# ANNUAL REPORT

PACIFIC LIFE FUNDING, LLC

## *Pacific Life Funding, LLC*

(Incorporated with limited liability in the Cayman Islands under company registration number 79187)

This report (the **"Annual Report"**) has been created in accordance with the requirements of the Netherlands Financial Markets Supervision Act (*Wet op het financieel toezicht*).

Unless the context otherwise requires, references in this Annual Report to **"Pacific Life"** mean Pacific Life Insurance Company, a stock life insurance company domiciled in the State of Nebraska, on a stand-alone basis. Unless the context otherwise requires, references in this Annual Report to the **"Company"** mean Pacific Life, together with its subsidiaries.

Unless otherwise specified, the financial information contained in this Annual Report (1) has been prepared in accordance with accounting principles generally accepted in the United States of America (**"GAAP"**), and (2) is derived from the Company's audited GAAP consolidated financial statements, including the notes thereto, as of December 31, 2012 and 2011 (As Adjusted) and for the years ended December 31, 2012 and December 31, 2011 and 2010 (As Adjusted) (the **"Audited GAAP Financial Statements"**).

Dated: April 29, 2013

## MANAGEMENT REPORT

### PACIFIC LIFE FUNDING, LLC

### Background

Pacific Life Funding, LLC (**"PLF"**) is an exempted company incorporated in the Cayman Islands with limited liability on January 23, 1998 pursuant to the Companies Law of the Cayman Islands.

The only business activity of PLF is to issue debt instruments and to purchase funding agreements from Pacific Life. The indentures governing the terms of the instruments issued by PLF prohibit PLF from engaging in any other business activity. PLF has not issued any instruments or purchased any funding agreements since 2005. Between its organization in 1998 and 2005, PLF issued $5,813 million in aggregate principal amount of instruments, of which $918 million aggregate principal amount remained outstanding as of December 31, 2012. PLF issued these instruments in a variety of currencies and with maturities that varied from one to 20 years both to institutional investors in a variety of jurisdictions and to retail investors in the United Kingdom, The Netherlands, Germany and Switzerland.

PLF's principal assets are funding agreements issued by Pacific Life. Each outstanding series of instruments issued by PLF is secured by one or more funding agreements. No instruments of a series have any right to receive payments under a funding agreement related to any other series of instruments. Accordingly, PLF is only able to make timely payments with respect to a series of instruments if Pacific Life has made all required payments under the funding agreements securing such series of instruments. Because PLF's ability to satisfy its obligations under a series of instruments depends upon Pacific Life's performance under the related funding agreements, this Annual Report includes detailed information regarding Pacific Life. See "Pacific Life Insurance Company" below.

The obligations of PLF evidenced by the instruments are not obligations of, and are not guaranteed or insured by, any other person, including, but not limited to, Pacific Life or any of its subsidiaries or affiliates. None of these entities nor any agent or trustee of PLF is under any obligation to provide funds or capital to PLF, except for Pacific Life's payment obligations under the funding agreements and an agreement by Pacific Life to pay certain operating expenses of and fees to PLF. In addition, the instruments do not benefit from any insurance guaranty fund coverage or similar protection.

### Management

The directors of PLF are Ms. Dianne Farjallah and Mr. Martin Couch. Each of the directors is also an employee of MaplesFS Limited. MaplesFS Limited acts as administrator to PLF (the **"Administrator"**). The office of the Administrator serves as the general business office of PLF. Through the office, and pursuant to the terms of an administration agreement between PLF and the Administrator, the Administrator performs in the Cayman Islands various management functions on behalf of PLF, including communications with shareholders and the general public, and the provision of certain clerical, administrative and other services until termination of the administration agreement. The Administrator's principal office is P.O. Box 1093, Boundary Hall, Cricket Square, George Town, Grand Cayman KY1-1102, Cayman Islands. There are currently no committees of the board of directors. There are currently no existing or proposed service contracts between PLF or any subsidiary thereof and any of the directors of PLF. The directors of PLF are not currently entitled to remuneration or benefits in kind from PLF and do not currently hold any interests in the share capital of PLF.

### Capitalization

The authorized share capital of PLF is US$50,000 divided into 50,000 ordinary shares of US$1.00 each, 1,000 of which have been issued. All of the issued shares of PLF are fully paid and are held by MaplesFS Limited (the **"Share Trustee"**) under the terms of a Declaration of Trust dated April 15, 1998 (the **"Declaration of Trust"**) under which the Share Trustee holds the shares in trust. Under the terms of the

Declaration of Trust, so long as there are instruments outstanding, the Share Trustee may not sell or otherwise deal with the shares except to a person previously approved in writing by the indenture trustee for the instruments. It is not anticipated that any distribution will be made on the shares while any instrument is outstanding. When all of the outstanding instruments have matured or otherwise been redeemed, it is expected that the Share Trustee will wind up the trust and make a final distribution to charity. The Share Trustee has no beneficial interest in, and derives no benefit (other than its fee for acting as Share Trustee) from, its holding of the shares.

The following table presents PLF's capitalization as of December 31, 2012 prepared in conformity with GAAP. The information as of December 31, 2012 in this table is derived from the audited GAAP financial statements of PLF as of December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010.

| | December 31, 2012 |
|---|---|
| **Debt:** | |
| Short-term debt | – |
| Long-term debt | $ 918,165,498 |
| Total Debt | 918,165,498 |
| **Equity:** | |
| Paid-in capital | 1,000 |
| Retained earnings | 24,589 |
| Accumulated other comprehensive income | – |
| Total Equity | 25,589 |
| **Total capitalization** | $ 918,191,087 |

**Development of PLF's Business**

Other than as described herein, there were no developments having a material effect on PLF or its business during the year ended December 31, 2012. In addition, other than as described herein, there have been no recent developments having a material effect on PLF or its business since December 31, 2012. As of the date of this Annual Report, there exists no condition or event that would constitute an event of default under the terms of the instruments issued by PLF that are currently outstanding.

There are currently no indications that the business of PLF will change between the date of this report and June 30, 2013.

**STATEMENT OF RESPONSIBILITY**

**Pacific Life Funding, LLC**

The directors of PLF confirm, to the best of their knowledge, that:

- the financial statements of PLF included in this report were prepared in accordance with U.S. GAAP and applicable law; and
- this report constitutes a review by PLF's management of the business and position of PLF during the year ended December 31, 2012, and contains a fair review of that period.

Dated: April 29, 2013

/s/ Martin Couch
Martin Couch
Director

/s/ Dianne Farjallah
Dianne Farjallah
Director

**PACIFIC LIFE INSURANCE COMPANY**

**Selected Consolidated GAAP Financial Information of the Company**

The following tables set forth selected consolidated GAAP financial information for the Company. You should read it in conjunction with the sections of the Annual Report that follow and the Audited GAAP Financial Statements included in this Annual Report. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results may differ from such estimates. Additionally, the results for past accounting periods are not necessarily indicative of the results to be expected for any future accounting period.

The selected consolidated GAAP financial information for the Company as of December 31, 2012 and 2011 (other than "life insurance in force" and "employees" included in "Other Data") and for the years ended December 31, 2012, 2011 and 2010 has been derived from the Audited GAAP Financial Statements included in this Annual Report. The selected consolidated GAAP financial information for the Company as of December 31, 2010 (other than "life insurance in force" and "employees" included in "Other Data") has been derived from the Company's audited GAAP consolidated financial statements not included in this Annual Report.

In October 2010, the Financial Accounting Standards Board ("**FASB**"), issued Accounting Standards Update ("**ASU**") 2010-26 to the Accounting Standards Codification's Financial Services – Insurance Topic. ASU 2010-26 significantly amended the guidance applicable to accounting for costs associated with acquiring or renewing insurance contracts. The amendment specified that only the following costs incurred in the acquisition of new and renewal contracts should be capitalized: 1) incremental direct costs of contract acquisition and 2) certain costs related directly to underwriting, policy issuance and processing, medical and inspecting, and sales force contract selling activities. This amendment also specified that costs may only be capitalized based on successful contract acquisition efforts. The financial information presented in the following tables has been adjusted to reflect the retrospective adoption of this guidance.

As a result of this accounting change, total equity decreased due to the reduction of the Company's deferred policy acquisition cost ("**DAC**") asset for deferred costs that did not meet the provisions of the revised standard. The impact of the retrospective adoption on previously reported December 31, 2011 and 2010 balances was a reduction in the DAC asset of $999 million and $829 million, respectively, and a reduction in total equity of $649 million and $545 million, after tax, respectively. The impact of the retrospective adoption on previously reported net income attributable to the Company for the years ended December 31, 2011 and 2010 was a decrease of $121 million and $6 million, respectively.

| | Consolidated Statements of Operations | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| | | (in millions) | |
| For the year ended December 31, 2011: | | | |
| Net income attributable to the Company | $ 683 | $ (121) | $ 562 |
| For the year ended December 31, 2010: | | | |
| Net income attributable to the Company | 472 | (6) | 466 |

| | Consolidated Statements of Financial Condition | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| | | (in millions) | |
| December 31, 2011: | | | |
| Total equity | $ 9,176 | $ (649) | $ 8,527 |
| December 31, 2010: | | | |
| Total equity | 7,930 | (545) | 7,385 |

| Consolidated Statements of Operations Data: | Years Ended December 31, 2012 | 2011 (As Adjusted) | 2010 (As Adjusted) |
|---|---|---|---|
| | | (in millions) | |
| Revenues: | | | |
| Policy fees and insurance premiums | $ 3,324 | $ 3,081 | $ 2,367 |
| Net investment income | 2,281 | 2,186 | 2,122 |
| Net realized investment loss | (349) | (661) | (94) |
| Other than temporary impairments | (63) | (153) | (113) |
| Investment advisory fees | 298 | 268 | 245 |
| Aircraft leasing revenue | 660 | 607 | 591 |
| Other income | 237 | 226 | 230 |
| Total revenues | 6,388 | 5,554 | 5,348 |
| Benefits and Expenses: | | | |
| Policy benefits paid or provided | 2,444 | 1,951 | 1,351 |
| Interest credited to policyholder account balances | 1,252 | 1,318 | 1,317 |
| Commission expenses | 648 | 122 | 836 |
| Operating and other expenses | 1,601 | 1,441 | 1,268 |
| Total benefits and expenses | 5,945 | 4,832 | 4,772 |
| Income from continuing operations before provision (benefit) for income taxes | 443 | 722 | 576 |
| Provision (benefit) for income taxes | (67) | 80 | 60 |
| Income from continuing operations | 510 | 642 | 516 |
| Discontinued operations, net of taxes | - | (9) | - |
| Net income | 510 | 633 | 516 |
| Less: net income attributable to the noncontrolling interest from continuing operations | (68) | (71) | (50) |
| Net income attributable to the Company | $ 442 | $ 562 | $ 466 |

| Consolidated Statements of Financial Condition: | December 31, 2012 | 2011 (As Adjusted) | 2010 (As Adjusted) |
|---|---|---|---|
| | | ($ in millions) | |
| Assets: | | | |
| Investments | $ 49,546 | $ 45,884 | $ 44,222 |
| Cash and cash equivalents | 2,256 | 2,829 | 2,270 |
| Restricted cash | 294 | 280 | 214 |
| Deferred policy acquisition costs | 4,329 | 4,264 | 3,606 |
| Aircraft leasing portfolio, net | 6,760 | 5,845 | 5,259 |
| Other assets | 3,305 | 3,069 | 2,579 |
| Separate account assets | 55,302 | 51,450 | 55,683 |
| Total assets | $ 121,792 | $ 113,621 | $ 113,833 |
| Liabilities and Equity: | | | |
| Liabilities: | | | |
| Policyholder account balances | $ 34,983 | $ 34,392 | $ 35,076 |
| Future policy benefits | 11,105 | 9,467 | 7,080 |
| Debt | 7,765 | 7,152 | 6,516 |
| Other liabilities | 3,069 | 2,633 | 2,093 |
| Separate account liabilities | 55,302 | 51,450 | 55,683 |
| Total liabilities | 112,224 | 105,094 | 106,448 |
| Equity: | | | |
| Common stock | 30 | 30 | 30 |
| Paid-in capital | 982 | 982 | 982 |
| Retained earnings | 6,489 | 6,177 | 5,761 |
| Accumulated other comprehensive income | 1,648 | 1,004 | 361 |
| Total stockholder's equity | 9,149 | 8,193 | 7,134 |
| Noncontrolling interest | 419 | 334 | 251 |
| Total equity | 9,568 | 8,527 | 7,385 |
| Total liabilities and equity | $ 121,792 | $ 113,621 | $ 113,833 |
| **Other Data:** | | | |
| Life insurance in force | $ 296,620 | $ 302,532 | $ 221,560 |
| Employees | 2,699 | 2,701 | 2,541 |

## Management’s Discussion and Analysis of Financial Condition and Results of Operations of the Company

*The following should be read in conjunction with the Selected Consolidated GAAP Financial Information of the Company set forth above and the Audited GAAP Financial Statements included in this Annual Report.*

### Background

Pacific Life was established in 1868 and is a Nebraska stock life insurance company that conducts business in the District of Columbia and every state except the State of New York. Pacific Life is a direct, wholly owned subsidiary of Pacific LifeCorp, a Delaware stock holding company. Pacific LifeCorp is a direct, wholly owned subsidiary of Pacific Mutual Holding Company (**“PMHC”**), a Nebraska mutual insurance holding company. PMHC and Pacific LifeCorp were created in 1997 when Pacific Life converted into a mutual insurance holding company structure. Under this mutual insurance holding company structure, certain owners of insurance policies and annuity contracts (other than funding agreements and certain other types of contracts) issued by Pacific Life are automatically members of PMHC. Members of PMHC have the right to elect the directors of PMHC, to vote on other matters coming to a vote of the members at annual and special meetings and to receive distributions of surplus in the event of the dissolution or liquidation of PMHC. Under Nebraska law and the applicable organizational and conversion documents, PMHC must at all times own at least 51% of the outstanding voting stock of Pacific LifeCorp, and Pacific LifeCorp must at all times own all of the voting stock of Pacific Life.

The Company’s primary business operations consist of life insurance, annuities, mutual funds, aircraft leasing and reinsurance. As of December 31, 2012, 2011 and 2010, the Company had $121.8 billion, $113.6 billion and $113.8 billion, respectively, in total assets, and total stockholder’s equity of $9.1 billion, $8.2 billion and $7.1 billion, respectively. Life insurance in force was $296.6 billion, $302.5 billion and $221.6 billion as of December 31, 2012, 2011 and 2010, respectively. Net income attributable to the Company was $442 million for the year ended December 31, 2012 as compared to $562 million for the year ended December 31, 2011 and $466 million for the year ended December 31, 2010.

On August 31, 2011, Pacific Life and Pacific Life Reinsurance (Barbados) Limited (**“PLRB”**), a newly formed insurer and wholly owned subsidiary of Pacific LifeCorp, acquired Manulife Financial Corporation's (**“Manulife”**) retrocession business. In July 2011, the Company acquired a pension advisory business, which began operations in a newly formed, wholly owned subsidiary of Pacific Life named Pacific Global Advisors LLC (**“PGA”**). See the Audited GAAP Financial Statements included in this Annual Report for additional information on these 2011 acquisitions.

Pacific Annuity Reinsurance Company (**“PARC”**) is organized and licensed as an Arizona domiciled captive reinsurance company and is subject to regulatory supervision by the Arizona Department of Insurance. PARC was initially formed as a wholly owned subsidiary of Pacific Life. On December 28, 2012, Pacific Life distributed all of PARC’s outstanding shares of common stock as a dividend to Pacific LifeCorp.

PARC was formed to reinsure benefits provided by variable annuity contracts and contract rider guarantees issued by Pacific Life. Base annuity contracts are reinsured on a modified coinsurance basis and the contract guarantees are reinsured on a coinsurance with funds withheld basis. On December 1, 2012, the effective date of the reinsurance agreement, Pacific Life initially ceded 5% of its existing variable annuity business to PARC and has and will cede 5% of new business issued thereafter.

Pacific Life’s principal administrative offices are at 700 Newport Center Drive, Newport Beach, California, in a 285,000 square-foot office building it owns.

### Segments

The Company's primary operating segments are: Life Insurance, Retirement Solutions, Aircraft Leasing, Reinsurance and Corporate and Other, as well as its principal subsidiaries and affiliates.

The Life Insurance segment provides a broad range of life insurance products through multiple distribution channels operating in the upper income and corporate markets. Principal products include universal life and interest sensitive whole life; indexed universal life; variable universal life; survivor life; variable survivor; variable corporate owned life insurance; and traditional products such as whole life and term life. Distribution channels include regional life offices, marketing organizations, broker-dealer firms, wirehouses and M Financial, an association of independently owned and operated insurance and financial producers. As of December 31, 2012 and 2011, the Life Insurance segment represented 28% and 27% of the Company's total assets, respectively.

The Retirement Solutions segment's principal products include a diversified range of variable and fixed annuity products, mutual funds and institutional and structured products, such as structured settlement annuities and group retirement annuities, through multiple distribution sources. Distribution channels include independent planners, financial institutions and national/regional wirehouses. As of December 31, 2012 and 2011, this segment represented 60% and 58% of the Company's total assets, respectively.

The Aircraft Leasing segment encompasses the operations of Aviation Capital Group Corp. (**"ACG"**), a wholly owned subsidiary of Pacific Life. This segment focuses on acquiring, leasing, managing and trading commercial jet aircraft, while also engaging in long-term aviation investments in owned aircraft, third-party aircraft management advisory services, aircraft trading activities and aircraft brokerage services. The Aircraft Leasing segment's portfolio included, as of December 31, 2012, 250 owned and managed aircraft. As of December 31, 2012 and 2011, the Aircraft Leasing segment represented 7% of the Company's total assets.

The Reinsurance segment primarily includes the domestic life portion of the retrocession business acquired from Manulife in 2011 and international reinsurance the Company has assumed from Pacific Life Re Limited, a wholly owned subsidiary of Pacific LifeCorp incorporated in the United Kingdom. As of December 31, 2012 and 2011, the Reinsurance segment represented 1% of the Company's total assets.

The Corporate and Other segment consists of all other assets, liabilities and activities not allocated to any other segment. Corporate and Other provides various corporate administrative and investment management services on behalf of the other business segments, the majority of which are allocated to the segments at cost. Additionally, the Corporate and Other segment manages the surplus assets of the Company, issues long-term and short-term debt, engages in entity level hedging activities and manages the Company's institutional investment products in addition to other Corporate activities. Discontinued operations are also included in the Corporate and Other segment.

### Principal Subsidiaries and Affiliates

ACG was founded in 1989 and comprises the Company's Aircraft Leasing segment. ACG's business focuses on acquiring, leasing, managing and trading commercial jet aircraft to airlines worldwide. ACG is headquartered in Newport Beach, California (U.S.), and has regional offices in Seattle (U.S.), Shanghai (China), Beijing (China), Singapore and Santiago (Chile) and representatives in the United Kingdom. ACG's business is comprised of two basic components. The first component is ACG's primary focus and consists of long-term aviation investments in owned aircraft, which ACG offers to its clients worldwide under operating leases. The second component involves third-party aircraft management advisory services, aircraft trading activities and aircraft brokerage services.

Pacific Life & Annuity Company (**"PL&A"**) is a stock life insurance company domiciled in Arizona and is a wholly owned subsidiary of Pacific Life. PL&A markets and distributes variable universal life, structured settlement annuities, guaranteed investment contracts and variable annuities. PL&A is licensed to sell certain of its products in the state of New York and currently sells variable universal life insurance, term life insurance, variable annuity products and institutional products and services in New York. Additionally, PL&A has been deemed to be commercially domiciled in the state of New York and subject to certain requirements under New York insurance law that do not otherwise apply to New York-licensed insurers domiciled outside New York.

Pacific Select Distributors, Inc. (**"PSD"**) is a registered broker-dealer and a wholly owned subsidiary of Pacific Life that serves as the underwriter and wholesale distributor of the Company's registered investment-related products and services, principally variable life and annuity contracts and retail mutual funds. Effective May 1, 2007, a service plan adopted by the Pacific Select Fund went into effect whereby the fund pays PSD, as distributor of the fund, a service fee in connection with services rendered or procured to or for shareholders of the fund or its variable contract owners. These services may include, but are not limited to, payment of compensation to broker-dealers, including PSD itself, and other financial institutions and organizations that assist in providing any of the services.

The Company's former broker-dealer operations have been reflected as discontinued operations in the Audited GAAP Financial Statements included in this Annual Report. In March 2007, the Company classified its broker-dealer subsidiaries, other than PSD, as held for sale. During 2008 and 2007, these broker-dealers were sold. Discontinued operations do not include the operations of PSD.

Pacific Asset Holding LLC (**"PAH**") is a wholly owned subsidiary of Pacific Life that invests in commercial real estate properties and ventures, and other private equity investments.

Pacific Life Fund Advisors LLC (**"PLFA"**), a wholly owned subsidiary of Pacific Life formed in 2007, serves as the investment adviser for the Pacific Select Fund, an investment vehicle provided to our variable life insurance policyholders and variable annuity contract owners, and the Pacific Life Funds, the investment vehicle for our mutual fund products. Prior to May 1, 2007, Pacific Life served in this capacity. PLFA charges advisory and other fees based primarily upon the net asset value of the underlying portfolios.

PGA, a wholly owned subsidiary of Pacific Life, acquired JP Morgan Chase's Pension Advisory Group in 2011. PGA's target market is businesses and plan trustees managing employee defined benefit retirement plans. PGA's expertise is in the delivery of advisory services concentrated in the areas of liability-driven investing, hedging, risk management, and actuarial services.

Pacific Alliance Reinsurance Company of Vermont ("**PAR Vermont**"), a wholly owned subsidiary of Pacific Life, is a captive life reinsurance company domiciled in Vermont. PAR Vermont is licensed as a special purpose financial captive insurance company in accordance with Vermont captive insurance laws and was formed in 2007 to provide reinsurance exclusively to Pacific Life for certain no lapse guarantee rider benefits ("**NLGRs**") of Pacific Life's universal life, insurance products subject to AG38 statutory reserving requirements. AG38 results in additional statutory reserves on universal life products with NLGRs issued after June 30, 2005. Substantially all statutory reserves relating to NLGRs issued after June 30, 2005 through approximately March 31, 2010 have been ceded from Pacific Life to PAR Vermont. In August 2011, PAR Vermont was accredited as an authorized reinsurer in Nebraska, making it unnecessary for Pacific Life to provide security for statutory reserve credits taken by Pacific Life. Funded economic reserves and a letter of credit agreement with a maximum commitment amount of $843 million and expiration date of October 2031 support the statutory reserves at PAR Vermont. As of December 31, 2012, the letter of credit amounted to $495 million. The letter of credit agreement is non-recourse to Pacific LifeCorp or any of its affiliates, other than PAR Vermont. The letter of credit facility is supported by an excess reinsurance facility through a Vermont captive reinsurer named Pacific Alliance Excess Reinsurance ("**PAX Re**"); Pacific LifeCorp has provided a capital maintenance agreement for the benefit of PAX Re.

### Revenues and Expenses

The Company derives operating revenues from (1) premiums and policy fees on life and other insurance products, (2) net investment income from general account assets, (3) asset management fees and mortality and expense fees related to variable annuities and variable life insurance policies and (4) fees for other services, including aircraft leasing revenue. Under GAAP, total premiums paid on guaranteed premium policies are included in revenues with a corresponding expense for increases in policy reserves. For universal life and investment-type products, amounts received from policyholders are considered deposits and are not recorded as revenues, and increases in reserves are not shown as an expense. Only the amounts deducted from policy values for mortality and expenses, as and when deducted, are recorded as revenues on universal life and investment-type products.

Operating earnings result primarily from (1) the spread between the rates earned on invested assets and the rates credited to policyholders, (2) the fees earned on mortality and expense charges on variable products, (3) investment advisory fees earned on separate account assets and (4) income generated from aircraft leasing. Operating earnings are affected by claims experience and the persistency of policies and their continuing premiums and the investment markets. In addition, the Company seeks to increase earnings by carefully managing operating expenses through its budgeting process, monitoring of expense recoveries and improvements through the use of technology. Included in operating expenses are components such as salary and wages, employee benefits, rent, professional services, interest, depreciation and other sundry expenses.

### Results of Operations

***Year Ended December 31, 2012 compared to the Year Ended December 31, 2011***

Net income attributable to the Company during 2012 was $442 million as compared to $562 million for 2011. The decrease in net income attributable to the Company was primarily due to higher macro equity hedge losses partially offset by higher gains from real estate sales in the Corporate and Other segment. In addition, in the Life Insurance segment, there were losses during 2012 from lower expense spreads, lower capital gains and higher reserves on secondary guarantee business. In the Retirement Solutions segment, net income was higher in 2012 due to lower net losses from certain embedded derivatives related to variable annuity guaranteed living benefits, net of reinsurance, hedges and rider policy fees in 2012 as compared to 2011, that were driven by higher market returns, lower interest rates and lower implied volatility and tightening credit spreads. In addition, 2011 included gains from dedesignated cash flow hedges (forward starting swaps) compared to losses in 2012. For more information, see the discussion of the consolidated statement of operations line items below.

