and Intact exclude them. So do you think we should be looking at IAS here on an EBITDA basis? Maybe you can think about that in terms of how you want to disclose the impact of IAS because if we allocate those noncash expenses to IAS, like, maybe we should be looking at IAS on an EBITDA basis that excludes those noncash expenses.

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

Tom, it's Denis here. I think you're right. And I must say to you that we are in the process of reviewing our calculation of our core earnings for next year, what it does include and what it does not include. And certainly, your comments will be taken into consideration. I think you are right to say that this should be excluded.

Operator

Our next question comes from Scott Chan with Canaccord Genuity.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Just with the second wave that really started post quarter, post Q3, and maybe too early as you just alluded to, but is there any lessons or what you can draw from the first wave that maybe has affected your business growth or your overall business thus far?

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

Yes. I think, Mike, you should follow up on that question.

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

Okay. Thanks. Yes, we've learned that this is hard to predict, I guess. And I guess when I looked through the company in terms of our various businesses, we have learned how to manage with it. And I'd say, all of these businesses, some better than others, obviously, I mean I'm really quite impressed with how we've done with our Individual Insurance businesses in both countries. Obviously, there's a lot more digital sales and so on. And going through our other businesses, the same sort of thing. Obviously, our Dealer business is a little tough because we're dependent on car sales, and there's some headwinds there because of COVID. And I guess the other one that's hitting -- hit hard, but it's a small business, is the travel insurance business.

So in terms of the second wave, that part is hard to predict. In my mind, it all depends on government lockdowns if they come back. You're seeing that in Europe right now. I don't -- my own view is Canada doesn't need it yet. The infection rates are still, I think, pretty well managed or under control in Canada. The U.S. is -- got higher infection rates, but it also has a very unusual political situation right now. So I don't think there's a political will to make it happen in the U.S. So my best guess would be we carry on for the next few quarters just as we have for the last quarter.

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

And maybe one thing I would like to add on this is, and Mike mentioned that, that we've been resilient. I mean a lot of our businesses is being distributed through advisors, and whether it's on the Wealth Management side, Life Insurance side, Canada, U.S. And we don't, maybe we should talk about it much more, but our technology, we're quite advanced versus our peers. And it allowed us to maintain, and even increase, the level of our sales because, all of a sudden, the distributors, they needed to have tools to be able to make their living, to obviously grow their business. And we were able to provide them with those tools very quickly. We had invested, I mean we haven't started investing in technology during pandemic. We have started doing it in the recent past. I mean over the last few years. It really paid off. That's -- I think that's the lesson here of this pandemic that's going to help us through the second wave is that, because we have invested so much in technology and we are still continuing it, that we should be in good shape if a second wave is going to hit seriously.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

And my second question is just on IAS. You, I guess you included it from May 22, so just over a month, and you kind of called out it added about \$0.01. Can you quantify how much IAS impacted Q3 in terms of earnings?

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

What you have in the number is \$0.04. So if you subtract that \$0.01, if you want to have a kind of a run rate for Q3, it would be \$0.03.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

\$0.03, okay. And just lastly, you called out that vehicle inventories are weak and, obviously, it's from the pandemic in the U.S. Do you have any visibility on when that improves, as I think you said it's the lowest level it's been during the quarter?

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

Yes, Mike Stickney here. The industry predictions that I've seen, I guess, is that inventory levels should be back to, let's say, close to normal Q1, Q2 next year. So it's just kind of a temporary phase we're going through.

Operator

Our next 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, I'm really hoping you could update your thinking on your real estate exposure, especially in the context of the sale of the residential mortgage portfolio. So I noticed there was some commentary in terms of looking at doing a real estate and infrastructure review tied to the annual assumption review. So just sort of an update there in terms of your thinking, in terms of overall real estate and where the market is going from that asset class specifically.

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

Jacques speaking. In regards of real estate, we are using external valuation to look at all our real estate portfolio. And during those appraisal performance, there are reviews of some cash flows. Believe it or not, some are positive, some are negative in the current context. Overall, since the beginning of the year, I can tell that at the end of Q3, we already have \$130 million worth of present value in reserve impact, a negative impact, but it has been compensated by all the management action we've done so far this year.

