S&P Global
Ratings

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Pacific LifeCorp And Insurance Subsidiaries

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Pacific LifeCorp And Insurance Subsidiaries

Major Rating Factors

Strengths	Weaknesses
• Very strong competitive position with solid market positions in the U.S. individual life and annuity markets • Well-diversified earnings profile complemented by ownership of aircraft-lessor Aviation Capital Group (ACG) • Very strong capitalization	• Legacy variable annuity (VA) exposure albeit declining as a percentage of assets • Meaningful investments in 'BBB' rated corporate bonds and large commercial real estate loans

Rationale

S&P Global Ratings' rating on Pacific Life group reflects its very strong business risk and financial risk profiles, leading us to an anchor of 'aa-'. Our ratings on the group reflect its strong brand and well-diversified business profile with diverse income streams from life, non-life, and noninsurance operations. Pacific Life continues to retain its majority ownership in ACG, a strategically important subsidiary, following a partial sale (20%) to Japan-based Tokyo Century Corp.

Our ratings are also based on Pacific Life's very strong capital adequacy levels and it's well managed investment portfolio. The group displays exceptional liquidity resulting from its well diversified asset portfolio. We consider Pacific Life's enterprise risk management (ERM) framework as adequate with strong risk controls, reflecting our positive view of its risk-management culture, risk controls and risk models.

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 $278 million in cash and short-term investments at year-end 2017. Primary subsidiary, Pacific Life Insurance Co., can pay up to $784 million in dividends to Pacific LifeCorp in 2018 without regulatory approval.

Outlook: Stable

The stable outlook on Pacific LifeCorp reflects our 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 near 20% and fixed-charge coverage above 8x.

Downside scenario

We could lower our ratings in the next 12 to 24 months if the group's financial risk profile erodes due to investment losses or a decline in operating earnings that result in 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 the ratings in the next two years if the group shows strong and sustainable capital redundancy at the 'AAA' level and further improves its business profile relative to peers.

Macroeconomic Assumptions

- U.S. real GDP growth of about 2.9% in 2018 and 2.6% in 2019
- Average unemployment rate of 3.9% in 2018 and 3.6% in 2019
- Average 10-year U.S. Treasury yield of about 2.9% in 2018 and 3.3% in 2019
- S&P 500 Index at 2,813 in 2018 and 2,869 in 2019

Key Metrics

	--Year ended Dec. 31--				
(Mil. $)	**2019***	**2018***	**2017**	**2016**	**2015**
Net income§	>800	750-800	1,374.0	847.0	657.0
Financial leverage (%)§	<20.0	<20.0	16.7	19.4	20.2
Fixed-charge coverage (x)§	>10.0	>10.0	11.9	10.2	8.8
Net investment yield (%)	>4.0	>4.0	4.6	4.2	4.6
Total adjusted capital	>9,200	>9,000	9,929.5	9,246.0	8,475.3
S&P Global Ratings' capital adequacy/redundancy.	AA	AA	AA*	AAA	AAA

*S&P Global Ratings' forecast. §GAAP basis. Note: Financial data reflect consolidated group parent, Pacific Mutual Holding Co., figures.

Business Risk Profile: Very Strong

We view Pacific Life Group'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 segment and mostly 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 indexed universal life (IUL) and has consistently ranked among the top 10 in individual life sales and VA. Over the past few years, the group has successfully moved away from more risky product offerings like VA with guaranteed living benefits (VAGLB) to investment-only variable annuities (IOVA)--the majority of new VA sales are IOVAs. The group also benefits from well-diversified earnings before taxes: about 66% from retirement solution, 19% from life operations, 15% from aircraft leasing, 11% from reinsurance and retrocession, and a roughly 14% pretax loss from the corporate division in 2017. The company is also expanding its international footprint through its aircraft-leasing and reinsurance businesses.

We view the group's operating performance as stable, supporting the overall competitive position. For year-end 2017, it generated generally accepted accounting principles (GAAP) pretax ROA of 0.95%--in line with similar rated peers. Consolidated GAAP net income of $1.4 billion reflects recent tax reform. Excluding that benefit, net income was close to $750 million. We expect the group to generate net income of about $750 million-$800 million.

Financial Risk Profile: Very Strong

Pacific Life has consistently maintained very strong capital and earnings at the 'AA' confidence level, and its statutory risk-based capital ratio was 688% at year-end 2017. Its very strong capitalization reflects the group's steady earnings stream coupled with a conservative investment profile. Our consolidated view of Pacific Life's capital includes assessment of all key operating companies along with international operations. The group has also been able to strengthen its 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, it's very strong capital position provides a buffer against this. We expect the company to maintain capital commensurate with our 'AA' level of capital adequacy.

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. While most of the investment portfolio comprises fixed maturities (59%), the group is exposed to commercial mortgage loans representing about 17% of total invested assets. The weighted-average rating of the overall portfolio is 'BBB' with about 5% exposure to speculative-grade securities. We do not anticipate any meaningful changes in general asset allocation or credit quality.

We consider Pacific Life's financial flexibility to be adequate. The group has been able to raise long-term external funding and recently refinanced $750 million of subordinated debt in 2017--which we view favorably. Given the stability of its customer base, very strong capitalization, and exceptional liquidity, we don't anticipate any need for additional external capital. We believe sources of financial flexibility have led to improving metrics, including a financial leverage ratio of 17% with EBITDA fixed-charge coverage above 10x at year-end 2017. Through year-end 2018 and 2019, we expect Pacific Life to maintain financial leverage of less than 20% with fixed-charge coverage above 8.0x.

Pacific Life's liquidity continues to be exceptional with a liquidity ratio of 250% as of year-end 2016. The stand-alone liquidity profiles 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.

Other Assessments

Enterprise risk management

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

While we view strategic risk management as neutral, the group has been increasingly using economic capital and other elements of its ERM framework in its strategic decision making. We view its risk models as strong and emerging risk management neutral.

Management and Governance

We view Pacific Life's management and governance practices as strong. It has a clear strategic planning process balanced with a risk appetite for each division. The risk appetite statement has a well-defined set of risk tolerances toward statutory capital, as well as GAAP earnings. The group has successfully executed its strategy towards international reinsurance operations as well as aircraft leasing, while maintaining a strong position in the U.S. market. It is gradually lowering its equity market exposure by moving away from VAGLB and shifting its focus to fixed-indexed annuities and investment-only VAs. The group is also developing its life reinsurance and retrocession businesses, while managing growth in its aircraft leasing business in a controlled manner.

Rating Score Snapshot

Holding company rating:	A-/Stable/--
Financial strength rating:	AA-/Stable
Anchor:	aa-
Business risk profile:	Very strong
IICRA:	Low risk
Competitive position:	Very strong
Financial risk profile:	Very strong

Capital and earnings:	Very strong
Risk position:	Intermediate
Financial flexibility:	Adequate
Modifiers:	0
ERM and management:	0
Enterprise risk management (ERM):	Adequate with strong risk controls
Management and governance:	Strong
Holistic analysis:	0
Liquidity:	Exceptional
Support:	0
Group support:	0
Government support:	0

IICRA--Insurance industry and country risk assessment. Note: Support does not consider ratings above sovereign criteria.

Related Criteria

- 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
- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 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
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria - Insurance - Life: Liquidity Model For U.S. And Canadian Life Insurers, April 22, 2004

Ratings Detail (As Of May 23, 2018)	
Pacific LifeCorp	
Counterparty Credit Rating	
Local Currency	A-/Stable/--
Senior Unsecured	A-
Related Entities	
Aviation Capital Group LLC	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
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
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.