

Pacific LifeCorp And Its U.S. Insurance Operations

Major Rating Factors

Strengths:

- Very strong competitive position in the affluent market, with robust individual life and individual annuity businesses.
- Stable life insurance returns, with a long-track record of favorable mortality and persistency.
- Very strong liquidity and a diverse business mix.

Weaknesses:

- High investment risk, particularly related to commercial real estate loans and residential mortgage-backed securities (RMBS) investments, which could lead to outsized losses and weaken capital adequacy under distressed market conditions.
- Volatile operating performance that is sensitive to movements in equity markets.
- Limited external financial flexibility and low fixed-charge coverage.

Rationale

The insurer financial strength ratings on Pacific Life Insurance Co. and Pacific Life & Annuity Co. (collectively referred to as Pacific Life) and the counterparty credit rating on Pacific LifeCorp (PLC) reflect Pacific Life's sustained competitive position in the U.S. individual life and individual annuity marketplace and stable liquidity profile. Partially offsetting these strengths is the company's exposure to commercial mortgage loans, which could experience elevated losses over the next two years under distressed market conditions and could put downward pressure on capital levels. In our view, the company's holdings of construction loans and high-end resorts/hotels have the potential for high losses in a stressed economic

Holding Company:

Pacific LifeCorp

Counterparty Credit Rating

Local Currency

BBB+/Stable/—

Operating Companies Covered By
This Report

Financial Strength Rating

Local Currency

A+/Stable/—

Primary Credit Analysts:

Jeff Watson
San Francisco
(1) 415-371-5018
jeff_watson@
standardandpoors.com

RatingsDirect
Publication Date

June 16, 2010

environment. The sensitivity of Pacific Life's operating performance to equity markets and the ongoing competitive pressures within the U.S. insurance market will continue to challenge the insurer's ability to maintain its top sales positions while sustaining price discipline.

Factors Specific To Holding Company

PLC is an intermediary holding company held directly by Pacific Mutual Holding Co. As a holding company, PLC relies largely on cash flows it receives from its operating subsidiaries to meet its obligations, including the payment of interest and principal on debt and other expenses. The company's primary source of cash flow comes from earnings generated by its U.S. insurance operations, most notably from Pacific Life Insurance Co. (PLIC). The standard notching between the holding company and the operating company reflects Standard & Poor's Ratings Services' prevailing view of normal regulatory limitations on the movement of funds between subsidiary and parent.

The holding company has a low appetite for operating dividends, and we do not expect it to demand much capital from its subsidiaries over the next two years. PLC's largest expense is its annual debt service of approximately \$70 million, with few other expenses. Consequently, the vast majority of the group's earnings have historically remained at the insurance operating companies, which has provided the capital necessary to finance above-average sales growth. We expect very little dividends to PLC during the next few years as the group preserves and rebuilds operating-company capital.

PLC also benefits from steady cash flows from Aviation Capital Group (ACG), which contributes approximately \$80 million annually in earnings and has historically added some liquidity and flexibility to the holding company outside of the regulatory framework. At year-end 2009, however, PLC transferred its ownership of ACG to PLIC, which could somewhat restrict ACG's cash-flow contribution to PLC prospectively. Still, the incremental cash flows will remain within the Pacific Life family and should, if less directly, continue to benefit the holding company.

At year-end 2009, PLC's consolidated debt leverage was 26.9%, and consolidated fixed-charge coverage was approximately 7x. However, in February 2010, PLC issued a \$450 million senior note, which increased financial leverage to 30.4%. As a result of higher financial leverage, combined with our expectation of restrained earnings over the next two years, we expect interest coverage to drop to about 4x in 2010, which we consider low for the rating. The operating subsidiaries hold most of the leverage, and we expect the weakness in coverage to be temporary as earnings stabilize and slowly rebound from early 2009 lows.

In addition to the \$450 million note issued in 2010, PLC also has outstanding a \$600 million senior note (issued in 2003) that matures in September 2033 and a revolving credit facility with various banks for \$500 million (\$220 million outstanding at year-end 2009). Although the credit facility matures in 2011, the flexibility it affords enhances PLC's liquidity by ensuring timely access to funds as unforeseen needs arise.

Most of the other debt on PLC's consolidated balance sheet is nonrecourse to PLC and is made up of operational leverage at various subsidiaries within the PLC corporate family. ACG issued the bulk of this nonrecourse debt (approximately \$4.5 billion), which it uses to finance its aircraft leasing business. Standard & Poor's views this debt as operational leverage and does not include the debt or interest expense in its calculation of PLC's financial leverage and interest coverage.