Policy fees and insurance premiums for 2012 were $3,324 million compared to $3,081 million for 2011, an increase of 8%. Policy fees consist of cost-of-insurance charges, expense loads, surrender charges and other fees related to products. The Reinsurance segment had increased premiums due to the acquisition of Manulife's retrocession business in August 2011. In addition, there was an increase in insurance premiums in 2012 as compared to 2011 resulting from the sale of life contingent payout annuities in the Retirement Solutions segment. These increases in insurance premiums were offset somewhat by a decrease in the Life Insurance segment's policy fees principally due to decreased unearned revenue reserve amortization and lower surrender charges, partly offset by increased cost of insurance and policy charges.

Net investment income increased from $2,186 million in 2011 to $2,281 million in 2012. The increase in 2012 as compared to 2011 was primarily related to higher investment income from mortgage loan, real estate and fixed maturity investments, partially offset by lower returns from all other investments.

Net realized investment loss for 2012 amounted to $349 million compared to $661 million for 2011. The primary reason for the lower net realized investment loss was lower net losses from certain embedded derivatives related to variable annuity guaranteed living benefits in the Retirement Solutions segment, net of reinsurance, hedges and rider policy fees in 2012 as compared to 2011. These lower losses were partially offset by net losses in 2012 as compared to net gains in 2011 related to the macro equity hedges and forward starting swaps. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of net realized investment gain (loss).

Other than temporary impairments ("**OTTI**") decreased from $153 million for 2011 to $63 million in 2012 primarily from lower OTTI from the Company's residential mortgage-backed securities and corporate securities portfolios. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of OTTI.

Investment advisory fees increased $30 million, or 11%, to $298 million in 2012 as compared to $268 million in 2011. This increase was due to the acquisition of PGA that occurred in July 2011 and rising mutual fund assets driven by strong mutual fund sales in 2012 for the Retirement Solutions segment.

Aircraft leasing revenue increased $53 million to $660 million in 2012 as compared to $607 million in 2011. This increase of $53 million was due to the acquisition and placement of 32 new aircraft with commercial airlines in the Aircraft Leasing segment.

Other income increased $11 million to $237 million in 2012 as compared to $226 million in 2011. The increase of $11 million was primarily due to a claims settlement and higher mutual fund related administrative and service fees driven by rising mutual fund assets and sales in the Retirement Solutions segment, partially offset by fewer sales of aircraft in 2012 in the Aircraft Leasing segment.

Policy benefits paid or provided increased $493 million, or 25%, to $2,444 million for 2012 as compared to $1,951 million for 2011. This increase was mainly attributable to the Company's Reinsurance segment, which also experienced a corresponding increase in insurance premiums as described above. In addition, there was an increase in life contingent payout annuity benefits and general account reserve increases in the Company's Retirement Solutions segment. The Life Insurance segment also experienced an increase primarily from increased reserves on its secondary guarantee business.

Interest credited to policyholder account balances decreased to $1,252 million for 2012 as compared to $1,318 million for 2011. This decrease was primarily the result of less interest credited as a result of declining liabilities in corporate products in the Company's Corporate and Other segment, partially offset by an increase in interest credited on larger policyholder account values in the Life Insurance segment.

Commission expenses for 2012 increased $526 million to $648 million from $122 million for 2011. Commission expenses include components of DAC. The increase in commission expenses primarily relates to DAC amortization in the Company's Retirement Solutions segment, which had negative DAC amortization in 2011, driven by net rider losses, compared to positive amortization in 2012. This was partly offset by a decrease in the Life Insurance segment as a result of decreased amortization.

Operating and other expenses for 2012 increased by $160 million, or 11%, from $1,441 million to $1,601 million as compared to 2011. Operating and other expenses include components of DAC, and the amortization of DAC is dependent on various factors that affect future gross profits by business segment. The 2012 increase was primarily due to an increased DAC amortization in the Retirement Solutions segment and higher distribution expenses. The Company's Aircraft Leasing segment had increased maintenance expense and increased depreciation of aircraft in 2012 due to an increase in the number of aircraft. Interest expense also increased in the Corporate and Other segment as 2011 interest expense was reduced by gains from interest rate swaps. These swaps were terminated at the end of 2011.

The benefit from income taxes for 2012 amounted to $67 million as compared to an expense of $80 million for 2011. The decrease in taxes in 2012 compared to 2011 was primarily due to a decrease in pre tax income and a nonrecurring deferred tax liability basis adjustment. Income taxes were also lower than the statutory rate due to dividends received deductions, the transfer of aircraft to Singapore and the utilization of low income housing and foreign tax credits.

***Year Ended December 31, 2011 compared to the Year Ended December 31, 2010***

Net income attributable to the Company increased $96 million from $466 million in 2010 to $562 million in 2011. The increase was primarily due to macro hedging gains during 2011 compared to losses during 2010 and from higher returns from the corporate surplus portfolio in the Corporate and Other segment. Additionally, there were higher gains during 2011 from dedesignated cash flow hedges (forward starting swaps) in the Retirement Solutions segment. These gains were partially offset by slightly lower income in the Aircraft Leasing segment. For more information, see the discussion of the consolidated statement of operations line items below.

Policy fees and insurance premiums increased $714 million in 2011 to $3,081 million as compared to $2,367 million in 2010. Policy fees consist of cost-of-insurance charges, expense loads, surrender charges and other fees related to products. The Retirement Solutions segment had an increase in insurance premiums and policy fees of $436 million principally from sales of a new product and higher retail contract fees. Also contributing to the increase was an increase in insurance premiums of $188 million in the Reinsurance segment, primarily due to the Manulife life retrocession business acquired in 2011. Policy fees also increased in the Life Insurance segment primarily as the result of higher policy charges.

Net investment income increased from $2,122 million in 2010 to $2,186 million in 2011. The increase was primarily related to higher investment income from mortgage loan and real estate investments and higher returns from partnership and joint venture investments, partially offset by lower investment income from fixed maturity securities and other investments.

Net realized investment loss for 2011 was $661 million compared to a net realized investment loss of $94 million for 2010. This increase in net realized investment loss was primarily related to higher net losses from certain embedded derivatives related to variable annuity guaranteed living benefits in the Retirement Solutions segment, net of reinsurance, hedges and rider policy fees in 2011 as compared to 2010, primarily as a result of lower interest rates. Partially offsetting these losses were gains from the Company's macro hedging in the Corporate and Other segment. In addition, the Company experienced higher gains on forward starting interest rate swaps and foreign currency interest rate swaps in 2011 as compared to 2010. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of net realized investment gain (loss).

OTTIs increased to $153 million in 2011 as compared to $113 million in 2010. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of OTTI.

Investment advisory fees increased $23 million to $268 million in 2011 from $245 million in 2010. This increase was primarily attributable to fees earned in 2011 related to the PGA acquisition and higher advisory fees earned in the Retirement Solutions segment on higher average separate account assets under management.

Aircraft leasing revenue increased $16 million to $607 million in 2011 from $591 million in 2010. This increase was primarily the result of an increase in operating lease revenue due to the addition of aircraft to the portfolio, partially offset by an increase in the number of aircraft sold, lower lease rates on certain existing aircraft and an increase in the number of aircraft in transition.

Other income was $226 million in 2011 as compared to $230 million in 2010. Other income for the Aircraft Leasing segment decreased due to a reduction in the release of maintenance reserves, based on the timing of lease transitions, into earnings when the liabilities no longer exist, partially offset by an increase in the gains on sales of aircraft. Additionally, the Retirement Solutions segment had higher service and other fees.

Policy benefits paid or provided increased $600 million to $1,951 million for 2011 from $1,351 million for 2010. The increase was primarily related to higher policy benefits in the Retirement Solutions segment, principally from higher reserves. Also contributing to the increase was an increase in policy benefits in the Reinsurance segment primarily due to the Manulife life retrocession business acquired in 2011.

Interest credited to policyholder account balances was $1,318 million for 2011 compared to $1,317 million for 2010. This slight increase of $1 million was attributable to an increase in the Retirement Solutions segment's average fixed account liability balances and an increase in the Life Insurance segment's policyholder account values, partially offset by a decrease in crediting rates and a decrease in the Corporate and Other segment's institutional investment products resulting from liability maturities.

Commission expenses for 2011 decreased $714 million to $122 million compared to $836 million in 2010. Commission expenses include components of DAC and vary with the level of sales by business segment due to the mix of products, as well as the change in the embedded derivative related to variable annuity guaranteed living benefits and hedges in the Retirement Solutions segment. The decrease in commission expenses in 2011, as compared to 2010, was primarily related to the Retirement Solutions segment, which allocated negative DAC amortization to commission expenses, driven by variable annuity guaranteed living benefit embedded derivative and hedge losses in 2011 and the Company's change in accounting method relating to the DAC amortization method effective October 1, 2011. Partially offsetting this decrease was a net increase for the Life Insurance segment's higher DAC amortization.

Operating and other expenses for 2011 increased by $173 million compared to 2010, from $1,268 million to $1,441 million. Operating and other expenses include components of DAC, and the amortization of DAC is dependent on various factors that affect future gross profits by business segment, including the change in the embedded derivative related to variable annuity guaranteed living benefits and hedges, in the Retirement Solutions segment. The Retirement Solutions segment had lower operating expenses in 2011 as compared to 2010, primarily resulting from negative DAC amortization allocated to operating expenses, driven by variable annuity guaranteed living benefit embedded derivative, hedge losses in 2011 and the Company's change in accounting method relating to the DAC amortization method effective October 1, 2011. The Life Insurance segment had increases in operating and other expenses in 2011 as compared to 2010. The Aircraft Leasing segment had an increase in operating expenses primarily due to higher aircraft maintenance expenses, aircraft depreciation, operating lease expenses and interest expense. The Reinsurance segment's operating expenses were higher due to the Manulife retrocession business acquired in 2011.

The provision for income taxes for 2011 amounted to $80 million compared to $60 million for 2010. The increase in tax expense was primarily due to higher income before tax in 2011. The taxes in 2011 and in 2010 were lower than the statutory rate primarily due to the separate account dividends received deductions and utilization of low income housing and foreign tax credits. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on income taxes.

**Assets**

As of December 31, 2012, the Company had total assets of $121.8 billion as compared to $113.6 billion as of December 31, 2011. This increase in total assets was partially due to an increase in separate account assets from $51.5 billion at December 31, 2011 to $55.3 billion at December 31, 2012. Total investments also increased from $45.9 billion as of December 31, 2011 to $49.5 billion as of December 31, 2012, primarily due to increases in fixed maturity securities. The Company's aircraft leasing portfolio also increased by $0.9 billion from December 31, 2011 to December 31, 2012. The increase in total assets was partially offset by a $0.6 billion decrease in cash and cash equivalents. See the Audited GAAP Financial Statements included in this Annual Report for additional information on investments.

As of December 31, 2011, the Company had total assets of $113.6 billion as compared to $113.8 billion as of December 31, 2010. This slight decrease in total assets was partly attributable to a decrease in separate account assets from $55.7 billion at December 31, 2010 to $51.5 billion at December 31, 2011 due primarily to the decline in the equity markets during 2011. Partially offsetting this decrease was an increase to total investments of $1.7 billion, an increase in cash and cash equivalents of $0.5 billion, an increase in DAC of $0.7 billion, an increase in the aircraft leasing portfolio of $0.6 billion and an increase in other assets of $0.5 billion.

**Liabilities**

As of December 31, 2012, the Company had total liabilities of $112.2 billion as compared to $105.1 billion as of December 31, 2011. This increase in total liabilities was primarily a result of the increase in separate account liabilities from $51.5 billion as of December 31, 2011 to $55.3 billion as of December 31, 2012. Future policy benefits also increased to $11.1 billion as of December 31, 2012 as compared to $9.5 billion as of December 31, 2011. Debt increased by $0.6 billion primarily due to the issuance of debt by the Aircraft Leasing segment. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on liabilities.

As of December 31, 2011, the Company had total liabilities of $105.1 billion as compared to $106.4 billion as of December 31, 2010. This decrease in total liabilities was primarily a result of the decrease in separate account liabilities from $55.7 billion as of December 31, 2010 to $51.5 billion as of December 31, 2011, primarily due to the decline in the equity markets during 2011. The decrease was also due to a decrease in policyholder account balances of $0.7 billion. The decrease in liabilities was partially offset by increases in future policy benefits of $2.4 billion, long-term debt of $0.6 billion and other liabilities of $0.5 billion.

**Liquidity and Capital Resources**

The Company's principal capital resources come from insurance premiums, deposits to policyholder account balances, investment income, sales, maturities, calls and principal repayments of investments and cash flows from other operations, including aircraft leasing revenue. The principal uses of these funds are investment purchases, payment of policy acquisition costs, payment of policyholder benefits, withdrawal of policyholder account balances, income taxes and current operating expenses. Remaining funds not used as noted above are generally used to increase the asset base, to provide funds to meet the need for future policy benefit payments and for writing new business. As described below, total cash and cash equivalents decreased $573 million during 2012 as compared to an increase $559 million during 2011 and an increase of $351 million during 2010.

Net cash provided by operating activities was $3,555 million during 2012, $3,589 million during 2011 and $3,024 million during 2010. Net cash provided by operating activities can vary depending on the level and type of sales, particularly those of annuity and other investment-type products. For example, sales of universal life insurance products and investment-type products result in cash flows that are predominantly shown as cash flows from financing activities rather than as cash flows from operations, while sales of variable products result in cash flows that are predominantly reflected in the separate accounts and are not a part of the cash flow statement.

Net cash used in investing activities was $3,905 million during 2012, $1,195 million during 2011 and $2,301 million in 2010. Net cash used in investing activities was higher in 2012 as compared to 2011 primarily due to higher purchases and lower sales of fixed maturity and equity securities, lower repayments of mortgage loans, and net cash outflows for collateral received or pledged as compared to net cash inflows in 2011, partially offset by lower fundings of mortgage loans and real estate and higher proceeds from sale of real estate. Net cash used in investing activities was lower in 2011 as compared to 2010 due to lower purchases of fixed maturity and equity securities and the aforementioned increase in cash received from the Manulife retrocession business acquisition in 2011, partially offset by higher fundings of mortgage loans and real estate and higher purchases and advance payments on aircraft. It is the Company's objective to remain fully invested in assets with maturities and yields that it believes are matched to its product liabilities. As assets mature, are redeemed or are sold, the Company evaluates the available investment alternatives, reinvests according to existing and expected product liabilities and seeks to ensure that sufficient marketable assets and other sources of liquidity are in place to provide for large unexpected demands for cash. Discrepancies between the timing of financial statement preparation and the timing of reinvestment activity sometimes result in the presentation of levels of short-term investments that are not typical of day-to-day operations. These short-term investments are considered cash equivalents.

Net cash used in financing activities was $223 million during 2012, $1,835 million during 2011 and $372 million in 2010. The decline in net cash used in financing activities for 2012 as compared to 2011 primarily related to higher policyholder account balance deposits and lower withdrawals. The increase in net cash used in financing activities in 2011 as compared to 2010 primarily related to higher policyholder account balance withdrawals, partially offset by higher deposits.

The payment of dividends by Pacific Life to Pacific LifeCorp is subject to restrictions set forth in the insurance laws of the State of Nebraska. Under these laws, Pacific Life must deliver notice to the Nebraska Department of Insurance of any dividend or distribution to Pacific LifeCorp within five business days after declaration of the dividend or distribution, and may not pay the dividend or distribution to Pacific LifeCorp within the ten business day period following delivery of such notice unless the Nebraska Department of Insurance approves payment of the dividend or distribution within such ten business day period. In addition, Pacific Life may not pay an “extraordinary” dividend or distribution to Pacific LifeCorp until the Nebraska Department of Insurance has either (i) approved the payment of the dividend or distribution or (ii) not disapproved the payment of the dividend or distribution within thirty days after receiving notice of the declaration of the dividend or distribution. For purposes of applicable Nebraska law, an “extraordinary” dividend or distribution is a dividend or distribution of cash or other property with a fair market value that, together with that of other dividends or distributions made by Pacific Life to Pacific LifeCorp within the preceding twelve months, exceeds the greater of either (i) 10% of Pacific Life’s statutory policyholders surplus as of the preceding December 31 or (ii) Pacific Life’s statutory net gain from operations for the twelve month period ending the preceding December 31. Based on the 2012 statutory results, Pacific Life could pay $774 million in ordinary dividends or distributions during 2013, subject to the ten business day notice period described above. Dividends in excess of such amount would be considered “extraordinary” dividends or distributions for purposes of Nebraska law and would be subject to the thirty day notice and non-disapproval requirement described above. During 2012, 2011 and 2010, Pacific Life paid dividends as determined on a statutory accounting basis to Pacific LifeCorp of $133 million, $125 million and $150 million, respectively.

***Liquidity and Capital Sources and Requirements***

The Company’s liquidity needs vary by product line. Factors that affect each product line’s need for liquidity include interest rate levels, customer type, termination or surrender charges, Federal income taxes, benefit levels and level of underwriting risk. Pacific Life’s asset/liability management strategy takes into account the varying liquidity needs of its different product lines.

The Company believes that its product mix contributes to its strong liquidity position. The Company's blocks of variable life insurance and variable annuity contracts also limit its liquidity risk because the customer bears most of the investment risk for these types of products. A primary liquidity concern for the Company is the risk of early contract owner and policyholder withdrawals. The Company closely evaluates and manages this risk. A significant portion of the Company’s life insurance, institutional and annuity products contain surrender charges for varying durations or fair value adjustments, reducing the risk that customers will seek withdrawals during the periods when surrender charges or fair value adjustments are in place. Surrender charges or fair value adjustments help the Company to better plan the maturities of its invested assets by reducing the risk that future outflows will exceed anticipated levels. In addition, the Company monitors ACG’s liquidity requirements for future commitments to purchase aircraft. See the discussion below of ACG’s facilities to access the debt markets to meet their liquidity needs to fund future aircraft commitments.

The following table describes Pacific Life’s withdrawal characteristics of certain annuity actuarial reserves and deposit-type contracts, including guaranteed interest contracts (**“GICs”**), and funding agreements. Amounts are derived from Pacific Life’s statutory financial information at the dates noted.

| | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Amount | % of Total | Amount | % of Total |
| | ($ in millions) | | | |
| Subject to discretionary withdrawal: | | | | |
| With fair value adjustment | $ 3,594 | 5% | $ 3,267 | 5% |
| At book value less current surrender charge of 5% or more | 3,595 | 6% | 3,511 | 6% |
| At fair value | 46,392 | 73% | 43,253 | 71% |
| Total with adjustment or at fair value | 53,581 | 84% | 50,031 | 82% |
| At book value without adjustment | 1,943 | 3% | 1,904 | 3% |
| Not subject to discretionary withdrawal | 8,242 | 13% | 9,271 | 15% |
| Total (gross) | 63,766 | 100% | 61,206 | 100% |
| Reinsurance ceded | 32 | | 60 | |
| Total (net) | $63,734 | | $61,146 | |

As noted in the table above, as of December 31, 2012 and 2011, only 3% of these liabilities were subject to withdrawal at book value without adjustment. The other 97% of these liabilities as of December 31, 2012 and 2011 were either subject to withdrawal with an adjustment or at fair value or were not subject to discretionary withdrawal. The products are designed in this manner to discourage early withdrawals and protect Pacific Life from liquidity risks. Pacific Life believes the structuring of liabilities in this manner provides it with a stable block of liabilities that reduces its exposure to unexpected cash withdrawals and demands and the adverse financial effects that could occur as a result.

In June 2009, Pacific Life issued an aggregate principal amount of $1.0 billion in surplus notes maturing on June 15, 2039. Pacific Life is required to pay interest on these surplus notes at an annual rate of 9.25%. Pacific Life also has outstanding $150 million of surplus notes due December 30, 2023 on which Pacific Life is required to pay interest at an annual rate of 7.90%. For both of these surplus note issuances, all future payments of interest and principal on these surplus notes can be made only with the prior approval of the Nebraska Director of Insurance.

In January 2013, the Company, with the approval of the Nebraska Department of Insurance, repurchased and retired $323 million of the outstanding 9.25% surplus notes through a tender offer. The repurchase of the 9.25% surplus notes will be accounted for as an extinguishment of debt and the related unamortized deferred gains, and the premium paid, will be recognized in 2013.

In February 2010, Pacific LifeCorp issued $450 million of senior notes at a fixed interest rate of 6.0%, maturing on February 10, 2020. Interest is payable semiannually on February 10 and August 10. Pacific LifeCorp may redeem all or a portion of the notes at any time at the redemption price described under the terms of the senior notes. In March 2010, the Nebraska Director of Insurance approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for $450 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on February 5 and August 5 at a fixed annual rate of 6.0%. All future payments of interest and principal on the internal surplus note can be made only with the prior approval of the Nebraska Director of Insurance. The internal surplus note matures on February 5, 2020.

In January 2013, Pacific LifeCorp issued $500 million of senior notes at a fixed interest rate of 5.125%, maturing on January 30, 2043. Interest is payable semiannually on January 30 and July 30. Pacific LifeCorp may redeem all or a portion of the notes at any time at the redemption price described under the terms of the senior notes. Also, in January 2013, the Nebraska Director of Insurance approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for $500 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on January 25 and July 25 at a fixed annual rate of 5.125%, subject to regulatory approval. The internal surplus note matures on January 25, 2043. Pacific Life used the proceeds from the issuance of this internal surplus note primarily for the repurchase of a portion of its 9.25% suplus notes discussed above.

The Company’s principal sources of liquidity to meet unexpected cash outflows are its portfolio of liquid assets and its net operating cash flow. Liquid assets include U.S. Treasury securities, short-term money market investments, and other marketable securities. Furthermore, the Company monitors and manages cash flows in order to maximize investment returns relative to client obligations and to minimize the number, length of time and severity of asset and liability cash flow mismatches.

Additional sources of liquidity include facilities for short-term borrowing to meet working capital requirements. Pacific Life maintains a $700 million commercial paper program. There was no commercial paper debt outstanding as of December 31, 2012, 2011 and 2010. In addition, a bank revolving credit facility totaling $400 million is also in place that serves as a back-up line of credit for the commercial paper program. The credit facility matures in November 2016. This facility had no debt outstanding as of December 31, 2012, 2011 and 2010. As of December 31, 2012, 2011 and 2010, and for the years ended December 31, 2012, 2011 and 2010, Pacific Life was in compliance with its debt covenants related to this credit facility.

PL&A maintains reverse repurchase lines of credit with various financial institutions. These borrowings are at variable rates of interest based on collateral and market conditions. There was no debt outstanding in connection with these lines of credit as of December 31, 2012, 2011 and 2010.

Pacific Life is a member of the Federal Home Loan Bank (“**FHLB**”) of Topeka. Pacific Life has approval from the FHLB of Topeka to advance amounts up to 40% of Pacific Life’s statutory general account assets provided it has available collateral and is in compliance with debt covenant restrictions and insurance laws and regulations. There was no debt outstanding with the FHLB of Topeka as of December 31, 2012, 2011 and 2010. Certain assets of Pacific Life are on deposit with the FHLB of Topeka which gave it additional funding capacity of $5 million and zero as of December 31, 2012 and 2011, respectively. Pacific Life also has the ability to issue funding agreements to the FHLB of Topeka in exchange for cash.

PL&A is a member of the FHLB of San Francisco. PL&A is eligible to borrow from the FHLB of San Francisco amounts based on a percentage of statutory capital and surplus and could borrow amounts up to $136 million. Of this amount, half, or $68 million, can be borrowed for terms other than overnight, out to a maximum term of nine months. These borrowings are at variable rates of interest, collateralized by certain mortgage loan and government securities. As of December 31, 2012, 2011 and 2010, PL&A had no debt outstanding with the FHLB of San Francisco.

Two key elements of ACG’s financing strategy are its continued development of a diverse array of financing options and the issuance of debt with maturities appropriate for its long-lived aircraft assets and leases. ACG historically has had access, and expects to continue to have access, to multiple sources of financing, including bank financings, the ABS market, private debt placements in the unsecured debt market and debt guaranteed by Ex-Im Bank and the European ECAs. ACG has revolving credit agreements with banks for an aggregate of $650 million borrowing capacity. Interest on these loans is at variable rates, payable monthly. The facilities expire on various dates from October 2013 through April 2015. There was $292 million and zero outstanding in connection with ACG’s revolving credit agreements as of December 31, 2012 and 2011, respectively. This credit facility is recourse only to ACG.

In January 2013, ACG entered into an additional unsecured revolving credit facility for a $125 million borrowing capacity. This facility is set to expire in January 2016.

#### ***Dividends and Distributions from Subsidiaries***

The subsidiaries of Pacific Life can provide other sources of liquidity through the payment of distributions and dividends. Dividends received from subsidiaries of Pacific Life have been nominal during the past few years.

