

PACIFIC MUTUAL *2008 Report to Members*

Strength for Generations





PACIFIC MUTUAL



PACIFIC LIFE



**PACIFIC LIFE
& ANNUITY COMPANY**

Pacific Mutual Holding Company

Pacific Mutual Holding Company (Pacific Mutual) is the parent company of Pacific LifeCorp, which is the parent company of Pacific Life Insurance Company. Policyholders and contract holders of Pacific Life Insurance Company are members of Pacific Mutual and, as such, are able to attend an annual meeting of Pacific Mutual and to elect its board of directors. Through its direct and indirect subsidiaries, Pacific Mutual is engaged in a wide variety of insurance, financial services, and other investment-related businesses.

Pacific Life Insurance Company

Offering insurance since 1868, Pacific Life Insurance Company provides a wide range of life insurance products, annuities, and mutual funds, and offers a variety of investment products and services to individuals, businesses, and pension plans. With more than half of the 100 largest U.S. companies as its clients,¹ Pacific Life is also a member of the Insurance Marketplace Standards Association (IMSA), whose membership promotes high ethical standards for the sale of individual life insurance and annuities.

Pacific Life & Annuity Company

Pacific Life & Annuity Company offers a wide range of products, including life insurance, annuities, structured settlement annuities, and other investment products and services for individuals and businesses.

For current ratings, visit us online at www.PacificLife.com/ratings and www.PacificLifeandAnnuity.com/ratings.

The unabridged, audited consolidated financial statements are available at www.PacificLife.com/financials. If a paper version is desired, please send a request via e-mail to PublicAffairs@PacificLife.com or call (800) 800-7646, ext. 5002.

Pacific Life Insurance Company, a subsidiary of Pacific Mutual Holding Company, is licensed in all states except New York. In New York, individual life insurance and annuity products are available through Pacific Life & Annuity Company, a subsidiary of Pacific Life Insurance Company.

¹ Client count data compiled by Pacific Life using the FORTUNE 500® list as of April 2008.

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Product availability and features vary by state. Insurance product and rider guarantees are backed by the financial strength and claims-paying ability of the issuing company and do not protect the value of the variable investment options. Each company is solely responsible for the financial obligations accruing under the policies it issues.

Variable products are issued by Pacific Life Insurance Company and Pacific Life & Annuity Company. Mutual funds are offered by Pacific Life Funds. These products are distributed by **Pacific Select Distributors, Inc.** (member FINRA & SIPC), a subsidiary of Pacific Life Insurance Company and an affiliate of Pacific Life & Annuity Company, and are available through licensed third-party broker-dealers.

Pacific Mutual Holding Company

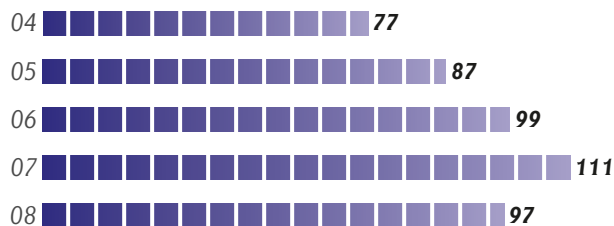
2008 Financial Summary

Dollars in Millions

December 31,	2008	2007
Company Assets	\$ 96,983	\$ 111,024
Policyholder & Other Liabilities	\$ 92,895	\$ 104,620
Equity ¹	\$ 5,876	\$ 6,263
Operating Revenues ²	\$ 5,252	\$ 5,077
Operating Income ³	\$ 534	\$ 654
Deposits ⁴	\$ 12,889	\$ 15,946

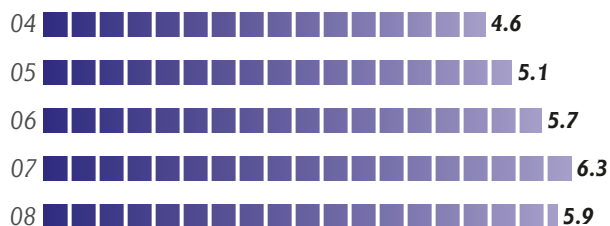
Company Assets

In Billions of Dollars



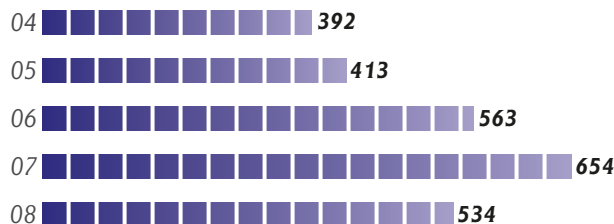
Equity¹

In Billions of Dollars



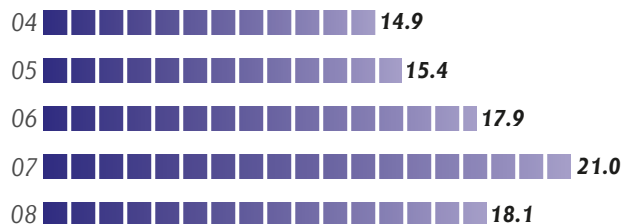
Operating Income³

In Millions of Dollars



Deposits⁴ & Operating Revenues²

In Billions of Dollars



¹ Excludes net unrealized gains/losses on derivatives and securities available for sale, and foreign currency translation adjustment.

² Excludes net realized investment gains/losses.

³ Excludes net realized investment gains/losses and discontinued operations.

⁴ Includes receipts from the following liabilities: universal life contracts, variable annuities, funding agreements, guaranteed interest contracts, and other deposits.

To Our Members

We will long remember 2008 as a year when an unprecedented mortgage crisis created a credit crisis that challenged the nation's financial systems and led to a sharp drop in investor confidence in stocks and bonds alike. The Standard & Poor's 500 index finished the year down 37 percent — its worst year since 1931. The bond market, typically a source of stability for investors, was anything but stable.

Our investment portfolio is sound and diversified, but it does reflect the general economy and, as such, it lost value in 2008. The insurance industry's greatest investment concerns have been in two primary areas — residential mortgage-backed securities and exposure to financial companies — and I am comfortable with our position in both. Our exposure to subprime mortgages (the mortgages often cited as the root cause of the financial crisis) is at just over 1.1 percent of our investments, and our exposure to Alt-A mortgage securities — sometimes referred to as midprime — is approximately 2.1 percent of investments. Our exposure to the entire financial services industry is low at approximately 5 percent of investments. Still, these exposures caused losses for our company that are not typical of our annual results.

Our results were also adversely affected by the significant drop in equity markets, which led to losses in our variable annuity product line. That is an unusual result for us, as we earned more than \$910 million in net income during the preceding five years in that business. While the company as a whole generated a gain in operating income of \$534 million in 2008, overall net income for the company was a loss of \$289 million. The poor net income result is due to significant investment losses that are uncharacteristic for us and are a reflection of the most difficult financial environment in decades.

Our structure as a mutual holding company continues to serve us well in all environments, especially during financially volatile periods. With no publicly traded stock and no outside investors, Pacific Life is operated for the benefit of our policyholders and clients. We can and do operate with a long-term view in our business and investment strategies. This long-term view is what keeps our company strong and stable.

During the year, we added to the long-term reserves that back our life insurance and annuity businesses, so we continue to operate with significant reserves and capital to support the long-term guarantees and promises we make to our policyholders.

Business Operations

In 2008, we benefited from our longstanding reputation for quality and strength as many individuals reviewed their financial plans and increased insurance coverage. We set a company record with new life insurance sales of \$349 million, an increase of more than 19 percent over one year ago. Our variable annuity sales were down, which was the situation throughout the industry. Because of the volatile investment environment, many investors were cautious in their decision making. In the last half of the year, we had success with a fixed annuity product that will become a larger part of our future plans. Our sales of guaranteed investment contracts were at a record level of over \$1 billion as investors looked for guarantees within their retirement plans. And last, even in an extremely difficult operating environment, Aviation Capital Group, our aircraft leasing subsidiary, had its best year ever with more than \$81 million in net income.



Most of our businesses and products fared well in 2008. We are very proud of the quality of our product offerings, the customization of the services we provide, and the care and treatment we provide to existing clients across all of our businesses.

Transactions

In the third quarter of 2008, we purchased the international reinsurance operations of Scottish Re. This London and Singapore based business is an excellent strategic fit for us and provides geographic and business line diversification for our company. We welcome David Howell, CEO of the newly named Pacific Life Re, and the entire team to the Pacific Life family.

Earlier in the year, we exercised our final right to require that Allianz purchase our remaining interest in PIMCO. This generated net income of \$62 million. Pacific Life continues to enjoy a close business relationship with PIMCO.

Acknowledgments

Bill Robinson, executive vice president, Annuities & Mutual Funds Division, retired at the end of 2008. Bill was instrumental in the startup, growth, and maturation of our annuities business and also spearheaded our entry into the mutual funds business. We thank him for his significant contributions during his many years with Pacific Life.

Frank A. Bruni, a member of our board of directors for years, retired from the board in 2008. We appreciate his wisdom and considerable contributions to our board during his long tenure. J. Michael Shepherd was elected to the boards of Pacific Mutual Holding Company and Pacific LifeCorp in July 2008. Mr. Shepherd, president and CEO of Bank of the West, brings a breadth of valuable experience to our boards.

Looking Forward

The future is sure to bring more change for all. We promise to maintain a heightened awareness of what our policyholders and clients expect from Pacific Life, and a determination to provide products and services that meet the evolving needs of individuals and businesses. In times such as these, our customers will have significantly increased needs for retirement savings, business planning, and insurance and will be interested in sound solutions that help them meet their goals. Our proven solutions do just that — solutions based on the fundamentals of financial strength, a long-term view toward managing our businesses, and a philosophy of providing our existing clients with industry-leading services.

Our company is not measured by one single year, but by the long term. We are proud to have provided strength and reliability to our policyholders and clients for generation after generation. We appreciate the trust you have placed in us and look forward to being there in the years ahead for you, your family, and future generations.