Chart 1

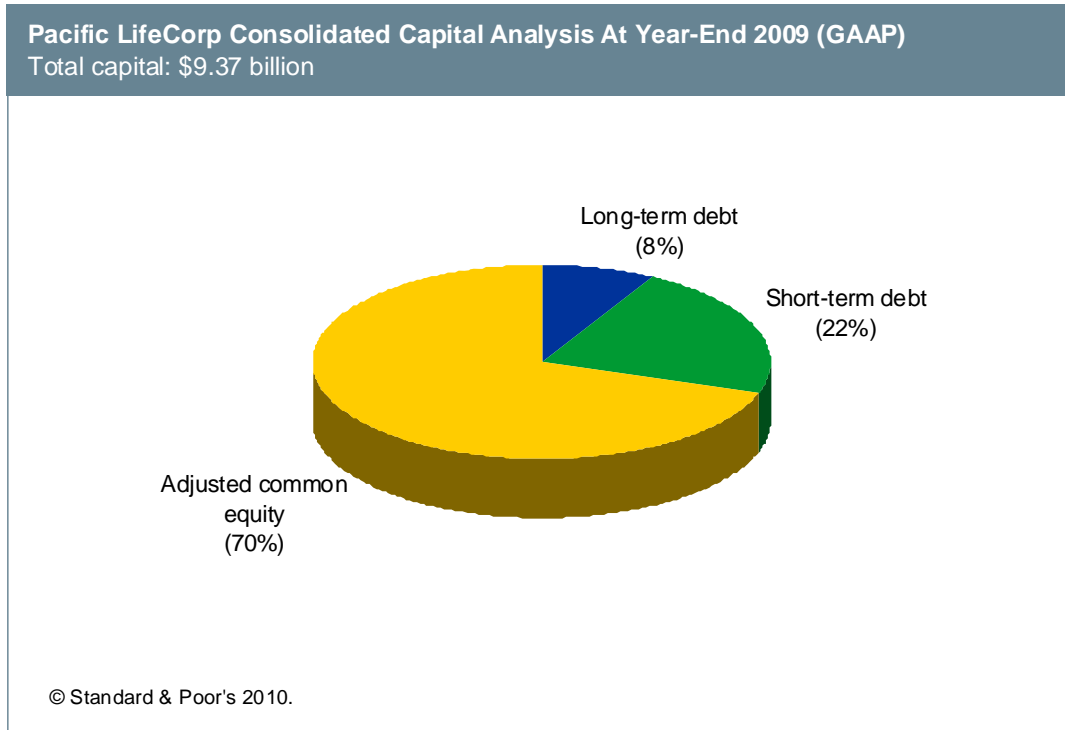


Chart 2

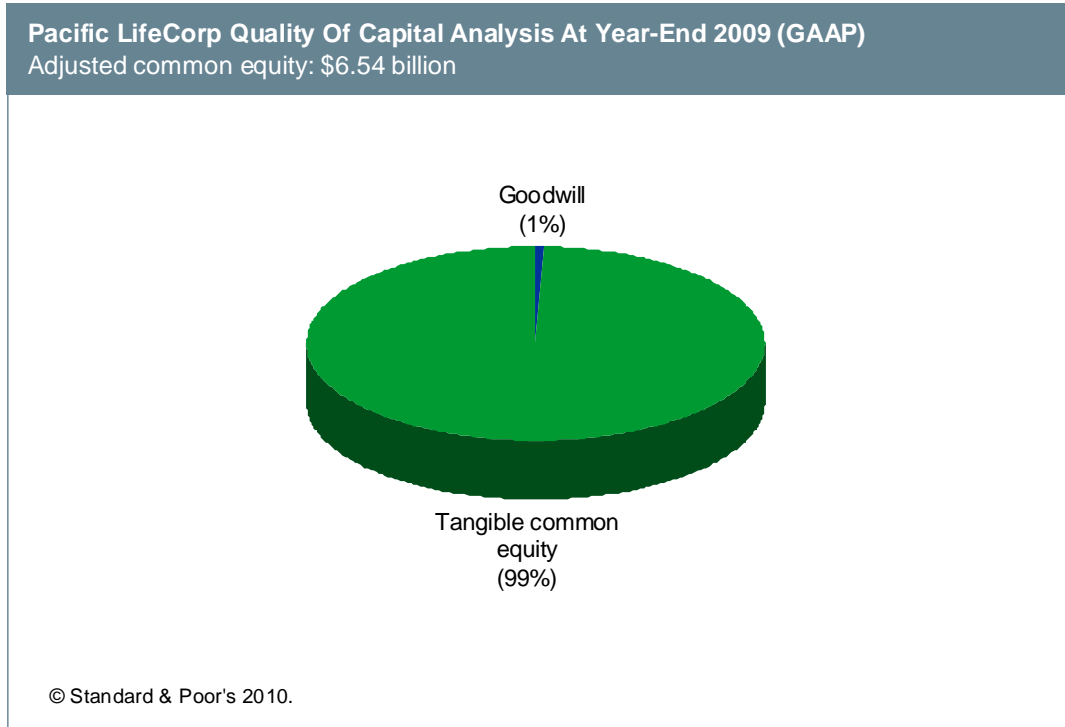


Table 1

Pacific LifeCorp/Financial Statistics					
	—Year ended Dec. 31—				
	2009	2008	2007	2006	2005
Debt to total capital (%)	27.0	19.1	17.5	15.9	16.7
Debt plus preferred plus hybrid to total capital (%)	27.0	19.1	17.5	15.9	16.7
GAAP interest coverage (excluding realized capital gains) (x)	6.7	9.4	11.2	12.7	9.1
Statutory interest coverage (x)	4.2	6.2	5.8	4.5	5.3

Outlook

The stable outlook reflects our expectation that current capital levels are sufficient to support elevated credit losses over the next two years at our 'A' confidence level. Notwithstanding these potential investment losses, capital levels likely will remain more stable, in part because of the company's revised hedging program, which is designed to limit the capital volatility associated with swings in equity markets. GAAP operating EBIT will likely total more than \$700 million in 2010.

