

# RatingsDirect®

---

## Pacific LifeCorp

**Primary Credit Analyst:**

Heena C Abhyankar, New York + 1 (212) 438 1106; heena.abhyankar@spglobal.com

**Secondary Contact:**

Peggy H Poon, CFA, New York (1) 212-438-8617; peggy.poon@spglobal.com

### Table Of Contents

---

Credit Highlights

Outlook

Key Assumptions

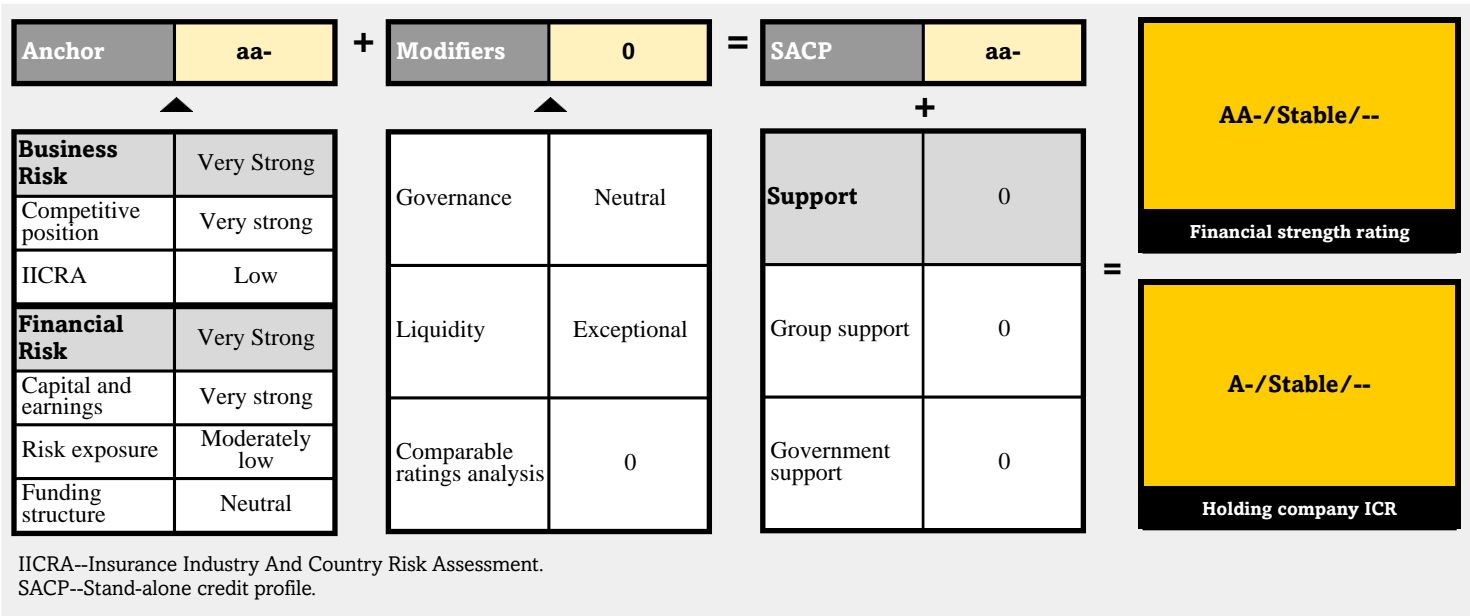
Business Risk Profile

Financial Risk Profile

Other Key Credit Considerations

Related Criteria

# Pacific LifeCorp



## Credit Highlights

Overview	
Strengths	Risks
Very strong competitive position with solid market positions in the U.S. individual life and annuity markets	Exposure to legacy variable annuity, albeit declining as a percentage of assets
Diversified earnings profile with stable operating performance in recent years	Meaningful investments in 'BBB' rated corporate bonds and large commercial real estate loans
Very strong capitalization with 'AA' level redundancy per our risk-based capital (RBC) model	

**We expect Pacific Life to maintain its market position in life insurance and annuities.** Pacific LifeCorp. (PacLife) holds top 15 market positions in almost all its key products. It's a leading provider of indexed universal life (IUL) insurance and ranked fifth in fixed annuities, seventh in fixed index annuities (FIA), and 12th in variable annuities (VA), through first-half 2019 per LIMRA. At year-end 2018, PacLife was ranked third in total life sales on a recurring premiums basis; we expect the company to maintain its top 10 market position.