James T. Morris

Chairman, President and Chief Executive Officer

Pacific Mutual Holding Company and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

<i>(In Millions)</i> DECEMBER 31,	2008	2007
ASSETS		
Investments:		
Fixed maturity securities available for sale, at estimated fair value	\$ 22,604	\$ 27,228
Equity securities available for sale, at estimated fair value	219	413
Mortgage loans	5,622	4,585
Policy loans	6,920	6,410
Other investments	2,111	2,204
TOTAL INVESTMENTS	37,476	40,840
Cash and cash equivalents	3,888	777
Restricted cash	235	234
Deferred policy acquisition costs	5,028	4,481
Aircraft leasing portfolio, net	4,999	4,655
Other assets	3,852	2,432
Separate account assets	41,505	57,605
TOTAL ASSETS	\$ 96,983	\$ 111,024
LIABILITIES AND MEMBERS' EQUITY		
Liabilities:		
Policyholder account balances	\$ 32,670	\$ 32,017
Future policy benefits	10,107	6,039
Short-term debt	799	851
Long-term debt	5,343	5,143
Other liabilities	2,471	2,965
Separate account liabilities	41,505	57,605
TOTAL LIABILITIES	92,895	104,620
Commitments and contingencies (Note 11)		
Members' Equity:		
Members' capital	5,928	6,217
Accumulated other comprehensive income (loss)	(1,840)	187
TOTAL MEMBERS' EQUITY	4,088	6,404
TOTAL LIABILITIES AND MEMBERS' EQUITY	\$ 96,983	\$ 111,024

See Notes to Condensed Consolidated Financial Statements

Pacific Mutual Holding Company and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND MEMBERS' EQUITY

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
REVENUES			
Policy fees and insurance premiums	\$ 2,103	\$ 1,792	\$ 1,546
Net investment income	2,029	2,157	2,075
Net realized investment gain (loss)	(1,351)	(28)	53
Realized investment gain on interest in PIMCO	109		32
Investment advisory fees	255	327	319
Aircraft leasing revenue	571	535	493
Other income	294	266	291
TOTAL REVENUES	4,010	5,049	4,809
BENEFITS AND EXPENSES			
Interest credited to policyholder account balances	1,234	1,266	1,219
Policy benefits paid or provided	1,302	862	786
Commission expenses	723	690	606
Operating and other expenses	1,376	1,445	1,361
TOTAL BENEFITS AND EXPENSES	4,635	4,263	3,972
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE			
PROVISION (BENEFIT) FOR INCOME TAXES	(625)	786	837
Provision (benefit) for income taxes	(339)	112	201
INCOME (LOSS) FROM CONTINUING OPERATIONS	(286)	674	636
Minority interest	3	(38)	(18)
Discontinued operations, net of taxes	(6)	11	(4)
NET INCOME (LOSS)	\$ (289)	\$ 647	\$ 614
MEMBERS' EQUITY, BEGINNING OF YEAR			
\$ 6,404			
MEMBERS' EQUITY, END OF YEAR			
\$ 4,088			
\$ 6,097			
\$ 5,733			
Comprehensive income:			
Net income (loss)	(289)	647	614
Change in unrealized gain (loss) on derivatives and securities available for sale, net	(1,889)	(295)	(242)
Change in other, net	(138)	(16)	(8)
Total comprehensive income (loss)	(2,316)	336	364
Cumulative effect of adoption of new accounting principle, net of tax		(29)	

See Notes to Condensed Consolidated Financial Statements

Pacific Mutual Holding Company and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss) excluding discontinued operations	\$ (283)	\$ 636	\$ 618
Adjustments to reconcile net income (loss) excluding discontinued operations to net cash provided by operating activities:			
Net accretion on fixed maturity securities	(144)	(147)	(122)
Depreciation and amortization	259	256	248
Deferred income taxes	(535)	88	79
Net realized investment (gain) loss	1,351	28	(53)
Realized investment gain on interest in PIMCO	(109)		(32)
Net change in deferred policy acquisition costs	(192)	(302)	(496)
Interest credited to policyholder account balances	1,234	1,266	1,219
Change in future policy benefits and other insurance liabilities	1,187	673	509
Other operating activities, net	(310)	(197)	220
NET CASH PROVIDED BY OPERATING ACTIVITIES BEFORE DISCONTINUED OPERATIONS	2,458	2,301	2,190
Net cash used in operating activities of discontinued operations	(18)	(71)	(16)
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,440	2,230	2,174
CASH FLOWS FROM INVESTING ACTIVITIES			
Fixed maturity and equity securities available for sale:			
Purchases	(3,128)	(5,889)	(5,210)
Sales	2,167	2,142	2,090
Maturities and repayments	2,298	2,911	3,138
Repayments of mortgage loans	470	439	1,330
Fundings of mortgage loans and real estate	(1,665)	(1,660)	(1,141)
Change in policy loans	(510)	(342)	(164)
Sale of interest in PIMCO	288		88
Change in restricted cash	(1)	60	88
Purchases and terminations of derivative instruments	289	(55)	(15)
Change in collateral received or pledged	1,029	17	143
Issuance of notes receivable on inventory financing	(1,214)	(1,153)	(658)
Repayments of notes receivable on inventory financing	1,382	988	538
Purchases of and advance payments on aircraft leasing portfolio	(694)	(646)	(713)
Acquisition of reinsurance business	(70)		
Other investing activities, net	370	25	(99)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES BEFORE DISCONTINUED OPERATIONS	1,011	(3,163)	(585)
Net cash provided by (used in) investing activities of discontinued operations	7	76	(9)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	1,018	(3,087)	(594)

See Notes to Condensed Consolidated Financial Statements

(continued)

Pacific Mutual Holding Company and Subsidiaries

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
CASH FLOWS FROM FINANCING ACTIVITIES			
Policyholder account balances:			
Deposits	\$ 7,320	\$ 6,876	\$ 4,760
Withdrawals	(7,602)	(7,131)	(5,940)
Net change in short-term debt	(52)	223	16
Issuance of long-term debt	335	1,013	927
Payments of long-term debt	(381)	(913)	(698)
Other financing activities, net	33	70	
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(347)	138	(935)
Net change in cash and cash equivalents	3,111	(719)	645
Cash and cash equivalents, beginning of year	777	1,496	851
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 3,888	\$ 777	\$ 1,496
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Income taxes paid (received), net	\$ (32)	\$ 48	\$ 25
Interest paid	\$ 271	\$ 349	\$ 332

See Notes to Condensed Consolidated Financial Statements

Pacific Mutual Holding Company and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND DESCRIPTION OF BUSINESS Pacific Mutual Holding Company (PMHC) is a Nebraska mutual holding company organized pursuant to consent received from the California Department of Insurance and the implementation of a plan of conversion to form a mutual holding company structure in 1997 (the Conversion). The Conversion created PMHC and Pacific LifeCorp, an intermediate Delaware stock holding company. Pacific LifeCorp owns 100% of Pacific Life Insurance Company (Pacific Life), a Nebraska domiciled stock life insurance company.

Pacific Life transferred its legal domicile from the State of California to the State of Nebraska effective September 1, 2005. PMHC transferred its state of legal domicile from the State of California to the State of Nebraska, effective June 29, 2007, to reunite PMHC and Pacific Life under one regulatory authority.

Prior to October 2006, PMHC owned 98% of Pacific LifeCorp. The remaining 2% ownership was held by an Employee Stock Ownership Plan (ESOP) within a Retirement Incentive Savings Plan provided by Pacific Life, pursuant to section 401(k) of the Internal Revenue Code (Note 9). As a result of Pacific LifeCorp's buyback of the outstanding allocated and unallocated shares from the ESOP in October 2006, Pacific LifeCorp became a wholly owned subsidiary of PMHC.

PMHC and its subsidiaries and affiliates have primary business operations consisting of life insurance, individual annuities, mutual funds, pension and institutional products, and aircraft leasing. Pacific Life's primary business operations provide life insurance products, individual annuities and mutual funds, and offer to individuals, businesses, and pension plans a variety of investment products and services.

BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION The accompanying condensed consolidated financial statements of PMHC and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and include the accounts of PMHC and its majority owned and controlled subsidiaries and variable interest entities (VIEs) in which the Company was determined to be the primary beneficiary. All significant intercompany transactions and balances have been eliminated. Included in other liabilities is minority interest of \$244 million and \$214 million as of December 31, 2008 and 2007, respectively.

Pacific Life prepares its regulatory financial statements in accordance with statutory accounting practices prescribed or permitted by the Nebraska Department of Insurance (NE DOI), which is a comprehensive basis of accounting other than U.S. GAAP (Note 2).

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In developing these estimates, management makes subjective and complex judgments that are inherently uncertain and subject to material change as facts and circumstances develop. Management has identified the following estimates as significant, as they involve a higher degree of judgment and are subject to a significant degree of variability:

- The fair value of investments in the absence of quoted market values
- Investment impairments
- Application of the consolidation rules to certain investments
- The fair value of and accounting for derivatives
- Aircraft valuation and impairment
- The capitalization and amortization of deferred policy acquisition costs (DAC)
- The liability for future policyholder benefits
- Accounting for income taxes and the valuation of deferred income tax assets and liabilities and unrecognized tax benefits
- Accounting for reinsurance transactions
- Litigation and other contingencies

Certain reclassifications have been made to the 2007 and 2006 condensed consolidated financial statements to conform to the 2008 financial statement presentation.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS Effective January 1, 2008, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements*. This statement creates a common definition of fair value to be used throughout U.S. GAAP. SFAS No. 157 applies whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value, which requires the use of observable market data whenever available. The statement also requires expanded disclosures, which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. The adoption of SFAS No. 157 did not have a material impact on the Company's condensed consolidated financial statements. See Note 8 for information on the Company's fair value measurements and expanded disclosures.

In October 2008, the Company adopted FASB Staff Position (FSP) Financial Accounting Standards (FAS) 157-3 – *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. This FSP clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The FSP was effective at issuance. The adoption of this FSP had no impact on the Company's condensed consolidated financial statements. See Note 8 for information on the Company's fair value measurements and expanded disclosure.

In February 2008, the FASB issued FSP FAS No. 157-2 – *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS No. 157 to January 1, 2009 for certain nonfinancial assets and nonfinancial liabilities. Examples of applicable nonfinancial assets and nonfinancial liabilities to which FSP FAS No. 157-2 applies include, but are not limited to:

- Nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination that are not subsequently remeasured at fair value;
- Reporting units measured at fair value in the goodwill impairment test as described in SFAS No. 142, *Goodwill and Other Intangible Assets*, and nonfinancial assets and nonfinancial liabilities measured at fair value in the SFAS No. 142 goodwill impairment test, if applicable; and
- Nonfinancial long-lived assets measured at fair value for impairment assessment under SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

As a result of this FSP, the Company has delayed until January 1, 2009 the implementation of SFAS No. 157 to the nonfinancial assets and nonfinancial liabilities within the scope of FSP FAS No. 157-2.

Effective December 31, 2007, the Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial

condition and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Company's adoption of SFAS No. 158 resulted in a reduction to other comprehensive income (OCI) of \$20 million, net of taxes as of December 31, 2007.

Effective January 1, 2007, the Company adopted American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts*. This SOP provides guidance on accounting for DAC on internal replacements on insurance and investment contracts other than those described in SFAS No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occur by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. In addition, in February 2007, the AICPA issued related Technical Practice Aids (TPAs) to provide further clarification of SOP 05-1. The TPAs became effective concurrently with the adoption of SOP 05-1. The adoption of SOP 05-1 and the related TPAs resulted in a reduction to DAC and the Company recorded a cumulative effect adjustment of \$29 million, net of taxes, which was recorded as a reduction to members' equity during the year ended December 31, 2007.

FUTURE ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements — an Amendment of ARB No. 51*. SFAS No. 160 improves the relevance, comparability and transparency of the financial information that a company provides in its financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective for the Company beginning January 1, 2009 and will be applied prospectively when adopted, except for the presentation and disclosure requirements, which will be applied retrospectively for all periods presented. Adoption of SFAS No. 160 is not expected to have a material impact on the Company's condensed consolidated financial statements.

INVESTMENTS Fixed maturity and equity securities available for sale are reported at estimated fair value, with unrealized gains and losses, net of deferred income taxes and adjustments related to DAC and future policy benefits, recorded as a component of OCI. For mortgage-backed securities and asset-backed securities included in fixed maturity securities available for sale, the Company recognizes income using a constant effective yield based on anticipated prepayments and the estimated economic life of the securities. When estimates of prepayments change, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. For fixed rate securities, the net investment in the securities is adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the securities. These adjustments are reflected in net investment income. Trading securities are reported at estimated fair value with changes in estimated fair value included in net realized investment gain (loss).