The payment of dividends and other distributions by PL&A to Pacific Life is subject to restrictions set forth in the insurance laws of the State of Arizona. These laws require that PL&A notify the Arizona Department of Insurance of the declaration of any dividend or distribution to be paid by PL&A to Pacific Life. PL&A may not pay an "extraordinary" dividend or distribution to Pacific Life until the Arizona Department of Insurance has either (i) approved the payment of the dividend or distribution or (ii) not disapproved the payment of the dividend or distribution within thirty days after receiving notice of the declaration of the dividend or distribution. For purposes of applicable Arizona law, an "extraordinary" dividend or distribution is a dividend or distribution of cash or other property whose fair market value, together with that of other dividends or distributions made by PL&A to Pacific Life within the preceding twelve months, exceeds the lesser of either (i) 10% of PL&A's statutory policyholders surplus as of the preceding December 31 or (ii) PL&A's statutory net gain from operations for the twelve month period ending the preceding December 31. Based on this limitation and 2012 statutory results, PL&A could pay $35 million in dividends to Pacific Life in 2013 without prior regulatory approval. PL&A did not pay any dividends to Pacific Life during the years ended December 31, 2012, 2011 or 2010.

***General***

The Company believes that its sources of liquidity are adequate to meet its anticipated cash obligations.

There can be no assurance that future experience regarding benefits and surrenders will be similar to historic experience since withdrawal and surrender levels are influenced by such factors as the interest rate environment and the Company's claims-paying and financial strength ratings.

**Principal Risks and Uncertainties**

The Company operates in a business environment that is subject to various risks and uncertainties which are difficult to predict and could have a material adverse effect on the Company's financial condition or results of operations. These risks and uncertainties include:

- difficult economic conditions and volatility in the equity and credit markets and the global economy;
- changes in the valuation of derivatives relating to, and fluctuation in reserves held in respect of, guaranteed minimum benefit riders;
- changes in interest rates;
- changes in capital and credit market conditions, including the effectiveness of governmental and regulatory measures in the U.S. and elsewhere in stabilizing such markets;
- losses due to defaults by others, including issuers of investment securities or reinsurance and derivative counterparties;
- requirements to post collateral or make payments related to declines in value of specified assets, including in connection with declines in estimated fair value of fixed maturity securities, cash or cash equivalents posted as collateral under derivative contracts in the ordinary course of business, funding agreements and certain indebtedness;
- adverse legislative or regulatory developments;
- changes to the calculation of reserves and impact of Regulation XXX and Actuarial Guidance 38;
- new accounting rules or changes to existing accounting rules;

- downgrades or potential downgrades in Pacific Life's ratings;
- strong competition in the Company's business;
- changes in tax laws and the interpretation thereof;
- significant market valuation fluctuations of any of the Company's investments that are relatively illiquid;
- performance of the Company's investment portfolio, which could suffer reduced returns or losses adversely affecting its profitability, capitalization and liquidity;
- subjectivity in the valuation of fixed maturity, equity and trading securities;
- sensitivity of the statutory risk-based capital the Company is required to hold to factors outside of the Company's control;
- market capacity constraints on statutory reserve financings;
- litigation and regulatory investigations;
- lack of available, affordable or adequate reinsurance or retrocessional coverage;
- the inability of Pacific LifeCorp, the parent company of Pacific Life, to access its credit facilities and the availability of credit to the Company as a whole;
- deviations from assumptions regarding future persistency, mortality and interest rates used in calculating reserve amounts and pricing the Company's products;
- lower demand for aircraft or the availability of credit to ACG;
- the uncertain financial condition of aircraft and engine manufacturers;
- the impaired financial condition and liquidity of ACG's lessees and defaults under ACG's leases;
- the inability of ACG to recover its investment in aircraft through re-leasing or selling;
- the impact on ACG of high concentrations of particular models of aircraft;
- the advent of superior aircraft technology or introduction of new lines of aircraft on ACG;
- the inability to attract and retain key personnel;
- the occurrence of events that would require the acceleration of the amortization of DAC;
- the impact of current international tensions between the U.S. and other nations, including any terrorist attack, or on-going military and other actions, or a large-scale pandemic;
- exposure to unidentified or unanticipated risks;
- foreign currency risk;

- a computer system failure or security breach; and
- global climate changes.

### Recently Adopted Accounting Pronouncements

For a discussion of recently adopted accounting pronouncements, see the Audited GAAP Financial Statements included in this Annual Report.

### Legal Proceedings

The Company is a respondent in a number of legal proceedings, some of which involve allegations for extra-contractual damages. Although the Company is confident of its position in these matters, success is not a certainty and a judge or jury could rule against the Company. In the opinion of management, the outcome of such proceedings is not likely to have a material adverse effect on the Company's consolidated financial statements. The Company believes adequate provision has been made in its consolidated financial statements for all probable and estimable losses for litigation claims against the Company. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on litigation.

**Ratings**

An insurer's financial strength rating represents an opinion by the issuing rating agency regarding the ability of an insurance company to meet its financial obligations to its policyholders and contract holders. A rating is an opinion of the rating agency only and not a statement of fact or recommendation to purchase, sell or hold any security, policy or contract. These ratings do not imply approval of the Company's products and do not reflect any indication of their performance. There can be no assurance that Pacific Life's ratings will continue for any given period of time or that they will not be adjusted or withdrawn. A negative outlook indicates that the rating could change based on certain future events relating to the financial condition of the rated entity. Pacific Life's financial strength ratings and outlook as of the date of this Annual Report are set forth in the chart below.

| Rating Agency | Rating | Rating Structure | Ratings Outlook |
|---|---|---|---|
| Moody's Investors Service, Inc. | A1 (Good) | Fifth highest of 21 ratings | Stable |
| Standard and Poor's Rating Services | A+ (Strong) | Fifth highest of 21 ratings | Stable |
| Fitch Ratings | A+ (Strong) | Fifth highest of 21 ratings | Stable |
| A.M. Best Company, Inc. | A+ (Superior) | Second highest of 16 ratings | Stable |

Pacific Life's ratings are of interest to policyholders and holders of debt securities of Pacific Life and PLF, but are not ratings of the instruments issued by PLF and do not reflect an evaluation of the safety and security of such instruments.

**Employees**

As of December 31, 2012, the Company had approximately 2,700 employees. None of the Company's employees are covered by a collective bargaining agreement. The Company believes that its employee relations are satisfactory.

**Properties**

The Company's principal administrative offices are located at 700 Newport Center Drive, Newport Beach, California, in a 285,000 square-foot office building it owns. The Company also leases office space at various locations throughout the U.S. Other principal leases include other subsidiary home offices, regional life and other sales offices and storage facilities. The Company believes that its facilities are adequate for its present needs in all material respects.

**FINANCIAL STATEMENTS OF**
**PACIFIC LIFE FUNDING, LLC AND**
**PACIFIC LIFE INSURANCE COMPANY**

**Audited GAAP Financial Statements of Pacific Life Funding, LLC as of December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010**



**Audited GAAP Consolidated Financial Statements of Pacific Life Insurance Company as of December 31, 2012 and 2011 (As Adjusted) and for the years ended December 31, 2012 and December 31, 2011 and 2010 (As Adjusted)**

**AUDITED GAAP FINANCIAL STATEMENTS OF PACIFIC LIFE FUNDING, LLC AS OF DECEMBER 31, 2012 AND 2011 AND FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010**

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**INDEPENDENT AUDITORS' REPORT**

Pacific Life Funding, LLC:

We have audited the accompanying financial statements of Pacific Life Funding, LLC (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations and retained earnings and cash flows for each of the three years in the period ended December 31, 2012 and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Life Funding, LLC as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

April 15, 2013

Member of
Deloitte Touche Tohmatsu

*Pacific Life Funding, LLC*

B A L A N C E   S H E E T S
(Expressed in United States Dollars)

| *(In Thousands)* | December 31, 2012 | 2011 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $26 | $26 |
| Funding Agreements | 918,166 | 913,401 |
| Accrued interest receivable | 27,275 | 26,364 |
| **TOTAL ASSETS** | $945,467 | $939,791 |
| **LIABILITIES AND MEMBER'S EQUITY** | | |
| Liabilities: | | |
| Notes payable | $918,166 | $913,401 |
| Accrued interest payable | 27,275 | 26,364 |
| TOTAL LIABILITIES | 945,441 | 939,765 |
| Member's Equity: | | |
| Share capital | 1 | 1 |
| Retained earnings | 25 | 25 |
| TOTAL MEMBER'S EQUITY | 26 | 26 |
| **TOTAL LIABILITIES AND MEMBER'S EQUITY** | $945,467 | $939,791 |

See Notes to Financial Statements

*Pacific Life Funding, LLC*

STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
(Expressed in United States Dollars)

| | Years Ended December 31, | | |
|---|---|---|---|
| *(In Thousands)* | 2012 | 2011 | 2010 |
| **INCOME** | | | |
| Interest on Funding Agreements | $45,925 | $61,034 | $83,256 |
| Foreign exchange gain on Funding Agreements | 33,325 | 0 | 0 |
| Foreign exchange gain on notes payable | 0 | 89,642 | 91,004 |
| TOTAL INCOME | 79,250 | 150,676 | 174,260 |
| **EXPENSES** | | | |
| Interest on notes payable | 45,925 | 61,034 | 83,256 |
| Foreign exchange loss on Funding Agreements | 0 | 89,642 | 91,004 |
| Foreign exchange loss on notes payable | 33,325 | 0 | 0 |
| TOTAL EXPENSES | 79,250 | 150,676 | 174,260 |
| **NET INCOME** | $0 | $0 | $0 |
| **RETAINED EARNINGS, BEGINNING OF YEAR** | $25 | $25 | $25 |
| Net income | 0 | 0 | 0 |
| **RETAINED EARNINGS, END OF YEAR** | $25 | $25 | $25 |

See Notes to Financial Statements

*Pacific Life Funding, LLC*

STATEMENTS OF CASH FLOWS
(Expressed in United States Dollars)

| *(In Thousands)* | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | $0 | $0 | $0 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Change in accrued interest receivable | (911) | 20,857 | 4,516 |
| Change in accrued interest payable | 911 | (20,857) | (4,516) |
| Amortization on Funding Agreements | 0 | 0 | 749 |
| Amortization on notes payable | 0 | 0 | (749) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 0 | 0 | 0 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Proceeds from maturities of Funding Agreements | 28,560 | 489,105 | 167,525 |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | 28,560 | 489,105 | 167,525 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Redemption of notes payable | (28,560) | (489,105) | (167,525) |
| NET CASH USED IN FINANCING ACTIVITIES | (28,560) | (489,105) | (167,525) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 0 | 0 | 0 |
| Cash and cash equivalents, beginning of year | 26 | 26 | 26 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | $26 | $26 | $26 |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION** | | | |
| Interest paid | $45,014 | $81,891 | $88,521 |

See Notes to Financial Statements

## 1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Pacific Life Funding, LLC (the Company) was incorporated on January 23, 1998, as an exempted company under the Companies Law of the Cayman Islands and commenced operations on May 28, 1998. The Company has received an undertaking from the Cayman Islands government exempting it from all local income or capital gains taxes until February 17, 2018. No such taxes are levied in the Cayman Islands at the present time. The Company was established as a special purpose vehicle under the terms of a Charitable Trust. QSPV Limited, the trustee of the Charitable Trust, is the sole member of the Company.

The Company has established a program (the Program) for the issuance of up to $8 billion of debt instruments. Each series or tranche of instruments issued under the Program is secured by a funding agreement (the Funding Agreements) entered into between the Company and Pacific Life Insurance Company (Pacific Life), a stock life insurance company domiciled in the State of Nebraska. The Company has funded its investment in the Funding Agreements through the issuance of notes payable (Note 4). The creation and issuance of each series of notes is governed by an indenture dated April 15, 1998, as supplemented between the Company, Banque Generale du Luxembourg S.A. as Transfer Agent and Paying Agent, and The Bank of New York as trustee.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PRESENTATION

The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). According to the European Commission Decision 2006/891/ED of 4 December 2006, third country issuers may prepare their annual and semi-annual financial statements in accordance with U.S GAAP finding it equivalent to International Financial Reporting Standards (IFRS). The Company's functional currency is the dollar of the United States of America (U.S. dollar).

The Company has evaluated events subsequent to December 31, 2012 through April 15, 2013, the date the financial statements were available to be issued. There are no events subsequent to December 31, 2012 that require disclosure.

### CASH AND CASH EQUIVALENTS

Cash and cash equivalents include all investments with an original maturity of three months or less from the purchase date. The carrying values approximate fair values due to the short-term maturities of these instruments.

### FUNDING AGREEMENTS AND NOTES PAYABLE

The Funding Agreements and related notes payable (together, the Instruments) are reported at amortized cost, adjusted for changes in foreign exchange rates. The Funding Agreements have been classified as held to maturity. Most of the instruments are denominated in currencies other than the U.S. dollar and are subject to both exchange and interest rate fluctuations.

### FOREIGN CURRENCY TRANSLATION

Assets and liabilities denominated in currencies other than the U.S. dollar have been translated at exchange rates prevailing at the balance sheet date. Income and expenses involving other currencies have been translated at exchange rates in effect at the time of those transactions. Gains or losses on foreign exchange are recorded in the statements of operations and retained earnings.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of financial instruments, disclosed in Note 5, has been determined using available market information and appropriate valuation methodologies. However, considerable judgment is often required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented may not be indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a significant effect on the estimated fair value amounts.

USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those amounts.

## 3. TRANSACTIONS WITH AFFILIATES

The Funding Agreements, included on the balance sheets, were purchased from Pacific Life. In addition, the Company has an agreement in which certain general operating and administrative expenses of the Company are paid directly by Pacific Life. During the years ended December 31, 2012, 2011 and 2010, Pacific Life paid $125 thousand, $122 thousand and $192 thousand, respectively, on behalf of the Company for general operating and administrative expenses.

## 4. FUNDING AGREEMENTS/NOTES PAYABLE

Each series of notes payable issued under the Program is secured by one or more Funding Agreements. Under the terms of the Funding Agreements, Pacific Life agrees to accept, and the Company agrees to pay, net proceeds from the issuance of notes payable under the Program. The notes of one series do not have any right to receive payments under a funding agreement related to any other series of notes. Therefore, the Company is only able to make timely payments with respect to a series of notes payable if Pacific Life has made all required payments under the Funding Agreements securing such series of notes payable.

The Company's obligations under the notes payable are not obligations of, and are not guaranteed or insured by, any other person, including, but not limited to, Pacific Life or any of its subsidiaries or affiliates. None of these entities nor any agent or trustee of the Company is under any obligation to provide funds or capital to the Company, except for Pacific Life's payment obligations under the Funding Agreements and an agreement by Pacific Life to pay certain operating expenses of and fees to the Company. In addition, the Instruments do not benefit from any insurance guaranty fund coverage or similar protection.

The Instruments may be interest bearing or non-interest bearing, and any interest may accrue at either a fixed or floating rate. The notes mature on dates ranging from February 2013 to February 2021.

The following schedules detail the notes payable outstanding as of December 31, 2012 and 2011. The detail schedules for the Funding Agreements are not included, but would contain similar information, except that the schedules would reflect the investments related to the Instruments.

**4. FUNDING AGREEMENTS/NOTES PAYABLE (CONTINUED)**

December 31, 2012:

| Issue | Currency | Principal Denominated in Currency of Issuance (In Thousands) | Maturity | Interest Rate | Principal | Foreign Currency Gains (Losses) | Carrying Value |
|---|---|---|---|---|---|---|---|
| | | | | | ($ In Thousands) | | |
| Series 11 Tranche 1 | EUR | 36,500 | 3/12/2019 | 4.70 % | $40,880 | $7,241 | $48,121 |
| Series 36 Tranche 1 | EUR | 29,000 | 9/29/2020 | 3 mth EURIBOR + .37% | 25,418 | 12,815 | 38,233 |
| Series 39 Tranche 1 | GBP | 25,000 | 12/7/2015 | 5.81 % | 35,500 | 5,137 | 40,637 |
| Series 40 Tranche 1 | EUR | 27,000 | 2/5/2021 | 3 mth EURIBOR + .43% | 25,313 | 10,285 | 35,598 |
| Series 47 Tranche 1 | GBP | 150,000 | 8/16/2013 | 6.00 % | 214,000 | 29,823 | 243,823 |
| Series 47 Tranche 2 | GBP | 50,000 | 8/16/2013 | 6.00 % | 72,900 | 8,374 | 81,274 |
| Series 66 Tranche 1 | HKD | 160,000 | 7/31/2014 | 5.00 % | 20,600 | 43 | 20,643 |
| Series 67 Tranche 1 | GBP | 200,000 | 1/20/2015 | 5.13 % | 375,000 | (49,902) | 325,098 |
| Series 68 Tranche 1 | HKD | 200,000 | 1/26/2015 | 4.28 % | 25,664 | 139 | 25,803 |
| Series PLF003 Tranche 1 | EUR | 25,358 | 2/15/2014 | 4.00 % | 33,219 | 213 | 33,432 |
| Series PLF007 Tranche 1 | GBP | 1,010 | 2/15/2013 | 5.00 % | 1,906 | (265) | 1,641 |
| Series PLF012 Tranche 1 | EUR | 10,000 | 3/15/2015 | 3.80 % | 12,860 | 324 | 13,184 |
| Series PLF014 Tranche 1 | GBP | 256 | 3/15/2013 | 4.80 % | 484 | (68) | 416 |
| Series PLF015 Tranche 1 | GBP | 500 | 5/15/2013 | 5.00 % | 959 | (146) | 813 |
| Series PLF019 Tranche 1 | EUR | 5,016 | 6/15/2017 | 4.00 % | 6,340 | 273 | 6,613 |
| Series PLF029 Tranche 1 | GBP | 650 | 11/15/2013 | 4.65 % | 1,159 | (102) | 1,057 |
| Series PLF031 Tranche 1 | EUR | 1,350 | 12/15/2015 | 3.80 % | 1,580 | 200 | 1,780 |
| TOTAL | | | | | $893,782 | $24,384 | $918,166 |

## 4. FUNDING AGREEMENTS/NOTES PAYABLE (CONTINUED)

December 31, 2011:

| Issue | Currency | Principal Denominated in Currency of Issuance (In Thousands) | Maturity | Interest Rate | Principal | Foreign Currency Gains (Losses) | Carrying Value |
|---|---|---|---|---|---|---|---|
| | | | | | | ($ In Thousands) | |
| Series 11 Tranche 1 | EUR | 36,500 | 3/12/2019 | 4.70 % | $40,880 | $6,502 | $47,382 |
| Series 33 Tranche 1 | USD | 28,560 | 9/15/2021 | 6 mth USD LIBOR + .40% | 28,560 | - | 28,560 |
| Series 36 Tranche 1 | EUR | 29,000 | 9/29/2020 | 3 mth EURIBOR + .37% | 25,418 | 12,228 | 37,646 |
| Series 39 Tranche 1 | GBP | 25,000 | 12/7/2015 | 5.81 % | 35,500 | 3,353 | 38,853 |
| Series 40 Tranche 1 | EUR | 27,000 | 2/5/2021 | 3 mth EURIBOR + .43% | 25,313 | 9,738 | 35,051 |
| Series 47 Tranche 1 | GBP | 150,000 | 8/16/2013 | 6.00 % | 214,000 | 19,114 | 233,114 |
| Series 47 Tranche 2 | GBP | 50,000 | 8/16/2013 | 6.00 % | 72,900 | 4,805 | 77,705 |
| Series 66 Tranche 1 | HKD | 160,000 | 7/31/2014 | 5.00 % | 20,600 | 1 | 20,601 |
| Series 67 Tranche 1 | GBP | 200,000 | 1/20/2015 | 5.13 % | 375,000 | (64,180) | 310,820 |
| Series 68 Tranche 1 | HKD | 200,000 | 1/26/2015 | 4.28 % | 25,664 | 87 | 25,751 |
| Series PLF003 Tranche 1 | EUR | 25,358 | 2/15/2014 | 4.00 % | 33,219 | (301) | 32,918 |
| Series PLF007 Tranche 1 | GBP | 1,010 | 2/15/2013 | 5.00 % | 1,906 | (337) | 1,569 |
| Series PLF012 Tranche 1 | EUR | 10,000 | 3/15/2015 | 3.80 % | 12,860 | 121 | 12,981 |
| Series PLF014 Tranche 1 | GBP | 256 | 3/15/2013 | 4.80 % | 484 | (86) | 398 |
| Series PLF015 Tranche 1 | GBP | 500 | 5/15/2013 | 5.00 % | 959 | (181) | 778 |
| Series PLF019 Tranche 1 | EUR | 5,016 | 6/15/2017 | 4.00 % | 6,340 | 171 | 6,511 |
| Series PLF029 Tranche 1 | GBP | 650 | 11/15/2013 | 4.65 % | 1,159 | (149) | 1,010 |
| Series PLF031 Tranche 1 | EUR | 1,350 | 12/15/2015 | 3.80 % | 1,580 | 173 | 1,753 |
| TOTAL | | | | | $922,342 | ($8,941) | $913,401 |

## 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

As described previously in Note 2, the Funding Agreements have been classified as held-to-maturity and are carried at amortized cost, adjusted for changes in foreign exchange rates. The estimated fair value of Funding Agreements and notes payable is estimated using the rates currently offered for deposits of similar remaining maturities.

The carrying amount and estimated fair value of the Company's financial instruments are as follows:

| | December 31, 2012 | |
|---|---|---|
| | Carrying Amount | Estimated Fair Value |
| | *(In Thousands)* | |
| Assets: | | |
| Funding Agreements (Note 4) | $918,166 | $941,962 |
| Liabilities: | | |
| Notes payable (Note 4) | 918,166 | 941,962 |

| | December 31, 2011 | |
|---|---|---|
| | Carrying Amount | Estimated Fair Value |
| | *(In Thousands)* | |
| Assets: | | |
| Funding Agreements (Note 4) | $913,401 | $956,155 |
| Liabilities: | | |
| Notes payable (Note 4) | 913,401 | 956,155 |

## 6. SHARE CAPITAL

Authorized:
50 thousand ordinary shares of U.S. $1 par value each

Issued and fully paid:
One thousand ordinary shares of U.S. $1 par value each

As of December 31, 2012 and 2011, one thousand ordinary shares had been issued at par to QSPV Limited.

**AUDITED GAAP CONSOLIDATED FINANCIAL STATEMENTS OF PACIFIC LIFE INSURANCE COMPANY AS OF DECEMBER 31, 2012 AND 2011 (AS ADJUSTED) AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND DECEMBER 31, 2011 AND 2010 (AS ADJUSTED)**

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Pacific Life Insurance Company and Subsidiaries:

We have audited the accompanying consolidated financial statements of Pacific Life Insurance Company and Subsidiaries (the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2012 and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pacific Life Insurance Company and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, the accompanying 2011 and 2010 consolidated financial statements have been retrospectively adjusted for the Company's adoption of guidance related to a change in accounting for the costs associated with acquiring or renewing insurance contracts. Our opinion is not modified with respect to this matter.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting and reporting for deferred policy acquisition costs in 2011. Our opinion is not modified with respect to this matter.

Deloitte & Touche LLP

March 8, 2013

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

| *(In Millions)* | December 31, 2012 | 2011 |
|---|---|---|
| ASSETS | | (As Adjusted) |
| Investments: | | |
| Fixed maturity securities available for sale, at estimated fair value | $32,183 | $28,853 |
| Equity securities available for sale, at estimated fair value | 152 | 301 |
| Mortgage loans | 7,729 | 7,599 |
| Policy loans | 6,998 | 6,812 |
| Other investments (includes VIE assets of $441 and $351) | 2,484 | 2,319 |
| TOTAL INVESTMENTS | 49,546 | 45,884 |
| Cash and cash equivalents (includes VIE assets of $14 and $26) | 2,256 | 2,829 |
| Restricted cash (includes VIE assets of $198 and $200) | 294 | 280 |
| Deferred policy acquisition costs | 4,329 | 4,264 |
| Aircraft leasing portfolio, net (includes VIE assets of $1,559 and $1,838) | 6,760 | 5,845 |
| Other assets (includes VIE assets of $26 and $32) | 3,305 | 3,069 |
| Separate account assets | 55,302 | 51,450 |
| TOTAL ASSETS | $121,792 | $113,621 |
| LIABILITIES AND EQUITY | | |
| Liabilities: | | |
| Policyholder account balances | $34,983 | $34,392 |
| Future policy benefits | 11,105 | 9,467 |
| Debt (includes VIE debt of $865 and $1,150) | 7,765 | 7,152 |
| Other liabilities (includes VIE liabilities of $292 and $338) | 3,069 | 2,633 |
| Separate account liabilities | 55,302 | 51,450 |
| TOTAL LIABILITIES | 112,224 | 105,094 |
| Commitments and contingencies (Note 21) | | |
| Stockholder's Equity: | | |
| Common stock - $50 par value; 600,000 shares authorized, issued and outstanding | 30 | 30 |
| Paid-in capital | 982 | 982 |
| Retained earnings | 6,489 | 6,177 |
| Accumulated other comprehensive income | 1,648 | 1,004 |
| Total Stockholder's Equity | 9,149 | 8,193 |
| Noncontrolling interest | 419 | 334 |
| TOTAL EQUITY | 9,568 | 8,527 |
| TOTAL LIABILITIES AND EQUITY | $121,792 | $113,621 |

The abbreviation VIE above means variable interest entity.