**The company has a very strong competitive position despite the announced sale of its Aviation Capital Group (ACG).** Although the announced sale of ACG affects the overall business diversity, we believe PacLife's earning profile is still fairly diversified with earnings contributions from retirement, life insurance, and reinsurance division. The company is diversified by product within each of these divisions.

**Capitalization will likely remain a strength over the next two years.** PacLife maintained very strong capital and earnings at the 'AA' confidence level at year-end 2018. We believe the ACG transaction will augment the group's capital position, and we expect the group to maintain 'AA' level capital redundancy through 2019-2020.

**Outlook: Stable**

The stable outlook reflects S&P Global Ratings' view that the group will maintain its very strong business risk profile and capital redundancy at least at the 'AA' confidence level. We expect its consolidated financial leverage to remain below 20% and fixed-charge coverage above 8x.

**Downside scenario**

We could lower the ratings over the next 12-24 months if Pacific LifeCorp's:

- Competitive position deteriorates due to a weakening market position;
- Operating performance declines significantly relative to peers'; or
- Earnings profile becomes significantly less diversified.

We may also lower our ratings if the group adopts a more-aggressive investment policy or if the quality of its overall investment portfolio deteriorates and capital is no longer redundant at the 'AA' level.

**Upside scenario**

We are unlikely to raise our ratings in the next 24 months.

**Key Assumptions**

- Real GDP growth of 2.3% in 2019 and 1.7% in 2020
- Core Consumer Price Index (CPI) growth of 1.9% in 2019 and 2.2% in 2020
- Real consumer spending growth of 2.6% in 2019 and 2.2% in 2020
- 10-year Treasury note yield of 2.2% in 2019 and 2.3% in 2020

**Key Metrics**

	2020f	2019f	2018	2017	2016	2015
Net income*	>800	>800	953	1,374	849	657
Financial leverage (%)*	<20.0	<20.0	16.3	13.0	17.7	19.1
Fixed-charge coverage (x)*	>8.0	>8.0	15.1	11.9	10.9	9.2
Net investment yield (%)	>4.0	>4.0	4.0	4.6	4.2	4.6
Total adjusted capital	>9,200	>9,200	11,211.7	9,929.5	9,246.0	8,475.3
S&P Global Ratings' capital adequacy/redundancy	AA	AA	AA	AA	AAA	AAA

\*Based upon consolidated GAAP financial statement of ultimate parent, Pacific Mutual Holding Co.

## Business Risk Profile: Very Strong

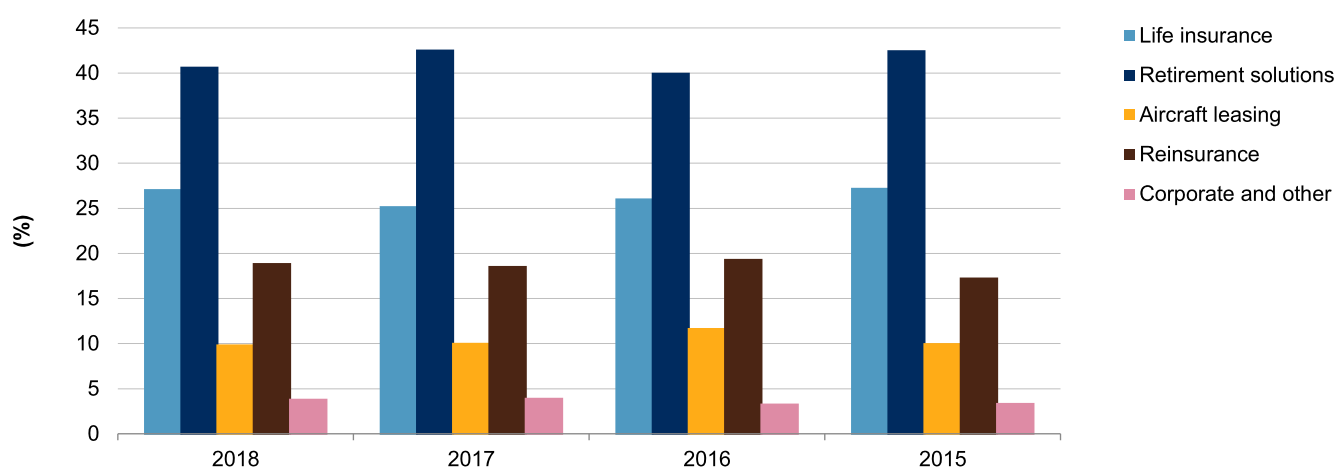
We view PacLife's competitive position as very strong based on its well-recognized brand, solid market share, and diversified product offerings. The group primarily caters to the affluent market and relies on a well-diversified distribution network comprising independent producers/planners, financial advisors, and financial institutions (regional banks and wirehouses). It's the leading player in IUL, has consistently ranked among the top 10 in individual life sales and annuities, and has a well-established institutional platform.