Investment income consists primarily of interest and dividends, net investment income from partnership interests, prepayment fees on fixed maturity securities and mortgage loans, and income from certain derivatives. Interest is recognized on an accrual basis and dividends are recorded on the ex-dividend date. Amortization of premium and accretion of discount on fixed maturity securities is recorded using the effective interest method.

The Company's available for sale securities are regularly assessed for other than temporary impairments. If a decline in the estimated fair value of an available for sale security is deemed to be other than temporary, a charge to net realized investment gain (loss) is recorded equal to the difference between the estimated fair value and net carrying amount of the security.

The evaluation of other than temporary impairments is a quantitative and qualitative process subject to significant estimates and management judgment. The Company has rigorous controls and procedures in place to monitor securities and identify those that are subject to greater analysis for other than temporary impairments. The Company has an investment impairment committee comprised of investment and accounting professionals that

reviews and evaluates securities for potential other than temporary impairments at least on a quarterly basis.

In evaluating whether a decline in value is other than temporary, the Company considers many factors including, but not limited to, the following: the extent and duration of the decline in value; the reasons for the decline (credit event, currency, or interest-rate related, including spread widening); the ability and intent to hold the investment for a period of time to allow for a recovery of value; and the financial condition of and near-term prospects of the issuer.

Given the recent turmoil and volatility in the financial markets and the severe economic recession, estimated fair values for most fixed maturity securities have declined significantly. Analysis of the probability that all cash flows will be collected under the contractual terms of the fixed maturity security and determination as to whether the Company has the intent and ability to hold the investment for a sufficient period of time to allow for recovery in value were key factors in determining whether a fixed maturity security is other than temporarily impaired.

For mortgage-backed and asset-backed securities, including residential and commercial mortgage-backed securities, scrutiny was placed on the performance of the underlying collateral and projected future cash flows. In projecting future cash flows and performance, the Company incorporates inputs from third-party sources and applies reasonable judgment in developing assumptions used to estimate the probability and timing of collecting all contractual cash flows.

In evaluating perpetual preferred securities, which do not have final contractual cash flows, the Company applied other than temporary impairment considerations used for debt securities, placing emphasis on the probability that all cash flows will be collected under the contractual terms of the security and the Company's intent and ability to hold the security to allow for a recovery of value. Perpetual preferred securities are reported as equity securities as they are structured in equity form, but have significant "debt-like" characteristics, including periodic dividends, call features, and credit ratings and pricing similar to debt securities. The *SEC Issues Letter Clarifying Other-Than-Temporary Impairment Guidance for Perpetual Preferred Securities* issued on October 15, 2008 states that if an investor in a perpetual preferred security with an estimated fair value below cost that is not attributable to the credit deterioration of the issuer would not be required to recognize an other than temporary impairment by asserting that it has the intent and ability to continue holding the security for a sufficient period to allow for an anticipated recovery in market value.

Realized gains and losses on investment transactions are determined on a specific identification basis and are included in net realized investment gain (loss).

Mortgage loans on real estate are carried at their unpaid principal balance, net of deferred origination fees and write-downs. Mortgage loans are considered to be impaired when management estimates that based upon current information and events, it is probable that the Company will not be able to collect amounts due according to the contractual terms of the mortgage loan agreement. For mortgage loans deemed to be impaired, a write-down is taken for the difference between the carrying amount and the Company's estimate of the present value of the expected future cash flows discounted at the current market rate and recorded in net realized investment gain (loss). The Company had no impairments during the years ended December 31, 2008, 2007 and 2006. Policy loans are stated at unpaid principal balances.

Other investments primarily consist of partnership and joint ventures, real estate investments, derivative instruments, non marketable equity securities, and low income housing related investments qualifying for tax credits (LIHTC). Partnership and joint venture interests where the Company does not have a controlling interest or majority ownership are recorded under the cost or equity method of accounting depending on the equity ownership position. Real estate investments are carried at depreciated cost, net of write-downs, or, for real estate acquired in satisfaction of debt, estimated fair value less estimated selling costs at the date of acquisition, if lower than the related unpaid balance.

Investments in LIHTC are recorded under either the effective interest method, if they meet certain requirements, including a projected positive yield based solely on guaranteed credits, or are recorded under the equity method if

these certain requirements are not met. For investments in LIHTC recorded under the effective interest method, the amortization of the original investment and the tax credits are recorded in the provision (benefit) for income taxes. For investments in LIHTC recorded under the equity method, the amortization of the initial investment is included in net investment income, and the related tax credits are recorded in the provision (benefit) for income taxes (Note 9). The amortization recorded in net investment income was \$5 million, \$20 million and \$24 million for the years ended December 31, 2008, 2007 and 2006, respectively.

All derivatives, whether designated in hedging relationships or not, are required to be recorded at estimated fair value. If the derivative is designated as a cash flow hedge, the effective portion of changes in the estimated fair value of the derivative is recorded in OCI and recognized in earnings when the hedged item affects earnings. If the derivative is designated as a fair value hedge, the changes in the estimated fair value of the derivative and the hedged item are recognized in net realized investment gain (loss). The change in value of the hedged item associated with the risk being hedged is reflected as an adjustment to the carrying amount of the hedged item. For derivative instruments not designated as hedges, the change in estimated fair value of the derivative is recorded in net realized investment gain (loss). Estimated fair value exposure is calculated based on the aggregate estimated fair value of all derivative instruments with each counterparty, net of collateral received, in accordance with legally enforceable counterparty master netting agreements (Note 5).

The periodic cash flows for all hedging derivatives are recorded consistent with the hedged item on an accrual basis. For derivatives that are hedging securities, these amounts are included in net investment income. For derivatives that are hedging liabilities, these amounts are included in interest credited to policyholder account balances. For derivatives not designated as hedging instruments, the periodic cash flows are reflected in net realized investment gain (loss) on an accrual basis. Upon termination of a cash flow hedging relationship, the accumulated amount in OCI is amortized into net investment income or interest credited to policyholder account balances over the remaining life of the hedged item. Upon termination of a fair value hedging relationship, the accumulated adjustment to the carrying value of the hedged item is amortized into net investment income, interest expense or interest credited to policyholder account balances over its remaining life.

CASH AND CASH EQUIVALENTS Cash and cash equivalents include all investments with an original maturity of three months or less. Secured lending transactions with maturities of three months or less are also included in cash equivalents. The Company entered into a series of Federal National Mortgage Association (FNMA) pass-through dollar roll transactions during the fourth quarter of 2008. The Company purchased FNMA pass through securities and was contractually obligated to resell the same or substantially the same securities within 30 days of purchase. The Company classified these dollar roll transactions as short-term secured loans and reported them as cash and cash equivalents. As of December 31, 2008, the loans amounted to \$403 million. The fair values of the securities held in connection with the secured lending were \$410 million as of December 31, 2008.

RESTRICTED CASH Restricted cash primarily consists of security deposits, commitment fees, maintenance reserve payments, supplemental rental payments and rental payments received from certain lessees related to the aircraft leasing business.

DEFERRED POLICY ACQUISITION COSTS The costs of acquiring new insurance business, principally commissions, medical examinations, underwriting, policy issue and other expenses, all of which vary with and are primarily associated with the production of new business, are deferred and recorded as an asset commonly referred to as DAC. DAC related to internally replaced contracts (as defined by SOP 05-1), is immediately written off to expense and any new deferrable expenses associated with the replacement are deferred if the contract modification substantially changes the contract. However, if the contract modification does not substantially change the contract, the existing DAC asset remains in place and any acquisition costs associated with the modification are immediately expensed. As of December 31, 2008 and 2007, the carrying value of DAC was \$5.0 billion and \$4.5 billion, respectively (Note 3).

For universal life (UL), variable annuities and other investment-type contracts, acquisition costs are amortized

through earnings in proportion to the present value of estimated gross profits (EGPs) from projected investment, mortality and expense margins, and surrender charges over the estimated lives of the contracts. Actual gross margins or profits may vary from management's estimates, which can increase or decrease the rate of DAC amortization. DAC related to traditional policies is amortized through earnings over the premium-paying period of the related policies in proportion to premium revenues recognized, using assumptions and estimates consistent with those used in computing policy reserves. DAC related to certain unrealized components in OCI, primarily unrealized gains and losses on securities available for sale, is recorded directly to equity through OCI.

Significant assumptions in the development of EGPs include investment returns, surrender and lapse rates, rider utilization, interest spreads, and mortality margins. The Company's long-term assumption for the underlying separate account investment return ranges up to 8.0%.

A change in the assumptions utilized to develop EGPs results in a change to amounts expensed in the reporting period in which the change was made by adjusting the DAC balance to the level DAC would have been had the EGPs been calculated using the new assumptions over the entire amortization period. In general, favorable experience variances result in increased expected future profitability and may lower the rate of DAC amortization, whereas unfavorable experience variances result in decreased expected future profitability and may increase the rate of DAC amortization. All critical assumptions utilized to develop EGPs are evaluated at least annually and necessary revisions are made to certain assumptions to the extent that actual or anticipated experience necessitates such a prospective change (Note 3).

The Company defers sales inducements and amortizes them over the life of the policy using the same methodology and assumptions used to amortize DAC. The Company offers a sales inducement to the policyholder where the policyholder receives a bonus credit, typically ranging from 4.0% to 8.0% of each deposit. The capitalized sales inducement balance included in the DAC asset was \$552 million as of December 31, 2008 and 2007.

AIRCRAFT LEASING PORTFOLIO Aviation Capital Group Corp. (ACG), a wholly owned subsidiary of Pacific LifeCorp, is engaged in the acquisition and leasing of commercial jet aircraft. Aircraft are recorded at cost, which includes certain acquisition costs, less accumulated depreciation. Major improvements to aircraft are capitalized when incurred. The Company evaluates carrying values of aircraft based upon changes in market and other physical and economic conditions and will record write-offs to recognize a loss in the value of the aircraft when management believes that, based on estimated future cash flows, the recoverability of the Company's investment in an aircraft has been impaired. The Company had two non-earning aircraft in the portfolio as of December 31, 2008 and no non-earning aircraft in the portfolio as of December 31, 2007.

GOODWILL FROM ACQUISITIONS Goodwill represents the excess of costs over the fair value of net assets acquired. Goodwill is not amortized but is reviewed for impairment at least annually or more frequently if events occur or circumstances change that would indicate that a triggering event, as defined in SFAS 142 has occurred. Goodwill from acquisitions, included in other assets, totaled \$43 million and \$41 million as of December 31, 2008 and 2007, respectively. There were no goodwill impairment write-downs from continuing operations during the years ended December 31, 2008, 2007 and 2006.

POLICYHOLDER ACCOUNT BALANCES Policyholder account balances on UL and investment-type contracts, such as funding agreements, fixed account liabilities and guaranteed interest contracts (GICs), are valued using the retrospective deposit method and are equal to accumulated account values, which consist of deposits received, plus interest credited, less withdrawals and assessments (Note 6). Interest credited to these contracts primarily ranged from 2.0% to 9.0%.

FUTURE POLICY BENEFITS Annuity reserves, which primarily consist of group retirement and structured settlement annuities, are equal to the present value of estimated future payments using pricing assumptions, as applicable, for interest rates, mortality, morbidity, retirement age and expenses (Note 6). Interest rates used in establishing such liabilities ranged from 1.9% to 11.3%.