See Notes to Consolidated Financial Statements

*Pacific Life Insurance Company and Subsidiaries*

## CONSOLIDATED STATEMENTS OF OPERATIONS

| | Years Ended December 31, | | |
|---|---|---|---|
| *(In Millions)* | 2012 | 2011 | 2010 |
| REVENUES | | (As Adjusted) | (As Adjusted) |
| Policy fees and insurance premiums | $3,324 | $3,081 | $2,367 |
| Net investment income | 2,281 | 2,186 | 2,122 |
| Net realized investment loss | (349) | (661) | (94) |
| OTTI, consisting of $116, $409 and $328 in total, net of $53, $256 and $215 recognized in OCI | (63) | (153) | (113) |
| Investment advisory fees | 298 | 268 | 245 |
| Aircraft leasing revenue | 660 | 607 | 591 |
| Other income | 237 | 226 | 230 |
| TOTAL REVENUES | 6,388 | 5,554 | 5,348 |
| | | | |
| BENEFITS AND EXPENSES | | | |
| Policy benefits paid or provided | 2,444 | 1,951 | 1,351 |
| Interest credited to policyholder account balances | 1,252 | 1,318 | 1,317 |
| Commission expenses | 648 | 122 | 836 |
| Operating and other expenses | 1,601 | 1,441 | 1,268 |
| TOTAL BENEFITS AND EXPENSES | 5,945 | 4,832 | 4,772 |
| | | | |
| INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION (BENEFIT) FOR INCOME TAXES | 443 | 722 | 576 |
| Provision (benefit) for income taxes | (67) | 80 | 60 |
| | | | |
| INCOME FROM CONTINUING OPERATIONS | 510 | 642 | 516 |
| Discontinued operations, net of taxes | | (9) | |
| | | | |
| Net income | 510 | 633 | 516 |
| Less: net income attributable to the noncontrolling interest from continuing operations | (68) | (71) | (50) |
| | | | |
| NET INCOME ATTRIBUTABLE TO THE COMPANY | $442 | $562 | $466 |

The abbreviation OTTI above means other than temporary impairment losses.

The abbreviation OCI above means other comprehensive income (loss).

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Years Ended December 31, | | |
|---|---|---|---|
| *(In Millions)* | 2012 | 2011 | 2010 |
| | | (As Adjusted) | (As Adjusted) |
| NET INCOME | $510 | $633 | $516 |
| Other comprehensive income, net of tax: | | | |
| Unrealized gains on securities: | | | |
| Unrealized holding gains arising during period | 698 | 601 | 749 |
| Reclassification adjustment for gains (loss) included in net income | (55) | 54 | (41) |
| Unrealized gains on securities | 643 | 655 | 708 |
| Holding gain (loss) on other securities | | (8) | 5 |
| Other | 2 | (4) | (3) |
| Other comprehensive income | 645 | 643 | 710 |
| Comprehensive income | 1,155 | 1,276 | 1,226 |
| Less: comprehensive income attributable to the noncontrolling interest | (69) | (71) | (50) |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO THE COMPANY | $1,086 | $1,205 | $1,176 |

See Notes to Consolidated Financial Statements

*Pacific Life Insurance Company and Subsidiaries*

## CONSOLIDATED STATEMENTS OF EQUITY

| *(In Millions)* | Common Stock | Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss): Unrealized Gain (Loss) On Derivatives and Securities Available for Sale, Net | Accumulated Other Comprehensive Income (Loss): Other, Net | Total Stockholder's Equity | Noncontrolling Interest | Total Equity |
|---|---|---|---|---|---|---|---|---|
| BALANCES, (As Adjusted) | | | | | | | | |
| JANUARY 1, 2010 | $30 | $982 | $5,445 | ($345) | ($4) | $6,108 | $231 | $6,339 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 466 | | | 466 | 50 | 516 |
| Other comprehensive income | | | | 708 | 2 | 710 | | 710 |
| Total comprehensive income | | | | | | 1,176 | | 1,226 |
| Dividend to parent | | | (150) | | | (150) | | (150) |
| Change in equity of noncontrolling interest | | | | | | | (30) | (30) |
| BALANCES, (As Adjusted) | | | | | | | | |
| DECEMBER 31, 2010 | 30 | 982 | 5,761 | 363 | (2) | 7,134 | 251 | 7,385 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 562 | | | 562 | 71 | 633 |
| Other comprehensive income (loss) | | | | 655 | (12) | 643 | | 643 |
| Total comprehensive income | | | | | | 1,205 | | 1,276 |
| Dividend to parent | | | (125) | | | (125) | | (125) |
| Non-cash dividend to parent | | | (21) | | | (21) | | (21) |
| Change in equity of noncontrolling interest | | | | | | | 12 | 12 |
| BALANCES, (As Adjusted) | | | | | | | | |
| DECEMBER 31, 2011 | 30 | 982 | 6,177 | 1,018 | (14) | 8,193 | 334 | 8,527 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 442 | | | 442 | 68 | 510 |
| Other comprehensive income | | | | 643 | 1 | 644 | 1 | 645 |
| Total comprehensive income | | | | | | 1,086 | | 1,155 |
| Dividends to parent | | | (130) | | | (130) | | (130) |
| Change in equity of noncontrolling interest | | | | | | | 16 | 16 |
| BALANCES, DECEMBER 31, 2012 | $30 | $982 | $6,489 | $1,661 | ($13) | $9,149 | $419 | $9,568 |

See Notes to Consolidated Financial Statements

*Pacific Life Insurance Company and Subsidiaries*

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Years Ended December 31, | | |
|---|---|---|---|
| *(In Millions)* | 2012 | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | (As Adjusted) | (As Adjusted) |
| Income from continuing operations | $510 | $642 | $516 |
| Adjustments to reconcile income from continuing operations | | | |
| to net cash provided by operating activities: | | | |
| Net accretion on fixed maturity securities | (119) | (116) | (136) |
| Depreciation and amortization | 389 | 329 | 299 |
| Deferred income taxes | (70) | 75 | 53 |
| Net realized investment loss | 349 | 661 | 94 |
| Other than temporary impairments | 63 | 153 | 113 |
| Net change in deferred policy acquisition costs | (199) | (663) | 126 |
| Interest credited to policyholder account balances | 1,252 | 1,318 | 1,317 |
| Net change in future policy benefits and other insurance liabilities | 1,574 | 1,215 | 648 |
| Other operating activities, net | (192) | (18) | (6) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES BEFORE DISCONTINUED OPERATIONS | 3,557 | 3,596 | 3,024 |
| Net cash used in operating activities of discontinued operations | (2) | (7) | |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 3,555 | 3,589 | 3,024 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Fixed maturity and equity securities available for sale: | | | |
| Purchases | (6,018) | (4,808) | (6,503) |
| Sales | 2,446 | 3,159 | 3,572 |
| Maturities and repayments | 2,076 | 2,256 | 2,138 |
| Repayments of mortgage loans | 644 | 1,172 | 746 |
| Fundings of mortgage loans and real estate | (1,157) | (2,177) | (870) |
| Proceeds from sale of real estate | 443 | 41 | 25 |
| Net change in policy loans | (186) | (122) | (181) |
| Change in restricted cash | (14) | (66) | 7 |
| Purchases of derivative instruments | | (79) | (116) |
| Terminations of derivative instruments, net | 188 | 172 | (51) |
| Proceeds from nonhedging derivative settlements | 129 | 151 | 9 |
| Payments for nonhedging derivative settlements | (688) | (505) | (569) |
| Net change in collateral received or pledged | (546) | 516 | 6 |
| Purchases of and advance payments on aircraft leasing portfolio | (1,388) | (1,397) | (754) |
| Acquisition of retrocession business | | 192 | |
| Acquisition of pension advisory business | | (45) | |
| Other investing activities, net | 166 | 345 | 240 |
| NET CASH USED IN INVESTING ACTIVITIES | (3,905) | (1,195) | (2,301) |

*(Continued)*

See Notes to Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| *(In Millions)* | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| *(Continued)* | | (As Adjusted) | (As Adjusted) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Policyholder account balances: | | | |
| Deposits | $5,453 | $4,521 | $4,272 |
| Withdrawals | (6,224) | (6,599) | (5,162) |
| Net change in short-term debt | 292 | | (105) |
| Issuance of long-term debt | 1,130 | 1,124 | 1,815 |
| Payments of long-term debt | (761) | (768) | (1,012) |
| Dividend to parent | (130) | (125) | (150) |
| Other financing activities, net | 17 | 12 | (30) |
| NET CASH USED IN FINANCING ACTIVITIES | (223) | (1,835) | (372) |
| Net change in cash and cash equivalents | (573) | 559 | 351 |
| Cash and cash equivalents, beginning of year | 2,829 | 2,270 | 1,919 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $2,256 | $2,829 | $2,270 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | |
| Income taxes paid (received), net | $154 | ($7) | $113 |
| Interest paid | $291 | $222 | $175 |

See Notes to Consolidated Financial Statements

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### ORGANIZATION AND DESCRIPTION OF BUSINESS

Pacific Life Insurance Company (Pacific Life) was established in 1868 and is domiciled in the State of Nebraska as a stock life insurance company. Pacific Life is an indirect subsidiary of Pacific Mutual Holding Company (PMHC), a Nebraska mutual holding company, and a wholly owned subsidiary of Pacific LifeCorp, an intermediate Delaware stock holding company. PMHC and Pacific LifeCorp were organized pursuant to consent received from the California Department of Insurance and the implementation of a plan of conversion to form a mutual holding company structure in 1997 (the Conversion).

Pacific Life and its subsidiaries and affiliates have primary business operations consisting of life insurance, annuities, mutual funds, aircraft leasing and reinsurance.

### BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements of Pacific Life and its subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and include the accounts of Pacific Life and its majority owned and controlled subsidiaries and variable interest entities (VIEs) in which the Company is the primary beneficiary. Noncontrolling interest is primarily comprised of private equity funds (Note 4). All significant intercompany transactions and balances have been eliminated in consolidation.

Pacific Life prepares its regulatory financial statements in accordance with statutory accounting practices prescribed or permitted by the Nebraska Department of Insurance (NE DOI), which is a comprehensive basis of accounting other than U.S. GAAP (Note 2). These consolidated financial statements materially differ from those filed with regulatory authorities.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In developing these estimates, management makes subjective and complex judgments that are inherently uncertain and subject to material change as facts and circumstances develop. Management has identified the following estimates as critical, as they involve a higher degree of judgment and are subject to a significant degree of variability:

- The fair value of investments in the absence of quoted market values
- Other than temporary impairment losses (OTTI) of investments
- Application of the consolidation rules to certain investments
- The fair value of and accounting for derivatives
- Aircraft valuation and impairment
- The capitalization and amortization of deferred policy acquisition costs (DAC)
- The liability for future policyholder benefits
- Accounting for income taxes
- Accounting for business combinations
- Accounting for reinsurance transactions
- Litigation and other contingencies

Certain reclassifications have been made to the 2011 and 2010 consolidated financial statements to conform to the 2012 financial statement presentation.

The Company has evaluated events subsequent to December 31, 2012 through March 8, 2013, the date the consolidated financial statements were available to be issued. See Notes 13 and 21 for discussion of subsequent events.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, which modifies the Accounting Standards Codification's (Codification) Fair Value Measurements and Disclosures Topic. The Company adopted this new guidance as of December 31, 2012 and applied it prospectively. This guidance only impacted financial statement disclosures and had no impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05 to the Codification's Comprehensive Income Topic. ASU 2011-05 revises the manner in which a company presents comprehensive income on the financial statements, however, in December 2011, the FASB deferred a portion of the presentation requirements by issuing ASU 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". ASU 2011-05 requires a company to present each component of net income along with total net income, each component of other comprehensive income (OCI) along with a total for OCI, and a total amount for comprehensive income. The Company adopted ASU 2011-05 as of December 31, 2012 after considering the deferral in ASU 2011-12 and included the new consolidated statements of comprehensive income immediately following the consolidated statements of operations. Retrospective adoption of this amendment did not have an impact on the Company's financial position, results of operations or cash flows.

Effective January 1, 2012, the Company adopted ASU 2011-08 to the Codification's Intangibles - Goodwill and Other Topic, which provides new guidance on goodwill impairment testing that simplifies how an entity tests goodwill for impairment. This new guidance allows a company to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value as a basis for determining whether it needs to perform the quantitative two-step goodwill impairment test. Only if the company determines, based on qualitative assessment, that it is more likely than not that a reporting unit’s fair value is less than its carrying value will it be required to calculate the fair value of the reporting unit. The adoption had no impact on the Company’s consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20 to the Codification's Receivables Topic for "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses", which requires enhanced disclosures related to the allowance for credit losses and the credit quality of a company's financing receivable portfolio. New disclosures are intended to provide additional information regarding the nature of the risk associated with financing receivables and how the assessment of the risk is used to estimate the allowance for credit losses. The Company adopted this new guidance as of December 31, 2012 and applied it retrospectively. This guidance only impacted its financial statement disclosures and had no impact on the Company's consolidated financial statements.

RETROSPECTIVE ADOPTION OF NEW ACCOUNTING PRONOUNCEMENT

In October 2010, the FASB issued ASU 2010-26 to the Codification's Financial Services – Insurance Topic. ASU 2010-26 significantly amends the guidance applicable to accounting for costs associated with acquiring or renewing insurance contracts. The amendment specifies the following costs incurred in the acquisition of new and renewal contracts should be capitalized: 1) incremental direct costs of contract acquisition and 2) certain costs related directly to underwriting, policy issuance and processing, medical and inspecting, and sales force contract selling activities. This amendment also specifies that costs may only be capitalized based on successful contract acquisition efforts.

The Company adopted ASU 2010-26 on January 1, 2012. Financial information presented in the accompanying consolidated financial statements has been adjusted to reflect the retrospective adoption of this guidance. As a result of this accounting change, total equity as of January 1, 2011 and 2010 decreased by $545 million and $578 million, after tax, respectively, due to the reduction of the Company’s DAC asset for deferred costs that did not meet the provisions of the revised standard. The impact of the retrospective adoption on December 31, 2011 balances prior to adoption was a reduction in the DAC asset of $999 million and a reduction in total equity of $649 million, after tax. The impact of the retrospective adoption on net income amounts for the years ended December 31, 2011 and 2010 prior to adoption were decreases of $121 million and $6 million, respectively.

The following tables present the effects of the retrospective adoption of ASU 2010-26 to the Company's consolidated financial statements prior to adoption, as applicable:

| | Consolidated Statement of Financial Condition | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| December 31, 2011: | | (In Millions) | |
| Assets: | | | |
| DAC | $5,263 | ($999) | $4,264 |
| Liabilities: | | | |
| Other liabilities (Net deferred tax liability) | 2,983 | (350) | 2,633 |
| Equity: | | | |
| Retained earnings | 6,896 | (719) | 6,177 |
| Accumulated other comprehensive income | 934 | 70 | 1,004 |
| Total Stockholder's Equity | 8,842 | (649) | 8,193 |
| Total Equity | 9,176 | (649) | 8,527 |

| | Consolidated Statements of Operations | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| For the year ended December 31, 2011: | | (In Millions) | |
| Expenses: | | | |
| Commission expenses | $83 | $39 | $122 |
| Operating and other expenses | 1,293 | 148 | 1,441 |
| Income from continuing operations before provision for income taxes | 909 | (187) | 722 |
| Provision for income taxes | 146 | (66) | 80 |
| Income from continuing operations | 763 | (121) | 642 |
| Net income | 754 | (121) | 633 |
| Net income attributable to the Company | 683 | (121) | 562 |
| For the year ended December 31, 2010: | | | |
| Expenses: | | | |
| Commission expenses | $831 | $5 | $836 |
| Operating and other expenses | 1,264 | 4 | 1,268 |
| Income from continuing operations before provision for income taxes | 585 | (9) | 576 |
| Provision for income taxes | 63 | (3) | 60 |
| Income from continuing operations | 522 | (6) | 516 |
| Net income | 522 | (6) | 516 |
| Net income attributable to the Company | 472 | (6) | 466 |

| | Consolidated Statements of Equity | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| | | (In Millions) | |
| Balances, January 1, 2011: | | | |
| Retained earnings | $6,359 | ($598) | $5,761 |
| Accumulated other comprehensive income | 308 | 53 | 361 |
| Total Stockholder's Equity | 7,679 | (545) | 7,134 |
| Total Equity | 7,930 | (545) | 7,385 |
| Balances, January 1, 2010: | | | |
| Retained earnings | $6,037 | ($592) | $5,445 |
| Accumulated other comprehensive income (loss) | (363) | 14 | (349) |
| Total Stockholder's Equity | 6,686 | (578) | 6,108 |
| Total Equity | 6,917 | (578) | 6,339 |

| | Consolidated Statements of Equity | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| | | (In Millions) | |
| For the year ended December 31, 2011: | | | |
| Net income attributable to the Company | $683 | ($121) | $562 |
| Other comprehensive income | 626 | 17 | 643 |
| Total comprehensive income | 1,309 | (104) | 1,205 |
| For the year ended December 31, 2010: | | | |
| Net income attributable to the Company | $472 | ($6) | $466 |
| Other comprehensive income | 671 | 39 | 710 |
| Total comprehensive income | 1,143 | 33 | 1,176 |

| | Consolidated Statements of Cash Flows | | |
|---|---|---|---|
| | Prior to Adoption | Effect of Adoption | As Currently Reported |
| | | (In Millions) | |
| For the year ended December 31, 2011: | | | |
| Income from continuing operations | $763 | ($121) | $642 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | | |
| Deferred income taxes | 141 | (66) | 75 |
| Net change in deferred policy acquisition costs | (850) | 187 | (663) |
| Net cash provided by operating activities | 3,589 | - | 3,589 |
| For the year ended December 31, 2010: | | | |
| Income from continuing operations | $522 | ($6) | $516 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | | |
| Deferred income taxes | 56 | (3) | 53 |
| Net change in deferred policy acquisition costs | 116 | 10 | 126 |
| Other operating activities, net | (5) | (1) | (6) |
| Net cash provided by operating activities | 3,024 | - | 3,024 |

## INVESTMENTS

Fixed maturity and equity securities available for sale are reported at estimated fair value, with unrealized gains and losses, net of adjustments related to DAC, future policy benefits and deferred income taxes, recognized as a component of OCI. For mortgage-backed securities and asset-backed securities included in fixed maturity securities available for sale, the Company recognizes income using a constant effective yield based on anticipated prepayments and the estimated economic life of the securities. When estimates of prepayments change, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. For fixed rate securities, the net investment in the securities is adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the securities. These adjustments are reflected in net investment income.

Investment income consists primarily of interest and dividends, net investment income from partnership interests, prepayment fees on fixed maturity securities and mortgage loans, and income from certain derivatives. Interest is recognized on an accrual basis and dividends are recorded on the ex-dividend date. Amortization of premium and accretion of discount on fixed maturity securities is recorded using the effective interest method.

The Company's available for sale securities are regularly assessed for OTTI. If a decline in the estimated fair value of an available for sale security is deemed to be other than temporary, the OTTI is recognized equal to the difference between the estimated fair value and net carrying amount of the security. If the OTTI for a fixed maturity security is attributable to both credit and other factors, then the OTTI is bifurcated and the non credit related portion is recognized in OCI while the credit portion is recognized in earnings. If the OTTI is related to credit factors only, it is recognized in earnings.

The evaluation of OTTI is a quantitative and qualitative process subject to significant estimates and management judgment. The Company has controls and procedures in place to monitor securities and identify those that are subject to greater analysis for OTTI. The Company has an investment impairment committee that reviews and evaluates securities for potential OTTI at least on a quarterly basis.

In evaluating whether a decline in value is other than temporary, the Company considers many factors including, but not limited to, the following: the extent and duration of the decline in value; the reasons for the decline (credit event, currency, interest rate related, or spread widening); the ability and intent to hold the investment for a period of time to allow for a recovery of value; and the financial condition of and near-term prospects of the issuer.

Analysis of the probability that all cash flows will be collected under the contractual terms of a fixed maturity security and determination as to whether the Company does not intend to sell the security and that it is more likely than not that the Company will not be required to sell the security before recovery of the investment are key factors in determining whether a fixed maturity security is other than temporarily impaired.

For mortgage-backed and asset-backed securities, the Company evaluates the performance of the underlying collateral and projected future discounted cash flows. In projecting future discounted cash flows, the Company incorporates inputs from third-party sources and applies reasonable judgment in developing assumptions used to estimate the probability and timing of collecting all contractual cash flows.

In evaluating investment grade perpetual preferred securities, which do not have final contractual cash flows, the Company applies OTTI considerations used for debt securities, placing emphasis on the probability that all cash flows will be collected under the contractual terms of the security and the Company's intent and ability to hold the security to allow for a recovery of value. Perpetual preferred securities are reported as equity securities as they are structured in equity form, but have significant debt-like characteristics, including periodic dividends, call features, and credit ratings and pricing similar to debt securities.

Realized gains and losses on investment transactions are determined on a specific identification basis and are included in net realized investment gain (loss).

Mortgage loans on real estate are carried at their unpaid principal balance, net of deferred origination fees and write-downs. Mortgage loans are considered to be impaired when management estimates that based upon current information and events, it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the mortgage loan agreement. For mortgage loans deemed to be impaired, an impairment loss is recorded when the carrying amount is greater than the Company's estimated fair value of the underlying collateral of the loan. When the underlying collateral of the mortgage loan is greater than the carrying amount, the mortgage loan is not considered to have an impaired loss and no write-down is recorded.

Policy loans are stated at unpaid principal balances.

Other investments primarily consist of partnerships and joint ventures, real estate investments, derivative instruments, non-marketable equity securities, low income housing investments qualifying for tax credits (LIHTC), trading securities, and securities of consolidated investment fund companies that operate under the Investment Company Act of 1940 (40 Act Funds). Partnership and joint venture interests are recorded under the cost or equity method of accounting. Real estate investments are carried at depreciated cost, net of write-downs, or, for real estate acquired in satisfaction of debt, estimated fair value at the date of acquisition, if lower than the related unpaid balance. Non-marketable equity securities are carried at estimated fair value with unrealized gains or losses recognized in OCI. Trading securities and the securities of the 40 Act Funds are reported at estimated fair value with changes in estimated fair value included in net realized investment gain (loss).

Real estate investments are evaluated for impairment based on the future estimated undiscounted cash flows expected to be received during the estimated holding period. When the future estimated undiscounted cash flows are less than the current carrying value of the property (gross cost less accumulated depreciation), the property is considered impaired and will be written-down to its estimated fair value.

Investments in LIHTC are recorded under the effective interest method since they meet certain requirements, including a projected positive yield based solely on guaranteed credits. The amortization of the original investment and the tax credits are recorded in the provision for income taxes.

All derivatives, whether designated in hedging relationships or not, are required to be recorded at estimated fair value. If the derivative is designated as a cash flow hedge, the effective portion of changes in the estimated fair value of the derivative is recorded in OCI and recognized in earnings when the hedged item affects earnings. See discussion of the discontinuance of cash flow hedge accounting for insurance operations in Note 10. If the derivative is designated as a fair value hedge, changes in the estimated fair value of the hedging derivative, including amounts measured as ineffectiveness, and changes in the estimated fair value of the hedged item related to the designated risk being hedged, are reported in net realized investment gain (loss). The change in estimated value of the hedged item associated with the risk being hedged is reflected as an adjustment to the carrying amount of the hedged item. For derivative instruments not designated as hedges, the change in estimated fair value of the derivative is recorded in net realized investment gain (loss).

The periodic cash flows for all hedging derivatives are recorded consistent with the hedged item on an accrual basis. For derivatives that are hedging securities, these amounts are included in net investment income. For derivatives that are hedging liabilities, these amounts are included in interest credited to policyholder account balances or interest expense, which is included in operating and other expenses. For derivatives not designated as hedging instruments, the periodic cash flows are reflected in net realized investment gain (loss) on an accrual basis. Upon termination of a cash flow hedging relationship, the accumulated amount in OCI is amortized into net investment income or interest credited to policyholder account balances over the remaining life of the hedged item. Upon termination of a fair value hedging relationship, the accumulated adjustment to the carrying value of the hedged item is amortized into net investment income or interest expense, which is included in operating and other expenses, or interest credited to policyholder account balances over its remaining life.

## CASH AND CASH EQUIVALENTS

Cash and cash equivalents include all investments with a maturity of three months or less from purchase date. Cash equivalents consist primarily of U.S. Treasury bills and money market securities.

## RESTRICTED CASH

Restricted cash primarily consists of liquidity reserves related to VIEs, security deposits, commitment fees, maintenance reserve payments and rental payments received from certain lessees related to the aircraft leasing business.