We could lower the ratings if GAAP operating EBIT declines and pushes fixed-charge coverage to significantly less than 4x, if actual investment losses outstrip our incremental stress factors and weaken capital adequacy to levels below expectations for the 'A' rating category, or if Pacific Life's very strong competitive profile deteriorates. We could raise the ratings if investment performance materially improves above current expectations, if the company is able to achieve sustainable levels of fixed-charge coverage (of more than 6x) considering the embedded volatility of earnings, and if capital adequacy improves to levels in line with the 'AA' rating category.

Competitive Position: Very Strong, With Leading Positions In Its Key Markets

Pacific Life's competitive position is very strong and a significant strength to the rating. The company maintains solid and diverse distribution relationships, strong market share in its protection and wealth accumulation businesses, and innovative and competitive products.

Table 2

Pacific Life/Selected Statistics					
	—Year ended Dec. 31—				
(Mil. \$)	2009	2008	2007	2006	2005
Capital adequacy ratio (%)	N.A.	N.A.	N.A.	274.7	302.9
Statutory earnings adequacy ratio (%)	N.A.	N.A.	165.8	391.2	440.8
Liquidity ratio (%)	N.A.	245.0	273.7	271.9	278.3
Total assets (including separate accounts)	98,277.6	85,868.5	98,597.4	87,629.1	76,032.1
Total premiums and considerations	9,384.0	8,379.9	9,947.4	10,686.6	9,785.7
Pretax income	743.8	(1,601.8)	360.7	440.7	201.1
Total adjusted capital (including asset valuation reserve)	5,137.6	3,555.5	4,131.4	3,593.9	3,409.1

N.A.—Not available.

Table 3

Pacific Life/Business Statistics					
	—Year ended Dec. 31—				
(Mil. \$)	2009	2008	2007	2006	2005
Total revenue	11,189.9	15,684.5	16,917.3	15,146.0	12,300.8
Total premiums and considerations	9,384.0	8,379.9	9,947.4	10,686.6	9,785.7
Premium revenue increase (%)	12.0	(15.8)	(6.9)	9.2	1.0
Deposits	169.9	1,099.1	2,228.4	1,075.4	1,418.8
Total premiums, considerations, and deposits	9,553.9	9,479.0	12,175.8	11,762.0	11,204.5
Premiums, consideration, and deposit revenue increase (%)	0.8	(22.1)	3.5	5.0	(0.9)
Net first-year premiums	6,234.8	4,397.1	5,904.5	7,243.1	6,430.8
Net first-year increase (%)	41.8	(25.5)	(18.5)	12.6	5.6
Net single premiums*	273.8	173.2	149.0	123.2	85.9
Net single increase (%)	58.1	16.2	20.9	43.5	121.1
Separate accounts assets	52,680.8	41,688.4	57,848.1	49,121.5	38,071.6
Increase in separate accounts assets (%)	26.4	(27.9)	17.8	29.0	18.6
Major lines					
Individual life	1,278.2	1,970.7	1,971.4	1,816.6	1,815.1
Individual annuities	6,952.4	5,283.8	7,516.0	8,713.3	7,339.2
Group life	(0.0)	0.0	(0.1)	(0.5)	3.2
Group annuities	1,153.4	1,125.3	460.1	158.0	424.2
Group accident and health	0.0	0.0	(0.0)	(0.8)	204.0
Deposits	169.9	1,099.1	2,228.4	1,075.4	1,418.8

Life insurance

Pacific Life targets upper-income individuals for estate planning and wealth accumulation. In its core life insurance division, the company has stayed competitive by focusing on strong distribution relationships with multiple independent channels and well-structured products. The quality of business continues to be favorable, with a history of strong persistency and mortality experience and average premium and face amounts consistently among the highest in the industry.

Pacific Life has maintained a Top 10 market share in individual life sales, fueled by organic growth. Despite a sales decline of 19% to \$282 million in 2009, Pacific Life's sales performance was stronger than industry averages, and the company continued to gain market share throughout the year. The mix of business is about 67% fixed-rate and 33% variable, with sales concentrated in universal life and variable universal life products.

The company has been very successful in penetrating the highly competitive affluent marketplace (average policy size of more than \$1.3 million) because of its unique and diverse distribution network. The company reaches its life insurance market through four primary channels:

- Independent producers. This channel consists of 27 regional life offices, which Pacific Life fully owns. The brokerage offices are located in major metropolitan areas and focused on the recruitment of seasoned independent producers to sell to the high-end market. This distribution network remains Pacific Life's most productive channel, generating about 65% of all new life sales in 2009.

