MOODY'S INVESTORS SERVICE

Credit Opinion: Pacific Life Insurance Company

Global Credit Research - 07 Dec 2011

Nebraska, United States

Ratings

Category	Moody's Rating
Rating Outlook	STA
Insurance Financial Strength	A1
ST Insurance Financial Strength	P-1
Surplus Notes	A3 (hyb)
Commercial Paper	P-1
Pacific LifeCorp	
Rating Outlook	STA
Senior Unsecured	Baa1
Pacific Life & Annuity Company	
Rating Outlook	STA
Insurance Financial Strength	A1
Pacific Life Funding, LLC	
Rating Outlook	STA
Senior Unsecured	A1

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Key Indicators

Pacific Life Insurance Company[1]

	2010	2009	2008	2007	2006
Total Assets ($ Mil.)	$ 115,992	$ 109,954	$ 96,983	$ 111,024	$ 99,346
Shareholders' Equity ($ Mil.)	$ 7,543	$ 6,378	$ 4,332	$ 6,618	$ 6,204
Net Income ($ Mil.)	$ 532	$ 422	$ (291)	$ 686	$ 632
Total Revenues ($ Mil.)	$ 5,603	$ 5,211	$ 4,010	$ 5,049	$ 4,809
High Risk Assets % Shareholders' Equity	63.6%	69.2%	32.0%	48.5%	56.1%
Goodwill & Intangibles % Shareholders' Equity	61.0%	76.8%	117.1%	68.3%	69.2%
Shareholders' Equity % Total Assets	6.1%	5.4%	4.3%	5.7%	5.9%
Return on Capital (1 yr.)	5.9%	6.1%	-4.4%	9.2%	9.0%
Sharpe Ratio of ROC (5 yr.)	92.5%	96.1%	---	---	---
Adjusted Financial Leverage	23.4%	24.5%	21.3%	16.0%	15.2%
Total Leverage	23.4%	24.5%	21.3%	16.0%	15.2%
Earnings Coverage (1 yr.)	5.6x	7.1x	-9.0x	10.9x	13.2x
Cashflow Coverage (1 yr.)	12.1x	17.0x	5.3x	5.7x	6.2x

[1] Information based both on statutory/regulatory and GAAP financial statements

Opinion

SUMMARY RATING RATIONALE

Moody's A1 long-term insurance financial strength ratings of Pacific Life Insurance Company (Pacific Life) and its subsidiary, Pacific Life & Annuity Company (PL&A), and the Baa1 senior debt rating of its parent Pacific LifeCorp, are based on the companies' strong market position in the high end life insurance market, excellent capitalization, broad product distribution and good profitability. Pacific Life's excellent business profile includes established market positions in variable and universal life, and a more modest position in annuities. Pacific Life's P-1 short-term insurance financial strength rating is based on the company's excellent liquidity, careful liability management and access to alternative funding sources if necessary.

The company's strengths are somewhat offset by risks arising from the variable annuity (VA) business' sensitivity to equity market fluctuations, and to a lesser extent, exposure to credit losses in the investment portfolio, especially in residential mortgage backed securities (RMBS) and commercial mortgage loans.

Aviation Capital Group (ACG), its aircraft leasing subsidiary, has remained consistently profitable through difficult times for the airline industry and continues to deliver favorable results even in the current challenging environment.

PL&A's A1 IFS rating is based on the commonality of the operations of this subsidiary with its parent, Pacific Life: shared name, products, management and distribution among other key factors.

Credit Strengths

Pacific Life's credit strengths include:

- Excellent capitalization

- Established market positions in variable and universal life and VAs

- Broad and balanced independent distribution

Credit Challenges

Pacific Life's credit challenges include:

- High degree of sensitivity of regulatory capital, earnings, asset-based revenue, and GAAP equity to equity market movements

- Guarantees on VAs that are challenging to hedge

- The potential for incurring credit losses in a stress scenario

- Strong competition in core affluent business and professional life insurance markets

Rating Outlook

The outlook on Pacific Life is stable.

What to Watch For

- Volatility in RBC ratio from Pacific Life's VA products with guarantees

- Diversification of product sales away from variable annuities

What Could Change the Rating - Up

Factors that could cause Pacific Life's ratings to be upgraded include:

- Reduced capital and earnings sensitivity to capital market movements

- GAAP return on capital is above 8%

- Adjusted financial leverage below 20% (was 23% as of 12/31/10) and earnings coverage is consistently above 8x (was 5.6x in 2010).