## DEFERRED POLICY ACQUISITION COSTS

The direct and incremental costs associated with the successful acquisition of new or renewal insurance business; principally commissions, medical examinations, underwriting, policy issue and other expenses; are deferred and recorded as an asset referred to as DAC. DAC related to internally replaced contracts (as defined in the Codification's Financial Services – Insurance Topic), is immediately written off to expense and any new deferrable expenses associated with the replacement are deferred if the contract modification substantially changes the contract. However, if the contract modification does not substantially change the contract, the existing DAC asset remains in place and any acquisition costs associated with the modification are immediately expensed. The Company defers sales inducements and amortizes them over the life of the policy using the same methodology and assumptions used to amortize DAC.

For universal life (UL), variable annuities and other investment-type contracts, acquisition costs are amortized through earnings in proportion to the present value of estimated gross profits (EGPs) from projected investment, mortality and expense margins, and surrender charges over the estimated lives of the contracts. Actual gross margins or profits may vary from management's estimates, which can increase or decrease the rate of DAC amortization. DAC related to traditional policies is amortized through earnings over the premium-paying period of the related policies in proportion to premium revenues recognized, using assumptions and estimates consistent with those used in computing policy reserves. DAC related to certain unrealized components in OCI, primarily unrealized gains and losses on securities available for sale, is adjusted with corresponding charges or benefits, respectively, directly to equity through OCI.

Effective October 1, 2011, the Company changed its DAC amortization method for periods when actual gross profits (AGPs) are negative. During reporting periods of negative AGPs, DAC amortization may be negative, which would result in an increase to the DAC balance. The specific facts and circumstances surrounding the potential negative amortization are evaluated to determine whether it is appropriate for recognition in the consolidated financial statements. Negative amortization is only recorded when the increased DAC balance is determined to be recoverable and is also limited to amounts originally deferred plus interest.

Significant assumptions in the development of EGPs include investment returns, surrender and lapse rates, rider utilization, interest spreads, and mortality margins. The Company's long-term assumption for the underlying separate account investment return ranges up to 8.0%. A change in the assumptions utilized to develop EGPs results in a change to amounts expensed in the reporting period in which the change was made by adjusting the DAC balance to the level DAC would have been had the EGPs been calculated using the new assumptions over the entire amortization period. In general, favorable experience variances result in increased expected future profitability and may lower the rate of DAC amortization, whereas unfavorable experience variances result in decreased expected future profitability and may increase the rate of DAC amortization. All critical assumptions utilized to develop EGPs are evaluated at least annually and necessary revisions are made to certain assumptions to the extent that actual or anticipated experience necessitates such a prospective change. The Company may also identify and implement actuarial modeling refinements to projection models that may result in increases or decreases to the DAC asset.

The DAC asset is reviewed periodically to ensure that the unamortized balance does not exceed expected recoverable EGPs.

AIRCRAFT LEASING PORTFOLIO

Aircraft are recorded at depreciated cost, which includes certain acquisition costs. Depreciation to estimated residual values is computed using the straight-line method over the estimated useful lives of the aircraft. Major improvements to aircraft are capitalized when incurred and depreciated over the shorter of the remaining useful life of the aircraft or the useful life of the improvement. The Company evaluates carrying values of aircraft generally quarterly or based upon changes in market and other physical and economic conditions that indicate the carrying amount of the aircraft may not be recoverable. The Company will record impairments to recognize a loss in the value of the aircraft when management believes that, based on future estimated undiscounted cash flows, the recoverability of the Company’s investment in an aircraft has been impaired.

GOODWILL

Goodwill represents the excess of acquisition costs over the fair value of net assets acquired. Goodwill is not amortized but is reviewed for impairment at least annually or more frequently if events occur or circumstances indicate that the goodwill might be impaired. Goodwill is included in other assets and decreased to $101 million as of December 31, 2012 from $87 million as of December 31, 2011 due to the finalization of acquisition accounting. There were no goodwill impairment write-downs during the years ended December 31, 2012, 2011 and 2010.

POLICYHOLDER ACCOUNT BALANCES

Policyholder account balances on UL and certain investment-type contracts, such as funding agreements and guaranteed interest contracts (GICs), are valued using the retrospective deposit method and are equal to accumulated account values, which consist of deposits received, plus interest credited, less withdrawals and assessments. Other investment-type contracts such as payout annuities without life contingencies are valued using a prospective method that estimates the present value of future contract cash flows at the assumed credited or contract rate. Interest credited to these contracts primarily ranged from 0.2% to 7.7%.

FUTURE POLICY BENEFITS

Annuity reserves, which primarily consist of group retirement and structured settlement annuities with life contingencies, are equal to the present value of estimated future payments using pricing assumptions, as applicable, for interest rates, mortality, morbidity, retirement age and expenses. Interest rates used in establishing such liabilities ranged from 0.4% to 11.0%.

The Company offers variable annuity contracts with guaranteed minimum benefits, including guaranteed minimum death benefits (GMDBs) and riders with guaranteed living benefits (GLBs) that guarantee net principal over a ten-year holding period or a minimum withdrawal benefit over specified periods, subject to certain restrictions. If the guarantee includes a benefit that is only attainable upon annuitization or is wholly life contingent (e.g. GMDBs or guaranteed minimum withdrawal benefits for life), it is accounted for as an insurance liability (Note 12). All other GLB guarantees are accounted for as embedded derivatives (Note 10).

Policy charges assessed against policyholders that represent compensation to the Company for services to be provided in future periods, or for consideration for origination of the contract, are deferred as an unearned revenue reserves (URR), and recognized in revenue over the expected life of the contract using the same methods and assumptions used to amortize DAC. Unearned revenue related to certain unrealized components in OCI, primarily unrealized gains and losses on securities available for sale, is recorded to equity through OCI.

Life insurance reserves are valued using the net level premium method on the basis of actuarial assumptions appropriate at policy issue. Mortality and persistency assumptions are generally based on the Company's experience, which, together with interest and expense assumptions, include a margin for possible unfavorable deviations. Interest rate assumptions ranged from 3.0% to 9.3%. Future dividends for participating business are provided for in the liability for future policy benefits.

As of December 31, 2012 and 2011, participating experience rated policies paying dividends represent less than 1% of direct life insurance in force.

Estimates of future policy benefit reserves and liabilities are continually reviewed and, as experience develops, are adjusted as necessary. Such changes in estimates are included in earnings for the period in which such changes occur.

REINSURANCE

The Company has ceded reinsurance agreements with other insurance companies to limit potential losses, reduce exposure arising from larger risks, provide additional capacity for future growth and also assumes reinsurance agreements. As part of a strategic alliance, the Company also reinsures risks associated with policies written by an independent producer group through modified coinsurance and yearly renewable term (YRT) arrangements with this producer group's reinsurance company. The ceding of risk does not discharge the Company from its primary obligations to contract owners. To the extent that the assuming companies become unable to meet their obligations under reinsurance contracts, the Company remains contingently liable. Each reinsurer is reviewed to evaluate its financial stability before entering into each reinsurance contract and throughout the period that the reinsurance contract is in place. In August 2011, the Company acquired a retrocession business (Note 5).

All assets associated with business reinsured on a modified coinsurance basis remain with, and under the control of, the Company. As part of its risk management process, the Company routinely evaluates its reinsurance programs and may change retention limits, reinsurers or other features at any time.

Reinsurance accounting is utilized for ceded and assumed transactions when risk transfer provisions have been met. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss to the reinsurer.

Reinsurance premiums ceded and reinsurance recoveries on benefits and claims incurred are deducted from their respective revenue and benefit and expense accounts. Prepaid reinsurance premiums, included in other assets, are premiums that are paid in advance for future coverage. Reinsurance recoverables, included in other assets, include balances due from reinsurance companies for paid and unpaid losses. Amounts receivable and payable are offset for account settlement purposes for contracts where the right of offset exists.

REVENUES, BENEFITS AND EXPENSES

Premiums from annuity contracts with life contingencies and traditional life and term insurance contracts are recognized as revenue when due. Benefits and expenses are provided against such revenues to recognize profits over the estimated lives of the contracts by providing for liabilities for future policy benefits, expenses of contract administration and DAC amortization.

Receipts for UL and investment-type contracts are reported as deposits to either policyholder account balances or separate account liabilities and are not included in revenue. Policy fees consist of mortality charges, surrender charges and expense charges that have been earned and assessed against related account values during the period and also include the amortization of URR. The timing of policy fee revenue recognition is determined based on the nature of the fees. Benefits and expenses include policy benefits and claims incurred in the period that are in excess of related policyholder account balances, interest credited to policyholder account balances, expenses of contract administration and the amortization of DAC.

Investment advisory fees are primarily fees earned by Pacific Life Fund Advisors LLC (PLFA), a wholly owned subsidiary of Pacific Life, which serves as the investment advisor for the Pacific Select Fund, an investment vehicle provided to the Company's variable universal life (VUL) and variable annuity contract holders, and the Pacific Life Funds, the investment vehicle for the Company's mutual fund products. These fees are based upon the net asset value of the underlying portfolios and are recorded as earned. Related subadvisory expense is included in operating and other expenses and recorded when incurred.

Aircraft leases, which are structured as triple net leases, are accounted for as operating leases. Aircraft leasing revenue is recognized ratably over the terms of the lease agreements.

DEPRECIATION AND AMORTIZATION

Aircraft and certain other assets are depreciated or amortized using the straight-line method over estimated useful lives, which range from three to 40 years. Depreciation and amortization of aircraft under operating leases and certain other assets are included in operating and other expenses. Depreciation of investment real estate is computed using the straight-line method over estimated useful lives, which range from five to 30 years, and is included in net investment income.

INCOME TAXES

Pacific Life and its includable subsidiaries are included in the consolidated Federal income tax return of PMHC. Pacific Life, Pacific Life & Annuity Company (PL&A), an Arizona domiciled life insurance company, and Pacific Alliance Reinsurance Company of Vermont (PAR Vermont), a Vermont-based life reinsurance company, both wholly owned by Pacific Life, are taxed as life insurance companies for Federal income tax purposes. Pacific Life Reinsurance Company II Limited (PLRC), a Barbados-based life reinsurance company formed in 2012 and wholly owned by Pacific Life, files a separate Federal tax return. Pacific Life's non-insurance subsidiaries are either included in PMHC's combined California franchise tax return or, if necessary, file separate state tax returns. Companies included in the consolidated Federal income tax return of PMHC and/or the combined California franchise tax return of PMHC are allocated tax expense or benefit based principally on the effect of including their operations in PMHC's returns under a tax sharing agreement. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years the differences are expected to be recovered or settled.

CONTINGENCIES

Each reporting cycle, the Company evaluates all identified contingent matters on an individual basis. A loss is recorded if probable and reasonably estimable. The Company establishes reserves for these contingencies at the best estimate, or, if no one amount within the range of possible losses is more probable than any other, the Company records an estimated reserve at the low end of the range of losses.

SEPARATE ACCOUNTS

Separate accounts primarily include variable annuity and life contracts, as well as other guaranteed and non-guaranteed accounts. Separate account assets are recorded at estimated fair value and represent legally segregated contract holder funds. A separate account liability is recorded equal to the amount of separate account assets. Deposits to separate accounts, investment income and realized and unrealized gains and losses on the separate account assets accrue directly to contract holders and, accordingly, are not reflected in the consolidated statements of operations or cash flows. Amounts charged to the separate account for mortality, surrender and expense charges are included in revenues as policy fees.

For separate account funding agreements in which the Company provides a guarantee of principal and interest to the contract holder and bears all the risks and rewards of the investments underlying the separate account, the related investments and liabilities are recognized as investments and liabilities in the consolidated statements of financial condition. Revenue and expenses are recognized within the respective revenue and benefit and expense lines in the consolidated statements of operations.

Separate account funding agreement liabilities were $106 million and $107 million as of December 31, 2012 and 2011, respectively.

ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of financial instruments has been determined using available market information and appropriate valuation methodologies. However, considerable judgment is often required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented may not be indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies could have a significant effect on the estimated fair value amounts.

## 2. STATUTORY FINANCIAL INFORMATION AND DIVIDEND RESTRICTIONS

STATUTORY ACCOUNTING PRACTICES

Pacific Life prepares its regulatory financial statements in accordance with statutory accounting practices prescribed or permitted by the NE DOI, which is a comprehensive basis of accounting other than U.S. GAAP. Statutory accounting practices primarily differ from U.S. GAAP by charging policy acquisition costs to expense as incurred, recognizing certain policy fees as revenue when billed, establishing future policy benefit liabilities using different actuarial assumptions, reporting surplus notes as surplus instead of debt, as well as the valuation of investments and certain assets and accounting for deferred income taxes on a different basis.

As of December 31, 2012 and 2011, Pacific Life had two permitted practices. Under the first permitted practice, Pacific Life utilizes book value accounting for certain guaranteed separate account funding agreements. The underlying separate account assets are recorded at book value instead of at fair value as required by National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual* (NAIC SAP). As of December 31, 2012 and 2011, the underlying separate account assets had unrealized losses of zero and $25 million, respectively. Under the second permitted practice, investments in Working Capital Finance Notes (WCFN), an investment being considered by the NAIC for admissibility, are recorded as admitted assets provided they are rated by the NAIC Securities Valuation Office as an NAIC 1 or 2 investment. As of December 31, 2012 and 2011, admitted WCFN investments totaled $92 million and $29 million, respectively.

The NE DOI has a prescribed accounting practice for certain synthetic GIC reserves that differs from NAIC SAP. The NE DOI reserve method is based on an annual accumulation of 30% of the contract fees on synthetic GICs and is subject to a maximum of 150% of the annualized contract fees. This reserve amounted to $43 million and $36 million as of December 31, 2012 and 2011, respectively, and has been recorded by Pacific Life. The NAIC SAP basis for this reserve equals the excess, if any, of the value of guaranteed contract liabilities over the market value of the assets in the segregated portfolio less deductions based on asset valuation reserve factors. As of December 31, 2012 and 2011, the reserve for synthetic GICs using the NAIC SAP basis was zero.

STATUTORY NET INCOME (LOSS) AND SURPLUS

Statutory net income (loss) of Pacific Life was $962 million, ($735) million and $741 million for the years ended December 31, 2012, 2011 and 2010, respectively. Statutory capital and surplus of Pacific Life was $6,175 million and $5,577 million as of December 31, 2012 and 2011, respectively.

RISK-BASED CAPITAL

Risk-based capital is a method developed by the NAIC to measure the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formulas for determining the amount of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Additionally, certain risks are required to be measured using actuarial cash flow modeling techniques, subject to formulaic minimums. The adequacy of a company's actual capital is measured by a comparison to the risk-based capital results. Companies below minimum risk-based capital requirements are classified within certain levels, each of which requires specified corrective action. As of December 31, 2012 and 2011, Pacific Life, PL&A and PAR Vermont exceeded the minimum risk-based capital requirements.

NO LAPSE GUARANTEE RIDER REINSURANCE

Certain no lapse guarantee rider (NLGR) benefits of Pacific Life's UL insurance products are subject to Actuarial Guideline 38 (AG 38) statutory reserving requirements. AG 38 results in additional statutory reserves on UL products with NLGRs issued after June

30, 2005. Substantially all statutory reserves relating to NLGRs issued after June 30, 2005 through approximately March 31, 2010 were ceded from Pacific Life to PAR Vermont under a reinsurance agreement. In August 2011, PAR Vermont was accredited as an authorized reinsurer in Nebraska. Funded economic reserves and a letter of credit, approved as an admitted asset for PAR Vermont for statutory accounting, were issued and will continue to be held in a trust with Pacific Life as beneficiary. See Note 21.

DIVIDEND RESTRICTIONS

The payment of dividends by Pacific Life to Pacific LifeCorp is subject to restrictions set forth in the State of Nebraska insurance laws. These laws require (i) notification to the NE DOI for the declaration and payment of any dividend and (ii) approval by the NE DOI for accumulated dividends within the preceding twelve months that exceed the greater of 10% of statutory policyholder surplus as of the preceding December 31 or statutory net gain from operations for the preceding twelve months ended December 31. Generally, these restrictions pose no short-term liquidity concerns for Pacific LifeCorp. Based on these restrictions and 2012 statutory results, Pacific Life could pay $774 million in dividends in 2013 to Pacific LifeCorp without prior approval from the NE DOI, subject to the notification requirement. During the years ended December 31, 2012, 2011 and 2010, Pacific Life paid dividends as determined on an NAIC SAP basis to Pacific LifeCorp of $133 million, $125 million and $150 million, respectively.

The maximum amount of ordinary dividends that can be paid by PL&A to Pacific Life without restriction cannot exceed the lesser of 10% of statutory surplus as regards to policyholders, or the statutory net gain from operations. Based on this limitation and 2012 statutory results, PL&A could pay $35 million in dividends to Pacific Life in 2013 without prior regulatory approval. No dividends were paid during 2012, 2011 and 2010.

## 3. CLOSED BLOCK

In connection with the Conversion, an arrangement known as a closed block (the Closed Block) was established, for dividend purposes only, for the exclusive benefit of certain individual life insurance policies that had an experience based dividend scale for 1997. The Closed Block was designed to give reasonable assurance to holders of the Closed Block policies that policy dividends will not change solely as a result of the Conversion.

Assets that support the Closed Block, which are primarily included in fixed maturity securities and policy loans, amounted to $293 million and $289 million as of December 31, 2012 and 2011, respectively. Liabilities allocated to the Closed Block, which are primarily included in future policy benefits, amounted to $298 million and $301 million as of December 31, 2012 and 2011, respectively. The net contribution to income from the Closed Block was $2 million, $1 million, and zero for the years ended December 31, 2012, 2011 and 2010, respectively.

4. VARIABLE INTEREST ENTITIES

The Company evaluates its interests in VIEs on an ongoing basis and consolidates those VIEs in which it has a controlling financial interest and is thus deemed to be the primary beneficiary. A controlling financial interest has both of the following characteristics: (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, and (ii) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Creditors or beneficial interest holders of VIEs, where the Company is the primary beneficiary, have no recourse against the Company in the event of default by these VIEs.

The following table presents, as of December 31, 2012 and 2011, (i) the consolidated assets, consolidated liabilities and maximum exposure to loss relating to VIEs, which the Company has consolidated because it is the primary beneficiary or (ii) the net carrying amount and maximum exposure to loss relating to VIEs in which the Company holds a significant variable interest, but has not consolidated because it is not the primary beneficiary (*In Millions*):

| | Primary Beneficiary | | | Not Primary Beneficiary | |
|---|---|---|---|---|---|
| | Consolidated Assets | Consolidated Liabilities | Maximum Exposure to Loss | Net Carrying Amount | Maximum Exposure to Loss |
| December 31, 2012: | | | | | |
| Aircraft securitizations | $1,782 | $1,139 | $678 | | |
| Investment funds | 456 | 18 | 69 | $40 | $40 |
| Asset-backed securities | | | | 106 | 106 |
| Total | $2,238 | $1,157 | $747 | $146 | $146 |
| December 31, 2011: | | | | | |
| Aircraft securitizations | $2,070 | $1,466 | $604 | | |
| Investment funds | 377 | 22 | 50 | | |
| Asset-backed securities | | | | $105 | $105 |
| Total | $2,447 | $1,488 | $654 | $105 | $105 |

AIRCRAFT SECURITIZATIONS

Aviation Capital Group Corp. (ACG), a wholly owned subsidiary of Pacific Life engaged in the acquisition and leasing of commercial aircraft, has sponsored three financial asset securitizations secured by interests in aircraft. ACG serves as the remarketing agent and provides various aircraft related services in all three securitizations for a fee. This fee is eliminated for the two consolidated securitizations and is included in other income as earned for the unconsolidated securitization.

In 2005, ACG sponsored a securitization transaction whereby Aviation Capital Group Trust III (ACG Trust III) acquired 74 of ACG's aircraft through a private placement note offering in the amount of $1,860 million. ACG owns 100% of the equity and has a controlling financial interest in this VIE. Therefore, ACG was determined to be the primary beneficiary of this VIE and ACG Trust III is consolidated into the consolidated financial statements of the Company. These private placement notes are the obligation of ACG Trust III and represent debt that is non-recourse to the Company (Note 13). VIE non-recourse debt consolidated from ACG Trust III was $632 million and $795 million as of December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, the maximum exposure to loss, based on the Company's interest in ACG Trust III, was $407 million and $397 million, respectively.

In 2003, ACG sponsored a securitization transaction whereby Aviation Capital Group Trust II (ACG Trust II) acquired 37 of ACG's aircraft through a private placement note offering in the amount of $1,027 million. ACG owns 100% of the equity and has a controlling financial interest in this VIE. Therefore, ACG was determined to be the primary beneficiary of this VIE and ACG Trust II is consolidated into the consolidated financial statements of the Company. These private placement notes are the obligation of ACG Trust II and represent debt that is non-recourse to the Company (Note 13). VIE non-recourse debt consolidated from ACG Trust II was $215 million and $335 million as of December 31, 2012 and 2011, respectively. As of December 31, 2012 and 2011, the maximum exposure to loss, based on the Company's interest in ACG Trust II, was $271 million and $207 million, respectively.

In 2000, ACG sponsored a financial asset securitization of aircraft to Aviation Capital Group Trust (Aviation Trust). ACG and Pacific Life are beneficial interest holders in Aviation Trust. Aviation Trust is not consolidated as ACG is not the primary beneficiary as ACG does not have the obligation to absorb losses of Aviation Trust that could potentially be significant to Aviation Trust or the right to receive benefits from Aviation Trust that could potentially be significant to it. The carrying value is comprised of beneficial interests issued by Aviation Trust. As of December 31, 2012 and 2011, the maximum exposure to loss, based on carrying value, was zero.

INVESTMENT FUNDS

Investment funds are primarily private equity funds (the Funds), which are limited partnerships that invest in private equity investments for outside investors, where the Company is the general partner. The Company provides investment management services to the Funds for a fee and receives carried interest based upon the performance of the Funds. The Funds are a VIE due to the purpose and design of the Funds and the lack of control by the other equity investors. The Company has determined itself to be the primary beneficiary since it has a controlling financial interest in the Funds and the Funds are consolidated into the consolidated financial statements of the Company. The Company has not guaranteed the performance, liquidity or obligations of the Funds, and the Company's maximum exposure to loss is equal to the carrying amounts of its retained interest. VIE non-recourse debt consolidated from the Funds was $18 million and $20 million as of December 31, 2012 and 2011, respectively (Note 13).

In 2012, ACG made a limited partnership investment in an aviation-related limited partnership investment fund (Aviation Fund) for which it is a minority investor and not the sponsor. The Aviation Fund's investment focus is on aviation-related assets, including aircraft, aviation-related asset-backed securities and securitized aircraft. The Aviation Fund is a VIE due to the lack of control by equity investors. In addition to its limited partnership investment, ACG agreed to provide aircraft-related management services for any aircraft, engine or tangible asset acquired by the Aviation Fund for a fee and minority interest in the general partnership. ACG determined it was not the primary beneficiary as it does not have the authority to direct the activities of the VIE that most significantly impact the VIE's economic performance. As of December 31, 2012, the carrying amount of its limited partnership investment and maximum exposure to loss was $40 million, and is included in other investments.

ASSET-BACKED SECURITIES

As part of the Company's investment strategy, the Company purchases primarily investment grade beneficial interests issued from bankruptcy-remote special purpose entities (SPEs), which are collateralized by financial assets including corporate debt. The Company has not guaranteed the performance, liquidity or obligations of the SPEs, and the Company's maximum exposure to loss is limited to its carrying value of the beneficial interests in the SPEs. The Company has no liabilities related to these VIEs. The Company has determined that it is not the primary beneficiary of these entities since it does not have the power to direct their financial activities. Therefore, the Company does not consolidate these entities. The investments are reported as fixed maturity securities available for sale.

OTHER NON-CONSOLIDATED VIEs

As part of normal investment activities, the Company will make passive investments in structured securities and limited partnerships for which it is not the sponsor. The structured security investments include residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralized debt obligations, and other asset-backed securities which are reported in fixed maturities securities available for sale. The limited partnership investments include private equity funds and real estate funds which are reported in other investments. For these investments, the Company determined it is not the primary beneficiary due to the relative size of the Company's investment in comparison to the original amount issued by the VIEs. In addition, the Company does not have the authority to direct the activities of these VIEs that most significantly impact the VIEs economic performance. The Company's maximum exposure to loss is limited to the amount of its carrying value. See Note 8 for the carrying amount and estimated fair value of the structured security investments. The Company's carrying value of limited partnerships was $906 million and $789 million as of December 31, 2012 and 2011, respectively. The Company's unfunded commitment to the limited partnerships was $476 million and $621 million as of December 31, 2012 and 2011, respectively.