And this one is quite important to understand that every year, we do management action. But this year, the value of those management actions went through the roof because of the widening of the spread in Q1 and Q2. So we've been able to create a lot of margin to face those downward pressure. So that's what we've done there. So the situation is fluid in regards of that. But when we look at where we're heading, we are quite fine to where we are right now.

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

And in terms of the thinking on the residential real estate portfolio, what was the driving thought behind that?

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

Okay. We exited the market, we mentioned it, the decision was taken last year, we exited the market. So we closed the transaction during the quarter. That's what happened during that quarter. But it's really that we have had that business for many years. At that time, it proved well, it was useful to match our liabilities. But recently, when we did our strategic thinking a couple of years ago, we decided that it no longer served our purposes. We will have had to invest into it. So for us, the best value for our shareholders was to sell it. So that's it.

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

And then just if I can ask on a topic that Tom talked about, the COVID uncertainty there. And definitely, 2 quarters in now, it looks like your business is very resilient to COVID. I think in Q2, you talked about the 2020 results being better than initially assessed. So maybe a little bit more specific in terms of where the concerns lie as you look ahead, where do the risks fall in your view, which specific businesses is really the source of your concern or where you think there's elevated risk that you wanted to adjust.

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

Actually, I will say mortality. When we look at the mortality in the U.S., Q3 has been very bad. Q2 was less bad. We don't know, is it fluctuation. And we said that half of the mortality is coming from COVID. But the fact that because of "distanciation", people are consulting less their physicians, there are ripple effects in regards of mortality. So this one, it's tough to call, but this one, I want to be prudent on it. After that, one of the things that we mentioned is the governmental program that gives money to many people. If ever it stops, will we see a spike in claims on disability because it would put a lot of pressure on the household, and that's the kind of stuff.

So just remember, our thinking in May, when we said that we were seeing a lot of things that were back, in Q2, like you said, we've been very resilient, and we are very happy with that. We had good news, iAAH Dealer Services has been -- also claims has been lower than expected and all that kind of stuff. But will they continue the same as the negativity? Quite tough to say. So for me, it's that. When I look at lapse, lapse has been positive so far this year, which is great. But it's tough to say that it will continue that way. So those are the things that I will look at.

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

Maybe Meny, just one thing to add on this. I think I would say -- I think it gives -- it should give comfort to investors that we are able to deliver such strong results, quarterly results and, at the same time, being able to get some additional comfort. The examples that Jacques gave regarding some of the management actions that we've taken, the reinsurance treaty that we're working on right now. So I think it should give comfort. And this is been the philosophy of the company trying to be prudent, at the same time, being looking forward.

Operator

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

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

Just a follow-up on that reinsurance question. I know you don't want to quantify stuff, but could you tell me what blocks of business, what risks were reinsured? Like, what downside issues are you trying to address, I guess, or mitigate?

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

Okay. Like I said earlier, every year, we kick the tire about reinsurance. And this year, when we look at all the quotes, we got, we felt pretty comfortable with our assumption, where we are. There's a small adjustment I will make at year-end. There would be an adjustment. It's not about mortality improvement, it's really the level for the ultimate mortality for a product that the table has not been well constructed. So that is one thing that I will fix there. But overall, the mortality we're expecting in the future, we're quite fine where we're sitting. And that's the message. That's the conclusion when I look at that. However, for that deal, it is because there was aggressiveness in the market, the reinsurance market is healthy, so it's a good value on an ROE basis. And it's for individual insurance in Canada and also in the U.S. for final expenses.

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

So it's mortality related.

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

Mortality related, yes.

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

Got you. And I guess while we're on mortality, you did touch upon it earlier, but there have been a few quarters here where we've seen mortality losses, gains on the pension side, but losses in the insurance businesses. Too early to call it a trend, but let's -- maybe are you thinking any differently yet about it next -- this quarter than you were last quarter? Because last quarter, you also said it wasn't a trend, but it might be.

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

Yes, that's a good question. No, it's pretty much the same as last quarter actually, except that we are advancing, we are progressing on our experience study. And I refer to a trend that started. It was very, very small last year. It's starting to show this year, but it will only grow if we don't fix it. So that's why we will fix it at year-end. But if we look at this year, it's probably a lot temporary here because of the COVID situation, the fact that people are not seeing their physician and all that kind of stuff. So that's why the difficulty this year is really to figure out what's permanent, what's temporary. And most of it, I would expect is temporary.