What Could Change the Rating - Down

Factors that could cause Pacific Life's ratings to be lowered include:

- NAIC company action level RBC ratio falls below 325% (was 617% as of 12/31/10)

- Adjusted financial leverage exceeds 30%

- Investment losses (credit related) exceed $750 million pre-tax in 2012.

Notching Considerations

The spread between Pacific LifeCorp's senior debt rating and the IFS ratings of Pacific Life is three notches, consistent with Moody's typical notching spread for U.S. insurance holding company structures. Pacific Life also has surplus notes outstanding with a rating of A3, which is consistent with Moody's standard practice of notching life insurer's surplus note ratings two notches below the insurance financial strength rating of the insurer issuing the surplus note.

Recent Results and Company Events

Pacific Life reported statutory net loss for the first nine months ended September 30,2011 of $950 million, compared to net income of $384 million for the same period in 2010. The loss reported for YTD Q3 2011 was partially offset by an unrealized gains of $623 million (principally from derivatives), which is reflected in statutory capital, but not in net income. The reduction in net income--after adjusting for the unrealized gains--was driven by a decline in the S&P 500 in Q3 2011 as well as the decline in risk free interest rates, the combination of which drove an increase in statutory reserves associated with variable annuities.

Statutory surplus at Pacific Life, excluding the asset valuation reserve, was $5.2 billion at September 30, 2011 down from $5.8 billion at December 31, 2010. The decline was primarily due to the statutory net loss during Q3 2011. The asset valuation reserve also increased by approximately $374 million resulting in a reduction of statutory capital of approximately $200 million from year-end.

On 1 August 2011, Pacific Life, announced that it acquired JP Morgan Chase & Co's (Aa3 negative) US Pension Advisory Group. Terms of the deal were not disclosed. On 18 July 2011, Pacific Life announced that it agreed to buy Manulife Financial Corporation's (Manulife, not rated) life retrocession business. Terms of the deal, which closed in the third quarter of 2011, were not disclosed. Both deals were credit positive for Pacific Life since they use a portion of its excess capital to diversify its earnings stream and strengthen its institutional investments' franchise (see "Moody's Weekly Credit Outlook" dated August 8, 2011 and "Moody's Weekly Credit Outlook" dated July 25, 2011 for further details).

DETAILED RATING CONSIDERATIONS

Moody's rates Pacific Life A1 for insurance financial strength, which is in line with the rating indicated by the Moody's insurance financial strength adjusted rating scorecard.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

Factor 1 - Market Position and Brand: Aa

We have adjusted this factor to Aa from the unadjusted scorecard result of A due to the company's strong, focused position in the high end life insurance market serving the very affluent and business markets. With the company having leading market shares in both the individual life insurance and VA segments, Moody's views Pacific Life's market position and brand as being excellent. Pacific Life's market position is especially strong in the universal life and variable universal life insurance segments. As of December 31, 2010, Pacific Life was the 13th largest U.S life insurance company ranked by assets and was the 4th largest organized as a mutual or mutual holding company.

Factor 2 - Distribution: A

Pacific Life relies primarily upon a wide variety of third-parties such as independent agents, financial advisors, banks and registered representatives for its life insurance product distribution. As a result, Pacific Life maintains less direct control over its distribution and could see relatively lower persistency and more volatile sales for its third-party sold products than those companies with more control over their distribution systems. However, Pacific Life also benefits from a strong market breadth in most major channels other than career agents, resulting in a Aa score for diversity of distribution. Pacific Life also has long standing relationships with many key distributors, and a reputation for excellent customer service that benefits the company in the market, increasing its sustainability in the independent channels. Overall, Moody's views Pacific Life's distribution as consistent with A-rated insurance companies and we have left this factor at the unadjusted scorecard result of A.

Factor 3 - Product Focus and Diversification: A

Pacific Life has a very diverse set of product offerings in life and annuity markets, including fixed and variable products, as well as institutionally oriented products. Pacific Life is particularly strong in serving the high net-worth life insurance market and benefits from very strong persistency on its products. Virtually all of Pacific Life's life insurance business is of the non-participating variety. Pacific Life benefits from a good balance between fixed and variable products although until recently VA business had been becoming an ever larger part of the company. Moody's views Pacific Life's product focus and diversification as consistent with A-rated insurance companies and we have left this factor at the unadjusted scorecard result of A.

