

Research

Pacific LifeCorp and Insurance Subsidiaries

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Pacific LifeCorp and Insurance Subsidiaries

SACP* Assessments				SACP*		Support		Ratings	
Anchor	aa-	Modifiers	0	aa-		0		Financial Strength Rating	
Business Risk		ERM and Management	0	Liquidity	0	Group Support	0	AA-/Stable/--	
Very Strong		Holistic Analysis	0	Sovereign Risk	0	Gov't Support	0	Holding Company Rating	
Financial Risk								A-/Stable/--	
Very Strong									

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Rationale

Business Risk Profile: Very Strong

- Leading market positions in the U.S. individual life and annuity markets
- Positive product diversification complemented by ownership of aircraft-lessor Aviation Capital Group (ACG)
- Strong earnings, with potential volatility associated with exposures to equity markets and interest rates.

Financial Risk Profile: Very Strong

- Very strong capitalization
- Declining legacy variable annuity (VA) exposure as a percentage of assets
- Meaningful investments in 'BBB' rated corporate bonds and large commercial real estate loans

Other Factors

- Adequate enterprise risk management (ERM) with strong risk controls

Factors Specific to the Holding Company

Our issuer credit rating on Pacific LifeCorp, Pacific Life group's intermediary holding company, is three notches lower than our financial strength rating on the group's insurance operating companies reflecting the structural subordination of the holding company obligations. Pacific LifeCorp relies upon subsidiary interest payments on internal surplus notes as well as its own cash and short-term investments to meet its fixed charges. It maintained \$240 million in cash and short-term investments at year-end 2016. Primary subsidiary, Pacific Life Insurance Co., can pay up to \$803 million in dividends to Pacific LifeCorp in 2017 without regulatory approval.

Outlook: Stable

The stable outlook on Pacific LifeCorp and its core insurance operating subsidiaries (Pacific Life) reflects our expectation that the group will maintain its very strong competitive position in the highly affluent life and annuity market. We anticipate consolidated generally accepted accounting principles (GAAP) net income above \$600 million annually, with some variance possible due to changing interest rates and equity markets. We expect capital above the 'AA' level as measured by our risk-based capital (RBC) model with financial leverage below 25% and adjusted EBITDA fixed-charge coverage above 7x.

Downside scenario

We could lower our ratings if the group's financial risk profile were to erode through investment losses or a decline in operating earnings that lead to reduced capitalization. We view its competitive position and business risk profile as sustaining the credit profile over our two year rating horizon. But any diminished diversification in the business profile could lead to a downgrade.

Upside scenario

Although unlikely, we could raise our ratings on Pacific Life and its core insurance operating subsidiaries in the next two years if the company continues to increase capital and we project the company will sustain capital above the 'AAA' level per our capital model.

Base-Case Scenario

Macroeconomic Assumptions

- U.S. real GDP growth of about 2.3% in 2017 and 2.4% in 2018
- Average unemployment rate of 4.5% in 2017 and 4.3% in 2018
- Average 10-year U.S. Treasury yield of about 2.5% in 2017 and 3.0% in 2018
- S&P 500 Index at 2,361 in 2017 and 2,396 in 2018

Company-Specific Assumptions

- Single-digit growth in premium volumes annually
- Consolidated GAAP net income exceeding \$600 million annually
- Capital above the 'AA' level per the our capital model
- Financial leverage of less than 25% with adjusted EBITDA fixed-charge coverage of more than 7.0x

Key Metrics

(Mil. \$)	--Year ended Dec. 31--				
	2017*	2016	2015	2014	2013
Net premiums earned	2,480.0	2,385.0	2,077.0	1,793.0	1,702.0
EBIT	1,050.0	1,187.0	1,036.0	810.0	926.0
Net income	760.0	847.0	657.0	536.0	739.0
S&P Global Ratings capital adequacy/redundancy	AAA	AAA	AAA	AAA	AA
Financial leverage (%)	18.0	19.4	20.2	21.6	22.8
Fixed-charge coverage (x)	9.3	10.2	8.8	7.5	8.2

*Forecast data reflect S&P Global Ratings' base case assumptions. Financial data in all tables reflect consolidated data of Pacific Mutual Holding Co., the ultimate parent of Pacific LifeCorp and its subsidiaries.