- M Financial. This channel consists of independent producers from more than 100 offices nationwide. Pacific Life's relationship with M Financial dates back more than 20 years. Although we only expect M Financial to provide limited sales growth prospectively, the relationship has built a strong track record of very high-quality life business, with above-average mortality, persistency, and policy size. M Financial contributed approximately 11% of new life sales in 2009.
- National Financial Partners (NFP). NFP was formed by a group of insurance companies (of which Pacific Life has been a member since 2004) and is made up of independent insurance agents in 480 offices nationwide. The channel is expanding distribution capacity aggressively and presents an opportunity for sales growth.
- Brokerage/wirehouse. The fourth channel consists of national brokerage firms that, though only representing modest sales volume historically, have been growing rapidly in recent years and should continue to increase its penetration.

Retirement Solutions

The Retirement Solutions division emphasizes sales of annuities and mutual funds and has been highly concentrated in equity-sensitive products in recent years, predominantly variable annuities. The sharp decline in equity markets in 2008 and early 2009 put tremendous pressure on this line of business and has prompted the company to lower the risk of its variable annuity product portfolio, increase pricing, and pursue a more balanced mix of business (fixed versus variable). This constitutes a significant strategic shift in Pacific Life's product offerings, and the company has managed the transition fairly seamlessly through early 2010. Although we believe it will be challenging for the company to maintain its top-tier position in the annuity marketplace, we expect that its competitive position will remain strong based on the company's competitive and innovative product offerings, high service standards, and productive distribution.

Total annuity sales decreased to \$7.0 billion in 2009 from \$8.1 billion in 2008 and \$10.7 billion in 2007, largely reflecting the market disruption over the past 18 months. Historically, the vast majority of the annuity sales (more than 90%) were variable annuities. The company has reassessed its risk appetite and has increased prices and eliminated or de-risked several variable annuity benefits to reduce its exposure to another sharp drop in equity markets. In addition, the company is emphasizing its fixed annuity products to further mitigate its sensitivity to equity markets. We expect a roughly 50%/50% split between variable and fixed annuities.

Pacific Life's mutual fund business generated only \$445 million in gross sales in 2009 versus \$635 million in 2007. We view the mutual fund business as nonstrategic because of its lack of scale and prominence relative to the insurer's other businesses.

Prospective

Standard & Poor's expects Pacific Life to sustain its very strong competitive position within its key life and annuity lines of business. We expect the strong life franchise to offer stability as the company executes a more balanced mix of annuity business.

Management And Corporate Strategy: Shifting Product Mix And Reduced Risk Appetite

Following the recent turmoil in the global credit and equity markets, Pacific Life has conducted a thorough review of all lines of business and has implemented several strategic responses, including changes in pricing, risk management, capital management, and product mix. Although the company remains focused on its two core businesses—life insurance and annuities for high-net-worth individuals—management is now operating with a distinctly lower risk appetite, with a renewed emphasis on capital protection and less emphasis on sales growth.

Operational management

Pacific Life has demonstrated the ability to manage quality distribution, product innovation, and an efficient cost structure. Management has proven to be quite adept in executing high-level initiatives, such as the reorganization to a stock company under a mutual holding company in 1997, the acquisition of various blocks of business in the 1990s, the divestiture of its group health and other businesses in the 2000s, and the \$2.5 billion piecemeal sale of Pacific Investment Management Co. LLC, which concluded in 2008.

Financial management

The equity market downturn in 2008 and 2009 significantly affected Pacific Life as well as many of its peers. Falling equity markets caused a steep drop in capital and volatile earnings, primarily because of the company's concentration of variable annuities within its product profile. The company has revamped its variable annuity hedging strategy in the past several months, layering on additional macro-hedges, including swaps and put options, to protect its capital position. In addition, Pacific Life has aggressively replenished lost capital via \$1.45 billion in note issuances and has adjusted its risk appetite to reduce its exposure to another potential extreme equity tail event. Management seems content to deliver a somewhat lower return on equity in exchange for more capital stability. Although results will take time to materialize in operating performance, we expect the strategic shift to lead to a stable profile relative to the tremendous volatility seen over the past 18 months.

Management has a good track record of deploying capital efficiently and opportunistically harvesting appreciated assets. The parent company has avoided placing excessive dividend requirements on the life company by avoiding excessive holding-company leverage.

Enterprise Risk Management: An Important Rating Factor Because Of Company's Product Mix

We view Pacific Life's enterprise risk management (ERM) program as adequate but with strong risk controls for certain risks. Because the company is a leading national variable annuity and universal life insurance provider, ERM is much more important to its financial strength and rating structure than it is to the ratings on less-complex insurers. It is also more important given its aggressive risk profile.

We do not expect that Pacific Life will experience losses outside of normal range from traditional risk areas. The most important risk for Pacific Life is from equity market exposure from its variable annuity business. The company manages this risk through a combination of product design, customer investment selection, and an evolving hedging program. The hedge effectiveness has experienced volatility recently. Interest rate and credit risk exposures are much smaller than equity risk. Pacific Life

also has notable exposures to lapse and mortality risk but has a history of favorable performance. It manages lapse risk via product design and regular monitoring.

For variable annuity equity risks, Pacific Life has long encouraged utilization of portfolio allocation models, which have been extremely successful, with more than 90% utilization. These model portfolios provide Pacific Life with more predictability, which could drive lower hedging costs over time. The guaranteed benefits and fee income are hedged on an aggregate basis. Pacific Life rebalances the hedge positions as needed, with a primary focus on preserving statutory capital levels. It uses both short- and long-term hedges. The results have been somewhat volatile in recent quarters.