Policy charges assessed against policyholders that represent compensation to the Company for services to be provided in future periods, or unearned revenue reserves (URR), are recognized in revenue over the expected life of the contract using the same methods and assumptions used to amortize DAC. Unearned revenue related to certain unrealized components in OCI, primarily unrealized gains and losses on securities available for sale, is recorded directly to equity through OCI.

Life insurance reserves are valued using the net level premium method on the basis of actuarial assumptions appropriate at policy issue. Mortality and persistency assumptions are generally based on the Company's experience, which, together with interest and expense assumptions, include a margin for possible unfavorable deviations. Interest rate assumptions ranged from 4.5% to 9.3%. Future dividends for participating business are provided for in the liability for future policy benefits.

As of December 31, 2008 and 2007, participating experience rated policies paying dividends represent less than 1% of direct life insurance in force.

Estimates of future policy benefit reserves and liabilities are continually reviewed and, as experience develops, are adjusted as necessary. Such changes in estimates are included in earnings for the period in which such changes occur.

REINSURANCE The Company has ceded reinsurance agreements with other insurance companies to limit potential losses, reduce exposure arising from larger risks, provide additional capacity for future growth, and assumed reinsurance agreements intended to offset reinsurance costs and increase risk spread. As part of a strategic alliance, the Company also reinsures risks associated with policies written by an independent producer group through modified coinsurance and yearly renewable term arrangements with this producer group's reinsurance company.

All assets associated with business reinsured on a modified coinsurance basis remain with, and under the control of, the Company. As part of its risk management process, the Company routinely evaluates its reinsurance programs and may change retention limits, reinsurers or other features at any time.

Reinsurance accounting is followed for ceded and assumed transactions when the risk transfer provisions of SFAS No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, have been met. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss to the reinsurer.

Reinsurance premiums ceded and reinsurance recoveries on benefits and claims incurred are deducted from their respective revenue and benefit and expense accounts. Included in other assets are prepaid reinsurance premiums, which represent the portion of premiums ceded to reinsurers applicable to the unexpired terms of the reinsurance contracts. Reinsurance recoverables, included in other assets, include balances due from reinsurance companies for paid and unpaid losses. Amounts receivable and payable are offset when a written legal right of offset exists.

REVENUES, BENEFITS AND EXPENSES Insurance premiums, annuity contracts with life contingencies and traditional life and term insurance contracts, are recognized as revenue when due. Benefits and expenses are matched against such revenues to recognize profits over the lives of the contracts. This matching is accomplished by providing for liabilities for future policy benefits, expenses of contract administration and the amortization of DAC and URR.

Receipts for UL and investment-type contracts are reported as deposits to either policyholder account balances or separate account liabilities, and are not included in revenue. Policy fees consist of mortality charges, surrender charges and expense charges that have been earned and assessed against related account values during the period. The timing of policy fee revenue recognition is determined based on the nature of the fees. Benefits and expenses include policy benefits and claims incurred in the period that are in excess of related policyholder account balances, interest credited to policyholder account balances, expenses of contract administration and the amortization of DAC.

Investment advisory fees are primarily fees earned from Pacific Life Fund Advisors LLC (PLFA), a wholly owned subsidiary of Pacific Life formed in 2007, which serves as the investment advisor for the Pacific Select Fund, an investment vehicle provided to the Company's variable universal life and variable annuity contract holders. These fees are based upon the net asset value of the underlying portfolios, and are recorded as earned. Related subadvisory expense is included in operating and other expenses and recorded when incurred.

Aircraft leases, which are structured as triple net leases, are accounted for as operating leases. Aircraft leasing revenue is recognized ratably over the terms of the lease agreements. ACG has four capital leases, which are accounted for under the provisions of SFAS No. 13, *Accounting for Leases*. As of December 31, 2008 and 2007, capital leases in the amount of \$11 million and \$13 million, respectively, are classified in other assets.

DEPRECIATION AND AMORTIZATION Depreciation of investment real estate is computed using the straight-line method over estimated useful lives, which range from 5 to 30 years. Depreciation of investment real estate is included in net investment income. Certain other assets and aircraft are depreciated or amortized using the straight-line method over estimated useful lives, which range from 3 to 40 years. Depreciation and amortization of certain other assets and aircraft under operating leases are included in operating and other expenses.

INCOME TAXES PMHC files a consolidated Federal income tax return and a combined California franchise tax return with its includable subsidiaries. Certain of the Company's non-insurance subsidiaries also file separate state tax returns, if necessary. Pacific Alliance Reinsurance Ltd. (PAR Bermuda), a Bermuda-based life reinsurance company wholly owned by Pacific LifeCorp, files a separate Federal tax return. Pacific Life and its wholly owned, Arizona domiciled life insurance subsidiary, Pacific Life & Annuity Company (PL&A), Pacific Alliance Reinsurance Company of Vermont (PAR Vermont), a Vermont-based life reinsurance company wholly owned by Pacific Life, and PAR Bermuda are taxed as life insurance companies for Federal income tax purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years the differences are expected to be recovered or settled.

CONTINGENCIES The Company follows the requirements of SFAS No. 5, *Accounting for Contingencies*. This statement requires the Company to evaluate each contingent matter separately. A loss is recorded if probable and reasonably estimable. The Company establishes reserves for these contingencies at the best estimate, or, if no one number within the range of possible losses is more probable than any other, the Company records an estimated reserve at the low end of the range of losses. See Note 11.

SEPARATE ACCOUNTS Separate accounts primarily include variable annuity and life contracts, as well as other guaranteed and non-guaranteed accounts. Separate account assets and liabilities are recorded at estimated fair value and represent legally segregated contract holder funds. Deposits to separate accounts, investment income and realized and unrealized gains and losses on the separate account assets accrue directly to contract holders and, accordingly, are not reflected in the condensed consolidated statements of operations or cash flows. Amounts charged to the separate account for mortality, surrender and expense charges are included in revenues as policy fees.

In accordance with SOP 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Non Traditional Long-Duration Contracts and for Separate Accounts*, for separate account funding agreements where the Company provides a guarantee of principal and interest to the contract holder and the Company bears all the risks and rewards of the investments underlying the separate account, the related investments and liabilities are recognized as investments and liabilities in the condensed consolidated statements of financial condition. Revenue and expenses are recognized within the respective revenue, and benefit and expense lines in the condensed consolidated statements of operations.

FAIR VALUE OF FINANCIAL INSTRUMENTS The estimated fair value of financial instruments, disclosed in Notes 4, 5 and 8, has been determined using available market information and appropriate valuation

methodologies. However, considerable judgment is often required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented may not be indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a significant effect on the estimated fair value amounts.

DISCONTINUED OPERATIONS The Company's broker-dealer operations and group insurance business have been reflected as discontinued operations in the Company's condensed consolidated financial statements. Discontinued operations do not include the operations of Pacific Select Distributors, Inc. (PSD), a wholly owned broker-dealer subsidiary of Pacific Life, which primarily serves as the underwriter/distributor of registered investment-related products and services, principally variable life and variable annuity contracts issued by the Company, and mutual funds.

2. STATUTORY FINANCIAL INFORMATION AND DIVIDEND RESTRICTIONS

STATUTORY ACCOUNTING PRACTICES The Company's principal operating subsidiary, Pacific Life, prepares its regulatory statutory financial statements in accordance with statutory accounting practices prescribed or permitted by the NE DOI, which is a comprehensive basis of accounting other than U.S. GAAP. Statutory accounting practices primarily differ from U.S. GAAP by charging policy acquisition costs to expense as incurred, recognizing certain policy fees as revenue when billed, establishing future policy benefit liabilities using different actuarial assumptions, reporting surplus notes as surplus instead of debt, as well as valuing investments and certain assets and accounting for deferred income taxes on a different basis.

As of December 31, 2008, Pacific Life has two permitted practices approved by the NE DOI that differ from statutory accounting practices adopted by the National Association of Insurance Commissioners (NAIC). The first permitted practice relates to the valuation of certain statutory separate account assets that are carried at book value instead of estimated fair value. Pacific Life's statutory capital and surplus as of December 31, 2008 and 2007 did not reflect unrealized losses of \$88 million and \$54 million, respectively, with regards to this permitted practice. The second permitted practice has a financial statement filing date of December 31, 2008 and will continue until December 30, 2009. This permitted practice allows Pacific Life to apply the revised version of Actuarial Guideline 39 for variable annuity reserves that is contained in the final recommendations submitted by the Capital & Surplus Relief Working Group to the Executive Committee of the NAIC. This permitted practice resulted in an increase to statutory surplus and net income of \$442 million as of December 31, 2008.

In addition, Pacific Life uses a NE DOI prescribed accounting practice for certain synthetic GIC reserves that differs from statutory accounting practices adopted by the NAIC. As of December 31, 2008 and 2007, this NE DOI prescribed accounting practice resulted in statutory reserves of \$12 million and \$9 million, respectively, as opposed to statutory reserves of \$640 million and zero, respectively, using statutory accounting practices adopted by the NAIC.

STATUTORY NET INCOME (LOSS) AND SURPLUS Statutory net income (loss) of Pacific Life was (\$1,529) million, \$362 million and \$362 million for the years ended December 31, 2008, 2007 and 2006, respectively. Statutory capital and surplus of Pacific Life was \$3,136 million and \$3,708 million as of December 31, 2008 and 2007, respectively.

RISK-BASED CAPITAL Risk-based capital is a method developed by the NAIC to measure the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formulas for determining the amount of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Additionally, certain risks are required to be measured using actuarial cash flow modeling techniques, subject to formulaic minimums. The adequacy of a company's actual capital is measured by a comparison to the risk-based capital results. Companies below minimum risk-based capital requirements are classified within certain levels, each of which requires specified corrective action. As of December 31, 2008 and 2007, Pacific Life, PL&A and PAR Vermont exceeded the minimum risk-based capital requirements.

DIVIDEND RESTRICTIONS The payment of dividends by Pacific Life to Pacific LifeCorp is subject to restrictions set forth in the State of Nebraska insurance laws. These laws require (i) notification to the NE DOI for the declaration and payment of any dividend and (ii) approval by the NE DOI for accumulated dividends within the preceding twelve months that exceed the greater of 10% of statutory policyholder surplus as of the preceding December 31 or statutory net gain from operations for the preceding twelve months ended December 31. Generally, these restrictions pose no short-term liquidity concerns for Pacific LifeCorp. Based on these restrictions and 2008 statutory results, Pacific Life could pay \$256 million in dividends in 2009 to Pacific LifeCorp without prior approval from the NE DOI, subject to the notification requirement.

During the year ended December 31, 2008, Pacific Life paid a cash dividend to Pacific LifeCorp of \$345 million. No dividends were paid during 2007. During the year ended December 31, 2006, Pacific Life paid two dividends totaling \$185 million to Pacific LifeCorp; a \$25 million dividend, consisting of \$9 million in cash and a real estate investment with an estimated fair value of \$16 million, and a \$160 million cash dividend.

The maximum amount of ordinary dividends that can be paid by PL&A to Pacific Life without restriction cannot exceed the lesser of 10% of statutory surplus as regards to policyholders, or the statutory net gain from operations. Based on this limitation and because PL&A recorded a \$116 million statutory net loss from operations for the year ended December 31, 2008, PL&A will be unable to pay dividends to Pacific Life in 2009 without prior regulatory approval. No dividends were paid during 2008, 2007 and 2006.