## 5. BUSINESS ACQUISITIONS

On August 31, 2011, Pacific Life and Pacific Life Reinsurance (Barbados) Limited (PLRB), a newly formed insurer and wholly owned subsidiary of Pacific LifeCorp, acquired Manulife Financial Corporation's retrocession business. The acquisition was structured utilizing five coinsurance transactions in which Pacific Life entered into three contracts covering the lives of U.S. persons and PLRB entered into two contracts covering non-U.S. persons. By operation of the five reinsurance transactions, Pacific Life and PLRB each obtained control of a business requiring the application of the acquisition accounting provisions of the Codification's Business Combinations Topic.

The acquisition allows Pacific Life to gain access to a large block of mortality-based business without adding significant concentration risk. The addition of this mortality risk helps Pacific Life diversify its overall risk profile by providing balance against the more volatile risks of equity, credit, and interest rates. The expectation is that the acquired retrocession business will also provide a platform to generate new business. For financial reporting purposes, the retrocession business is a component of the Company's reinsurance segment.

Ceding commissions in the form of non-cash consideration in connection with the acquisition of the U.S. life business by Pacific Life and the non-U.S. life business by PLRB was $198 million and $39 million, respectively. In anticipation of the acquisition, Pacific LifeCorp invested $120 million of capital in PLRB. Pacific Life incurred acquisition-related costs of $6 million, which is included in operating and other expenses for the year ended December 31, 2011. PLRB capitalized $5 million of debt issuance cost.

Pacific Life and PLRB finalized the acquisition accounting in the third quarter of 2012. Included in the amounts below were the following adjustments made by the Company as a result of changes in the finalized estimated fair value amounts as compared to the initial estimate of assets acquired and liabilities assumed: value of business acquired decreased $3 million, receivables increased $91 million, other assets increased $35 million, future policy benefits increased $185 million, other liabilities decreased $66 million and a gain on acquisition of $4 million was recognized.

The following table presents the estimated fair value of the assets acquired and liabilities assumed on August 31, 2011:

| | Pacific Life | PLRB | Combined |
|---|---|---|---|
| Assets acquired: | | *(In Millions)* | |
| Cash | $192 | $520 | $712 |
| Value of business acquired (1) | 69 | 12 | 81 |
| Receivables (2) | 3 | 88 | 91 |
| Other assets | 27 | 8 | 35 |
| Goodwill (2) | 20 | | 20 |
| Total assets | $311 | $628 | $939 |
| Liabilities assumed: | | | |
| Future policy benefits | $219 | $592 | $811 |
| Other liabilities | 92 | 32 | 124 |
| Total liabilities | 311 | 624 | 935 |
| Gain on acquisition | | 4 | 4 |
| Total liabilities and gain on acquisition | $311 | $628 | $939 |

(1) Included in DAC (2) Included in other assets

On July 29, 2011, Pacific Global Advisors LLC (PGA), a wholly owned subsidiary of Pacific Life, acquired JP Morgan Chase's Pension Advisory Group. PGA's target market is businesses and plan trustees managing employee defined benefit retirement plans. PGA's expertise is in the delivery of advisory services concentrated in the areas of liability-driven investing, hedging, risk management, and actuarial services. This acquisition allows Pacific Life to strengthen its ability to deliver financial security solutions to retirement plans sponsors and trustees. PGA will also provide additional diversification to Pacific Life's business mix.

PGA paid $45 million to acquire the pension advisory business. In anticipation of the acquisition, Pacific Life invested $48 million of capital in PGA. The Company incurred acquisition-related expense of $5 million, which is included in operating and other expenses for the year ended December 31, 2011. The Company has obtained all the necessary information to establish the fair value of the assets acquired and the liabilities assumed as required by U.S. GAAP. The Company finalized the acquisition accounting in the first quarter of 2012, which did not result in any adjustments from the initial estimate.

The following table presents the estimated fair value of the assets acquired and liabilities assumed on July 29, 2011 (*In Millions*):

| | |
|---|---|
| Assets acquired: | |
| Intangibles (1) | $7 |
| Goodwill (1) | 38 |
| Total assets | $45 |
| Liabilities assumed: | |
| Other liabilities | - |
| Total liabilities | - |

(1) Included in other assets

6. DISCONTINUED OPERATIONS

The Company's former broker-dealer operations have been reflected as discontinued operations in the Company's consolidated financial statements. Discontinued operations do not include the operations of Pacific Select Distributors, Inc. (PSD), a wholly owned broker-dealer subsidiary of Pacific Life, which primarily serves as the underwriter/distributor of registered investment-related products and services, principally variable life and variable annuity contracts issued by the Company, and mutual funds. In March 2007, the Company classified its broker-dealer subsidiaries, other than PSD, as held for sale. During 2008 and 2007, these broker-dealers were sold.

Operating results from the discontinued operations were as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | | *(In Millions)* | |
| Benefits and expenses | | $13 | |
| Loss from discontinued operations | - | (13) | - |
| Benefit from income taxes | | (4) | |
| Discontinued operations, net of taxes | - | ($9) | - |

7. DEFERRED POLICY ACQUISITION COSTS

Components of DAC are as follows:

| | Years Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| | *(In Millions)* | | |
| Balance, January 1 | $4,264 | $3,606 | $3,917 |
| Additions: | | | |
| Capitalized during the year | 486 | 511 | 430 |
| Amortization: | | | |
| Allocated to commission expenses | (261) | 232 | (531) |
| Allocated to operating expenses | (26) | (8) | (25) |
| Total amortization | (287) | 224 | (556) |
| Allocated to OCI | (134) | (77) | (185) |
| Balance, December 31 | $4,329 | $4,264 | $3,606 |

During the years ended December 31, 2012, 2011 and 2010, the Company revised certain assumptions to develop EGPs for its products subject to DAC amortization. This resulted in decreases in DAC amortization expense of $42 million and $89 million for the years ended December 31, 2012 and 2011, respectively, and an increase in DAC amortization expense of $33 million for the year ended December 31, 2010. The revised EGPs also resulted in decreased URR amortization of $25 million for the year ended December 31, 2012 and increased URR amortization of $35 million and $20 million for the years ended December 31, 2011 and 2010, respectively. The capitalized sales inducement balance included in the DAC asset was $639 million and $645 million as of December 31, 2012 and 2011, respectively.

8. INVESTMENTS

The net carrying amount, gross unrealized gains and losses, and estimated fair value of fixed maturity and equity securities available for sale are shown below. The net carrying amount of fixed maturity securities represents amortized cost adjusted for OTTI recognized in earnings and terminated fair value hedges. The net carrying amount of equity securities represents cost adjusted for OTTI. See Note 14 for information on the Company's estimated fair value measurements and disclosure.

| | Net Carrying Amount | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | *(In Millions)* | | | |
| December 31, 2012: | | | | |
| U.S. Government | $47 | $10 | | $57 |
| Obligations of states and political subdivisions | 790 | 153 | | 943 |
| Foreign governments | 661 | 102 | | 763 |
| Corporate securities | 21,964 | 2,981 | $82 | 24,863 |
| RMBS | 3,901 | 245 | 130 | 4,016 |
| CMBS | 638 | 47 | | 685 |
| Collateralized debt obligations | 111 | 9 | 1 | 119 |
| Other asset-backed securities | 652 | 85 | | 737 |
| Total fixed maturity securities | $28,764 | $3,632 | $213 | $32,183 |
| Perpetual preferred securities | $144 | $13 | $22 | $135 |
| Other equity securities | 12 | 5 | | 17 |
| Total equity securities | $156 | $18 | $22 | $152 |

| | Net Carrying Amount | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | *(In Millions)* | | | |
| December 31, 2011: | | | | |
| U.S. Government | $27 | $8 | | $35 |
| Obligations of states and political subdivisions | 1,064 | 117 | $2 | 1,179 |
| Foreign governments | 456 | 51 | 4 | 503 |
| Corporate securities | 19,468 | 2,210 | 186 | 21,492 |
| RMBS | 4,475 | 189 | 491 | 4,173 |
| CMBS | 740 | 37 | 6 | 771 |
| Collateralized debt obligations | 115 | 17 | 17 | 115 |
| Other asset-backed securities | 523 | 69 | 7 | 585 |
| Total fixed maturity securities | $26,868 | $2,698 | $713 | $28,853 |
| Perpetual preferred securities | $283 | $5 | $60 | $228 |
| Other equity securities | 74 | | 1 | 73 |
| Total equity securities | $357 | $5 | $61 | $301 |

The Company has investments in perpetual preferred securities that are issued primarily by European banks. The net carrying amount and estimated fair value of the available for sale perpetual preferred securities was $241 million and $208 million, respectively, as of December 31, 2012. Included in these amounts are perpetual preferred securities carried in trusts with a net carrying amount and estimated fair value of $97 million and $73 million, respectively, that are held in fixed maturities and included in the tables above in corporate securities. Perpetual preferred securities reported as equity securities available for sale are presented in the tables above as perpetual preferred securities.

The net carrying amount and estimated fair value of fixed maturity securities available for sale as of December 31, 2012, by contractual repayment date of principal, are shown below. Expected maturities may differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Net Carrying Amount | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | *(In Millions)* | | | |
| Due in one year or less | $1,100 | $37 | $1 | $1,136 |
| Due after one year through five years | 5,895 | 589 | 10 | 6,474 |
| Due after five years through ten years | 9,247 | 1,218 | 37 | 10,428 |
| Due after ten years | 7,220 | 1,402 | 34 | 8,588 |
| | 23,462 | 3,246 | 82 | 26,626 |
| Mortgage-backed and asset-backed securities | 5,302 | 386 | 131 | 5,557 |
| Total fixed maturity securities | $28,764 | $3,632 | $213 | $32,183 |

The following tables present the number of investments, estimated fair value and gross unrealized losses on investments where the estimated fair value has declined and remained continuously below the net carrying amount for less than twelve months and for twelve months or greater. Included in the tables are gross unrealized losses for fixed maturity securities available for sale and other investments, which include equity securities available for sale and cost method investments.

| | Total | | |
|---|---|---|---|
| | Number | Estimated Fair Value | Gross Unrealized Losses |
| | | (In Millions) | |
| December 31, 2012: | | | |
| Corporate securities | 153 | $1,601 | $82 |
| RMBS | 102 | 1,171 | 130 |
| Collateralized debt obligations | 1 | 54 | 1 |
| Total fixed maturity securities | 256 | 2,826 | 213 |
| Perpetual preferred securities | 6 | 36 | 22 |
| Other investments | 11 | 41 | 2 |
| Total other investments | 17 | 77 | 24 |
| Total | 273 | $2,903 | $237 |

| | Less than 12 Months | | | 12 Months or Greater | | |
|---|---|---|---|---|---|---|
| | Number | Estimated Fair Value | Gross Unrealized Losses | Number | Estimated Fair Value | Gross Unrealized Losses |
| | | (In Millions) | | | (In Millions) | |
| December 31, 2012: | | | | | | |
| Corporate securities | 88 | $921 | $16 | 65 | $680 | $66 |
| RMBS | 10 | 91 | 2 | 92 | 1,080 | 128 |
| Collateralized debt obligations | | | | 1 | 54 | 1 |
| Total fixed maturity securities | 98 | 1,012 | 18 | 158 | 1,814 | 195 |
| Perpetual preferred securities | | | | 6 | 36 | 22 |
| Other investments | 7 | 23 | 1 | 4 | 18 | 1 |
| Total other investments | 7 | 23 | 1 | 10 | 54 | 23 |
| Total | 105 | $1,035 | $19 | 168 | $1,868 | $218 |

| | Total | | |
|---|---|---|---|
| | Number | Estimated Fair Value | Gross Unrealized Losses |
| | | (In Millions) | |
| December 31, 2011: | | | |
| Obligations of states and political subdivisions | 4 | $71 | $2 |
| Foreign governments | 11 | 73 | 4 |
| Corporate securities | 314 | 2,183 | 186 |
| RMBS | 207 | 2,624 | 491 |
| CMBS | 10 | 77 | 6 |
| Collateralized debt obligations | 3 | 91 | 17 |
| Other asset-backed securities | 13 | 101 | 7 |
| Total fixed maturity securities | 562 | 5,220 | 713 |
| Perpetual preferred securities | 19 | 177 | 60 |
| Other investments | 12 | 89 | 5 |
| Total other investments | 31 | 266 | 65 |
| Total | 593 | $5,486 | $778 |

| | Less than 12 Months | | | 12 Months or Greater | | |
|---|---|---|---|---|---|---|
| | Number | Estimated Fair Value | Gross Unrealized Losses | Number | Estimated Fair Value | Gross Unrealized Losses |
| | | (In Millions) | | | (In Millions) | |
| December 31, 2011: | | | | | | |
| Obligations of states and political subdivisions | | | | 4 | $71 | $2 |
| Foreign governments | 11 | $73 | $4 | | | |
| Corporate securities | 217 | 1,159 | 49 | 97 | 1,024 | 137 |
| RMBS | 49 | 401 | 14 | 158 | 2,223 | 477 |
| CMBS | 7 | 37 | 2 | 3 | 40 | 4 |
| Collateralized debt obligations | | | | 3 | 91 | 17 |
| Other asset-backed securities | 8 | 89 | 6 | 5 | 12 | 1 |
| Total fixed maturity securities | 292 | 1,759 | 75 | 270 | 3,461 | 638 |
| Perpetual preferred securities | 8 | 57 | 6 | 11 | 120 | 54 |
| Other investments | 6 | 42 | 2 | 6 | 47 | 3 |
| Total other investments | 14 | 99 | 8 | 17 | 167 | 57 |
| Total | 306 | $1,858 | $83 | 287 | $3,628 | $695 |

The Company has evaluated fixed maturity securities and other investments with gross unrealized losses and has determined that the unrealized losses are temporary. The Company does not intend to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their net carrying amounts.

The table below presents non-agency RMBS and CMBS by investment rating from independent rating agencies and vintage year of the underlying collateral as of December 31, 2012.

| Rating | Net Carrying Amount | Estimated Fair Value | Rating as % of Net Carrying Amount | Vintage Breakdown 2004 and Prior | 2005 | 2006 | 2007 | 2008 and Thereafter |
|---|---|---|---|---|---|---|---|---|
| | ($ In Millions) | | | | | | | |
| Prime RMBS: | | | | | | | | |
| AAA | $30 | $31 | 1% | | | | | 1% |
| AA | 56 | 57 | 3% | 3% | | | | |
| A | 98 | 104 | 5% | 4% | 1% | | | |
| BAA | 230 | 242 | 11% | 9% | 2% | | | |
| BA and below | 1,719 | 1,741 | 80% | 10% | 31% | 32% | 7% | |
| Total | $2,133 | $2,175 | 100% | 26% | 34% | 32% | 7% | 1% |
| Alt-A RMBS: | | | | | | | | |
| AAA | $7 | $7 | 1% | 1% | | | | |
| AA | 32 | 35 | 5% | 4% | 1% | | | |
| A | 11 | 12 | 2% | 2% | | | | |
| BAA | 28 | 30 | 5% | 4% | 1% | | | |
| BA and below | 532 | 462 | 87% | 2% | 14% | 30% | 41% | |
| Total | $610 | $546 | 100% | 13% | 16% | 30% | 41% | 0% |
| Sub-prime RMBS: | | | | | | | | |
| AAA | $12 | $12 | 4% | 4% | | | | |
| AA | 5 | 5 | 2% | 2% | | | | |
| A | 28 | 28 | 8% | 8% | | | | |
| BAA | 37 | 36 | 11% | 11% | | | | |
| BA and below | 248 | 229 | 75% | 58% | 15% | 1% | 1% | |
| Total | $330 | $310 | 100% | 83% | 15% | 1% | 1% | 0% |
| CMBS: | | | | | | | | |
| AAA | $326 | $346 | 53% | 11% | 1% | 1% | 18% | 22% |
| AA | 159 | 180 | 26% | 8% | | 1% | | 17% |
| A | 96 | 99 | 15% | | | | | 15% |
| BAA | 10 | 11 | 2% | | | | | 2% |
| BA | 28 | 29 | 4% | | | | 4% | |
| Total | $619 | $665 | 100% | 19% | 1% | 2% | 22% | 56% |

Prime mortgages are loans made to borrowers with strong credit histories, whereas sub-prime mortgage lending is the origination of residential mortgage loans to borrowers with weak credit profiles. Alt-A mortgage lending is the origination of residential mortgage loans to customers who have good credit ratings, but have limited documentation for their source of income or some other standard input used to underwrite the mortgage loan. The greater use of affordability mortgage products and relaxed underwriting standards by some originators for these loans has led to higher delinquency and loss rates, especially within the 2007 and 2006 vintage years.

Pacific Life is a member of the Federal Home Loan Bank (FHLB) of Topeka. As of December 31, 2012, the Company has received advances of $150 million from the FHLB of Topeka and has issued funding agreements to the FHLB of Topeka. The funding agreement liabilities are included in policyholder account balances. As of December 31, 2012, fixed maturity securities with an estimated fair value of $170 million are in a custodial account pledged as collateral for the funding agreements. The Company is required to purchase stock in FHLB of Topeka each time it receives an advance. As of December 31, 2012, the Company holds $8 million of FHLB of Topeka stock, which is recorded in other investments.

PL&A is a member of FHLB of San Francisco. As of December 31, 2012, no assets are pledged as collateral. As of December 31, 2012, PL&A holds FHLB of San Francisco stock with an estimated fair value of $5 million, which has been restricted for sale and is recorded in other investments.

In connection with the acquired retrocession business (Note 5), as of December 31, 2012, fixed maturity securities and cash and cash equivalents with estimated fair values of $434 million and $72 million, respectively, have been pledged as collateral in reinsurance trusts.

Major categories of investment income and related investment expense are summarized as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | | *(In Millions)* | |
| Fixed maturity securities | $1,506 | $1,458 | $1,506 |
| Equity securities | 12 | 15 | 19 |
| Mortgage loans | 437 | 391 | 337 |
| Real estate | 129 | 107 | 93 |
| Policy loans | 204 | 204 | 214 |
| Partnerships and joint ventures | 164 | 163 | 119 |
| Other | 11 | 16 | |
| Gross investment income | 2,463 | 2,354 | 2,288 |
| Investment expense | 182 | 168 | 166 |
| Net investment income | $2,281 | $2,186 | $2,122 |

The components of net realized investment gain (loss) are as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Fixed maturity securities: | | | |
| Gross gains on sales | $161 | $113 | $167 |
| Gross losses on sales | (8) | (16) | (32) |
| Total fixed maturity securities | 153 | 97 | 135 |
| Equity securities: | | | |
| Gross gains on sales | 12 | 9 | 4 |
| Gross losses on sales | (4) | | |
| Total equity securities | 8 | 9 | 4 |
| Trading securities | 12 | (7) | 12 |
| Real estate | 147 | 5 | 21 |
| Non-marketable securities | | 34 | |
| Variable annuity GLB embedded derivatives | 119 | (1,191) | 185 |
| Variable annuity GLB policy fees | 229 | 197 | 208 |
| Variable annuity derivatives - total return swaps | (588) | (366) | (534) |
| Variable annuity derivatives - equity put options | (45) | (35) | |
| Equity put options | (427) | 170 | (159) |
| Foreign currency and interest rate swaps | 81 | 75 | 16 |
| Forward starting interest rate swaps | (79) | 299 | |
| Synthetic GIC policy fees | 42 | 43 | 30 |
| Indexed universal life embedded derivatives | (21) | 19 | (20) |
| Call options | 31 | (7) | 20 |
| Other | (11) | (3) | (12) |
| Total | ($349) | ($661) | ($94) |

The table below summarizes the OTTI by investment type:

| | Recognized in Earnings | Included in OCI | Total |
|---|---|---|---|
| | | *(In Millions)* | |
| Year ended December 31, 2012: | | | |
| Corporate securities | $7 | | $7 |
| RMBS | 35 | $53 | 88 |
| Equity securities | 13 | | 13 |
| OTTI - fixed maturity and equity securities | 55 | 53 | 108 |
| Mortgage loans | 8 | | 8 |
| Total OTTI | $63 | $53 | $116 |
| Year ended December 31, 2011: | | | |
| Corporate securities [(1)] | $24 | | $24 |
| RMBS | 102 | $256 | 358 |
| Equity securities | 11 | | 11 |
| OTTI - fixed maturity and equity securities | 137 | 256 | 393 |
| Mortgage loans | 5 | | 5 |
| Real estate | 1 | | 1 |
| Other investments | 10 | | 10 |
| Total OTTI | $153 | $256 | $409 |
| Year ended December 31, 2010: | | | |
| Corporate securities | $10 | | $10 |
| RMBS | 64 | $215 | 279 |
| Collateralized debt obligations | 1 | | 1 |
| OTTI - fixed maturity securities | 75 | 215 | 290 |
| Real estate | 27 | | 27 |
| Other investments | 11 | | 11 |
| Total OTTI | $113 | $215 | $328 |

[(1)] Included are $7 million of OTTI recognized in earnings on perpetual preferred securities carried in trusts.

The table below details the amount of OTTI attributable to credit losses recognized in earnings for which a portion was recognized in OCI:

| | Years Ended December 31, 2012 | Years Ended December 31, 2011 |
|---|---|---|
| | *(In Millions)* | |
| Cumulative credit loss, January 1 | $268 | $245 |
| Additions for credit impairments recognized on: | | |
| Securities previously other than temporarily impaired | 23 | 87 |
| Securities not previously other than temporarily impaired | 9 | 15 |
| Total additions | 32 | 102 |
| Reductions for credit impairments previously recognized on: | | |
| Securities sold | (51) | (71) |
| Securities expected to be disposed before cost recovery | (5) | |
| Securities due to an increase in expected cash flows and time value of cash flows | (4) | (8) |
| Total subtractions | (60) | (79) |
| Cumulative credit loss, December 31 | $240 | $268 |

The table below presents gross unrealized losses on investments for which OTTI has been recognized in earnings in current or prior periods and gross unrealized losses on temporarily impaired investments for which no OTTI has been recognized.

| | Gross Unrealized Losses | | |
|---|---|---|---|
| | OTTI Investments | Non-OTTI Investments | Total |
| | | (In Millions) | |
| December 31, 2012: | | | |
| Corporate securities | | $82 | $82 |
| RMBS | $103 | 27 | 130 |
| Collateralized debt obligations | 1 | | 1 |
| Total fixed maturity securities | $104 | $109 | $213 |
| Perpetual preferred securities | | $22 | $22 |
| Total equity securities | - | $22 | $22 |
| December 31, 2011: | | | |
| Obligations of states and political subdivisions | | $2 | $2 |
| Foreign governments | | 4 | 4 |
| Corporate securities | | 186 | 186 |
| RMBS | $301 | 190 | 491 |
| CMBS | | 6 | 6 |
| Collateralized debt obligations | 17 | | 17 |
| Other asset-backed securities | | 7 | 7 |
| Total fixed maturity securities | $318 | $395 | $713 |
| Perpetual preferred securities | | $60 | $60 |
| Other equity securities | | 1 | 1 |
| Total equity securities | - | $61 | $61 |

The change in unrealized gain (loss) on investments in available for sale securities is as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | | (In Millions) | |
| Available for sale securities: | | | |
| Fixed maturity | $1,434 | $1,117 | $1,185 |
| Equity | 52 | (32) | 23 |
| Total available for sale securities | $1,486 | $1,085 | $1,208 |

Trading securities, included in other investments, totaled $208 million and $215 million as of December 31, 2012 and 2011, respectively. The cumulative net unrealized gains on trading securities held as of December 31, 2012 and 2011 were $10 million and $9 million, respectively. Unrealized gains and losses recognized in net realized investment gain (loss) on trading securities still held at the reporting date were $6 million, ($7) million and $8 million as of December 31, 2012, 2011 and 2010, respectively.

As of December 31, 2012 and 2011, fixed maturity securities of $12 million were on deposit with state insurance departments to satisfy regulatory requirements.

Mortgage loans totaled $7,729 million and $7,599 million as of December 31, 2012 and 2011, respectively. Mortgage loans are collateralized by commercial properties primarily located throughout the U.S. As of December 31, 2012, $1,270 million, $1,229 million, $898 million, $854 million and $725 million were located in California, Washington, Texas, District of Columbia, and New York, respectively. As of December 31, 2012, $380 million was located in Canada. The Company did not have any mortgage loans with accrued interest more than 180 days past due as of December 31, 2012 or 2011. As of December 31, 2012, there was no single mortgage loan investment that exceeded 10% of stockholder's equity.

The Company reviews the performance and credit quality of the mortgage loan portfolio on an on-going basis, including loan payment and collateral performance. Collateral performance includes a review of the most recent collateral inspection reports and financial statements. Analysts track each loan's debt service coverage ratio (DCR) and loan-to-value ratio (LTV). The DCR compares the collateral's net operating income to its debt service payments. DCRs less than 1.0 times indicate that the collateral operations do not generate enough income to cover the loan's current debt payments. A larger DCR indicates a greater excess of net operating income over the debt service. The LTV compares the amount of the loan to the fair value of the collateral and is commonly expressed as a percentage. LTVs greater than 100% indicate that the loan amount exceeds the collateral value. A smaller LTV percentage indicates a greater excess of collateral value over the loan amount.