Collateralization of redundant regulatory reserves might prove to be a challenge, as options previously available from reinsurers or banks are no longer available.

Pacific Life's credit and interest rate risk management programs are strong and adequate, respectively. For credit risk, they have migrated to risk limits that are tied to high levels. In addition, they are in the process of implementing a total portfolio loss estimates tool to enhance their process. Information on credits from multiple sources feeds into an early warning system. Interest rate risk is managed in a series of separate portfolios for groups of similar products. There are clear duration targets for each portfolio, and they do attend to the interest rate sensitivity of the corporate surplus, which is the retained interest rate risk.

Pacific Life manages insurance and lapse risks through product design, underwriting, monitoring, and reinsurance, though mortality reinsurance has become more costly in the last 18 months. The company has generally experienced favorable results for these risks.

Pacific Life has a formalized enterprise-level risk infrastructure, with committees staffed by senior management. Those committees have well-defined risk accountabilities. The current approach to economic capital is not consistently applied across the enterprise and does not consider all of the sub-risk capitals typically addressed by peers with more advanced economic capital processes. However, plans are underway to further enhance the approach to economic capital measurement and risk aggregation. This should provide a more robust view of risk that should also help to provide a consistent and comprehensive basis for risk/reward decision-making over time.

Accounting

Standard & Poor's relies on audited statutory financial statements for the regulated insurance units and audited GAAP financial statements for PLC and its subsidiaries.

Standard & Poor's makes two material adjustments in its analysis of Pacific Life's leverage and capital position. First, we exclude all nonrecourse debt to Pacific Life and its parent, PLC, when calculating financial leverage. In 2009, PLC transferred ownership of ACG, an aircraft leasing company, to Pacific Life. ACG's nonrecourse debt of about \$4.5 billion is excluded in our calculation of consolidated financial leverage, which was 27% at year-end 2009. Following the February 2010 issuance of \$450 million of senior notes, consolidated financial leverage increased to almost 30% on a pro forma basis.

In addition, as a result of quality-of-capital considerations, we only allow up to 15% of operating company capital to be made up of surplus notes; we would view any amount in excess of 15% of capital as of lower quality and would remove it from total adjusted capital within our capital model. As a result of these criteria, we exclude approximately \$380 million of Pacific Life's operating-company total adjusted capital in our assessment of capital adequacy for year-end 2009.

Operating Performance: More Stable, Though Lower, Returns Prospectively

Pacific Life's operating performance has been volatile during the past 18 months as a result of its strong correlation to equity markets. The earnings sensitivity is largely concentrated in the company's variable annuity line of business, where the combination of lower fee-based income, increased costs associated with guaranteed living benefits, and increased hedging costs led to a sharp deterioration in performance in 2008 and 2009. Although GAAP net income could remain somewhat volatile, reflecting the company's over-hedged position to protect statutory capital, we expect operating earnings (excluding hedging activities and realized losses) to stabilize as we move through 2010 and 2011, as expense reductions and strategic initiatives take hold and as equity markets return to more normalized trends.

Table 4

Pacific Life/Summary Operating Statistics					
	—Year ended Dec. 31—				
(Mil. \$)	2009	2008	2007	2006	2005
Pretax income	743.8	(1,601.8)	360.7	440.7	201.1
Net income	769.4	(1,644.4)	364.1	367.9	271.4
Statutory earnings adequacy ratio (%)	N.A.	N.A.	N.A.	222.1	179.2
Return on revenue (%)	6.65	(10.21)	2.13	2.91	1.64
Return on assets (%)	0.81	(1.73)	0.39	0.54	0.28
Pretax statutory rate of return on capital (%)	N.A.	N.A.	N.A.	16.13	8.45
Pretax GAAP income	644.0	602.9	715.3	592.7	751.0
Pretax GAAP rate of return on capital (%)	N.A.	N.A.	N.A.	21.70	31.56
Pretax GAAP return on assets (%)	0.63	0.67	0.82	0.76	1.07

N.A.—Not available.

Table 5

Pacific Life/Operating Statistics					
	—Year ended Dec. 31—				
(Mil. \$)	2009	2008	2007	2006	2005
General expenses	519.0	510.1	616.5	635.9	623.9
General expense ratio (%)	4.8	3.9	3.9	4.8	5.3
Expense ratio (%)	11.8	11.6	10.8	12.8	12.7
Unit expenses (in whole dollars)	413.4	425.5	470.3	532.3	533.7
General expenses as a percentage of total assets	0.5	0.6	0.6	0.7	0.8
Commission ratio (%)	7.8	8.0	7.5	8.4	8.9
Lapse ratio (ordinary only) (%)	11.5	6.9	5.7	6.3	6.0
Mortality ratio (%)	412.3	384.0	388.6	328.2	284.0
Investment spread (%)	N.A.	4.5	2.7	2.6	2.8
Accident and health					
Loss ratio (%)	N.A.	N.A.	507.4	200.5	58.4
Expense ratio (%)	N.A.	N.A.	162.4	(95.7)	27.2
Combined ratio (%)	N.A.	N.A.	669.9	104.8	85.6

N.A.—Not available.