Company Description

Pacific Life maintains leading market positions in the U.S. individual life and annuity segments with a significant presence in reinsurance and aircraft leasing through its insurance and noninsurance operating companies. Pacific Life generated \$9 billion in revenue and reported shareholder's equity of more than \$11 billion as of year-end 2016

Business Risk Profile: Very Strong

Pacific Life's very strong business risk profile reflects its well-recognized brand and market standing as a top 10 life insurer in the U.S. with significant ranking among the VA, fixed annuity, universal life, structured settlement and pension risk transfer product lines, as well as the overall diversification of its revenue and operating income. It also offers competitive solutions in its reinsurance division, as well as various products through its nonregulated investment advisory and ACG operations.

Insurance industry and country risk: Strong

We believe Pacific Life faces low industry and country risk based on our low risk assessment for the U.S. life insurance sector. Our view of low country risk stems from the economic growth prospects, relatively effective and stable political institutions, sophisticated financial system, and strong payment culture in the U.S. In our view, Pacific Life's insurance operations are exposed to low industry risks due to moderate product risk as shown by a strong track record of maintaining asset-liability mismatch within one year. The availability of fixed-income instruments of sufficient duration to match insurance liabilities in the capital markets greatly supports this capability. But we also see sensitivity to interest rates and equity market volatility as somewhat offsetting these strengths. We believe persistent low interest rates and intense competition will limit the sector's growth prospects and potential for higher operating margins.

Table 1

Pacific Life Insurance Co. -- Industry And Country Risk

Insurance sector	Risk	Business mix (%)
U.S. life	Low	96.00
U.K. life	Low	3.00

Table 1

Pacific Life Insurance Co. -- Industry And Country Risk (cont.)		
Insurance sector	Risk	Business mix (%)
Ireland Life	Low	1.00
Canada Life	Low	1.00

Competitive position

We regard Pacific Life's competitive position as very strong. It maintains a well-recognized brand, solid market share, and diversified product offerings and distribution. Through its operating insurance subsidiaries, the group targets the very affluent market segment with competitive protection-based and wealth-accumulation products, along with reinsurance and aircraft leasing. The company maintains leading market shares in both individual life and individual annuities, fostered by its multipronged distribution system including independent producers/planners, financial advisors, and financial institutions (regional banks and wirehouses). This plays to Pacific Life's strengths, while lowering many fixed costs associated with directly employing captive agents.

Pacific Life reported gross premiums of \$2.8 billion in 2016, an increase of 13% over 2015. While sales growth in traditional life and VA were muted in 2016 by individual universal life illustration rates and uncertainty over the new U.S. Dept. Labor fiduciary rule, respectively, growth stemmed from strong fixed indexed annuity sales, pension risk transfer sales, and new reinsurance business. Consolidated GAAP net income totaled \$824 million in 2016 versus \$661 million in 2015. Earnings remain well diversified with retirement solutions generating about 53% of 2016 earnings, reinsurance 23%, ACG 16%, and life insurance 8%.

Table 2

Pacific Life Insurance Co. -- Competitive Position						
	--As of Dec. 31--					
(Mil. \$)	2016	2015	2014	2013	2012	2011
Gross premiums written	2,783	2,471	2,174	2,063	2,215	1,586
Net premiums written	2,385	2,077	1,793	1,702	1,882	1,244
Total assets under management	133,149	126,587	127,158	120,448	112,963	104,445
Growth in assets under management (%)	5.2	(0.4)	5.6	6.6	8.2	(1.5)

Financial Risk Profile: Very Strong

Pacific Life's very strong financial risk profile is based on its very strong capital adequacy per our RBC model and projections, and its consistent earning generation. The group also maintains strong fixed-charge coverage. Offsetting these strengths is an elevated risk profile stemming from the group's sizable VA with guaranteed living benefit block of business. While the size of this business is incrementally declining as a percentage of assets and benefits from hedging, it can still lead to earnings and capital volatility.