The loan review process will result in each loan being placed into one of four levels: 1) No Credit Concern, 2) Minimal Credit Concern, 3) Moderate Credit Concern and 4) Significant Credit Concern. Loans in the Level 1 category are performing and no issues are noted. The collateral exhibits a strong DCR and LTV and there are no near term maturity concerns. The loan credit profile and borrower sponsorship have not experienced any significant changes and remain strong. For construction loans, projects are progressing as planned with no significant cost overruns or delays. Loans in Level 2 are also performing, as payments are current with no history of delinquency, however, one or more of the following factors may exist: there may be some negative market pressure and outlook due to economic factors and financial covenants may have been triggered due to a decline in performance. The credit profile and borrower sponsorship remain stable, but require monitoring due to declining trends.

Level 3 loans are experiencing significant or prolonged negative market pressure and/or some performance uncertainty due to economic factors affecting the collateral. One or more of the following situations may exist: financial covenants may have been triggered due to declines in performance or the borrower may have requested covenant relief; loan credit profile and/or the borrower sponsorship's financial status give cause for concern; and/or near term maturity is coupled with negative market conditions, low collateral performance, and/or borrower instability resulting in increased refinance risk. The collateral performance is not expected to support a refinance without a principal reduction or other substantive credit enhancement. Level 4 loans have experienced prolonged severe negative market and/or collateral performance trends and the borrower has expressed an inability to pay or asked for accommodations from the Company. Without additional capital infusion or an acceptable modification to the existing loan terms, default and subsequent legal action is likely. This category includes loans in payment default. Impairment is likely and specific reserves or write downs may be required. Loans that have been classified as Level 3, Moderate Credit concern or Level 4, Significant Credit Concern are placed on a watch list and monitored on a monthly basis.

Loans that have been identified as Level 4 Significant Credit Concern are evaluated to determine if the loan is impaired. A loan is impaired if it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. Once a loan is impaired the amount of the impairment is calculated by comparing the fair value of the loan to the book value of the loan. The loan value can be based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is a collateral dependent loan. See Note 14.

As of December 31, 2012, there were four mortgage loans in the amount of $73 million that were considered impaired and an impairment loss of $4 million was recognized as the fair value of the underlying collateral of two of these loans was lower than their carrying value. No impairment loss was recorded on the other loans since the estimated fair value of the collateral was greater than the carrying amount. During the year ended December 31, 2012, two loans totaling $3 million were foreclosed upon and one loan totaling $285 million was returned to the Company through a deed in lieu of foreclosure process. All three loans became real estate property investments. An impairment loss totaling $4 million was recorded on the loan that went through the deed in lieu of foreclosure process as the estimated value of the underlying collateral was lower than the carrying amount. As of December 31, 2011, there were three mortgage loans totaling $288 million that were considered impaired, and an impairment loss of $5 million was recorded as the underlying collateral of two of these mortgage loans was lower than the carrying amount and they were in the process of foreclosure. No impairment loss was recorded for the other mortgage loan since the estimated fair value of the collateral was greater than the carrying amount.

The following tables set forth mortgage loan credit levels as of December 31, 2012 and 2011 (*$ In Millions*):

| | December 31, 2012 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Level 1 No Credit Concern | | Level 2 Minimal Credit Concern | | Level 3 Moderate Credit Concern | | Level 4 Significant Credit Concern | | All Levels | |
| Property Type | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR |
| Apartment | $469 | 1.35 | $117 | 1.38 | $114 | 1.55 | | | $700 | 1.39 |
| Golf course | 187 | 1.49 | 51 | 0.90 | | | $6 | 0.82 | 244 | 1.35 |
| Hotel/Lodging | 814 | 2.09 | | | | | | | 814 | 2.09 |
| Industrial | | | 21 | 1.07 | | | | | 21 | 1.07 |
| Mixed use | 95 | 1.10 | | | | | | | 95 | 1.10 |
| Mobile home park | 115 | 2.18 | | | | | | | 115 | 2.18 |
| Multiple | 95 | 2.03 | | | | | | | 95 | 2.03 |
| Office | 3,193 | 2.00 | 79 | 1.17 | 34 | (0.07) | | | 3,306 | 1.96 |
| Resort | 1,036 | 2.69 | | | | | 66 | 4.66 | 1,102 | 2.81 |
| Retail | 852 | 2.09 | | | | | | | 852 | 2.09 |
| Construction loans | 385 | N/A | | | | | | | 385 | N/A |
| Total mortgage loans | $7,241 | 2.06 | $268 | 1.20 | $148 | 1.17 | $72 | 4.33 | $7,729 | 2.03 |

| | December 31, 2011 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Level 1 No Credit Concern | | Level 2 Minimal Credit Concern | | Level 3 Moderate Credit Concern | | Level 4 Significant Credit Concern | | All Levels | |
| Property Type | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR | Carrying Amount | Weighted Average DCR |
| Apartment | $433 | 1.40 | $99 | 1.79 | $138 | 0.88 | | | $670 | 1.35 |
| Golf course | 201 | 1.50 | 53 | 0.90 | | | $5 | 0.41 | 259 | 1.35 |
| Hotel/Lodging | 831 | 1.90 | | | | | | | 831 | 1.90 |
| Industrial | | | 21 | 1.22 | | | 285 | 1.08 | 306 | 1.09 |
| Mixed use | 96 | 1.11 | | | | | | | 96 | 1.11 |
| Mobile home park | 123 | 2.22 | | | 18 | 0.53 | | | 141 | 2.00 |
| Multiple | 178 | 2.49 | | | | | | | 178 | 2.49 |
| Office | 2,741 | 1.93 | | | 34 | 0.63 | | | 2,775 | 1.82 |
| Resort | 1,040 | 2.45 | 66 | 4.02 | | | | | 1,106 | 2.55 |
| Retail | 780 | 1.95 | | | | | | | 780 | 1.95 |
| Construction loans | 418 | N/A | 39 | N/A | | | | | 457 | N/A |
| Total mortgage loans | $6,841 | 1.93 | $278 | 2.15 | $190 | 0.80 | $290 | 1.07 | $7,599 | 1.87 |

Real estate investments totaled $581 million and $534 million as of December 31, 2012 and 2011, respectively. The Company had no real estate investment write-downs during the year ended December 31, 2012. During the years ended December 31, 2011 and 2010, real estate investment write-downs totaled $1 million and $27 million, respectively.

## 9. AIRCRAFT LEASING PORTFOLIO, NET

Aircraft leasing portfolio, net, consisted of the following:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | *(In Millions)* | |
| Aircraft | $5,955 | $4,569 |
| Aircraft consolidated from VIEs | 2,353 | 2,613 |
| | 8,308 | 7,182 |
| Accumulated depreciation | 1,548 | 1,337 |
| Aircraft leasing portfolio, net | $6,760 | $5,845 |

Included in the table below are four aircraft ACG has subleased to airlines with lease maturity dates of 2021 through 2024. The revenue related to these aircraft, included in aircraft leasing revenue, was $15 million, $11 million and $1 million for the years ended December 31, 2012, 2011 and 2010, respectively. These aircraft were sold to third-parties and subsequently leased back with lease maturity dates of 2023 through 2025. See Note 21 for the future lease commitments and minimum rentals to be received related to these sale leaseback transactions.

As of December 31, 2012, domestic and foreign future minimum rentals scheduled to be received under the noncancelable portion of operating leases are as follows (*In Millions*):

| | 2013 | 2014 | 2015 | 2016 | 2017 | Thereafter |
|---|---|---|---|---|---|---|
| Domestic | $97 | $94 | $86 | $81 | $71 | $334 |
| Foreign | 542 | 490 | 427 | 375 | 310 | 717 |
| Total operating leases | $639 | $584 | $513 | $456 | $381 | $1,051 |

As of December 31, 2012 and 2011, aircraft with a carrying amount of $4,431 million and $4,317 million, respectively, were assigned as collateral to secure debt (Notes 4 and 13).

During the years ended December 31, 2012, 2011 and 2010, ACG recognized aircraft impairments of $16 million, $15 million and $4 million, respectively, which are included in operating and other expenses. See Note 14.

The Company had eight and four non-earning aircraft in the portfolio as of December 31, 2012 and 2011, respectively.

During the years ended December 31, 2012, 2011 and 2010, ACG recognized pre-tax gains on the sale of aircraft of $12 million, $33 million and $18 million, respectively, which are included in other income. Aircraft held for sale totaled $151 million and $6 million as of December 31, 2012 and 2011, respectively, and are included in aircraft leasing portfolio, net.

See Note 21 for future aircraft purchase commitments.

## 10. DERIVATIVES AND HEDGING ACTIVITIES

The Company primarily utilizes derivative instruments to manage its exposure to interest rate risk, foreign currency risk, credit risk, and equity risk. Derivative instruments are also used to manage the duration mismatch of assets and liabilities. The Company utilizes a variety of derivative instruments including swaps and options. In addition, certain insurance products offered by the Company contain features that are accounted for as derivatives.

Accounting for derivatives and hedging activities requires the Company to recognize all derivative instruments as either assets or liabilities at estimated fair value in its consolidated statement of financial condition. The Company applies hedge accounting by designating derivative instruments as either fair value or cash flow hedges on the date the Company enters into a derivative contract. The Company formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. In this documentation, the Company specifically identifies the asset, liability, firm commitment, or forecasted transaction that has been designated as a hedged item and states how the hedging instrument is expected to hedge the risks related to the hedged item. The Company formally assesses and measures effectiveness of its hedging relationships both at the hedge inception and on an ongoing basis in accordance with its risk management policy.

The Company developed a pattern of forecasted transactions that did not occur as originally forecasted, and as a result, derivative instruments in the Company's insurance operations previously designated as cash flow hedges should have been reported as derivatives not designated as hedging instruments during 2010. The impact of the discontinuance of cash flow hedge accounting was insignificant to the consolidated financial statements for the year ended December 31, 2010, and therefore, the consolidated financial statements and footnote disclosures for the year ended December 31, 2010 were not revised. Effective June 29, 2012, the insurance operations reestablished its ability to utilize cash flow hedge accounting. The insurance operations did not designate any derivatives as cash flow hedges during the year ended December 31, 2012.

DERIVATIVES NOT DESIGNATED AS HEDGING INSTRUMENTS

The Company has certain insurance and reinsurance contracts that are considered to have embedded derivatives. When it is determined that the embedded derivative possesses economic and risk characteristics that are not clearly and closely related to those of the host contract, and that a separate instrument with the same terms would qualify as a derivative instrument, it is separated from the host contract and accounted for as a stand-alone derivative.

The Company offers a rider on certain variable annuity contracts that guarantees net principal over a ten-year holding period, as well as riders on certain variable annuity contracts that guarantee a minimum withdrawal benefit over specified periods, subject to certain restrictions. These variable annuity GLBs are considered embedded derivatives and are recorded in future policy benefits.

GLBs on variable annuity contracts issued between January 1, 2007 and March 31, 2009 are partially covered by reinsurance. These reinsurance arrangements are used to offset a portion of the Company's exposure to the GLBs for the lives of the host variable annuity contracts issued. The ceded portion of the GLBs is considered an embedded derivative and is recorded as a component of net reinsurance recoverable in other assets.

The Company employs hedging strategies (variable annuity derivatives) to mitigate equity risk associated with the GLBs not covered by reinsurance. The Company utilizes total return swaps and equity put options based upon the S&P 500 Index (S&P 500) and the EAFE Index (Europe, Australia, Asia, and Far East) to economically hedge the equity risk of the guarantees in its variable annuity products. The total return swaps provide periodic payments to the Company in exchange for the total return of the S&P 500 and changes in fair value of the EAFE indices in the form of a payment or receipt, depending on whether the return relative to the indices on trade date is positive or negative, respectively. The equity put options involve the exchange of an upfront payment for the return, at the end of the option agreement, of the equity index below a specified strike price. Payments, amortization of upfront premiums and receipts are recognized in net realized investment gain (loss).

The Company also uses equity put options to hedge equity and credit risks. These equity put options involve the exchange of periodic fixed rate payments for the return, at the end of the option agreement, of the equity index below a specified strike price. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party.

The Company issues synthetic GICs to Employee Retirement Income Security Act of 1974 (ERISA) qualified defined contribution employee benefit plans (ERISA Plan). The ERISA Plan uses the contracts in its stable value fixed income option. The Company receives a fee for providing book value accounting for the ERISA Plan stable value fixed income option. The Company does not manage the assets underlying synthetic GICs. In the event that plan participant elections exceed the estimated fair value of the assets or if the contract is terminated and at the end of the termination period the book value under the contract exceeds the estimated fair value of the assets, then the Company is required to pay the ERISA Plan the difference between book value and estimated fair value. The Company mitigates the investment risk through pre-approval and monitoring of the investment guidelines, requiring high quality investments and adjustments to the plan crediting rates to compensate for unrealized losses in the portfolios.

Foreign currency interest rate swap agreements are used to convert a fixed or floating rate, foreign-denominated asset or liability to a U.S. dollar fixed rate asset or liability. The foreign currency interest rate swaps involve the exchange of an initial principal amount in two currencies and the agreement to re-exchange the currencies at a future date at an agreed exchange rate. There are also periodic exchanges of interest payments in the two currencies at specified intervals, calculated using agreed upon rates and the exchanged principal amounts. The main currencies that the Company hedges are the Euro, British Pound, and Canadian Dollar.

Interest rate swaps are used by the Company primarily to reduce market risk from changes in interest rates and other interest rate exposure arising from duration mismatches between assets and liabilities. These agreements involve the exchange, at specified intervals, of interest payments resulting from the difference between fixed rate and floating rate interest amounts calculated by reference to an underlying notional amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party.

Forward starting interest rate swaps are used to hedge the variability in the future interest payments from the purchase price from the anticipated purchase of fixed rate securities or issuance of fixed rate liabilities due to changes in benchmark interest rates. These derivatives are predominantly used to lock in interest rate levels to match future cash flow characteristics of assets and liabilities. Forward starting interest rate swaps involve the exchange, at specified intervals, of interest payments resulting from the difference between fixed and floating rate interest amounts calculated by reference to an underlying notional amount to begin at a specified date in the future for a specified period of time. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. The notional amounts of the contracts do not represent future cash requirements, as the Company intends to close out open positions prior to their effective dates.

Financial futures contracts obligate the holder to buy or sell the underlying financial instrument at a specified future date for a set price and may be settled in cash or by delivery of the financial instrument. Price changes on futures are settled daily through the required margin cash flows. As part of its asset/liability management, the Company generally utilizes futures contracts to manage its interest rate and market risk related to fixed maturity securities. Futures contracts have limited off-balance sheet credit risk as they are executed on organized exchanges and require security deposits, as well as daily cash settlement of margins.

The Company offers indexed universal life insurance products, which credit the price return of an underlying index to the policyholder's cash value. A policyholder may allocate the policy’s net accumulated value to one or a combination of the following: fixed return account, one year S&P 500 indexed account currently capped at 13%, two year S&P 500 index account currently capped at 32%, five year S&P 500 indexed account, or one year global index account currently capped at 13%. The indexed products contain embedded derivatives and are recorded in policyholder account balances.

The Company utilizes call options to hedge the credit paid to the policy on the underlying index. These options are contracts to buy the index at a predetermined time at a contracted price. The contracts will be net settled in cash based on differentials in the index at the time of exercise and the strike price subject to a cap, net of option premium and the settlements will be recognized in net realized investment gain (loss).

The Company had the following outstanding derivatives not designated as hedging instruments:

| | Notional Amount | |
|---|---|---|
| | December 31, | |
| | 2012 | 2011 |
| | *(In Millions)* | |
| Variable annuity GLB embedded derivatives | $37,308 | $38,960 |
| Variable annuity GLB reinsurance contracts | 15,442 | 14,744 |
| Variable annuity derivatives - total return swaps | 2,634 | 3,666 |
| Variable annuity derivatives - equity put options | 998 | 998 |
| Equity put options | 5,135 | 5,135 |
| Synthetic GICs | 20,194 | 21,593 |
| Foreign currency and interest rate swaps | 7,221 | 8,020 |
| Forward starting interest rate swaps | | 1,140 |
| Futures | | 1,400 |
| Indexed universal life embedded derivatives | 1,091 | 830 |
| Call options | 977 | 789 |
| Other | 604 | 465 |

Notional amount represents a standard of measurement of the volume of derivatives. Notional amount is not a quantification of market risk or credit risk and is not recorded in the consolidated statements of financial condition. Notional amounts generally represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps.

The following table summarizes amounts recognized in net realized investment gain (loss) for derivatives not designated as hedging instruments. Gains and losses include the changes in estimated fair value of the derivatives and amounts realized on terminations. The amounts presented do not include the periodic net payments and amortization of $680 million, $418 million and $560 million for the years ended December 31, 2012, 2011 and 2010, respectively, which are recognized in net realized investment gain (loss).

| | Amount of Gain (Loss) Recognized in Income on Derivatives | | |
|---|---|---|---|
| | Years Ended December 31, | | |
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Variable annuity derivatives - total return swaps | ($96) | ($121) | ($84) |
| Equity put options | (319) | 252 | (60) |
| Foreign currency and interest rate swaps | (45) [1] | 170 [1] | |
| Forward starting interest rate swaps | (79) | 281 | |
| Call options | 74 | 33 | 36 |
| Other | 38 | 1 | 3 |
| Embedded derivatives: | | | |
| Variable annuity GLB embedded derivatives (including reinsurance contracts) | 119 | (1,191) | 185 |
| Indexed universal life embedded derivatives | (21) | 19 | (20) |
| Other | (21) | 4 | (3) |
| Total | ($350) | ($552) | $57 |

[1] Includes foreign currency translation gains and (losses) for foreign currency interest rate swaps.

DERIVATIVES DESIGNATED AS CASH FLOW HEDGES

The Company primarily uses foreign currency interest rate swaps, forward starting interest rate swaps and interest rate swaps to manage its exposure to variability in cash flows due to changes in foreign currencies and benchmark interest rates. These cash flows include those associated with existing assets and liabilities, as well as the forecasted purchase price related to anticipated investment purchases and forecasted interest cash flows related to anticipated liability issuances. The maximum length of time over which the Company was hedging its exposure to variability in future cash flow in the non-insurance company operations (primarily ACG) for forecasted transactions did not exceed 21 years.

When a derivative is designated as a cash flow hedge, the effective portion of changes in the estimated fair value of the derivative is recognized in OCI and reclassified to earnings when the hedged item affects earnings, and the ineffective portion of changes in the estimated fair value of the derivative is recognized in net realized investment gain (loss). Hedge ineffectiveness related to dedesignated cash flow hedges was zero for the years ended December 31, 2012 and 2011 and immaterial for the year ended December 31, 2010.

The Company reclassified ($4) million and $18 million from accumulated other comprehensive income (loss) (AOCI) to earnings resulting from the discontinuance of cash flow hedges due to forecasted transactions that were no longer probable of occurring for the years ended December 31, 2012 and 2011, respectively. Amounts reclassified from AOCI to earnings resulting from the discontinuance of cash flow hedges due to forecasted cash flows that were no longer probable of occurring for the year ended December 31, 2010 were immaterial. Over the next twelve months, the Company anticipates that $13 million of deferred losses on derivative instruments in AOCI will be reclassified to earnings consistent with when the hedged forecasted transaction affects earnings. For the years ended December 31, 2012 and 2011, all of the non-insurance company operation's (primarily ACG) hedged forecasted transactions for outstanding cash flow hedges were determined to be probable of occurring.

The Company had outstanding derivatives designated as cash flow hedges with notional amounts for interest rate swaps of $1,184 million and $1,531 million as of December 31, 2012 and 2011, respectively. The Company had gains recognized in OCI for changes in estimated fair value for derivatives designated as cash flow hedges for interest rate swaps of $27 million, $5 million and $15 million for the years ended December 31, 2012, 2011 and 2010, respectively. These amounts do not include the periodic net settlements of the derivatives.

DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES

Interest rate swap agreements are used to convert a U.S. dollar denominated fixed rate asset or liability to a floating U.S. dollar denominated rate to hedge the changes in estimated fair value of the hedged asset or liability due to changes in benchmark interest rates. These derivatives are used primarily to closely match the duration of the assets supporting specific liabilities. Pacific Life also used interest rate swaps to convert fixed rate surplus notes to variable notes (Note 13). The Company had no outstanding derivatives designated as fair value hedges as of December 31, 2012 and 2011.

The Company had gains (losses) recognized in net realized investment gain (loss) for derivatives designated as fair value hedges for interest rate swaps of zero, $328 million and $85 million on derivatives and zero, ($334) million and ($98) million on hedged items for the years ended December 31, 2012, 2011 and 2010, respectively. Gains and losses include the changes in estimated fair value of the derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk. The Company includes the gain or loss on the derivative in the same line item as the offsetting gain or loss on the hedged item. These amounts do not include the periodic net settlements of the derivatives or the income (expense) related to the hedged item.

For the years ended December 31, 2012, 2011 and 2010, hedge ineffectiveness related to designated fair value hedges reflected in net realized investment gain (loss) was zero, ($6) million and ($13) million, respectively. No component of the hedging instrument's estimated fair value is excluded from the determination of effectiveness.

CONSOLIDATED FINANCIAL STATEMENT IMPACT

Derivative instruments are recorded on the Company's consolidated statements of financial condition at estimated fair value and are presented as assets or liabilities determined by calculating the net position for each derivative counterparty by legal entity, taking into account income accruals and net cash collateral.

The following table summarizes the gross asset or liability derivative estimated fair value and excludes the impact of offsetting asset and liability positions held with the same counterparty, cash collateral payables and receivables and income accruals. See Note 14.

| | Asset Derivatives Estimated Fair Value | | | Liability Derivatives Estimated Fair Value | | |
|---|---|---|---|---|---|---|
| | December 31, | | | December 31, | | |
| | 2012 | 2011 | | 2012 | 2011 | |
| | (In Millions) | | | (In Millions) | | |
| Derivatives designated as hedging instruments: | | | | | | |
| Interest rate swaps | | | | $84 | $111 | [5] |
| Total derivatives designated as hedging instruments | - | - | | 84 | 111 | |
| Derivatives not designated as hedging instruments: | | | | | | |
| Variable annuity derivatives - total return swaps | | $1 | [1] | 11 | 63 | [1] |
| | | | | 17 | 2 | [5] |
| Variable annuity derivatives - equity put options | | 45 | [1] | | | |
| Equity put options | $87 | 498 | [1] | | 2 | [1] |
| | 88 | | [5] | 31 | | [5] |
| Call options | 33 | 28 | [1] | | | |
| | 24 | | [5] | | | |
| Foreign currency and interest rate swaps | 89 | 332 | [1] | 98 | 242 | [1] |
| | 127 | 8 | [5] | 204 | 104 | [5] |
| Forward starting interest rate swaps | | 293 | [1] | | | |
| | | 29 | [5] | | | |
| Other | | 7 | [1] | | 29 | [1] |
| | 1 | 2 | [5] | 24 | | [5] |
| Embedded derivatives: | | | | | | |
| Variable annuity GLB embedded derivatives (including reinsurance contracts) | 293 | 230 | [2] | 1,801 | 1,938 | [3] |
| Indexed universal life embedded derivatives | | | | 104 | 64 | [4] |
| Other | | | | 16 | 3 | [4] |
| Total derivatives not designated as hedging instruments | 742 | 1,473 | | 2,306 | 2,447 | |
| Total derivatives | $742 | $1,473 | | $2,390 | $2,558 | |

Location on the consolidated statements of financial condition:

[1] Other investments [2] Other assets [3] Future policy benefits [4] Policyholder account balances [5] Other liabilities

Cash collateral received from counterparties was $175 million and $658 million as of December 31, 2012 and 2011, respectively. This unrestricted cash collateral is included in cash and cash equivalents and the obligation to return it is netted against the estimated fair value of derivatives in other investments or other liabilities. Cash collateral pledged to counterparties was $99 million and $36 million as of December 31, 2012 and 2011, respectively. A receivable representing the right to call this collateral back from the counterparty is netted against the estimated fair value of derivatives in other investments or other liabilities. If the net estimated fair value of the exposure to the counterparty is positive, the amount is reflected in other investments, whereas, if the net estimated fair value of the exposure to the counterparty is negative, the estimated fair value is included in other liabilities.

As of December 31, 2012 and 2011, the Company had also accepted collateral consisting of various securities with an estimated fair value of $81 million and $77 million, respectively, which are held in separate custodial accounts. The Company is permitted by contract to sell or repledge this collateral and as of December 31, 2012 and 2011, none of the collateral had been repledged. As of December 31, 2012 and 2011, the Company provided collateral in the form of various securities with an estimated fair value of zero and $1 million, respectively, which are included in fixed maturity securities. The counterparties are permitted by contract to sell or repledge this collateral.

CREDIT EXPOSURE AND CREDIT RISK RELATED CONTINGENT FEATURES

Credit exposure is measured on a counterparty basis as the net positive aggregate estimated fair value, net of collateral received, if any. The credit exposure for over the counter derivatives as of December 31, 2012 was $12 million. The maximum exposure to any single counterparty was $5 million at December 31, 2012.