Factor 4 - Asset Quality: A

Pacific Life's general account investment portfolio consists primarily of fixed-income securities and commercial mortgages. As of the end of 2010, Pacific Life's ratio of high risk assets as a percentage of shareholders' equity was 64%, consistent with a A score. These high risk assets are approximately half invested in below investment grade debt, with the remainder split among equities, alternative investments and real estate. Goodwill and other intangibles are equal to 61% of shareholders' equity (year-end 2010), consistent with a Ba score, but virtually all of these intangibles are deferred acquisition costs (DAC) resulting from sales of insurance products to clients, which we believe to be of higher quality than goodwill because of the greater likelihood that DAC will eventually be converted into tangible equity as profits net of DAC amortization flow through income.

On a GAAP basis, the company incurred $44 million of pre-tax, other than temporary impairments during the first nine months of 2011. The company reported $113 million of impairments for 2010. The majority of these impairments, which are in line with our expectations, arose from investments in RMBS. Moody's expects additional impairments to be incurred during 2012, but at a modest level.

The company has manageable exposure to the peripheral Euro area. As of June 30, 2011 (the last time this was reported) the company held approximately 1.4% of its total investments ($46 billion) in Ireland, Spain, Italy, Portugal or Greece. Exposure to below investment grade bonds in the corporate portfolio was approximately 6%.

Pacific Life has exposure to a portfolio of commercial mortgage loans and commercial mortgage-backed securities (CMBS). The company's commercial mortgage portfolio is heavily concentrated in hotels, resorts and golf courses and includes constructions loans on high end apartments, making it atypical for a life insurer. These portfolios have performed well to date.

We have left the score on this factor to A, unchanged from the unadjusted scorecard result.

Factor 5 - Capital Adequacy: Aa

Pacific Life has adequate capital adequacy, as measured by capital as a percentage of total assets of 6.1% as of year-end 2010, which is in line with Moody's expectation for a A rated company. However, for U.S. firms we consider the NAIC company action level RBC ratio to be a more reliable measure of a U.S. insurer's capital adequacy. Pacific Life's NAIC RBC ratio was 617% as of year-end 2010, which is well above our minimum expectation for life insurers rated Aaa, but this metric has been quite volatile in recent years in response to equity market movements.

Pacific Life has substantially expanded its equity hedging program in an effort to better stabilize its reported statutory capital position even when equity markets have major moves. That said, given that Pacific Life does not utilize a captive, like many of its peers, its required capital, the denominator of the RBC ratio, and hence its RBC ratio, has been volatile. Moody's will focus on the economic capital needed to support the VA business; however, Pacific Life's ability to stabilize its reported amount of capital and the RBC ratio, even if equity markets exhibit major movements, will be a major factor in the company's ability to maintain an overall A1 rating. Given new hedges added in Q3 2011, Pacific Life's RBC should be less sensitive to more dramatic down movements in the S&P 500.

We believe that Pacific Life is best positioned in the Aa range on this factor given its high level of reported capital, partially offset by its high degree of sensitivity to equity markets. We have consequently raised this factor score to Aa from the unadjusted scorecard result of A.

Factor 6 - Profitability: A

Moody's considers Pacific Life's level of profitability to be good. However, the company's earnings have been more volatile than we expect from an A rated company. This volatility is primarily due to the Retirement Solutions ("RSD") segment's high degree of equity market sensitivity, stemming from both changes in the level of reserves required to support VA product guarantees and fluctuations in product related fees earned.

Pacific Life has been addressing RSD's sensitivity to equity market fluctuations through several coordinated efforts including: (1) an expanded hedging program that actively uses derivatives to offset some of the VA block's inherent equity market sensitivity; (2) increased customer asset diversification requirements and product redesigns that both reduce its equity market sensitivity; (3) reinsurance that transfers some of the equity market risk to third parties; and (4) a heavier emphasis on fixed annuities, which are not sensitive to equity market movements. Moody's believes that RSD's earnings will continue to be sensitive to equity market movements, but these changes should serve to reduce its sensitivity to future market fluctuations over the long run. However, this reduced sensitivity comes at the cost of a reduced level of expected earnings as these efforts will also reduce the business' expected profitability.