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

Got you. And then to wrap up my questions here. IAS, I guess the premise I'm going to go with here is that there were, maybe still are, some concerns that due to low sales and maybe, obviously, changes in the macroeconomic environment, the goodwill that that came with that acquisition was maybe looking too high and maybe subject to a write-down. Based on the communication you're giving us today, sales are looking up and profits are in line with expectations, is there -- is it still something we should be thinking about? Or can we put that to bed? And if that's your position, maybe give me some clarity on why.

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

Okay, Jacques speaking again. The outlook has not changed at all since the last conference call. So we don't expect a goodwill write-down now and in the foreseeable future. And I will give you 3 reasons for that. First, it's really a short-term profitability, the COVID, we don't see long-lasting effect on that. It's temporary and remember that IAS acquisition is a growth story. And just keep in mind that we have the financial strength to go through that crisis as our capital ratio is showing, as our market protection are showing. And that market is very fragmented. So we believe that we will thrive after the COVID period because there are many mom-and-pop that don't have our financial strength. So growth for the future, we still believe in it, and that part is intact.

We said also in Q2 that on integration, we will go further than what we had in our acquisition model. And the reason why is because of work-from-anywhere experience we are living through with the COVID situation make us see that we can go further and we can be more efficient. You don't need to be in the same city to do some of the things efficiently. So that's another added value that we will have compared to the acquisition plan. And the third reason, which is not the least, we will completely consolidate those operations with DAC, with the DAC operation. It will be only one company at the end of the day. And just remember, we bought DAC 2 years ago. And the value of DAC has increased a lot since that time because both on growth side and on profitability side, it has been always above expectation. So it could give an additional comfort to what I said in Q2.

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, maybe this is for you. If I take the -- just going back to IAS and the accretion. And so the accretion for the quarter was \$0.01. If I take out the incremental increase in the amortization for acquisition-related items and after-tax that, that's about \$0.08. So I get to about \$0.09. And then it looks like you -- your accretion integration expenses was better than you had built into your expected profit, so there was a gain of \$0.02 related to that. So then if I take that out, I get the \$0.07 accretion, post the noise around the amortization. Does that seem reasonable? And is that what we should be thinking of as a baseline going forward? And I get there's 5 extra weeks related to May to June that's included in there, so maybe it's \$0.06. Is that a reasonable approach to think about it?

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

Not necessarily. I would say the best way to look at IAS -- because one of the things that I need to confess is the fact that IAS was not calculating -- was not doing its financial statement on an IFRS basis. So when we did our plan and our expected profit, our amortization of intangible and so on, we put all amortization of intangible into the surplus line. We didn't put anything into the expected profit. And in reality, there will be some assets that will be amortized at the subsidiary level, which will be included in expected profit. So the best way to eliminate all that noise is really to look at it overall, from an overall basis. So the accretion for Q3, the number you have, it's \$0.04. But the best is what we said in Q2, is really that we expect that the accretion for this year would be 5 to 10 bps lower and the same next year than what we said. So for next year, what it means for 2021, it's between \$0.17 and \$0.22. That's what we expect for the moment. That's the best information I can provide.

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

Yes. And that does not consider the amortization and finite life intangibles. So if we were to consider that, we would add another...

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

\$0.24.

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

\$0.24, yes.

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

Okay. So that's -- yes, \$0.17 to \$0.22 is including the amortization, okay. Yes, it just is wild. I've never seen a situation where there's been a gain on the amortization or the integration costs. Anyway, that's just maybe something -- it just adds a little bit of confusion there. And then just on the actuarial assumption review for Q4, I think you've been crystal clear, you don't expect a material net impact from all the moving pieces. And then you've announced there's real estate or reinsurance transaction or deals that's going to create a gain. Is that -- is the view that the actuarial assumption review is not going to have a material impact on results include the gain from the reinsurance transactions? Or are those two separate?

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

No, those two, I look at them separately. As I'm trying to show on Slide 13, I'm really doing my actuarial assumption the same as I was doing in previous year. I look at the long-term view, I conduct the experience today, and I will put my assumption for that. The reinsurance, what I will do with that is more look at the short-term negative impact that COVID will bring to us, so what are the headwinds. So it's really two different things that are attached together at the end of the day because those are assumptions, but it's really two different ways of looking at it. I don't want to change my normal annual process of actuarial review.