Capital and earnings: Very strong

We view Pacific Life's capital and earnings as very strong with capital redundancy at the 'AA' level per our RBC model. Statutory capital grew to \$9.3 billion at year-end 2016 from \$8.5 billion at year-end 2015 due to increased statutory

earnings. Pacific Life generated a National Assn. of Insurance Commissioners (NAIC) RBC ratio of 680% as of year-end 2016. We believe its key balance sheet risks remain equity market, interest rate, insurance, and credit. While the company employs hedging techniques, both GAAP and statutory earnings can exhibit some volatility. Nevertheless, its very strong capital position provides a meaningful buffer against such volatility. We believe management is committed to maintaining 'AA' level capital.

Table 3

Pacific Life Insurance Co. -- Capitalization Statistics						
	--As of Dec. 31--					
(Mil. \$)	2016	2015	2014	2013	2012	2011
Common shareholders' equity	11,140	10,108	10,231	8,973	9,499	8,285
Change in common shareholders' equity (%)	10.2	(1.2)	14.0	5.5	14.7	9.82
Total reported capital	21,111	20,418	19,397	17,642	18,115	16,296
Change in total capital (reported) (%)	3.4	5.3	10.0	(2.6)	11.2	8.2

Table 4

Pacific Life Insurance Co. -- Earnings Statistics						
	--As of Dec. 31--					
(Mil. \$)	2016	2015	2014	2013	2012	2011
Total revenue	9,032	8,428	7,712	7,521	7,250	6,660
EBIT adjusted	1,187	1,036	1,050	1,323	833	1,021
EBITDA adjusted	1,518	1,378	1,147	1,252	691	1,157
Net income (attributable to all shareholders)	847	657	536	739	528	620
Return on revenue (%)	13.1	12.3	10.5	12.3	5.4	13.5
Net expense ratio (%)	98.7	117.6	86.1	147.8	91.9	87.9

Risk position: Intermediate

In our view, Pacific Life's intermediate risk position reflects a well-diversified investment portfolio and the absence of material risks not already captured in our capital and earnings analysis. It maintains a low level of high-risk assets (speculative-grade bonds, unaffiliated common equities, equity real estate and alternative investments) relative to capital. Bonds, comprising both corporate and government securities, made up about 57% of total invested assets at year-end 2016, with commercial mortgages representing the second-largest asset class at 18% of invested assets. The corporate bond portfolio is of good quality with meaningful exposure to 'BBB' rated securities. The credit quality of the corporate bond portfolio is about 36% rated 'A' and higher; 59% rated 'BBB'; and 5% speculative-grade. We do not anticipate any meaningful change in general asset allocation or credit quality.

Table 5

Pacific Life Insurance Co. -- Risk Position						
	--As of Dec. 31--					
(Mil. \$)	2016	2015	2014	2013	2012	2011
Total invested assets	127,390	121,029	121,259	114,970	109,031	101,739
Net investment income	2651	2,623	2,476	2,352	2,330	2216
Net investment yield (%)	4.0	4.2	4.3	4.4	4.5	4.5

Table 5

Pacific Life Insurance Co. -- Risk Position (cont.)						
	--As of Dec. 31--					
(Mil. \$)	2016	2015	2014	2013	2012	2011
Net investment yield including realized capital gains/(losses) (%)	4.2	4.6	3.2	5.4	3.8	2.9

Financial flexibility: Adequate

We consider Pacific Life's financial flexibility to be adequate. The group has been able to raise long-term external funding (excluding ACG's financings), most recently \$500 million in 2013. We have a favorable view of this access to external funding. Given the stability of its customer base, very strong capitalization, and exceptional liquidity, we don't anticipate any great need for additional external capital. We believe its sources of financial flexibility have led to improving metrics, including a financial leverage ratio of 19% with EBITDA fixed-charge coverage of 10x at year-end 2016. Through year-end 2017 and 2018, we expect Pacific Life to maintain financial leverage of less than 25% with fixed-charge coverage above 7.0x.