Pacific Life is pursuing a more balanced mix of annuity business, with an emphasis on driving more fixed annuity sales. Historically, at least 90% of the company's annuity sales have been in variable annuity products. This unbalanced product mix drove a tremendous increase in profitability during the strong equity market of 2004-2007; however, it also led to steep losses as equity markets plummeted in 2008 and 2009. In response, the company is targeting a more balanced split of fixed/variable annuity sales prospectively (it was 50%/50% in 2009) and has eliminated or reduced the risk of certain features of its variable product offerings. In addition, the company has layered on additional macro-hedges that, though offering capital protection if equity markets further decline, will also add expense and, consequently, will lower profitability. As a result of the new product mix, re-designed variable annuity offerings, and additional hedging activity, we expect prospective operating earnings to exhibit more stability, though returns will not be as strong as historical levels.

Notwithstanding the earnings volatility and weakness in Pacific Life's variable annuity business, the company's operating profile benefits from product diversification, sound underwriting, and good expense management. The company has achieved strong growth and very stable and high-quality earnings in its core life insurance business, bolstered by favorable mortality and persistency and strong underwriting discipline. The stable life insurance returns have helped partially offset the losses in the annuities and investment management divisions.

Pacific Life's GAAP net income improved to positive \$436 million in 2009 from negative \$288 million in 2008, mostly because of a lower level of realized losses in 2009 as equity markets rebounded. We expect that the company's GAAP earnings will continue to stabilize in 2010 to levels approaching \$500 million.

Prospective

We expect the company's operating performance to stabilize in 2010, reflecting more normalized equity markets. GAAP operating EBIT will likely be greater than \$700 million in 2010.

Investments: Strong Investment Management, But Exposure To Real Estate Assets Could Increase Investment Losses

Although we still view Pacific Life's investment and asset/liability management as strong, we consider it a weakness to the rating. The company maintains a disciplined investment strategy and has demonstrated a long track record of strong investment returns. Still, we view Pacific Life's investment risk as somewhat higher than peers' because of its concentration of investments in commercial and residential real estate assets that we believe could experience outsized losses under distressed market conditions.

Table 6

<i>Pacific Life/Investment Statistics</i>					
	<i>—Year ended Dec. 31—</i>				
<i>(Mil. \$)</i>	<i>2009</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>
Net investment income	773.0	3,192.5	2,321.6	2,207.6	2,193.5
Total invested assets	43,743.7	43,188.9	39,855.4	37,630.0	36,882.5
Net realized capital gains	28.5	(299.0)	8.3	45.7	36.1
Asset risk to invested assets (%)	N.A.	N.A.	3.7	3.3	2.7
High-risk assets to total invested assets (%)	9.4	7.9	7.9	7.6	7.2

Table 6

Pacific Life/Investment Statistics (cont.'d)					
	—Year ended Dec. 31—				
<i>(Mil. \$)</i>	2009	2008	2007	2006	2005
Net investment yield (%)	1.78	7.69	5.99	5.93	5.98
Five-year realized capital gains to invested assets (%)	0.02	0.04	0.14	(0.07)	(0.08)
Portfolio composition					
Cash, cash equivalents, and short-term investments (%)	3.9	7.4	0.9	0.1	1.5
Bonds (%)	45.8	41.8	50.1	52.3	56.1
Mortgage-backed securities (%)	14.6	15.3	15.2	13.0	11.2
Mortgages (%)	15.5	13.2	11.7	9.6	10.8
Policy loans (%)	14.9	16.0	16.1	16.1	16.0
Stocks (%)	2.0	2.1	1.8	2.0	0.9
Real estate (%)	0.5	0.5	0.5	0.3	0.3
Other (%)	2.8	3.6	3.7	6.6	3.2

N.A.—Not available.

In May 2010, we updated our stress factors within our capital adequacy model. (For further details of our methodology see, “Methodology For Incorporating Incremental Stress Factors Into The Capital Adequacy Analysis Of U.S. Insurers,” published on April 12, 2010.) Following this criteria application, we are cautious that Pacific Life’s sizeable exposure to commercial whole loans (\$6.8 billion) and non-agency RMBS (\$4.8 billion) could lead to a spike in investment losses over the next two to three years if economic conditions deteriorate further.

Pacific Life’s commercial whole loan portfolio is actively managed and has performed well historically, with very low losses over time. We view the company as a strong underwriter, with an emphasis on high debt-service coverage. However, the commercial loan portfolio has a concentration of very large loans, which are focused on loan types or properties types that we believe are most vulnerable to elevated losses in a weak economic climate, most notably holdings of construction loans and high-end resorts/hotels. Pacific Life’s \$6.8 billion portfolio includes \$2.4 billion in loans to resorts/hotels and \$1.8 billion in construction loans. As noted above, the portfolio is concentrated in very large loans, with approximately 50% of the portfolio made up of loans in excess of \$100 million. These concentrations within the portfolio could lead to more volatile and unfavorable loss performance relative to peers. Despite Pacific Life’s strong and active loan management, we believe the portfolio could underperform in the current environment and could lead to sizeable losses in a more stressed economic climate.