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

Okay. So they're separate. So that's not -- you're not including the gain from the reinsurance deals and the fact that it's going to not be -- the assumption review is not going to be material, okay. So then just thinking about what you've talked about on Slide 11, I think it's interesting. I mean if you went to -- basically, maybe I'll just say, like, and you can tell me if I'm thinking about this right, if you went to a mark-to-market model on equities, private and public, that are backing liabilities versus the corridor approach, your LICAT would be 7 points higher, albeit you'd have more volatility in earnings, you'd have a higher LICAT ratio. So there's a bit of a trade-off between the two. Is that the right way to think of it?

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

Yes. That's the right way.

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

And would you ever move to the mark-to-market model? I mean you've never been under it. You've always used the corridor approach. But like, if you ever got down to that level, would you ever switch?

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

No, actually, I don't, not at all. I really like to be in that position right now. I think it allows us really to do transaction, looking at the long-term value, long-term protection, instead of having a short-term pressure to do transactions, so I prefer to be in that. The bad consequence is and that's what we're trying to do this quarter actually is to bring visibility to that extra margin that has proven to be very useful for us but we have not done a great job to put in front of everyone. But the thing that we need to remember as well is IFRS-17 will change everything, all the rules here.

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

Yes. We've been a strong believer in that methodology because of the long-term nature of our business. In my mind, it didn't make sense that because of some, let's say, changes in long-term interest rates from one quarter to the other, that the income statement will show such a volatility. I'm using interest rate, but the stock market is the same here. So for us, it's been, I would say, a consistent way of measuring our earning power, which is based on the long-term nature of our business. But Jacques is right, I mean, IFRS-17 is going to bring a new world here.

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

Yes. No, hands down, for sure. And then just lastly, on IAS, can you quantify what the contribution to expected profit was from IAS?

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

Doug, I have so many numbers in my head, so I don't want to answer that one because I will probably confuse everyone. So I will stick with what I said earlier, the best way to look at it.

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

Yes, the best way to look at it is really the \$0.04 EPS accretiveness on a core basis in 2020. And like Jacques said, if you want to know for next year, our best guess is something around \$0.20 on a core basis for 2021.

Operator

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

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

Actually, my question was on the U.S. operations and expected profit, similar -- basically the same thing. And when I -- if I look at your supplemental and I look at this source of earnings for the U.S. operations, and this would be on Page 8 of your supplemental, if you can appreciate from the outside looking in, there's a lot of moving parts this quarter. We have IAS now in there, plus it's in there since May; we have DAC bouncing back; and we have U.S. operations that's had bad mortality.

So as I look at this source of earnings, and I see the expected profit and a few other line items that are kind of moving all over the place, it would be very helpful, Jacques, if you can take some time and walk through these line items with me. You want to do it another time, that's fine. But for modeling purposes, it's very difficult to build a model without some sort of run rate assumptions here on all these line items, if you know where I'm coming from. So I realize you can't speak to it now, but maybe just a thought to give us a hand with the source of earnings model, especially for the U.S. operations, given all the noise this quarter. And I'll leave it at that. I guess if you can't speak to it now, it would be helpful at some point, if you could.

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

Okay. I got the point, Darko, so we will get in touch for that. And like I said, we did our best at the beginning of the year to try to put the model of IAS there. However, like I said, they didn't produce anything on an IFRS basis. So we took a shortcut, putting things in intangible. And this is bringing noise right now. The fact that we closed the transaction later than expected also its bringing noise compared to the expected. So that's not an easy year. Next year, it will be better, but I will certainly contact those at once to have more information, to give the details.

Operator

(Operator Instructions) Our next question comes from Paul Holden with CIBC World Markets.

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

So we've heard your messaging on the capital position and that you're quite comfortable with the solvency ratio given where it sits versus target and the protection you have put in place on it. One of the common feedbacks we hear from investors is the ratio is lower than peers. Just curious how you think about your solvency ratio versus your cost of capital. Like, how are you thinking about balancing that equation?

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

If I understand correctly your question, you want to know how do we perceive our capital ratio versus our peers to some extent. And the way I would respond to that is that it's not fair to only compare the absolute amount of the LICAT ratio. I think what is better to look at is really the sensitivity of the ratio versus the target. And what we've demonstrated is that our capital ratio is much less sensitive to macroeconomic factors and also embedded in it some protective cushion. So the way I look at it myself is that if we were to be mark-to-market, we would be at 132%.

That's the way I look at it. Obviously, there would be more volatility from one quarter to the other. But to me, it's more fair. And that is why we tried this quarter to be a bit more visible in terms of this because it's unfair to say we are at 125%. That means you're lower than the others. That means it's more risky. That's not the case. We are lower, but we have additional cushion. And if we did not have put this additional cushion, we would be at a much higher level.

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

So that is helpful. And sort of a follow-up question to that, last quarter, I think you said your capital priority is to continue to build the ratio over M&A and, clearly, you can't do buybacks or dividend increases right now. So any more context in terms of your thinking what the right capital ratio is would be helpful.

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

Yes. Well, I would say there's the COVID period and, let's say, there's the post-COVID period. In terms of the COVID period, I don't mind to be in a position where our capital ratio is, let's say, higher than what we would otherwise try to stay with. So right now, we're probably at, I think, much higher than where it is we would want to be in the long run. So in the post-COVID, certainly, we would think about doing buyback of shares or maybe thinking more about M&A. So for the time being, during the COVID, we're pleased with where we are and the fact that it increases with the pace it increases right now. But certainly, when the COVID is behind us, we will be, again, looking at how is it that we deploy capital. And as we said in the past, our priority is to grow the company. And if, for some reason, there is no opportunity, then there's other ways like buying back shares.

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

That's helpful. One final question, I mean a big, big theme across financials is obviously lower bond yields. I'm well aware that you've put in many layers of protection on the existing book of business. Just wondering how we think about your investment allocation on new sales? Is anything evolving there to help protect margins and maybe simply you've increased price on the product and therefore, investment allocation doesn't need to change? But curious on an update there.

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

That's a really good question. Actually, we discuss about investment strategy every time we develop new products, how we want to make review. But the good thing is more -- is the market allowing us to be able to increase our price and continue to get the sale, and that's exactly what we demonstrated in Q3. We just raised the price of the long-term guaranteed product because of a decrease of interest rate, and our sales are continuing to increase. And the market, some competitors have done the same thing because we are all in the same ballpark. We are all investing in the same kind of asset. And in regard of the investment strategy, I will say that we try to optimize, always balance the risk we're taking, diversification of the risk versus the plus value that it's bringing. And like I said in an earlier answer, in Q1 and Q2, we certainly took much more credit risks because we were paid to take it. In past year, we were very shy of getting credit risks. But this year's condition was simply amazing. So our investment team every day are doing a great job at optimizing that.

Operator

Our next question comes from Mario Mendonca with TD Securities.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Jacques, I'm sorry to do this to you, but I do need to go back to the IAS deal. You talked about the \$0.04 accretion, including that stub period from Q2. That number is pretty hard for me to get to when I just play with the numbers that you've already provided for us. Specifically, we know that the U.S. expected profit was up as much as almost \$22 million sequentially. And we also know that the -- there was about \$11.4 million associated with the amortization of the intangibles. That would suggest to us then that the IAS contributed, like, \$10 million, maybe even \$11 million, in expected profit in the quarter. And I can't find the other areas to subtract from that number to get me down to the \$0.04 accretion because, obviously, I'm a lot higher than \$0.04 accretion if I stop at the expected profit and then just tax-effect it. So is there something I'm missing that gets us down to the \$0.04?

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

Well, it's Denis here. I guess I'll spare Jacques on that one. I think you have to subtract in the line income on capital. The fact that we've obviously paid the price, and there are some less income on capital, so it's the net of the increase in expected minus the amortization that we discussed earlier, minus some of the income on capital that we don't earn anymore.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

So Denis, I went straight to that to see if I could find it there because that was my initial impression. And I looked at the financing line on Page 22 of your presentation, and the financing line hasn't changed at all. So my next obvious step was go to investment income. I see that investment income was down, but that's really a function of the software charges and the other charges in the quarter, not so much lower investment income. So I kind of have done my homework, trying to look for an entry here. And from what you disclosed, I can't see where the offset is, where is the negative to IAS, because it's not apparent in the schedule.

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

Okay. For sure, it won't show in the financing line because financing is really related to the debenture we issued. So it's really income on surplus that will be lower because of the fact that we have goodwill and intangible, finite intangible, which earn no return. Before the acquisition, we had assets that were earning return. So I don't believe that part will be isolated, so that's why it's a little bit tough to get to that number.

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

So I think here it's a similar question we had before. And maybe off-line, we can work on the numbers just to reconcile the accretiveness with you guys. So it would be a pleasure for us to do that. Yes.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

But just so we're clear, the decline in investment income, that appears on Page 22, I imagine a portion of it could be the lost capital, but most of that decline is associated with the software right off because that's where it went through. That's my understanding from looking at the disclosure. So I think it should be pretty clear from the nature of our discussions that the success and failure of IAS plays an important role in how investors are looking at your company. So really transparent disclosure around its accretion, we need more than just saying \$0.04. I think we all need to understand this better.

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

Okay. So maybe that's why I say there's so much noise because of the way that our gain and loss is working. So that's why the best summary is really to remember that we mentioned that the different acquisitions, IAS and Lubrico and Walker Group, they are immaterial. Let's say it's only IAS

here. We said \$0.15 earlier this year, okay? Now in Q2, we said it would be \$0.05 to \$0.10 lower than that. So it means that for this year, we expect it would be between \$0.05 and \$0.10. What we're seeing in the current result of Q3, what you're seeing is plus 4%. That's what you're seeing right now. We will see in Q4 what will it be. But overall, really, IAS will bring between \$0.05 and \$0.10 this year. That's what we're seeing actually.

Mario Mendonca - *TD Securities Equity Research - MD & Research Analyst*

I understand. And what I'm suggesting to you is that for something that's important to the company, it's not sufficient information to understand this one, IAS. And I think that was the point Darko was making.

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

Yes, thank you guys. I mean this is very helpful information. And it's funny because we're trying to be as transparent as possible. Our source of earnings provides much more detail than what you would find in, I mean per sector, for example, than what you would find elsewhere. But I realize on that one that we can go an extra step to be even more detailed.

Mario Mendonca - *TD Securities Equity Research - MD & Research Analyst*

Yes, because this is completely insufficient to understand it. On a different note, when I saw that there's a reinsurance gain coming down the pipe, and I think you also talked about maybe allocating it to other areas of uncertainty, the cynic in me immediately turned to the sub-prime auto lending. Is there any potential here that this could be allocated to further shore up the provision against the sub-prime model?

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

That's not at all what we're contemplating because, actually, if you look at the experience of the car loan, we succeeded having great result. And even if you look at the experience, it was better than expected. So we added an additional \$3 million over the provision during the quarter. So our provision now is sitting at \$27 million, and we are very comfortable with that. So that's not our intention, to use the reinsurance gain for that at all.

Mario Mendonca - *TD Securities Equity Research - MD & Research Analyst*

So what hole is it that you need to fix going into Q4?

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

It really depends. If I look at -- if you're speaking particularly about the reinsurance agreement, I mentioned earlier that for sure mortality, specifically in the U.S., but there's some mortality as well in Canada, there could be some impact coming from lapse so far. So it has been positive, but I'm not sure it would be the same. I have also to think about maybe some infrastructure, some private equity, some more private bonds, maybe some real estate. So there are things like that, that we are thinking through right now. What are the things that have not gone well since the beginning of the crisis, what are the things that have been going well because of government programs, so that's the thinking we are having. And I want to look at that for maybe a couple of -- thinking that those effect will last for a couple of years, so that's really the thinking behind that.

Operator

Mr. Ricard, there are no further questions at this time. Please continue with your presentation or closing remarks.

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

Well, thank you. I think you've seen that our strong results for this quarter is a testimony of the resilience of our business model. One thing that I think is very important or two things that are very important is, as I mentioned before, the fact that we've invested significantly in technology has been a -- we've developed competitive advantages on that. And you can see that very clearly on our sales results this year. And the second thing is, and we try to emphasize it this quarter is on the strength of our capital. And you've seen it on Slide 11, to compare it on a fairly basis with, let's say, any other players, that we've got additional cushion in our balance sheet to compensate for any downturn in the market. I think it's very important that we had to explain that. It's very important for us. So anyway, good quarter, and thank you very much.

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, everyone.

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