FitchRatings

FITCH RATES PACIFIC LIFE INSURANCE COMPANY'S DEBT 'A-'; AFFIRMS RATINGS

Fitch Ratings-Chicago-12 October 2017: Fitch Ratings has assigned an 'A-' rating to Pacific Life Insurance Company's (PLIC) proposed issuance of surplus notes. Fitch has also affirmed the ratings of Pacific LifeCorp (PLC) and certain of its subsidiaries, including PLIC. The Rating Outlook is Stable. A full list of ratings follows at the end of this release.

The rating for the new offering is equivalent to the rating on PLIC's existing surplus notes. The 'A-' rating assigned to the surplus note reflects Fitch's standard notching from the company's 'A+' Insurer Financial Strength (IFS) rating and considers the subordination of the surplus notes relative to policyholder obligations. The notes are rated one notch below PLIC's Long-Term Issuer Default Rating (IDR), reflecting one notch for Fitch's assumption of "below average" recovery prospects in the event of default and zero notches tied to its "minimal" non-performance risk.

Proceeds from the issuance will be used to fund the redemption of existing surplus notes. Fitch expects financial leverage to remain unchanged. The surplus notes are treated as 100% debt in the financial leverage ratio and 100% equity in Fitch's Prism capital model.

KEY RATING DRIVERS

PLC's ratings are based on the company's diverse business profile, very strong statutory capitalization and strong earnings, investment management and liquidity. Somewhat offsetting these positives are the company's high total financing and commitments (TFC) ratio and above-average, albeit moderating, variable annuity (VA) exposure.

PLC has diversified its product portfolio by further reducing its exposure to legacy VAs with more feature-rich riders and increasing its emphasis on fixed annuities (FA), investment-only VAs, indexed universal life (IUL) products, life reinsurance and pension risk transfers. Business diversification is further enhanced by its aircraft leasing subsidiary, Aviation Capital Group (ACG), and its reinsurance subsidiary, Pacific Life Re Limited.

Fitch views PLC's capitalization as very strong based on its RBC ratio of 680% and Prism capital model score of 'Very Strong' at year-end 2016. The company's total adjusted capital (TAC) totaled $9.6 billion at June 30, 2017, which represents a five-year compound annual growth rate (CAGR) of 6.7% driven primarily by retained earnings and unrealized capital gains. Asset leverage and financial leverage remained very strong at 14x and 18%, respectively, as of June 30, 2017.

While PLC's capital is exposed to equity market volatility related to its VA business, the company has taken steps over the years to reduce volatility. PLC modified the risk profile of its VA book by discontinuing sales of products with more feature-rich guarantee features while enhancing its hedging program. The company also reinsures a portion of its base VA contracts and contract guarantees to third party reinsurers and its captive subsidiary, Pacific Annuity Reinsurance Company.

Fitch views PLC's earnings profile as strong and in line with rating guidelines at the current level. Similar to peers, the company's earnings remain subject to market volatility with continued headwinds from low interest rates. Fitch expects near-term earnings growth to be constrained by hedging costs and lower investment yields. GAAP ROE is expected to remain in the 7% to 9% range. Through the first six months of 2017, PLC reported GAAP net operating income of $351 million and operating ROE of 6.8%. Fitch expects fixed charge coverage to improve following the debt refinance and remain in the high single digit range for the intermediate term.

Fitch views PLC's asset risk as modest demonstrated by its high-quality fixed income investments and minimal equity and Schedule BA assets. This is somewhat offset by its above-average exposure to corporate bonds rated 'BBB', which makes it susceptible to credit migration in a market downturn. PLC also has an above-average allocation to commercial mortgage loans, which Fitch views as well managed. Fitch expects investment losses to remain modest and manageable in context of PLC's capitalization and earnings over the near term.

Fitch views PLC's future financial flexibility as somewhat constrained given the company's limited access to external equity capital and modest organic statutory earnings generation prospects. However, the company has demonstrated an ability to access the debt markets through the issuance of surplus notes and senior debt.

Fitch views PLC's total financing and commitments (TFC) ratio of 1.0x as high relative to the broader industry, primarily driven by the capital-intensive profile of ACG. PLIC's statutory carrying value of ACG was $1.8 billion at year-end 2016 and ACG's debt is non-recourse to PLC.

Fitch views PLIC's ownership of ACG as a concentrated exposure to an entity with a stand-alone credit profile of 'BBB-'. PLIC's recent announcement of Tokyo Century Corporation's (TC) 20% minority investment in ACG is neutral to its ratings. PLIC's remaining 80% ownership of ACG represents a meaningful portion of the insurance company's equity base. Fitch views ACG's aircraft leasing business as well managed and related risks are captured in Fitch's ratings. The current ratings on both ACG and PLC implicitly assume that PLC would provide a modest level of support if necessary.

RATING SENSITIVITIES

The key rating sensitivities that could result in an upgrade include:

--Decline in financial leverage below 20%;
--Decline in TFC ratio to 1x or below;
--GAAP interest coverage ratio of 10x;
--Continued success in expanding product lines and reducing exposure to legacy blocks of VA contracts with enhanced rider benefits.

The key rating sensitivities that could result in a downgrade include:

--Deterioration in Prism capital model score below 'Very Strong';
--Higher leverage, such as financial leverage ratio at or above 30% or TFC above 1.4x;
--Significant earnings and capital volatility, such as a 10% or more drop in TAC;
--Significant losses at ACG.

FULL LIST OF RATING ACTIONS

Fitch has assigned the following rating:

Pacific Life Insurance Company
--Surplus notes 'A-'.

Fitch has affirmed the following ratings with a Stable Outlook:

Pacific LifeCorp

--Long-Term IDR at 'A-';
--Senior notes at 'BBB+'.

Pacific Life Insurance Company
--Long-Term IDR at 'A';
--Surplus notes at 'A-';
--Insurer Financial Strength (IFS) at 'A+';
--Short-Term IDR at 'F1';
--Commercial paper at 'F1'.

Pacific Life & Annuity Company
--IFS at 'A+'.

Pacific Life Re Limited
--IFS at 'A+'.

Pacific Life Funding, LLC
--Funding agreement-backed note program at 'A+'.
Pacific Life Global Funding
--Funding agreement-backed note program at 'A+'.

Contact:

Primary Analyst
Dafina M. Dunmore, CFA
Director
+1-312-368-3136
Fitch Ratings, Inc.
70 W. Madison Street
Chicago, IL 60602

Secondary Analyst
Doug L. Meyer, CFA
Managing Director
+1-312-368-2061

Committee Chairperson
Brian C. Schneider, CPA, CPCU
Senior Director
+1-312-606-2321

Media Relations: Benjamin Rippey, New York, Tel: +1 646 582 4588, Email: benjamin.rippey@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Insurance Rating Methodology (pub. 26 Apr 2017)
https://www.fitchratings.com/site/re/897260