In addition to commercial real estate exposure, Pacific Life also holds a sizeable position in non-agency residential mortgage investments, including approximately \$3.4 billion of non-agency prime RMBS, \$1.0 billion of Alternative-A (Alt-A) RMBS, and \$450 million of subprime RMBS. Over the past 18 months, Pacific Life’s RMBS portfolio has experienced downward ratings migration, particularly in the Alt-A and prime sectors. The RMBS holdings are concentrated in the most distressed vintages (approximately 75% in 2005 or later vintages), which are experiencing the most loan defaults and home price declines. At year-end 2009, almost 50% of Pacific Life’s Alt-A and Prime RMBS were rated speculative grade. Standard & Poor’s performs a recovery analysis for each RMBS security within

the RMBS portfolio to assess the potential losses; we embed this recovery analysis within our capital adequacy analysis. Based on our review of the specific holdings within Pacific Life's RMBS portfolio, we believe total lifetime losses could reach 8% of its total exposure at our 'A' level of confidence, which, though in line with industry averages, is high relative to the company's capital levels.

The aggregate investment portfolio is made up of approximately 55% in fixed-income securities, 17% in policy loans, 14% in mortgage loans, 8% in cash, and less than 6% in private equity and common stock. Pacific Life's corporate bond portfolio is of high quality, primarily consisting of investment-grade public securities (less than 5% are speculative grade). Pacific Life's investment portfolio has produced very strong investment income and net investment yields, though they've been clearly lower than historical levels because of weakness in alternative investment income. Annual net investment income was about \$1.9 billion, and net investment yield for 2009 was a competitive 4.8%.

Standard & Poor's believes Pacific Life has sound asset/liability management practices. It structures its investment portfolios according to the maturity and liquidity requirements of the underlying insurance obligations. Pacific Life matches assets and liabilities on a duration basis. The company has good liability duration diversification, with solid institutional liability management.

Liquidity: Very Strong, With Most Contracts Not Surrenderable

Pacific Life's liquidity has been very strong in recent years. The insurer's Standard & Poor's consolidated liquidity ratio for year-end 2008 was very strong at 266%. The stand-alone liquidity profiles of both PLIC and Pacific Life & Annuity have both been very strong. Although investment-only GICs and funding agreements constitute 20% of consolidated reserves, the majority of these contracts are not surrenderable before maturity.

Table 7

Pacific Life/Liquidity And Reserves Statistics

<i>(Mil. \$)</i>	<i>—Year ended Dec. 31—</i>				
	<i>2009</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>
<i>Allocation of reserves</i>					
Individual life	47.3	46.1	48.1	48.2	47.9
Group life	0.0	0.0	0.0	0.0	0.0
Individual annuities	27.9	25.4	18.8	19.4	19.7
Group annuities (including guaranteed investment contracts)	10.6	8.2	7.2	8.6	9.8
Accident and health	0.0	0.0	0.0	0.0	0.0
Other	14.1	20.3	25.8	23.7	22.5
Liquidity ratio (%)	N.A.	245.0	273.7	271.9	278.3
Surrenderable annuities to total reserves (%)	N.A.	12.3	13.1	N.A.	N.A.
Liquid assets to total assets (%)	N.A.	46.7	46.3	50.8	N.A.

N.A.—Not available.

In addition, an authorized \$700 million commercial paper program and a \$400 million bank line of credit enhance liquidity. Pacific Life has additional borrowing capacity by being a member of the Federal Home Loan Bank (FHLB) system. At the end of 2009, the company had additional capacity (over \$100 million) under the FHLB program.

Capitalization: Capital Levels Have Been Volatile And Could Be Vulnerable Under Distressed Real Estate Market Conditions

Pacific Life's capital adequacy has weakened over the past 18 months. We consider it adequate for the ratings, but it is no longer a ratings strength. Capital levels have demonstrated tremendous volatility through the recent equity market downturn, primarily because of the strong correlation of the group's large variable annuity block of business to swings in the equity markets. We expect that Pacific Life's capital adequacy will remain under pressure, though we expect that it will exhibit more stability. The company has shifted its hedging program to protect capital levels from another sharp drop in equity markets. However, we expect elevated credit losses and muted statutory net income to limit the company's ability to increase capital levels significantly in the near term.

Table 8

<i>Pacific Life/Capitalization Statistics</i>					
	<i>—Year ended Dec. 31—</i>				
<i>(Mil. \$)</i>	<i>2009</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>
Total assets	98,277.6	86,156.3	98,597.4	87,629.1	76,032.1
General account assets	45,596.9	44,180.1	40,749.3	38,507.6	37,960.5
Total liabilities (excluding separate accounts and asset valuation reserve)	40,101.1	40,637.1	36,630.1	34,926.2	34,564.2
Total adjusted capital (including asset valuation reserve)	5,137.6	3,555.5	4,131.4	3,593.9	3,409.1
Unrealized capital gains	(1,114.0)	715.7	117.1	(35.9)	43.3
Capital adequacy ratio (%)	N.A.	N.A.	N.A.	274.7	302.9
Company action level to NAIC risk-based capital ratio (%)	559.2	566.0	778.7	690.3	573.4
Assets risk to total adjusted capital ratio (%)	N.A.	N.A.	32.9	34.2	29.9
High-risk assets to total adjusted capital ratio (%)	80.0	96.2	76.7	79.1	78.4
Surplus from operating earnings after dividends (%)	8.8	69.1	170.7	133.6	145.3
Stockholder dividends/net income	413.0	N.A.	10.1	12.4	0.0
Net premiums to gross premiums (%)	87.2	70.2	72.0	87.7	93.0
Net reserves to gross reserves (%)*	96.0	97.7	98.0	98.4	98.9
Stockholders' dividends	N.A.	345.0	0.0	185.0	0.0
Stockholders' dividends to net operating income (%)	N.A.	N.A.	0.0	52.5	0.0