Over the past few years, the group has successfully moved away from riskier products like VA with guaranteed living benefits to investment-only variable annuities (IOVA)--the majority of new VA sales are IOVAs. At the same time, PacLife has achieved a strong position in FIA due to strong sales from its broker dealer channel and expansion of its independent marketing channel. The group also has a strong market presence in life-based LTC combo (also known as hybrid LTC) products, a product that has seen significant growth in recent years.

We view PacLife's operating performance as stable, supporting its competitive position. At year-end 2018, the group reported generally accepted accounting principles (GAAP) net income of \$913 million versus \$750 million in 2017 (excluding the benefits of tax reform) and generated GAAP pretax return on assets of about 1%--in line with similar rated peers.

Earnings in 2018 were also well-diversified, with about 54% from retirement solutions, 25% from aircraft leasing, 13% from reinsurance and retrocession, 13% from life insurance, and a roughly 5% pretax loss from the corporate division. The pending sale of ACG may have some near-term impact on GAAP earnings, but we believe the group will use the proceeds from this transaction to invest in its current portfolio and ultimately generate earnings in line with similarly rated peers'. We expect the group to generate net income of approximately \$800 million-\$900 million in 2019.

### Pacific LifeCorp--Business Diversity By GAAP Revenue



Copyright © 2019 by Standard & Poor's Financial Services LLC. All rights reserved.

## Financial Risk Profile: Very Strong

PacLife has consistently maintained very strong capital and earnings at the 'AA' confidence level--its statutory RBC ratio was 552% at year-end 2018. Our consolidated capital analysis covers non-U.S. operations, as well as captive entities. We also make adjustments to account for the risk associated with longevity swaps.

The group's very strong capitalization reflects its steady earnings stream coupled with a conservative investment profile. It has been able to boost capitalization by gradually lowering its exposure to more-capital-intensive products. While it uses hedging, both GAAP and statutory earnings have shown some volatility. Nevertheless, its very strong capital position provides a buffer against this. We expect the group to maintain capital commensurate with our 'AA' level of capital adequacy.

In our view, PacLife's moderately low risk position reflects a well-diversified investment portfolio and an absence of material risks not already captured in our capital and earnings analysis. The group maintains a low level of high-risk assets (speculative-grade bonds, unaffiliated common equities, equity real estate, and alternative investments) relative to capital.

While most of the investment portfolio comprises fixed maturities (63%), the group is exposed to commercial mortgage loans--about 15% of total invested assets. The weighted-average rating of the portfolio is 'BBB' with about 5% exposure to speculative-grade securities. We have a favorable view of the group's tight risk controls and believe they will prevent losses above the well-defined tolerances. While we do not anticipate any meaningful changes in general asset allocation or credit quality in the next couple of years, we will continue to monitor the group's investment strategy and the credit quality of its portfolio.

We assess PacLife's financial flexibility as adequate based on reported financial leverage of 16% and EBITDA fixed-charge coverage of about 15x as of Dec. 31, 2018. We expect the group to maintain financial leverage below 20% with fixed-charge coverage above 8.0x for full-year 2019 and 2020.

