

26 Jun 2019 | Upgrade

## Fitch Upgrades Pacific Life Insurance Co to 'AA-'; Outlook Stable

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Fitch Ratings-Chicago-26 June 2019: Fitch Ratings has upgraded the ratings of Pacific LifeCorp (PLC) and certain of its subsidiaries, including the Long-Term ratings of Pacific Life Insurance Company (PLIC). PLIC's Short-Term ratings were affirmed. The Rating Outlook is Stable. A full list of ratings follows at the end of this release.

The ratings were upgraded because Fitch has an improved view of PLC's business profile. PLC has continued to reduce its financial leverage and continued to expand its product lines, reducing exposure to legacy blocks of variable annuity (VA) contracts. Interest coverage on a statutory basis and a GAAP basis has also improved. The affirmation of PLIC's Short-Term ratings reflects use of the baseline correspondence to PLIC's Long-Term ratings per Fitch's Short-Term ratings criteria, and also considers PLIC's liquidity and financial flexibility.

### KEY RATING DRIVERS

PLC's ratings are based on the company's diverse business profile, extremely 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, but declining exposure to legacy VA business.

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, structured settlements and pension risk transfers. Business diversification is further enhanced by its aircraft leasing subsidiary, Aviation Capital Group (ACG), and its reinsurance division, Pacific Life Re.

Fitch views PLC's capitalization as extremely strong based on its RBC ratio of 552% at year-end 2018 and Prism capital model score of 'Extremely Strong' when last calculated at year-end 2017. The company's total adjusted capital (TAC) was \$10.7 billion at Dec. 31, 2018. This represents a five-year compound annual growth rate (CAGR) of 8.6%, driven primarily by retained earnings and unrealized capital gains. Operating leverage and financial leverage remained very strong at 7x and 15%, respectively, as of Dec. 31, 2018.

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 riders 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 low investment yields. GAAP ROE is expected to remain in the 6% to 8% range. Fitch expects fixed charge coverage to 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. 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 1.2x as high relative to the broader industry, primarily driven by the capital-intensive profile of ACG. PLIC's statutory carrying value of ACG was \$1.85 billion at year-end 2018 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 consistent with investment grade aircraft leasing peers. Tokyo Century Corporation's (TC) 25% minority investment in ACG is neutral to PLIC's ratings. PLIC's remaining 75% 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:

- A material change in business risk profile that indicates a risk appetite lower than the life insurance sector as a whole.
- Return on equity above 10%;
- Financial leverage of 15%;
- TFC ratio of 0.8x or below.
- The Short-Term ratings could be upgraded if PLIC's Long-Term IDR is upgraded to 'AA-' or if there are improvements in Fitch's assessment of both PLIC's Debt Service Capabilities and Financial Flexibility, and Asset/Liability and Liquidity Management.

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 20% or TFC above 1.2x;
- 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 upgraded the following ratings and revised the Rating Outlook to Stable from Positive:

##### Pacific LifeCorp

- Long-Term Issuer Default Rating (IDR) to 'A' from 'A-';
- Senior notes to 'A-' from 'BBB+'.

##### Pacific Life Insurance Company

- Long-Term IDR to 'A+' from 'A';
- Surplus notes to 'A' from 'A-';
- Insurer Financial Strength (IFS) to 'AA-' from 'A+'.

##### Pacific Life & Annuity Company

- IFS to 'AA-' from 'A+'.

##### Pacific Life Re Limited

- IFS to 'AA-' from 'A+'.

Pacific Life Funding, LLC

--Funding agreement-backed note program to 'AA-' from 'A+'.

Fitch has affirmed the following ratings:

Pacific Life Insurance Company

--Short-Term IDR at 'F1';

--Commercial paper at 'F1'.

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**Applicable Criteria**

[Insurance Rating Criteria \(pub. 11 Jan 2019\)](#)

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