Table 6

Pacific Life Insurance Co. -- Financial Flexibility						
	--As of Dec. 31--					
	2016	2015	2014	2013	2012	2011
EBITDA fixed-charge coverage (x)	10.2	8.8	7.5	8.2	4.4	7.1
Financial leverage including pension deficit as debt (%)	19.4	20.2	21.6	22.8	22.5	24.1
Debt leverage excluding pension deficit as debt (%)	12.8	13.4	14.2	14.9	10.8	11.5

Other Assessments**Enterprise risk management: Adequate with strong risk controls**

We view Pacific Life's ERM as adequate with strong risk controls. We consider the importance of ERM to our ratings as high as certain business lines, such as VA, but this could cause significant earnings and capital losses without effective risk controls and ERM processes. We view Pacific Life's risk management culture as positive due to management's demonstrated commitment to ERM, a well-established ERM governance structure, and a well-defined risk appetite statement and overall risk limits. We view overall risk controls as positive. Risk controls should prevent losses outside of tolerances as defined in the risk appetite statement.

We believe that Pacific Life has increased use of its economic capital model in the risk management processes. But we view strategic risk management as neutral since we've seen only limited evidence that the results of the economic capital model and other quantitative metrics are applied consistently across the enterprise in decision-making.

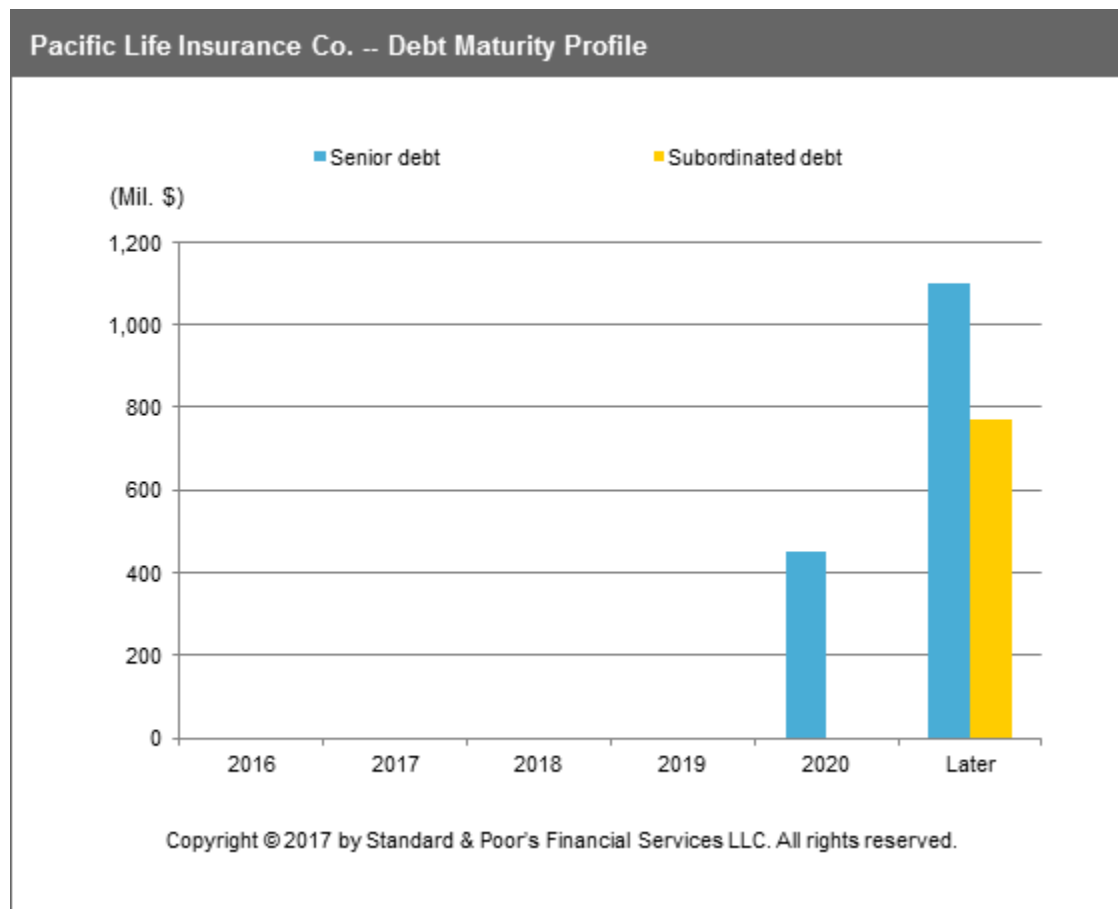
Management and Governance: Satisfactory

We believe Pacific Life's management and governance practices are satisfactory and that the company has a clear strategic planning process balanced with its risk appetite. The risk appetite statement has a well-defined set of risk tolerances toward statutory capital, as well as GAAP earnings. But equity and interest rate exposures related to VA living benefits can create volatility. It has diversified away from equity market exposure in its VA business in-part by

shifting the sales focus to fixed-indexed annuities and investment-only VAs, as well as by developing its life reinsurance and retrocession businesses. The group has also modified its life insurance products to become the leading writer of indexed universal life insurance in the industry.

Liquidity: Exceptional

Pacific Life's liquidity continues to be exceptional. Its liquidity ratio as of year-end 2015 was 242%. The stand-alone liquidity profiles of each of its U.S. domiciled operating subsidiaries remain strong in terms of liquidity. The invested asset base is well-diversified with the portfolio far exceeding liquid liabilities. Pacific Life also has borrowing capacity under its commercial paper, lines of credit, and Federal Home Loan Bank holdings to access for liquidity during stress events.



Accounting Considerations

In our analysis, we rely on audited statutory financial statements for the regulated insurance units and GAAP financial statements for Pacific Life Mutual Holding Group and its subsidiaries. We made two material adjustments in our analysis of Pacific Life's leverage and capitalization: we excluded all nonrecourse debt related to ACG when calculating financial leverage and fixed-charge coverage; and we disallowed hybrid equity credit for some portion of its surplus

notes outstanding due to time remaining to maturity.

Related Criteria And Research

- Treatment Of U.S. Life Insurance Reserves And Reserve Financing Transactions, March 12, 2015
- Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers , Nov. 13, 2012
- Methodology For Assessing Capital Charges For Commercial Mortgage Loans Held By U.S. Insurance Companies, May 31, 2012
- Methodology For Calculating The Convexity Risk In U.S. Insurance Risk-Based Capital Model, April 27, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Life Insurance Criteria: Liquidity, April 22, 2004

Ratings Detail (As Of May 12, 2017)

Holding Company: Pacific LifeCorp

Issuer Credit Rating

Local Currency A-/Stable/--

Senior Unsecured

A-

Operating Companies Covered By This Report

Pacific Life Insurance Co.

Financial Strength Rating

Local Currency AA-/Stable/--

Counterparty Credit Rating

Local Currency AA-/Stable/A-1+

Financial Enhancement Rating

Local Currency AA--/--

Commercial Paper

Local Currency A-1+

Subordinated

A

Pacific Life & Annuity Co.

Financial Strength Rating

Local Currency AA-/Stable/--

Issuer Credit Rating

Local Currency AA-/Stable/--

Ratings Detail (As Of May 12, 2017) (cont.)**Pacific Life Reinsurance Company II Ltd.**

Financial Strength Rating

Local Currency

AA-/Stable/--

Issuer Credit Rating

Local Currency

AA-/Stable/--

Pacific Life Re Ltd.

Financial Strength Rating

Local Currency

AA-/Stable/--

Domicile

Nebraska

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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