OTHER In November 2008, the NAIC issued Statement of Statutory Accounting Principles (SSAP) No. 98, *Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, An Amendment to SSAP No. 43 — Loan-backed and Structured Securities*. SSAP 98 requires the use of discounted cash flows for impairment analysis and subsequent valuation of loan-backed and structured securities. This statement is effective for quarterly and annual reporting periods beginning on or after January 1, 2009. Changes resulting from the adoption of this statement shall be accounted for prospectively. The Company anticipates that adoption of this statement will result in statutory losses based on current market conditions. Based on December 31, 2008 information, this would have resulted in additional statutory losses amounting to approximately \$320 million.

The Company has reinsurance contracts in place with a reinsurer whose financial stability has been deteriorating. In January 2009, the reinsurer's domiciliary state regulator issued an order of supervision, which requires the regulator's consent to any transaction outside the normal course of business. The Company will continue to monitor the events surrounding this reinsurer and evaluate its options to deal with any further deterioration of this reinsurer's financial condition. As of December 31, 2008, statutory reserves ceded to this reinsurer amounted to approximately \$160 million.

3. DEFERRED POLICY ACQUISITION COSTS

Components of DAC are as follows:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
Balance, January 1	\$ 4,481	\$ 4,248	\$ 3,787
Cumulative pre-tax effect of adoption of new accounting principle (Note 1)		(45)	
Additions:			
Capitalized during the year	774	852	999
Amortization:			
Allocated to commission expenses	(449)	(432)	(399)
Allocated to operating expenses	(133)	(118)	(104)
Total amortization	(582)	(550)	(503)
Allocated to OCI	355	(24)	(35)
Balance, December 31	\$ 5,028	\$ 4,481	\$ 4,248

During the years ended December 31, 2008, 2007 and 2006, the Company revised certain assumptions to develop EGPs for its products subject to DAC amortization (Note 1). This resulted in an increase in DAC amortization expense of \$20 million for the year ended December 31, 2008 and decreases in DAC amortization expense of \$12 million and \$16 million for the years ended December 31, 2007 and 2006, respectively. The revised EGPs also resulted in increased URR amortization of \$2 million and \$4 million for the years ended December 31, 2008 and 2006, respectively, and decreased URR amortization of \$15 million for the year ended December 31, 2007.

4. INVESTMENTS

The net carrying amount, gross unrealized gains and losses, and estimated fair value of fixed maturity and equity securities available for sale are shown below. The net carrying amount represents amortized cost adjusted for other than temporary impairments and changes in the estimated fair value of fixed maturity securities attributable to the hedged risk in a fair value hedge. The estimated fair value of publicly traded securities is based on quoted market prices. For securities not actively traded, fair values were estimated based on amounts provided by independent pricing services specializing in matrix pricing and modeling techniques. The Company also estimates certain fair values based on interest rates, credit quality and average maturity utilizing matrix pricing and other modeling techniques. See Note 8 for additional information on the Company's fair value measurements.

<i>(In Millions)</i>	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
DECEMBER 31, 2008:				
U.S. Treasury securities and obligations of				
U.S. government authorities and agencies	\$ 103	\$ 19		\$ 122
Obligations of states and political subdivisions	512	5	\$ 148	369
Foreign governments	307	46	7	346
Corporate securities	15,710	296	1,529	14,477
Mortgage-backed and asset-backed securities:				
Residential mortgage-backed securities	6,514	106	1,318	5,302
Commercial mortgage-backed securities	1,193	15	105	1,103
Other asset-backed securities	750	32	112	670
Redeemable preferred securities	294	16	95	215
Total fixed maturity securities	\$ 25,383	\$ 535	\$ 3,314	\$ 22,604
Perpetual preferred securities	\$ 389	\$ 3	\$ 175	\$ 217
Other equity securities	2			2
Total equity securities	\$ 391	\$ 3	\$ 175	\$ 219

The Company has investments in perpetual preferred securities that are primarily issued by European and U.S. banks. The net carrying amount and estimated fair value of the available for sale securities was \$557 million and \$269 million, respectively, as of December 31, 2008. Included in these amounts are perpetual preferred securities carried in trusts with a net carrying amount and estimated fair value of \$168 million and \$52 million, respectively, that are held in fixed maturities and included in the tables above in corporate securities. Perpetual preferred securities reported as equity securities available for sale are presented in the tables above as perpetual preferred securities.

The net carrying amount and estimated fair value of fixed maturity securities available for sale as of December 31, 2008, by contractual repayment date of principal, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

<i>(In Millions)</i>	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
Due in one year or less	\$ 1,634	\$ 10	\$ 25	\$ 1,619
Due after one year through five years	4,876	91	328	4,639
Due after five years through ten years	5,900	75	781	5,194
Due after ten years	4,516	206	645	4,077
	16,926	382	1,779	15,529
Mortgage-backed and asset-backed securities	8,457	153	1,535	7,075
Total	\$ 25,383	\$ 535	\$ 3,314	\$ 22,604

The following tables present the number of investments, estimated fair value and gross unrealized losses on investments where the estimated fair value has declined and remained continuously below the net carrying amount for less than twelve months and for twelve months or greater. Included in the tables are gross unrealized losses for fixed maturity securities available for sale and other securities, which include equity securities available for sale, cost method investments, and non marketable securities.

<i>(\$ In Millions)</i>	Number	Total	
		Estimated Fair Value	Gross Unrealized Losses
DECEMBER 31, 2008:			
Obligations of states and political subdivisions	33	\$ 279	\$ 148
Foreign governments	5	66	7
Corporate securities	996	9,599	1,529
Mortgage-backed and asset-backed securities:			
Residential mortgage-backed securities	459	3,989	1,318
Commercial mortgage-backed securities	47	798	105
Other asset-backed securities	57	335	112
Redeemable preferred securities	18	153	95
Total fixed maturity securities	1,615	15,219	3,314
Perpetual preferred securities	33	200	175
Other securities	24	95	28
Total other securities	57	295	203
Total	1,672	\$ 15,514	\$ 3,517

(\$ In Millions)	Less than 12 Months			12 Months or Greater		
	Number	Estimated Fair Value	Gross Unrealized Losses	Number	Estimated Fair Value	Gross Unrealized Losses
DECEMBER 31, 2008:						
Obligations of states and political subdivisions	30	\$ 257	\$ 144	3	\$ 22	\$ 4
Foreign governments	5	66	7			
Corporate securities	704	6,713	803	292	2,886	726
Mortgage-backed and asset-backed securities:						
Residential mortgage-backed securities	198	2,436	707	261	1,553	611
Commercial mortgage-backed securities	33	571	73	14	227	32
Other asset-backed securities	38	211	50	19	124	62
Redeemable preferred securities	5	43	6	13	110	89
Total fixed maturity securities	1,013	10,297	1,790	602	4,922	1,524
Perpetual fixed maturities	10	32	17	23	168	158
Other securities	18	89	27	6	6	1
Total other securities	28	121	44	29	174	159
Total	1,041	\$ 10,418	\$ 1,834	631	\$ 5,096	\$ 1,683

Gross unrealized losses as of December 31, 2008 have increased significantly from December 31, 2007. General spread widening on fixed maturity investments caused by the recent disruption in the financial markets have led to decreases in their estimated fair values. The Company has evaluated fixed maturity and other securities with gross unrealized losses and determined that the unrealized losses are temporary and that the Company has the ability and intent to hold the securities until recovery.

Prime mortgages are loans made to borrowers with strong credit histories, whereas sub-prime mortgage lending is the origination of residential mortgage loans to customers with weak credit profiles. Alt-A mortgage lending is the origination of residential mortgage loans to customers who have good credit ratings, but have limited documentation for their source of income or some other standard input used to underwrite the mortgage loan. The slowing U.S. housing market, greater use of affordability mortgage products and relaxed underwriting standards for some originators for these loans has led to higher delinquency and loss rates, especially within the 2007 and 2006 vintage years.

The following table illustrates the breakdown of non-agency residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) by investment rating from independent rating agencies and vintage year of the underlying collateral as of December 31, 2008.

(\$ In Millions) Rating	Net Carrying Amount	Estimated Fair Value	Rating as % of Net Carrying Amount	Vintage Breakdown					
				2003 and Prior	2004	2005	2006	2007	2008
Prime RMBS:									
AAA	\$ 3,291	\$ 2,542	87%	15%	18%	20%	22%	12%	
AA	262	177	7%			3%	4%		
A	122	80	3%			1%	2%		
BAA	73	46	2%					2%	
BA and below	27	16	1%			1%			
Total	\$ 3,775	\$ 2,861	100%	15%	18%	25%	28%	14%	0%
Alt-A RMBS:									
AAA	\$ 745	\$ 506	80%		8%	12%	22%	38%	
AA	90	75	10%			1%	8%	1%	
A	9	6	1%				1%		
BAA	4	4	0%						
BA and below	80	80	9%					9%	
Total	\$ 928	\$ 671	100%	0%	8%	13%	31%	48%	0%
Sub-prime RMBS:									
AAA	\$ 393	\$ 293	82%	27%	36%	16%	1%	2%	
AA	72	47	15%	14%	1%				
A	1	1	0%						
BA and below	15	6	3%			3%			
Total	\$ 481	\$ 347	100%	41%	37%	19%	1%	2%	0%
CMBS:									
AAA	\$ 1,053	\$ 992	89%	59%	12%	4%		13%	1%
AA	64	58	5%	5%					
A	36	29	3%	3%					
BAA	28	17	2%					2%	
BA and below	12	7	1%	1%					
Total	\$ 1,193	\$ 1,103	100%	68%	12%	4%	0%	15%	1%

Monoline insurers guarantee the timely payment of principal and interest of certain securities. Municipalities will often purchase monoline insurance to wrap a security issuance in order to benefit from better market execution. The Company's net carrying amount and estimated fair value of total monoline insured securities was \$845 million and \$700 million, respectively, as of December 31, 2008. Included in these amounts are monoline insured municipal securities with a net carrying amount and estimated fair value of \$560 million and \$438 million, respectively, as of December 31, 2008. Of the net carrying value of the municipal bond portfolio, 24% of the overall credit quality of the municipal bond portfolio, including the benefits of monoline insurance, was rated A or better and 76% was rated BAA by independent rating agencies. As of December 31, 2008, the Company had no direct investments in monoline insurers.

As of December 31, 2008, the Company has received advances of \$1.7 billion from the Federal Home Loan Bank (FHLB) of Topeka and has issued \$1.7 billion in funding agreements to the FHLB of Topeka. Funding agreements are used as an alternative source of funds for the Company's spread lending business and the funding agreement liabilities are included in general account policyholder account balances. Assets with an estimated fair value of \$2.2 billion as of December 31, 2008 are in a custodial account pledged as collateral for the funding agreements. The Company is required to purchase stock in FHLB of Topeka each time it receives an advance. As of December 31, 2008, the Company holds \$87 million of FHLB of Topeka stock.

PL&A is a member of FHLB of San Francisco. As of December 31, 2008, no assets are pledged as collateral. As of December 31, 2008, the Company holds \$25 million of FHLB of San Francisco stock.