## Other Key Credit Considerations

### Governance

In our view, PacLife's governance is neutral and in line with industry peers. The group has a well-engrained risk management framework and a well-defined risk appetite. It has a clear strategic planning process balanced with a risk appetite for each division. It has successfully executed its strategy toward expansion of its international reinsurance operations, as well as the pending sale of the ACG.

### Liquidity

PacLife's liquidity is exceptional with a liquidity ratio of 237% at year-end 2018. The stand-alone liquidity profile of each of its U.S.-domiciled operating subsidiaries remains strong. The invested asset base is well diversified with the portfolio, far exceeding liquid liabilities. The group has borrowing capacity under its commercial paper, lines of credit, and Federal Home Loan Bank holdings to access for liquidity during times of stress.

## Factors specific to the holding company

Our issuer credit rating on Pacific LifeCorp, the 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 \$295 million in cash and short-term investments at year-end 2018. Primary subsidiary Pacific Life Insurance Co. can pay up to \$927 million in dividends to Pacific LifeCorp in 2019 without regulatory approval.

### Pacific LifeCorp--Credit Metrics History

Ratio/metric	2018	2017	2016	2015	2014
S&P Global Ratings capital adequacy*	AA	AA	AAA	AAA	AAA
Total invested assets	79,291	71,206	64,882	59,771	55,469
Net premiums earned	12,799	9,788	8,764	9,381	9,043
EBIT	775	933	1,048	746	815
Net income (attributable to all shareholders)	928	1247	891	573	688
Return on revenue (%)	4.8	6.9	8.6	5.9	7.0
Return on assets (excluding investment gains/losses) (%)	0.6	0.7	0.9	0.6	0.7
EBITDA fixed-charge coverage (x)	15.09	11.87	10.94	9.19	8.31
Financial obligations/EBITDA adjusted	1.92	1.20	1.10	1.48	1.66
Financial leverage including pension deficit as debt (%)	16.3	13.0	17.7	19.1	19.2
Net investment yield (%)	3.98	4.57	4.19	4.62	4.51

## Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Insurance | Life: Methodology: Treatment Of U.S. Life Insurance Reserves And Reserve Financing Transactions, March 12, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | General: Methodology For The Classification And Treatment Of Insurance Companies' Operational Leverage, Oct. 31, 2014
- Criteria - Insurance - General: Methodology For Assessing Capital Charges For U.S. RMBS And CMBS Securities Held By Insurance Companies, Aug. 29, 2014
- Criteria | Insurance | General: Methodology For Assessing Capital Charges For Commercial Mortgage Loans Held By U.S. Insurance Companies, May 31, 2012
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

<b>Business And Financial Risk Matrix</b>								
<b>Business risk profile</b>	<b>Financial risk profile</b>							
	Excellent	<b>Very Strong</b>	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
<b>Very Strong</b>	aa	<b>aa/aa-</b>	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

**Note:** Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

### Ratings Detail (As Of December 5, 2019)\*

#### **Pacific LifeCorp**

Issuer Credit Rating

*Local Currency*

A-/Stable/--

Senior Unsecured

A-

#### **Related Entities**

##### **Aviation Capital Group LLC**

Issuer Credit Rating

A-/Watch Neg/A-2

Commercial Paper

*Local Currency*

A-2/Watch Neg

Senior Unsecured

A-/Watch Neg

##### **Pacific Life & Annuity Co.**

Financial Strength Rating

*Local Currency*

AA-/Stable/--

Issuer Credit Rating

*Local Currency*

AA-/Stable/--

##### **Pacific Life Insurance Co.**

Financial Strength Rating

*Local Currency*

AA-/Stable/--

Issuer Credit Rating

*Local Currency*

AA-/Stable/A-1+

Financial Enhancement Rating

*Local Currency*

AA-/--/--

Commercial Paper

*Local Currency*

A-1+

Subordinated

A

### Ratings Detail (As Of December 5, 2019)\*(cont.)

#### **Pacific Life Re (Australia) Pty Limited**

Financial Strength Rating

*Local Currency*

AA-/Stable/--

#### **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**

Delaware

\*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.



Copyright © 2019 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES 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, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties 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 or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. 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. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective 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 may receive compensation for its ratings and certain 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](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.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](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.