

## **FITCH DOWNGRADES RATINGS OF PACIFIC LIFECORP & SUBS; OUTLOOK STABLE**

Fitch Ratings-New York-03 February 2010: Fitch Ratings has downgraded by one notch the ratings assigned to Pacific LifeCorp (PLC) and certain of its subsidiaries, including Pacific Life Insurance Company (PLIC), which is PLC's primary life insurance subsidiary. The Rating Outlook is Stable. See the full rating list at the end of this release.

Today's rating action reflects the company's higher-than-expected earnings and capital volatility, weaker earnings profile going forward which will pressure organic capital generation, increased financial leverage across the enterprise and reduced financial flexibility. The rating action also reflects continued deterioration in the commercial real estate market which could result in higher-than-expected losses for PLC.

In addition, Fitch's revised treatment of equity credit afforded surplus notes (as published in the press release 'Fitch Updates U.S. Insurance Surplus Note Equity Credit Treatment' dated Jan. 29, 2010) has resulted in an increase in Fitch's calculation of PLC's equity-adjusted financial leverage ratios (excluding SFAS 115 and debt related to Aviation Capital Group) to 24% (reflects new criteria for surplus notes) from 14% at Sept. 30, 2009 (reflects former surplus notes criteria).

The company's relatively large variable annuity exposure has resulted in higher-than-expected statutory and GAAP earnings volatility over the past two years. Over the near term, Fitch expects PLC's earnings to moderate relative to historical levels but be less volatile due to increased hedging. Based on the company's increased financial leverage and Fitch's reduced earnings expectations, GAAP EBIT-to-interest coverage ratios are expected to decline to the 5-6 times range over the near term, which is lower than historical levels.

Fitch's concern about higher-than-expected investment losses is driven by PLC's above-average investment exposure to commercial real estate (CRE) related assets, which consists of directly placed commercial mortgage loans, commercial mortgage backed securities (CMBS), and equity real estate, which collectively represent over 16% of total invested assets (excluding policy loans) as of Sept. 30, 2009.

In addition to CRE-related investments, Fitch is also concerned about future investment losses resulting from the company's exposure to Prime and Alt-A residential mortgage backed securities (RMBS) and hybrid securities. PLC's gross unrealized loss position relating to these asset classes was \$1.2 billion as of Sept. 30, 2009, the majority of which are aged over one year. Total gross unrealized losses on fixed maturities were \$1.7 billion.

Based on a detailed analysis of PLC's investment portfolio using Fitch's stress testing methodology, Fitch projects the potential for further investment gross losses in the \$345 million - \$545 million range for the fourth quarter of 2009 and full year 2010. This projection has been factored into Fitch's expectations for the current ratings.

The Stable Rating Outlook reflects, in part, Fitch's view that the company's exposure to future investment losses under Fitch's base case loss scenario is manageable in the context of the company's statutory capital and projected operating earnings within parameters captured by the current rating. At Sept. 30, 2009, Fitch estimated PLIC's statutory total adjusted capital was \$4.1 billion. PLIC reported statutory net income of \$328 million for the first nine months of 2009 compared to a loss of \$1.5 billion for full year 2008. However, that loss was partially offset by unrealized hedging gains reported directly in PLIC's 2008 total adjusted capital of \$3.6 billion.

Additionally, Fitch notes that PLC's liquidity appears sound both from a holding company and insurance operating company perspective. The company has access to available sources of liquidity including but not limited to a \$700 million CP program. PLC and PLIC have no debt due until 2023

although the company will have to refinance a maturing letter of credit facility.

Fitch has downgraded the following and assigned a Stable Outlook:

Pacific LifeCorp

--Long-term Issuer Default Rating (IDR) to 'A-' from 'A';  
--\$600 million 6.6% senior notes due 2033 to 'BBB+' from 'A-'.

Pacific Life Insurance Company

--Long-term IDR to 'A' from 'A+';  
--IFS to 'A+' from 'AA-';  
--\$150 million 7.9% surplus notes due 2023 to 'BBB+' from 'A-';  
--\$1,000 million 9.25% surplus notes due 2039 to 'BBB+' from 'A-';  
--Short-term IDR to 'F1' from 'F1+';  
--CP to 'F1' from 'F1+'.

Pacific Life & Annuity Company

--IFS to 'A+' from 'AA-'.

Pacific Life Re Limited

--IFS to 'BBB+' from 'A-'.

Pacific Life Funding, LLC

--Funding Agreement-backed Note Program to 'A+' from 'AA-'.

Pacific Life Global Funding

--Funding Agreement-backed Note Program to 'A+' from 'AA-'.

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