Major categories of investment income and related investment expense are summarized as follows:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
Fixed maturity securities	\$ 1,489	\$ 1,518	\$ 1,441
Equity securities	23	26	30
Mortgage loans	289	248	300
Real estate	87	69	59
Policy loans	223	209	193
Partnerships and joint ventures	21	179	139
Other	34	47	37
Gross investment income	2,166	2,296	2,199
Investment expense	137	139	124
Net investment income	\$ 2,029	\$ 2,157	\$ 2,075

Net investment income includes prepayment fees on fixed maturity securities and mortgage loans of \$10 million, \$43 million and \$61 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The components of net realized investment gain (loss) are as follows:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
Fixed maturity securities:			
Gross gains on sales	\$ 106	\$ 117	\$ 39
Gross losses on sales	(44)	(23)	(37)
Other than temporary impairments	(458)	(98)	(6)
Other	4	20	12
Total fixed maturity securities	(392)	16	8
Equity securities:			
Gross gains on sales		5	14
Other than temporary impairments	(71)		(3)
Other	1		1
Total equity securities	(70)	5	12
Trading securities	(22)	(1)	2
Real estate and mortgage loans	27	18	
Variable annuity guaranteed living benefit embedded derivatives	(2,775)	(222)	41
Variable annuity guaranteed living benefit policy fees	108	78	64
Variable annuity derivatives	1,901	44	(71)
Other derivatives	(63)	(11)	(7)
Other investments - other than temporary impairments	(55)		
Other	(10)	45	4
Total	\$ (1,351)	\$ (28)	\$ 53

During the years ended December 31, 2008, 2007 and 2006, the Company recorded other than temporary impairments of \$584 million, \$98 million and \$9 million, respectively. In connection with the recent significant disruption in the housing, financial and credit markets, the other than temporary impairment charges recorded during the year ended December 31, 2008 were primarily related to the Company's exposure to Alt-A RMBS, certain structured securities and direct exposure to banks and corporate credits. The table below summarizes the other than temporary impairments by type:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
RMBS:			
Alt-A	\$ 214		
Prime	13		
Structured credit	31	\$ 15	
Collateralized debt obligations	125	73	
Other asset-backed securities	1	5	\$ 2
Corporate debt:			
Financial institutions	52	2	1
Other	22	3	3
Equities:			
Financial institutions	34		3
Other	37		
Private equity	51		
Other investments	4		
Total other than temporary impairments	\$ 584	\$ 98	\$ 9

5. DERIVATIVES AND HEDGING ACTIVITIES

The Company primarily utilizes derivative instruments to manage its exposure to interest rate risk, foreign currency risk, credit risk, and equity risk. Derivative instruments are also used to manage the duration mismatch of assets and liabilities. The Company utilizes a variety of derivative instruments including swaps, foreign exchange forward contracts, caps, floors, and options. In addition, certain insurance products offered by the Company contain features that are accounted for as derivatives.

The Company applies hedge accounting by designating derivative instruments as either fair value or cash flow hedges on the date the Company enters into a derivative contract. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. In this documentation, the Company specifically identifies the asset, liability, firm commitment, or forecasted transaction that has been designated as a hedged item and states how the hedging instrument is expected to hedge the risks related to the hedged item. The Company formally assesses and measures effectiveness of its hedging relationships both at the hedge inception and on an ongoing basis in accordance with its risk management policy.

The following table summarizes the notional amount and estimated fair value by hedge designation and derivative type. Collateral received from or pledged to counterparties is not included in the amounts below.

<i>(In Millions)</i> DECEMBER 31,	Notional Amount		Estimated Fair Value	
	2008	2007	Asset/(Liability)	2007
Cash flow hedges:				
Foreign currency interest rate swaps	\$ 6,488	\$ 8,043	\$ (57)	\$ 219
Forward starting interest rate swap agreements	1,535	1,935	252	29
Interest rate swaps	4,424	3,310	(235)	(72)
Total cash flow hedges	12,447	13,288	(40)	176
Fair value hedges:				
Interest rate swaps	1,264	2,055	(120)	(67)
Foreign currency interest rate swaps	18	18	1	2
Total fair value hedges	1,282	2,073	(119)	(65)
Derivatives not designated as hedging instruments:				
Variable annuity guaranteed living benefit embedded derivatives	33,455	27,935	(3,342)	(161)
Variable annuity derivatives - equity put swaps	5,173	2,827	937	18
Variable annuity derivatives - interest rate swaps	2,150		372	
Variable annuity derivatives - total return swaps	2,437	470	(31)	26
Variable annuity guaranteed living benefit reinsurance contracts	13,274	7,358	429	23
Synthetic GICs	23,856	11,477	(3)	
Interest rate swaps	3,277	3,062	(65)	1
Foreign currency interest rate swaps	460	367	3	(2)
Floors and options	359	272	5	10
Credit default swaps	163	265	(40)	(6)
Other	388	179		(11)
Total derivatives not designated as hedging instruments	84,992	54,212	(1,735)	(102)
Total	\$ 98,721	\$ 69,573	\$ (1,894)	\$ 9

Notional amount represents a standard of measurement of the volume of derivatives. Notional amount is not a quantification of market risk or credit risk and is not recorded on the condensed consolidated statements of financial condition. Notional amounts generally represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps. The notional amount of the variable annuity guaranteed living benefit reinsurance contracts represents the full protected basis of the underlying embedded derivative and estimated fair value represents the amount recoverable from reinsurers based on the portion of risk ceded.

CREDIT EXPOSURE Credit exposure is measured on a counterparty basis as the net positive aggregate estimated fair value, net of collateral received, if any. The credit exposure for over the counter derivatives as of December 31, 2008 and 2007 was \$167 million and \$218 million, respectively.

For all derivative contracts other than variable annuity guaranteed living benefits (GLBs) and synthetic GICs, the Company enters into master agreements that may include a termination event clause associated with the Company's insurer financial strength rating. If the Company's insurer financial strength rating falls below a specified level assigned by certain rating agencies or, in most cases, if one of the rating agencies ceases to provide an insurer financial strength rating, the counterparty can terminate the master agreement with payment due based on the estimated fair value of the underlying derivatives. As of December 31, 2008, the Company's insurer financial strength rating was above the specified level.

The Company attempts to limit its credit exposure by dealing with creditworthy counterparties, establishing risk control limits, executing legally enforceable master netting agreements, and obtaining collateral where appropriate. In addition, each counterparty is reviewed to evaluate its financial stability before entering into each agreement and throughout the period that the financial instrument is owned. All of the Company's credit exposure from derivative contracts is with investment grade counterparties. For the year ended December 31, 2008, the Company has incurred losses of \$7 million, included in net realized gain (loss), on derivative instruments due to a counterparty default related to the bankruptcy of Lehman Brothers Holdings Inc. These losses were a result of the contractual collateral threshold amounts and open collateral calls in excess of such amounts immediately prior to the bankruptcy filing. For the year ended December 31, 2008, swap contracts are still open with Lehman Brothers Special Finance with a fair value of (\$38) million, which resulted in a loss of \$21 million included in net realized investment gain (loss).

6. POLICYHOLDER LIABILITIES

POLICYHOLDER ACCOUNT BALANCES The detail of the liability for policyholder account balances is as follows:

<i>(In Millions)</i> DECEMBER 31,	2008	2007
Universal life	\$ 18,729	\$ 17,742
Funding agreements	7,890	9,190
Fixed account liabilities	4,515	4,159
GICs	1,536	926
Total	\$ 32,670	\$ 32,017

FUTURE POLICY BENEFITS The detail of the liability for future policy benefits is as follows:

<i>(In Millions)</i> DECEMBER 31,	2008	2007
Annuity reserves	\$ 4,506	\$ 4,184
Variable annuity guaranteed living benefit embedded derivatives	3,342	161
URR	928	726
Policy benefits payable	456	295
Life insurance	390	341
Closed Block liabilities	311	309
Other	174	23
Total	\$ 10,107	\$ 6,039

7. DEBT

Debt consists of the following:

<i>(In Millions)</i> DECEMBER 31,	2008	2007
Short-term debt:		
Revolving credit facilities	\$ 465	\$ 465
Commercial paper		100
Repurchase agreements	195	280
Other	139	6
Total short-term debt	\$ 799	\$ 851
Long-term debt:		
Surplus notes	\$ 150	\$ 150
Senior notes	600	600
Derivative fair value adjustment and deferred gains	339	85
ACG notes payable	1,271	1,110
ACG non-recourse debt	687	682
Other non-recourse debt	121	119
ACG VIE debt	2,173	2,382
Other VIE debt	2	15
Total long-term debt	\$ 5,343	\$ 5,143

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS NO. 157 SFAS No. 157 establishes a hierarchy that prioritizes the inputs of valuation methods used to measure fair value for financial assets and financial liabilities that are carried at fair value. The hierarchy consists of the following three levels that are prioritized based on observable and unobservable inputs.

Level 1 Unadjusted quoted prices for identical instruments in active markets. Level 1 financial instruments would include securities that are traded in an active exchange market.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments on inactive markets; and model-derived valuations for which all significant inputs are observable market data. Level 2 instruments include most corporate debt securities and U.S. government and agency mortgage-backed securities that are valued by models using inputs that are derived principally from or corroborated by observable market data.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs are unobservable. Level 3 instruments include less liquid securities for which significant inputs are not observable in the market, such as structured securities and variable annuity GLB embedded derivatives that require significant management assumptions or estimation in the fair value measurement.

This hierarchy requires the use of observable market data when available.

The following table presents, by fair value hierarchy level, the Company's financial assets and financial liabilities that are carried at fair value as of December 31, 2008.

<i>(In Millions)</i>	Level 1	Level 2	Level 3	Netting Adjustments ⁽¹⁾	Total
Assets:					
Fixed maturity securities		\$ 16,464	\$ 6,140		\$ 22,604
Equity securities		204	15		219
Trading securities ⁽²⁾		17	97		114
Cash equivalents	\$ 2,653				2,653
Other investments			168		168
Derivatives		1,345	1,435	\$ (678)	2,102
Separate account assets ⁽³⁾	41,145	275	61		41,481
Total	\$ 43,798	\$ 18,305	\$ 7,916	\$ (678)	\$ 69,341
Liabilities:					
Derivatives		\$ 1,197	\$ 3,477	\$ (678)	\$ 3,996
Total		\$ 1,197	\$ 3,477	\$ (678)	\$ 3,996

(1) Netting adjustments represent the impact of offsetting asset and liability positions held with the same counterparty.

(2) Trading securities are presented in other investments in the condensed consolidated statement of financial condition.

(3) Separate account assets are measured at fair value. Investment performance related to separate account assets is offset by corresponding amounts credited to contract holders whose liability is reflected in the separate account liabilities. Separate account liabilities are measured to equal the fair value of separate account assets as prescribed by SOP 03-1. Separate account assets as presented in the table above differ from the amounts presented in the condensed consolidated statement of financial condition because cash and receivables for securities are not subject to SFAS No. 157.

FAIR VALUE MEASUREMENT SFAS No. 157 defines fair value as the price that would be received to sell the asset or paid to transfer the liability at the measurement date. This "exit price" notion is a market-based measurement that requires a focus on the value that market participants would assign for an asset or liability.

The Company's SFAS No. 157 fair value is calculated as an aggregation of the Pre-SFAS No. 157 definition of fair value and additional risk margins including, Behavior Risk Margin, Mortality Risk Margin and Credit Standing Adjustment. The resulting aggregation is reconciled or calibrated, if necessary, to market information that is, or may be, available to the Company, but may not be observable by other market participants, including reinsurance discussions and transactions. Each of the components described below are unobservable in the market place and requires subjectivity by the Company in determining their value.