The Investment Management segment has also been sensitive to credit market losses. This segment is being deemphasized by Pacific Life and should consequently be a less important factor in the future. We expect that Pacific Life's future profitability will be somewhat less sensitive to equity market fluctuations, so we have adjusted the score on this factor to A from the unadjusted scorecard result of Baa.

Factor 7 - Liquidity and Asset/Liability Management (ALM): A

Moody's believes that Pacific Life has excellent liquidity to meet its near-term policyholder obligations based on the unadjusted scorecard metric, and this is supported by a stable liability profile (excluding VA guarantees). Pacific Life's institutional products (IIP) business is basically in runoff at this time. Moody's believes the company has ample liquidity to manage through a stressful liquidity scenario. Aside from liquid assets the company has a $400 million committed bank credit facility and a $750 million credit facility at the holdco. Pacific Life also maintains a membership in the Federal Home Loan Bank system, which can supply liquidity when needed if the company has available additional unpledged collateral.

Appropriately managing the risks assumed from a book of VAs containing embedded guarantees is a challenging task at best and is subject to model errors, difficulty in predicting clients' behavior and market disruptions. We have consequently lowered Pacific Life's rating on this factor to A from the Aa raw scorecard score due to these challenges.

Factor 8 - Financial Flexibility: A

Pacific Life's adjusted financial leverage (23% at December 31, 2010) is consistent with a Aa rating and has increased considerably in recent years as the company has been issuing additional debt. The company's financial leverage has remained relatively stable during 2011, ignoring the impacts of the increase in AOCI due to declining interest rates.

Cash flow coverage in 2010 was very strong at 12x, 1.5 times the minimum for a Aaa score. During 2011, Pacific Life has the ability to pay $688 million in dividends to its holding company; as of Q3 2011 it had paid $125 million. Compared to 2010, earnings coverage declined through the first three quarters of 2011, the result of the decline in GAAP earnings discussed above. In 2010 earnings interest coverage was 5.6x--at the lower A level. We anticipate earnings coverage to stay within the A range of 4x-8x in 2012. As of Q3 2011, the company held $13 million cash at the holdco relative to their anticipated annual interest expense of $67 million, of which $27 million is covered by interest income received from an internal surplus note issued by Pacific Life. To support any cash needs, the holdco may draw from its $750 million committed bank credit facility and dividend payments received from Pacific Life. We expect operating company dividends to improve the holding company cash position from the levels as of the end of Q3 2011.

Given the company is organized in a mutual holding company structure, we believe that raising external equity is not a realistic alternative for the company. Overall, we believe that Pacific Life's is best positioned in the A range for financial flexibility given its relatively high amount of leverage and lack of access to equity markets. We expect that future coverage ratios will be down from past levels given the increased level of debt the company supports.

Rating Factors

Pacific Life Insurance Company

Financial Strength Rating Scorecard [1][2]	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**B**	**Caa**	**Score**	**Adjusted Score**
Business Profile								**A**	**A**
Market Position and Brand (15%)								**A**	**Aa**
Relative Market Share Ratio			**X**						
Distribution (10%)								**A**	**A**
Distribution Control			**X**						
Diversity of Distribution			**X**						
Product Focus and Diversification (10%)								**A**	**A**

Product Risk			X						
Life Insurance Product Diversification			X						
Financial Profile								**A**	**A**
Asset Quality (10%)								**A**	**A**
High Risk Assets % Shareholders' Equity			**63.6%**						
Goodwill & Intangibles % Shareholders' Equity					**61.0%**				
Capital Adequacy (15%)								**A**	**Aa**
Shareholders' Equity % Total Assets			**6.1%**						
Profitability (15%)								**Baa**	**A**
Return on Capital (5 yr. avg)			**5.2%**						
Sharpe Ratio of ROC (5 yr. avg)					**92.5%**				
Liquidity and Asset/Liability Management (10%)								**Aa**	**A**
Liquid Assets % Liquid Liabilities		**X**							
Financial Flexibility (15%)								**Aa**	**A**
Adjusted Financial Leverage		**23.4%**							
Total Leverage		**23.4%**							
Earnings Coverage (5 yr. avg)			**5.5x**						
Cashflow Coverage (5 yr. avg)	**9.3x**								
Operating Environment (0%)								**Aaa - A**	**Aaa - A**
Aggregate Profile								**A2**	**A1**

[1] Information based both on statutory/regulatory and GAAP financial statements [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis