

### Research Update:

# Pacific LifeCorp And Subsidiaries Ratings Affirmed; Outlook Revised To Negative From Stable

**Primary Credit Analyst:**

Carmi Margalit, New York (1) 212-438-2281; carmi\_margalit@standardandpoors.com

**Secondary Contact:**

Michael Gross, San Francisco (1) 415-371-5003; michael\_gross@standardandpoors.com

## Table Of Contents

---

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

## Research Update:

# Pacific LifeCorp And Subsidiaries Ratings Affirmed; Outlook Revised To Negative From Stable

## Overview

- U.S. insurer Pacific Life's large book of variable annuities with guarantee riders and its hedging strategy, that focuses more on statutory capital rather than GAAP earnings, introduce a significant element of volatility into its operating performance.
- We affirmed the ratings on Pacific Life and revised the outlook to negative from stable.
- We are increasingly concerned about the strength and sensitivity of prospective earnings generation in light of ongoing unfavorable market conditions.

## Rating Action

On Dec. 16, 2011, Standard & Poor's Ratings Services affirmed its 'A+' financial strength rating on Pacific Life Insurance Co. (PLIC), Pacific Life & Annuity Co., and Pacific Life Re Ltd. (collectively, Pacific Life), and its 'BBB+' long-term counterparty credit rating on Pacific LifeCorp (PLC). We revised the outlook on the ratings to negative from stable.

## Rationale

The counterparty credit rating on PLC and the insurer financial strength ratings on Pacific Life reflect the organization's strong competitive position in the U.S. individual life and individual annuity marketplace, strong capital strength, and stable liquidity. Operating performance sensitivity, volatility due to unfavorable market conditions, and meaningful exposure to commercial mortgage loans partially offset its strengths.

Although Pacific Life can generate strong earnings from its diversified product offerings, sound underwriting, and good expense management, its large book of variable annuities with guarantee riders introduces a significant element of volatility into its operating performance. The company's hedging strategy focuses on the protection of statutory capital and, while mostly effective, leaves portions of its GAAP earnings' exposure to volatility unhedged. This was demonstrated during the third quarter of this year, when high equity market volatility and a steep drop in 10-year swap rates hurt the company's earnings and, to a lesser extent, affected surplus.

## Outlook

The negative outlook reflects our increasing concern about the consolidated strength and sensitivity of Pacific Life's prospective earnings in light of ongoing unfavorable market conditions, including equity market volatility and decreasing interest rates. Surplus is not immune to unfavorable market conditions, but is likely to be less affected, partly because of the company's hedging program, which is designed to limit the capital volatility associated with swings in the equity markets and interest rates.

We expect GAAP operating EBIT to total more than \$400 million for full-year 2011 and GAAP net income to be more than \$200 million. These have been revised from our previous expectations of \$700 million for GAAP operating EBIT and \$500 million for GAAP net income.

We could lower the ratings during the next 24 months if GAAP operating EBIT remains depressed, if fixed-charge coverage weakens to less than 4x, if actual investment losses outstrip our incremental stress factors and weaken capital adequacy to levels below expectations for the 'A' rating category, or if Pacific Life's strong competitive profile deteriorates. We could stabilize the ratings if the company successfully navigates challenging market conditions and generates strong earnings and increasing surplus strength.

## Related Criteria And Research

- U.S. Life Insurance 2012 Outlook: Solid Capital And Liquidity Support A Stable Outlook In The Face Of Macroeconomic Headwinds, Nov. 30, 2011
- Interest Rate Risk In 2012: With Low Rates Persisting, Insurance Companies Try To Muddle Through , Nov. 30, 2011
- Methodology For Assessing U.S. Insurers' Capital Adequacy Beyond The Financial Crisis, May 31, 2011
- Analysis Of North American Life Insurance Operating Performance , May 13, 2009

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Pacific LifeCorp Counterparty Credit Rating Local Currency	BBB+/Negative/--	BBB+/Stable/--
Pacific Life & Annuity Co. Counterparty Credit Rating Local Currency	A+/Negative/--	A+/Stable/--
Pacific Life & Annuity Co. Pacific Life Re Ltd. Pacific Life Insurance Co.		

*Research Update: Pacific LifeCorp And Subsidiaries Ratings Affirmed; Outlook Revised To Negative From Stable*

Financial Strength Rating

Local Currency

A+/Negative/--

A+/Stable/--

Pacific Life Insurance Co.

Counterparty Credit Rating

Local Currency

A+/Negative/A-1

A+/Stable/A-1

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Copyright © 2011 by Standard & Poors Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).