- **Behavior Risk Margin:** This component adds a margin that market participants would require for the risk that the Company's assumptions about policyholder behavior used in the Pre-SFAS No. 157 definition of fair value model could differ from actual experience.
- **Mortality Risk Margin:** This component adds a margin in mortality assumptions, both for decrements for policyholders with GLBs, and for expected payout lifetimes in guaranteed minimum withdrawal benefits.
- **Credit Standing Adjustment:** This component makes an adjustment that market participants would make to reflect the chance that GLB obligations or the GLB reinsurance recoverables will not be fulfilled (nonperformance risk).

LEVEL 3 RECONCILIATION The table below presents a reconciliation of the beginning and ending balances of the Level 3 financial assets and financial liabilities that have been measured at fair value on a recurring basis using significant unobservable inputs.

<i>(In Millions)</i>	Total Gains or Losses					December 31, 2008	Unrealized Losses Still Held ⁽¹⁾
	January 1, 2008	Included in Earnings	Included in Other Comprehensive Income (Loss)	Transfers In and/or Out of Level 3	Purchases, Sales, Issuances, and Settlements		
Assets:							
Fixed maturity securities	\$ 2,874	\$ (93)	\$ (597)	\$ 3,608	\$ 348	\$ 6,140	\$ (17)
Equity securities	50	(37)	(1)	1	2	15	
Trading securities	47	(12)		10	52	97	(11)
Other investments	478	105	(133)		(282)	168	
Derivatives, net	(104)	(1,947)	2		7	(2,042)	(1,828)
Separate account assets ⁽²⁾	11	(5)		46	9	61	(25)
Total	\$ 3,356	\$ (1,989)	\$ (729)	\$ 3,665	\$ 136	\$ 4,439	\$ (1,881)

(1) Represents the net amount of total gains or losses for the period, included in earnings, attributable to the change in unrealized losses relating to assets and liabilities classified as Level 3 that are still held as of December 31, 2008.

(2) The realized/unrealized gains (losses) included in net income (loss) for separate account assets are offset by an equal amount for separate account liabilities, which results in a net zero impact on net income (loss) for the Company.

Transfers in Level 3 primarily relate to RMBS previously priced by an independent third-party pricing service that were transferred from Level 2 to Level 3. The Company valued many RMBS internally based upon internal models due to the housing market crisis' impact on RMBS valuations and the absence of trading activity. The internal valuation models included detailed evaluations of the performance of the underlying collateral of specific securities across the entire RMBS portfolio with significant judgment in determining discount rates including liquidity premiums, default and prepayment assumptions, loss severity and other inputs.

9. INCOME TAXES

The provision (benefit) for income taxes is as follows:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
Current	\$ 196	\$ 24	\$ 122
Deferred	(535)	88	79
Provision (benefit) for income taxes from continuing operations	(339)	112	201
Provision (benefit) for income taxes on discontinued operations	(3)	18	(2)
Total	\$ (342)	\$ 130	\$ 199

A reconciliation of the provision (benefit) for income taxes from continuing operations based on the Federal corporate statutory tax rate of 35% to the provision (benefit) for income taxes from continuing operations reflected in the condensed consolidated financial statements is as follows:

<i>(In Millions)</i> YEARS ENDED DECEMBER 31,	2008	2007	2006
Provision (benefit) for income taxes at the statutory rate	\$ (219)	\$ 275	\$ 293
Separate account dividends received deduction	(107)	(103)	(43)
Low income housing and foreign tax credits	(31)	(33)	(34)
Other	18	(27)	(15)
Provision (benefit) for income taxes from continuing operations	\$ (339)	\$ 112	\$ 201

Upon adoption of FASB Interpretation No. (FIN) 48 *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, on January 1, 2007 (Note 1), the Company had unrecognized tax benefits of \$32 million, which relate entirely to an uncertain tax position regarding refund claims for the impact of short-term capital gains on computing dividends received deductions relating to the Company's separate accounts (DRD). A reconciliation of the changes in the unrecognized tax benefits is as follows:

<i>(In Millions)</i>	
Balance at January 1, 2007	\$ 32
Additions and deletions	—
Balance at December 31, 2007	32
Additions and deletions	402
Balance at December 31, 2008	\$ 434

Depending on the outcome of Internal Revenue Service (IRS) appeals proceedings, approximately \$7 million of the unrecognized DRD tax benefits may be realized during the next twelve months. All realized tax benefits and related interest will be recorded as a discrete item that will impact the effective tax rate in the accounting period in which the uncertain DRD tax position is ultimately settled.

During 2008, the Company's FIN 48 tax contingency increased by \$402 million for a tax position for which there is uncertainty about the timing, but not the deductibility, of certain tax deductions. Since the benefits of the tax position will be claimed on an amended return, the Company will not receive cash until the claim is audited and approved by the taxing authority and therefore will not accrue interest or penalties. Due to the nature of deferred tax accounting, the tax position will not have an impact on the annual effective tax rate.

10. TRANSACTIONS WITH AFFILIATES

PLFA serves as the investment adviser for the Pacific Select Fund, an investment vehicle provided to the Company's variable life insurance policyholders and variable annuity contract owners, and the Pacific Life Funds, the investment vehicle for the Company's mutual fund products. Prior to May 1, 2007, Pacific Life served in this capacity. Investment advisory and other fees are based primarily upon the net asset value of the underlying portfolios. These fees, included in investment advisory fees and other income, amounted to \$287 million, \$337 million and \$316 million for the years ended December 31, 2008, 2007 and 2006, respectively. In addition, Pacific Life provides certain support services to the Pacific Select Fund, the Pacific Life Funds and other affiliates based on an allocation of actual costs. These fees amounted to \$3 million for each of the years ended December 31, 2008, 2007 and 2006.

In addition, effective May 1, 2007, a service plan adopted by the Pacific Select Fund went into effect whereby the fund pays PSD as distributor of the fund, a service fee in connection with services rendered or procured to or for shareholders of the fund or their variable contract owners. These services may include, but are not limited to, payment of compensation to broker-dealers, including PSD itself, and other financial institutions and

organizations, which assist in providing any of the services. For the year ended December 31, 2008, PSD received \$100 million in service fees from the Pacific Select Fund, which are recorded in other income. For the period May 1, 2007 through December 31, 2007, PSD received \$74 million in service fees from the Pacific Select Fund, which are also recorded in other income. The service fees were allocated to the operating segments, primarily the Annuities & Mutual Funds segment.

11. COMMITMENTS AND CONTINGENCIES

COMMITMENTS The Company has outstanding commitments to make investments primarily in fixed maturity securities, mortgage loans, limited partnerships and other investments, as follows:

(In Millions) **YEARS ENDING DECEMBER 31:**

2009	\$ 1,148
2010 through 2013	841
2014 and thereafter	193
Total	\$ 2,182

The Company leases office facilities under various noncancelable operating leases. Rent expense, which is included in operating and other expenses, in connection with these leases was \$12 million, \$13 million and \$12 million for the years ended December 31, 2008, 2007 and 2006, respectively. In connection with the group insurance transaction, PL&A is contingently liable until September 2009 for certain future rent and expense obligations, not to exceed \$16 million, related to an office lease that has been assigned to the buyer. Aggregate minimum future commitments are as follows:

(In Millions) **YEARS ENDING DECEMBER 31:**

2009	\$ 10
2010 through 2013	28
2014 and thereafter	3
Total	\$ 41

As of December 31, 2008, ACG has commitments with major aircraft manufacturers to purchase aircraft at an estimated delivery price of \$6,823 million with delivery from 2009 through 2017. Such purchase commitments may be funded:

- up to \$488 million in less than one year,
- an additional \$1,734 million in one to three years,
- an additional \$2,222 million in three to five years, and
- an additional \$2,141 million thereafter.

As of December 31, 2008, deposits related to these agreements totaled \$238 million and are included in other assets.

In connection with an acquisition in 2005, ACG assumed residual value support agreements with expiration dates ranging from 2008 to 2015. The gross remaining residual value exposure under these agreements was \$99 million and \$129 million as of December 31, 2008 and 2007, respectively. As of December 31, 2007, ACG estimated its liability under these agreements to be \$9 million. During calendar year 2008, the \$9 million estimated liability was extinguished and recorded to other income as a result of terminating events by the counterparties to the residual value support agreements. As of December 31, 2008, the Company has estimated that it has no measurable liability under the remaining residual value guarantee agreements.

As of December 31, 2008, Pacific Asset Funding, LLC, a wholly owned subsidiary, had credit limits available to various clients amounting to \$805 million. These companies had utilized approximately \$278 million of these credit limits as of December 31, 2008, of which \$234 million was funded in the form of notes receivable, inventory and trade receivables and \$43 million in the form of letters of credit and other commitments.

In connection with the reinsurance of no lapse guaranteed rider benefits from Pacific Life to PAR Bermuda, Pacific LifeCorp entered into a three year credit agreement with a group of banks in March 2006. This agreement allows for the issuance of letters of credit of up to \$250 million. As of December 31, 2008, a letter of credit totaling \$240 million had been issued from this facility in which Pacific LifeCorp and PAR Bermuda are co-applicants. This letter of credit will expire in March 2009, and is expected to be replaced with a similar letter of credit facility. In addition, Pacific LifeCorp and PAR Vermont are co-applicants on a five year level letter of credit from a commercial bank amounting to \$55 million as of December 31, 2008. This letter of credit will expire in December 2012.

In connection with the acquisition of Pacific Life Re Limited (Pacific Life Re), Pacific LifeCorp provided a guarantee for the performance of certain obligations of Pacific Life Re. In addition, Pacific LifeCorp provided indemnification for certain matters, as set forth in the purchase agreement. As stated in the guarantee agreement, if Pacific Life Re is unable to meet its current obligations under unaffiliated reinsurance agreements, Pacific LifeCorp shall guarantee payment on any past, present and future obligations of Pacific Life Re. Management believes that any additional obligations, if any, related to the guarantee agreement are not likely to have a material adverse effect on the Company's condensed consolidated financial statements.

CONTINGENCIES: LITIGATION During the year ended December 31, 2007, Pacific Life settled a national class action lawsuit, *Cooper v. Pacific Life*, for a combination of cash distributions and contract credits to owners of qualified annuity contracts who purchased their contracts between August 19, 1998, and April 30, 2002, or paid premium payments during that time period. Pacific Life strongly disagreed with the claims in the lawsuit. The settlement is not considered an admission or concession with respect to any claims made in the lawsuit and did not have a material adverse effect on the Company's condensed consolidated financial position. Distributions were made to eligible class members in the first quarter of 2008 in accordance with the terms of the settlement agreement.

The Company is a respondent in a number of other legal proceedings, some of which involve allegations for extra-contractual damages. Although the Company is confident of its position in these matters, success is not a certainty and it is possible that in any case a judge or jury could rule against the Company. In the opinion of management, the outcome of such proceedings is not likely to have a material adverse effect on the Company's condensed consolidated financial position. The Company believes adequate provision has been made in its condensed consolidated financial statements for all probable and estimable losses for litigation claims against the Company.

CONTINGENCIES: IRS REVENUE RULING On August 16, 2007, the IRS issued Revenue Ruling 2007-54, which provided the IRS' interpretation of tax law regarding the computation of the Company's DRD. On September 25, 2007, the IRS issued Revenue Ruling 2007-61, which suspended Revenue Ruling 2007-54 and indicated the IRS would address the proper interpretation of tax law in a regulation project that has been added to the IRS' priority guidance plan. If, after public notice and comment, the IRS regulation project ultimately adopts the IRS' interpretation contained in Revenue Ruling 2007-54, the Company could lose a substantial amount of DRD tax benefits, which could have a material adverse effect on the Company's condensed consolidated financial statements.

CONTINGENCIES: OTHER In connection with the sale of certain broker-dealer subsidiaries, certain indemnifications triggered by breaches of representations, warranties or covenants were provided by the Company. Also, included in the indemnifications is indemnification for certain third-party claims arising from the normal operation of these broker-dealers prior to the closing and within the nine month period following the sale. Management believes that its exposure to loss, if any, is not likely to have a material adverse effect on the Company's condensed consolidated financial statements.

In connection with the sale of its entire ownership interest in an unconsolidated affiliate, ACG indemnified the buyer against losses which may arise from breaches of representations and warranties and from certain third-party claims. The indemnification protection is limited to the sales price and is the sole and exclusive remedy available under the agreement. Management believes that its exposure to loss, if any, is not likely to have a material adverse effect on the Company's condensed consolidated financial statements.

In the course of its business, the Company provides certain indemnifications related to other dispositions, acquisitions, investments, lease agreements or other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to time limitations that vary in duration, including contractual limitations and those that arise by operation of law, such as applicable statutes of limitation. Because the amounts of these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. The Company has not historically made material payments for these types of indemnifications. The estimated maximum potential amount of future payments under these obligations is not determinable due to the lack of a stated maximum liability for certain matters, and therefore, no related liability has been recorded. Management believes that judgments, if any, against the Company related to such matters are not likely to have a material adverse effect on the Company's condensed consolidated financial statements.

Most of the jurisdictions in which the Company is admitted to transact business require life insurance companies to participate in guaranty associations, which are organized to pay contractual benefits owed pursuant to insurance policies issued by insolvent life insurance companies. These associations levy assessments, up to prescribed limits, on all member companies in a particular state based on the proportionate share of premiums written by member companies in the lines of business in which the insolvent insurer operated. The Company has not received notification of any insolvency that is expected to result in a material guaranty fund assessment.

In relation to the Aviation Capital Group Trust II (ACG Trust II) securitization, the Company is contingently obligated to purchase certain notes from ACG Trust II to cover shortfalls in amounts due to the holders of the notes, up to certain levels as specified under the related agreements. As of December 31, 2008, the maximum potential amount of this future investment commitment was \$50 million.

The Asset Purchase Agreements of Aviation Trust, ACG Trust II and ACG Trust III provide that Pacific LifeCorp will guarantee the performance of certain obligations of ACG, as well as provide certain indemnifications, and that Pacific Life will assume certain obligations of ACG arising from the breach of certain representations and warranties under the Asset Purchase Agreements. Management believes that obligations, if any, related to these guarantees are not likely to have a material adverse effect on the Company's condensed consolidated financial statements. The financial debt obligations of Aviation Trust, ACG Trust II and ACG Trust III are non-recourse to the Company and are not guaranteed by the Company.

In connection with the operations of certain subsidiaries, the Company has made commitments to provide for additional capital funding as may be required.

See Note 5 for discussion of contingencies related to derivative instruments.

See Note 9 for discussion of other contingencies related to income taxes.

INDEPENDENT AUDITORS' REPORT

Pacific Mutual Holding Company and Subsidiaries:

We have audited the consolidated statements of financial condition of Pacific Mutual Holding Company and Subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations and members' equity and cash flows for each of the three years in the period ended December 31, 2008. Such consolidated financial statements and our report thereon dated March 5, 2009, expressing an unqualified opinion (which are not included herein) are included in the Company's annual filings made with the Insurance Department of the State of Nebraska. The accompanying condensed consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on such condensed consolidated financial statements in relation to the complete consolidated financial statements.

In our opinion, the information set forth in the accompanying condensed consolidated statements of financial condition of Pacific Mutual Holding Company and Subsidiaries as of December 31, 2008 and 2007, and the related condensed consolidated statements of operations and members' equity and cash flows for each of the three years in the period ended December 31, 2008, is fairly stated in all material respects in relation to the consolidated financial statements from which it has been derived.

As discussed in Note 1 to the condensed consolidated financial statements, in 2007 the Company changed its method of accounting and reporting for deferred acquisition costs in connection with modifications or exchanges of insurance contracts and for defined benefit pension and other postretirement plans.

Also, as discussed in Note 1 to the condensed consolidated financial statements, the accompanying condensed consolidated financial statements have been reclassified to give effect to broker-dealer discontinued operations.

Deloitte & Touche LLP

Costa Mesa, California
March 5, 2009

STATEMENT OF MANAGEMENT'S RESPONSIBILITY

The management of Pacific Mutual Holding Company and Subsidiaries (the Company) assumes responsibility for the preparation of the accompanying condensed consolidated financial statements and for all other information in this report to members. This responsibility includes maintaining the integrity and objectivity of all such information. The financial statements include amounts that are based on management's best estimates and judgments. The accompanying condensed consolidated financial statements are derived from consolidated financial statements that have been audited by Deloitte & Touche LLP, independent auditors. Their audits were conducted in accordance with auditing standards generally accepted in the United States of America and included consideration of internal controls and tests of transactions as part of planning and performing their audits.

The Company is committed to maintaining internal controls that provide reasonable assurance that assets are safeguarded and that transactions are properly executed and recorded in accordance with management's authorization. Internal controls are supported by appropriate divisions of responsibilities and separation of duties, specified delegations of authority, established policies and procedures that are clearly communicated, including a code of business conduct to foster a strong ethical climate, and the careful selection, training, and development of employees. A responsibility telephone line is available to all employees to anonymously report suspected violations of the code of business conduct. An internal audit department independently assesses the adequacy and effectiveness of internal controls and recommends possible improvements thereto. Management considers the recommendations of the internal auditors and Deloitte & Touche LLP concerning internal controls and takes appropriate actions to respond to these recommendations.

The Board of Directors of Pacific Mutual Holding Company has an audit committee composed entirely of external, independent directors who meet regularly with management, the internal auditors, and the independent auditors. Both the internal auditors and the independent auditors have direct access to and meet with the audit committee on a regular basis (or at a minimum at each audit committee meeting), without management representatives present, to discuss the scope and results of their audits, their views on the adequacy of internal controls, and the quality of financial reporting.

Finally, management also maintains policies to encourage a climate in which the Company's affairs are conducted in accordance with the highest standards of personal and professional conduct.

March 5, 2009

JAMES T. MORRIS

*Chairman, President and
Chief Executive Officer*

KHANH T. TRAN

*Executive Vice President and
Chief Financial Officer*

DIRECTORS

Mariann Byerwalter^{1, 2}

Chairman

JDN Corporate Advisory, LLC

Sharon A. Cheever³

*Senior Vice President and
General Counsel*

Pacific Life Insurance Company

Dwight W. Decker¹

*Retired Chairman and
Chief Executive Officer*
Conexant Systems, Inc.

Richard M. Ferry¹

Founder Chairman

Korn/Ferry International

John Gottschalk^{1, 2}

Chairman

Omaha World-Herald Company

Lawrence F. Harr³

Partner

Lamson, Dugan and Murray, LLP

Audrey L. Milfs³

Vice President and Secretary

Pacific Life Insurance Company

Jacqueline C. Morby^{1, 2}

Senior Advisor

TA Associates, Inc.

James T. Morris^{1, 2, 3}

Chairman, President and

Chief Executive Officer

Pacific Life Insurance Company

J. Fernando Niebla²

President

International Technology Partners, LLC

Susan Westerberg Prager¹

Executive Director,

Chief Executive Officer

Association of American Law Schools

Professor of Law and Dean, Emeritus

UCLA School of Law

J. Michael Shepherd^{1, 2}

President and

Chief Executive Officer

Bank of the West

Thomas C. Sutton^{1, 2}

Retired Chairman and

Chief Executive Officer

Pacific Life Insurance Company

William S. Thompson²

Retired Chief Executive Officer

PIMCO

Khanh T. Tran³

Executive Vice President and

Chief Financial Officer

Pacific Life Insurance Company

James R. Ukropina^{1, 2}

Chief Executive Officer

Directions, LLC

Dean A. Yoost²

Managing Partner (Retired)

PricewaterhouseCoopers

¹ Director of Pacific Mutual Holding Company

² Director of Pacific LifeCorp

³ Director of Pacific Life Insurance Company

CORPORATE SENIOR MANAGEMENT

James T. Morris, FSA
*Chairman, President and
Chief Executive Officer*

Mary Ann Brown, FSA
*Senior Vice President
Corporate Development*

Robert G. Haskell
*Senior Vice President
Public Affairs*

Khanh T. Tran
*Executive Vice President and
Chief Financial Officer*

Edward R. Byrd
*Senior Vice President and
Chief Accounting Officer*

Henry M. McMillan, PhD, FSA
*Senior Vice President and
Chief Risk Officer*

Anthony J. Bonno
*Senior Vice President
Human Resources and Facilities*

Sharon A. Cheever
*Senior Vice President and
General Counsel*

Andrew Oleksiw
*Senior Vice President
Business Development*

THE ANNUAL MEETING OF MEMBERS OF PACIFIC MUTUAL HOLDING COMPANY

(all life insurance and annuity policyholders of Pacific Life Insurance Company)
**will be held at 1:30 p.m. on May 20, 2009, at 700 Newport Center Drive,
Newport Beach, California, for the purpose of the election of directors and
for such other business as may properly come before the meeting.**

Audrey L. Milfs, Secretary

CONTACT INFORMATION

PACIFIC LIFE INSURANCE COMPANY/ PACIFIC LIFE & ANNUITY COMPANY

P.O. Box 9000
Newport Beach, CA 92658-9030
(800) 800-7646 / (949) 219-3011
E-mail: Info@PacificLife.com
www.PacificLife.com
www.PacificLifeandAnnuity.com

Life Insurance Division
45 Enterprise
Aliso Viejo, CA 92656-2601
(800) 800-7681 / (949) 420-6000

Annuities & Mutual Funds Division
(800) 722-4448

Investment Management Division
(800) 800-7646, ext. 3718

Real Estate Division
(800) 800-7646, ext. 4763

PRINCIPAL SUBSIDIARIES

Aviation Capital Group Corp.
610 Newport Center Drive, Suite 1400
Newport Beach, CA 92660-6465
(949) 219-4600
www.AviationCapitalGroup.com

Pacific Life Re Limited
Tower Bridge House
St. Katherine's Way
London E1W 1BA
+44 (0)20 7709 1700
www.PacificLifeRe.com

College Savings Bank
5 Vaughn Drive, Suite 100
Princeton, NJ 08540-6313
(800) 888-2723 / (609) 987-3700
www.CollegeSavings.com

Pacific Asset Funding, LLC
(800) 800-7646 / (949) 219-6493
www.PacificAssetFunding.com

Pacific Asset Management
(800) 800-7646 / (949) 219-1656
www.PAM.PacificLife.com

Pacific Select Distributors, Inc.
(800) 800-7646 / (949) 219-3881



PACIFIC MUTUAL

700 Newport Center Drive
Newport Beach, CA 92660-6397

www.PacificMutual.com