*Includes annuity and fund deposits. N.A.—Not available.

As equity markets plummeted in 2008 and early 2009, Pacific Life was faced with sharply higher reserve requirements associated with its variable annuities business, which had a direct negative impact on capital levels. Pacific Life moved quickly to protect its capital adequacy and reduce its exposure to equity markets. The company layered on macro-hedges to limit the impact of another equity tail event, issued \$1.45 billion in external notes to replenish lost capital, and de-risked or eliminated certain variable annuity product features that were most sensitive to falling equity markets. These management actions, though expensive, effectively supported the capital position of the company and should improve the risk profile.

Although we consider Pacific Life's capital adequacy to be adequate for the current rating, we feel the company's exposure to certain real estate investments could lead to outsized credit losses in a severe or prolonged real estate downturn, which could erode capital levels. We have performed a stress test on Pacific Life's real estate investments to determine the amount of capital that Pacific Life would need to cover potential losses in a distressed market conditions. Following our incremental stress test, we view

Pacific Life's capital levels as representative of 'A' category capital adequacy and supportive of the current ratings.

Financial Flexibility: Demonstrated Ability To Access Capital Markets, But Limited Capacity Remaining

We consider Pacific Life's financial flexibility to be good, but there is limited additional capacity for external funding. The group has aggressively raised external capital over the past 12 months, including a \$1 billion surplus note issuance in 2009 and a \$450 million senior note issuance in early 2010. We view this demonstrated access to external capital favorably, particularly with regard to its support of capitalization. However, we feel that Pacific Life has exhausted much of its capacity for external funding. The note issuances have added approximately \$120 million in annual debt service expense, which will likely reduce fixed-charge coverage to the low 4x range, from more than 10x historically. Nevertheless, given Pacific Life's stable customer base and very strong liquidity profile and strong capitalization, we do not expect an outsized need for external capital.

We consider Pacific Life's consistent and strong statutory earnings to be its most attractive form of financial flexibility. Although statutory earnings in 2010 and beyond probably will not achieve the strong returns of 2006 and 2007, we expect that the company's operating performance will stabilize and generate at least \$300 million annually on a normalized basis.

Ratings Detail (As Of 16-Jun-2010)*	
Holding Company: Pacific LifeCorp	
Issuer Credit Rating	
Local Currency	BBB+/Stable/—
Senior Unsecured (2 Issues)	BBB+
Operating Companies Covered By This Report	
Pacific Life Insurance Co.	
Financial Strength Rating	
Local Currency	A+/Stable/—
Counterparty Credit Rating	
Local Currency	A+/Stable/A-1
Financial Enhancement Rating	
Local Currency	A+/-/—
Commercial Paper	
Local Currency	A-1
Subordinated (2 Issues)	
	A-
Pacific Life & Annuity Co.	
Financial Strength Rating	
Local Currency	A+/Stable/—
Issuer Credit Rating	
Local Currency	A+/Stable/—
Domicile	Nebraska

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Published by Standard & Poor's Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc. Executive and Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280 Option 2. Copyright © 2010 by Standard & Poor's Financial Services LLC (S&P). All rights reserved.

No part of this information may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P. S&P, its affiliates, and/or their third-party providers have exclusive proprietary rights in the information, including ratings, credit-related analyses and data, provided herein. This information shall not be used for any unlawful or unauthorized purposes. Neither S&P, nor its affiliates, nor their third-party providers guarantee the accuracy, completeness, timeliness or availability of any information. S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents are not responsible for any errors or omissions, regardless of the cause, or for the results obtained from the use of such information. S&P, ITS AFFILIATES AND THEIR THIRD-PARTY PROVIDERS DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates or their third-party providers and their directors, officers, shareholders, employees or agents be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained herein even if advised of the possibility of such damages.

The ratings and credit-related analyses of S&P and its affiliates and the observations contained herein are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or make any investment decisions. S&P assumes no obligation to update any information following publication. Users of the information contained herein should not rely on any of it in making any investment decision. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of each of these activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

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

S&P uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from S&P, its affiliates, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 212-438-7280 or write to us at: privacy@standardandpoors.com. For more information about The McGraw-Hill Companies Customer Privacy Policy please visit www.mcgraw-hill.com/privacy.html.

Permissions: To reprint, translate, or quote Standard & Poor's publications, contact: Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280 Option 2; or by email to: research_request@standardandpoors.com.