For all derivative contracts, excluding embedded derivative contracts such as variable annuity GLBs and synthetic GICs, the Company enters into master agreements that may include a termination event clause associated with financial strength ratings assigned by certain independent rating agencies. If these financial strength ratings were to fall below a specified level, as defined within each counterparty master agreement or, in most cases, if one of the rating agencies ceased to provide a financial strength rating, the counterparty could terminate the master agreement with payment due based on the estimated fair value of the underlying derivatives. As of December 31, 2012, the Company's financial strength ratings were above the specified level.

The Company enters into collateral arrangements with derivative counterparties, which require both the pledge and acceptance of collateral when the net estimated fair value of the underlying derivatives reaches a pre-determined threshold. Certain of these arrangements include credit-contingent provisions that provide for a reduction of these thresholds in the event of downgrades in the credit ratings of the Company and/or the counterparty. If these financial strength ratings were to fall below a specific investment grade credit rating, the counterparties to the derivative instruments could request immediate and ongoing full collateralization on derivative instruments in net liability positions. The aggregate estimated fair value of all derivative instruments with credit risk related contingent features that are in a liability position on December 31, 2012, is $163 million for which the Company has posted collateral of $99 million in the normal course of business. If certain of the Company's financial strength ratings were to fall one notch as of December 31, 2012, the Company would have been required to post an additional $14 million of collateral to its counterparties.

The Company attempts to limit its credit exposure by dealing with creditworthy counterparties, establishing risk control limits, executing legally enforceable master netting agreements, and obtaining collateral where appropriate. In addition, each counterparty is reviewed to evaluate its financial stability before entering into each agreement and throughout the period that the financial instrument is owned. All of the Company's credit exposure from derivative contracts is with investment grade counterparties.

## 11. POLICYHOLDER LIABILITIES

POLICYHOLDER ACCOUNT BALANCES

The detail of the liability for policyholder account balances is as follows:

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | *(In Millions)* | |
| UL | $22,087 | $20,941 |
| Annuity and deposit liabilities | 10,313 | 9,162 |
| Funding agreements | 1,924 | 3,178 |
| GICs | 659 | 1,111 |
| Total | $34,983 | $34,392 |

FUTURE POLICY BENEFITS

The detail of the liability for future policy benefits is as follows:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | *(In Millions)* | |
| Annuity reserves | $6,591 | $5,572 |
| Variable annuity GLB embedded derivatives | 1,801 | 1,936 |
| Policy benefits payable | 1,296 | 741 |
| Life insurance | 666 | 591 |
| URR | 386 | 289 |
| Closed Block liabilities | 293 | 300 |
| Other | 72 | 38 |
| Total | $11,105 | $9,467 |

## 12. SEPARATE ACCOUNTS AND VARIABLE ANNUITY GUARANTEED BENEFIT FEATURES

The Company issues variable annuity contracts through separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contract holder (traditional variable annuities). These contracts also include various types of GMDB and GLB features. For a discussion of certain GLBs accounted for as embedded derivatives, see Note 10.

The GMDBs provide a specified minimum return upon death. Many of these death benefits are spousal, whereby a death benefit will be paid upon death of the first spouse. The survivor has the option to terminate the contract or continue it and have the death benefit paid into the contract and a second death benefit paid upon the survivor's death. The GMDB features include those where the Company contractually guarantees to the contract holder either (a) return of no less than total deposits made to the contract less any partial withdrawals (return of net deposits), (b) the highest contract value on any contract anniversary date through age 80 minus any payments or withdrawals following the contract anniversary (anniversary contract value), or (c) the highest of contract value on certain specified dates or total deposits made to the contract less any partial withdrawals plus a minimum return (minimum return).

The guaranteed minimum income benefit (GMIB) is a GLB that provides the contract holder with a guaranteed annuitization value after 10 years. Annuitization value is generally based on deposits adjusted for withdrawals plus a minimum return. In general, the GMIB requires contract holders to invest in an approved asset allocation strategy.

In 2011, the Company began offering variable annuity contracts with guaranteed minimum withdrawal benefits for life (GMWBL) features. The GMWBL is a GLB that provides, subject to certain restrictions, a percentage of a contract holder’s guaranteed payment base will be available for withdrawal for life starting at age 59.5, regardless of market performance. The rider terminates upon death of the contract holder or their spouse if a spousal form of the rider is purchased.

Information in the event of death on the various GMDB features outstanding was as follows (the Company's variable annuity contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed are not mutually exclusive):

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | ($ In Millions) | |
| **Return of net deposits** | | |
| Separate account value | $49,034 | $45,720 |
| Net amount at risk [1] | 922 | 2,311 |
| Average attained age of contract holders | 63 years | 63 years |
| **Anniversary contract value** | | |
| Separate account value | $15,165 | $14,832 |
| Net amount at risk [1] | 778 | 1,664 |
| Average attained age of contract holders | 65 years | 64 years |
| **Minimum return** | | |
| Separate account value | $1,032 | $1,040 |
| Net amount at risk [1] | 477 | 555 |
| Average attained age of contract holders | 68 years | 67 years |

[1] Represents the amount of death benefit in excess of the current account balance as of December 31.

Information regarding GMIB and GMWBL features outstanding is as follows:

| | December 31, 2012 | December 31, 2011 | December 31, 2012 | December 31, 2011 |
|---|---|---|---|---|
| | GMIB | | GMWBL | |
| | ($ In Millions) | | ($ In Millions) | |
| Separate account value | $2,296 | $2,345 | $2,429 | $700 |
| Average attained age of contract holders | 60 years | 59 years | 64 years | 63 years |

The determination of GMDB, GMIB and GMWBL liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates and mortality experience. The following table summarizes the GMDB, GMIB and GMWBL liabilities, which are recorded in future policy benefits, and changes in these liabilities, which are reflected in policy benefits paid or provided:

| | December 31, 2012 | December 31, 2011 | December 31, 2012 | December 31, 2011 | December 31, 2012 | December 31, 2011 |
|---|---|---|---|---|---|---|
| | GMDB | | GMIB | | GMWBL | |
| | (In Millions) | | (In Millions) | | (In Millions) | |
| Balance, beginning of year | | | $78 | $43 | | |
| Changes in reserves | $20 | $26 | (28) | 39 | $5 | |
| Benefits paid | (20) | (26) | (4) | (4) | | |
| Balance, end of year | - | - | $46 | $78 | $5 | - |

Variable annuity contracts with guarantees were invested in separate account investment options as follows:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | (In Millions) | |
| Asset type | | |
| Equity | $30,719 | $29,180 |
| Bonds | 18,002 | 16,137 |
| Money market | 313 | 403 |
| Total separate account value | $49,034 | $45,720 |

## 13. DEBT

Debt consists of the following:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | (In Millions) | |
| Short-term debt: | | |
| Credit facility recourse only to ACG | $292 | |
| Total short-term debt | $292 | |
| Long-term debt: | | |
| Surplus notes | $1,600 | $1,600 |
| Deferred gains from derivative hedging activities | 409 | 417 |
| Non-recourse long-term debt: | | |
| Debt recourse only to ACG | 3,793 | 3,332 |
| ACG non-recourse debt | 503 | 550 |
| Other non-recourse debt | 303 | 103 |
| ACG VIE debt (Note 4) | 847 | 1,130 |
| Other VIE debt (Note 4) | 18 | 20 |
| Total long-term debt | $7,473 | $7,152 |

### SHORT-TERM DEBT

Pacific Life maintains a $700 million commercial paper program. There was no commercial paper debt outstanding as of December 31, 2012 and 2011. In addition, Pacific Life has a bank revolving credit facility of $400 million maturing in November 2016 that will serve as a back-up line of credit to the commercial paper program. This facility had no debt outstanding as of December 31, 2012 and 2011. As of and during the year ended December 31, 2012, Pacific Life was in compliance with the debt covenants related to these facilities.

PL&A maintains reverse repurchase lines of credit with various financial institutions. These borrowings are at variable rates of interest based on collateral and market conditions. There was no debt outstanding in connection with these lines of credit as of December 31, 2012 and 2011.

Pacific Life has approval from the FHLB of Topeka to receive advances up to 40% of Pacific Life's statutory general account assets provided it has available collateral and is in compliance with debt covenant restrictions and insurance laws and regulations. There was no debt outstanding with the FHLB of Topeka as of December 31, 2012 and 2011. The Company had $5 million and zero of additional funding capacity from eligible collateral as of December 31, 2012 and 2011, respectively.

PL&A is eligible to borrow from the FHLB of San Francisco amounts based on a percentage of statutory capital and surplus and could borrow up to amounts of $136 million. Of this amount, half, or $68 million, can be borrowed for terms other than overnight, out to a maximum term of nine months. These borrowings are at variable rates of interest, collateralized by certain mortgage loan and government securities. As of December 31, 2012 and 2011, PL&A had no debt outstanding with the FHLB of San Francisco.

ACG has revolving credit agreements with banks for a $650 million borrowing capacity. Interest on these loans is payable monthly and was 2.7% as of December 31, 2012 and the facilities expire at various dates ranging from October 2013 through April 2015. There was $292 million outstanding in connection with these revolving credit agreements as of December 31, 2012. As of December 31, 2011, there was no debt outstanding on these agreements. In January 2013, ACG entered into an additional unsecured revolving credit facility for a $125 million borrowing capacity. This facility is set to expire in January 2016. These credit agreements are recourse only to ACG.

LONG-TERM DEBT

Pacific Life has $1.0 billion of surplus notes at a fixed interest rate of 9.25%, maturing on June 15, 2039. Interest is payable semiannually on June 15 and December 15. Pacific Life may redeem the 9.25% surplus notes at its option, subject to the approval of the Nebraska Director of Insurance for such optional redemption. The 9.25% surplus notes are unsecured and subordinated to all present and future senior indebtedness and policy claims of Pacific Life. All future payments of interest and principal on the 9.25% surplus notes can be made only with the prior approval of the Nebraska Director of Insurance. The Company entered into interest rate swaps converting the 9.25% surplus notes to variable rate notes based upon the London InterBank Offered Rate (LIBOR). The interest rate swaps were designated as fair value hedges of these surplus notes and the changes in fair value of the hedged surplus notes associated with changes in interest rates were reflected as an adjustment to their carrying amount. During the year ended December 31, 2011, the interest rate swaps were terminated and the fair value adjustment as of the termination date, which increased the carrying value by $364 million, will be amortized over the remaining life of the surplus notes using the effective interest method. The resulting effective interest rate of the surplus notes is 6.4%. Total unamortized deferred gains are $357 million and $362 million as of December 31, 2012 and 2011, respectively.

In January 2013, the Company, with the approval of the NE DOI, repurchased and retired $323 million of the 9.25% surplus notes through a tender offer. The repurchase of the 9.25% surplus notes will be accounted for as an extinguishment of debt and the related unamortized deferred gains as discussed above, and the premium paid, will be recognized in 2013.

Pacific Life has $150 million of surplus notes outstanding at a fixed interest rate of 7.9%, maturing on December 30, 2023. Interest is payable semiannually on June 30 and December 30. The 7.9% surplus notes may not be redeemed at the option of Pacific Life or any holder of the surplus notes. The 7.9% surplus notes are unsecured and subordinated to all present and future senior indebtedness and policy claims of Pacific Life. All future payments of interest and principal on the 7.9% surplus notes can be made only with the prior approval of the Nebraska Director of Insurance. The Company entered into interest rate swaps converting these surplus notes to variable rate notes based upon the LIBOR. The interest rate swaps were designated as fair value hedges of these surplus notes and the changes in estimated fair value of the hedged surplus notes associated with changes in interest rates were reflected as an adjustment to their carrying amount. During the year ended December 31, 2011, the interest rate swaps were terminated and the fair value adjustment as of the termination date, which increased the carrying value by $56 million, will be amortized over the remaining life of the surplus notes using the effective interest method. The resulting effective interest rate of the surplus notes is 4.0%. Total unamortized deferred gains are $52 million and $55 million as of December 31, 2012 and 2011, respectively.

The Nebraska Director of Insurance approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for $450 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on February 5 and August 5 at a fixed annual rate of 6.0%. All future payments of interest and principal on the internal surplus note can be made only with the prior approval of the Nebraska Director of Insurance. The internal surplus note matures on February 5, 2020.

In January 2013, the Nebraska Director of Insurance approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for $500 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on January 25 and July 25 at a fixed annual rate of 5.125%, subject to regulatory approval. The internal surplus note matures on January 25, 2043.

ACG enters into various secured loans that are guaranteed by the U.S. Export-Import bank or by the European Export Credit Agencies. Interest on these loans is payable quarterly and ranged from 0.5% to 4.3% as of December 31, 2012 and from 0.7% to 4.4% as of December 31, 2011. As of December 31, 2012, $1,627 million was outstanding on these loans with maturities ranging from 2014 to 2024. As of December 31, 2011, $1,455 million was outstanding on these loans. These loans are recourse only to ACG.

ACG enters into various senior unsecured notes and loans with third-parties. Interest on these notes and loans is payable quarterly or semi-annually and ranged from 2.0% to 7.2% as of December 31, 2012 and 2011. As of December 31, 2012, $2,113 million was outstanding on these notes and loans with maturities ranging from 2014 to 2023. As of December 31, 2011, $1,813 million was outstanding on these notes and loans. These notes and loans are recourse only to ACG.

In January 2013, ACG issued $300 million of senior unsecured notes at an interest rate of 4.6%, maturing in January 2018. These notes are recourse only to ACG.

ACG enters into various secured bank loans to finance aircraft orders and deposits. Interest on these loans is payable monthly and was 2.0% as of December 31, 2012 and 2011. As of December 31, 2012, $53 million was outstanding on these loans, which mature in 2013. As of December 31, 2011, $64 million was outstanding on these loans. These loans are recourse only to ACG.

ACG enters into various acquisition facilities and bank loans to acquire aircraft. Interest on these facilities and loans accrues at variable rates, is payable monthly and ranged from 2.7% to 3.2% as of December 31, 2012 and from 2.8% to 3.3% as of December 31, 2011. As of December 31, 2012, $503 million was outstanding on these facilities and loans with maturities ranging from 2013 to 2014. As of December 31, 2011, $550 million was outstanding on these facilities and loans. These facilities and loans are non-recourse to the Company.

Certain subsidiaries of Pacific Asset Holding LLC, a wholly owned subsidiary of Pacific Life, entered into various real estate property related loans with various third-parties. Interest on these loans accrues at fixed and variable rates and is payable monthly. Fixed rates ranged from 3.6% to 5.4% as of December 31, 2012 and 2011. Variable rates ranged from 2.4% to 4.5% as of December 31, 2012 and 1.5% to 4.0% as of December 31, 2011. As of December 31, 2012, there was $303 million outstanding on these loans with maturities ranging from 2013 to 2019. As of December 31, 2011, there was $103 million outstanding on these loans. During the year ended December 31, 2011, one of these loans totaling $32 million was returned in foreclosure. All of these loans are secured by real estate properties and are non-recourse to the Company.

The following summarizes aggregate scheduled principal payments during the next five years and thereafter:

| | | | Non-recourse Debt | | |
|---|---|---|---|---|---|
| | Surplus Notes | Debt Recourse Only to ACG | ACG Non-recourse Debt | Other Non-recourse Debt | Total |
| Year ended December 31, 2012: | | | (In Millions) | | |
| 2013 | | $301 | $431 | $14 | $746 |
| 2014 | | 251 | 72 | 2 | 325 |
| 2015 | | 604 | | 63 | 667 |
| 2016 | | 167 | | 181 | 348 |
| 2017 | | 217 | | 26 | 243 |
| Thereafter | $1,600 | 2,545 | | 17 | 4,162 |
| Total | $1,600 | $4,085 | $503 | $303 | $6,491 |

The table above excludes VIE debt and deferred gains from derivative hedging activities.

14. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The Codification's Fair Value Measurements and Disclosures Topic establishes a hierarchy that prioritizes the inputs of valuation methods used to measure estimated fair value for financial assets and financial liabilities that are carried at estimated fair value. The determination of estimated fair value requires the use of observable market data when available. The hierarchy consists of the following three levels that are prioritized based on observable and unobservable inputs.

Level 1 Unadjusted quoted prices for identical instruments in active markets. Level 1 financial instruments would include securities that are traded in an active exchange market.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in inactive markets; and model-derived valuations for which all significant inputs are observable market data. Level 2 instruments include most fixed maturity securities that are valued using inputs that are derived principally from or corroborated by observable market data.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs are not market observable. Level 3 instruments include less liquid securities such as certain private placement securities and variable annuity GLB embedded derivatives that require significant management assumptions or estimation in the fair value measurement.

The following tables present, by estimated fair value hierarchy level, the Company's financial assets and liabilities that are carried at estimated fair value as of December 31, 2012 and 2011.

| | Level 1 | Level 2 | Level 3 | Gross Derivatives Estimated Fair Value | Netting Adjustments [1] | Total |
|---|---|---|---|---|---|---|
| | | | | *(In Millions)* | | |
| December 31, 2012: | | | | | | |
| Assets: | | | | | | |
| U.S. Government | | $57 | | | | $57 |
| Obligations of states and political subdivisions | | 911 | $32 | | | 943 |
| Foreign governments | | 705 | 58 | | | 763 |
| Corporate securities | | 22,650 | 2,213 | | | 24,863 |
| RMBS | | 4,008 | 8 | | | 4,016 |
| CMBS | | 659 | 26 | | | 685 |
| Collateralized debt obligations | | 2 | 117 | | | 119 |
| Other asset-backed securities | | 370 | 367 | | | 737 |
| Total fixed maturity securities | - | 29,362 | 2,821 | | | 32,183 |
| Perpetual preferred securities | | 118 | 17 | | | 135 |
| Other equity securities | $13 | | 4 | | | 17 |
| Total equity securities | 13 | 118 | 21 | | | 152 |
| Trading securities | 16 | 141 | 51 | | | 208 |
| Other investments | 4 | 108 | 12 | | | 124 |
| Derivatives: | | | | | | |
| Foreign currency and interest rate swaps | | 216 | | $216 | ($225) | ($9) |
| Equity derivatives | | | 232 | 232 | (123) | 109 |
| Embedded derivatives | | | 293 | 293 | | 293 |
| Other | | 1 | | 1 | (1) | - |
| Total derivatives | - | 217 | 525 | 742 | (349) | 393 |
| Separate account assets [2] | 55,003 | 138 | 128 | | | 55,269 |
| Total | $55,036 | $30,084 | $3,558 | $742 | ($349) | $88,329 |
| Liabilities: | | | | | | |
| Derivatives: | | | | | | |
| Foreign currency and interest rate swaps | | $386 | | $386 | ($225) | $161 |
| Equity derivatives | | | $59 | 59 | (123) | (64) |
| Embedded derivatives | | | 1,921 | 1,921 | | 1,921 |
| Other | | 1 | 23 | 24 | (1) | 23 |
| Total | - | $387 | $2,003 | $2,390 | ($349) | $2,041 |

| | Level 1 | Level 2 | Level 3 | Gross Derivatives Estimated Fair Value | Netting Adjustments [1] | Total |
|---|---|---|---|---|---|---|
| | | | (In Millions) | | | |
| December 31, 2011: | | | | | | |
| Assets: | | | | | | |
| U.S. Government | | $35 | | | | $35 |
| Obligations of states and political subdivisions | | 1,170 | $9 | | | 1,179 |
| Foreign governments | | 422 | 81 | | | 503 |
| Corporate securities | | 19,875 | 1,617 | | | 21,492 |
| RMBS | | 3,137 | 1,036 | | | 4,173 |
| CMBS | | 520 | 251 | | | 771 |
| Collateralized debt obligations | | 4 | 111 | | | 115 |
| Other asset-backed securities | | 289 | 296 | | | 585 |
| Total fixed maturity securities | - | 25,452 | 3,401 | | | 28,853 |
| Perpetual preferred securities | | 202 | 26 | | | 228 |
| Other equity securities | $73 | | | | | 73 |
| Total equity securities | 73 | 202 | 26 | | | 301 |
| Trading securities | 89 | 91 | 35 | | | 215 |
| Other investments | | | 54 | | | 54 |
| Derivatives: | | | | | | |
| Foreign currency and interest rate swaps | | 340 | | $340 | ($250) | 90 |
| Forward starting interest rate swaps | | 322 | | 322 | (29) | 293 |
| Equity derivatives | | | 572 | 572 | (65) | 507 |
| Embedded derivatives | | | 230 | 230 | | 230 |
| Other | | 4 | 5 | 9 | (31) | (22) |
| Total derivatives | - | 666 | 807 | 1,473 | (375) | 1,098 |
| Separate account assets [2] | 51,184 | 128 | 113 | | | 51,425 |
| Total | $51,346 | $26,539 | $4,436 | $1,473 | ($375) | $81,946 |
| Liabilities: | | | | | | |
| Derivatives: | | | | | | |
| Foreign currency and interest rate swaps | | $457 | | $457 | ($250) | $207 |
| Forward starting interest rate swaps | | | | | (29) | (29) |
| Equity derivatives | | | $67 | 67 | (65) | 2 |
| Embedded derivatives | | | 2,005 | 2,005 | | 2,005 |
| Other | | 1 | 28 | 29 | (31) | (2) |
| Total | - | $458 | $2,100 | $2,558 | ($375) | $2,183 |

[1] Netting adjustments represent the impact of offsetting asset and liability positions on the consolidated statement of financial condition held with the same counterparty as permitted by guidance for offsetting in the Codification's Derivatives and Hedging Topic.

[2] Separate account assets are measured at estimated fair value. Investment performance related to separate account assets is offset by corresponding amounts credited to contract holders whose liability is reflected in the separate account liabilities. Separate account liabilities are measured to equal the estimated fair value of separate account assets as prescribed by guidance in the Codification's Financial Services – Insurance Topic for accounting and reporting of certain non traditional long-duration

contracts and separate accounts. Separate account assets as presented in the tables above differ from the amounts presented in the consolidated statements of financial condition because cash and receivables for securities, and investment income due and accrued are not subject to the guidance under the Codification's Fair Value Measurements and Disclosures Topic.

ESTIMATED FAIR VALUE MEASUREMENT

The Codification's Fair Value Measurements and Disclosures Topic defines estimated fair value as the price that would be received to sell the asset or paid to transfer the liability at the measurement date. This "exit price" notion is a market-based measurement that requires a focus on the value that market participants would assign for an asset or liability.

The following section describes the valuation methodologies used by the Company to measure various types of financial instruments at estimated fair value and the controls that surround the valuation process. The Company reviews its valuation methodologies and controls on an ongoing basis and assesses whether these methodologies are appropriate based on the current economic environment.

FIXED MATURITY, EQUITY AND TRADING SECURITIES

The estimated fair values of fixed maturity securities available for sale, equity securities available for sale and trading securities are determined by management after considering external pricing sources and internal valuation techniques. For securities with sufficient trading volume, prices are obtained from third-party pricing services. For securities that are traded infrequently, estimated fair values are determined after evaluating prices obtained from third-party pricing services and independent brokers or are valued internally using various valuation techniques.

The Company's management analyzes and evaluates prices received from independent third parties and determines whether they are reasonable estimates of fair value. Management's analysis may include, but is not limited to, review of third-party pricing methodologies and inputs, analysis of recent trades, comparison to prices received from other third parties, and development of internal models utilizing observable market data of comparable securities. The Company assesses the reasonableness of valuations received from independent brokers by considering current market dynamics and current pricing for similar securities.

For prices received from independent pricing services, the Company applies a formal process to challenge any prices received that are not considered representative of estimated fair value. If prices received from independent pricing services are not considered reflective of market activity or representative of estimated fair value, independent non-binding broker quotations are obtained, or an internally-developed valuation is prepared. Upon evaluation, the Company determines which source represents the best estimate of fair value. Overrides of third-party prices to internally developed valuations of estimated fair value did not produce material differences in the estimated fair values for the majority of the portfolio; accordingly, overrides were not material. In the absence of such market observable activity, management’s best estimate is used.

Internal valuation techniques include matrix model pricing and internally developed models, which incorporate observable market data, where available. Securities priced by the matrix model are primarily comprised of private placement securities. Matrix model pricing measures estimated fair value using cash flows, which are discounted using observable market yield curves provided by a major independent data service. The matrix model determines the discount yield based upon significant factors that include the security's weighted average life, rating and sector.

Where matrix model pricing is not used, estimated fair values are determined by other internally-derived valuation tools which use market-observable data if available. Generally, this includes using an actively-traded comparable security as a benchmark for pricing. These internal valuation methods primarily represent discounted cash flow models that incorporate significant assumptive inputs such as spreads, discount rates, default rates, severity, and prepayment speeds. These inputs are analyzed by the Company’s portfolio managers and analysts, investment accountants and risk managers. Internally-developed estimates may also use unobservable data, which reflect the Company’s own assumptions about the inputs market participants would use.

Most securities priced by a major independent third-party service and private placement securities that use the matrix model have been classified as Level 2, as management has verified that the significant inputs used in determining their estimated fair values are market observable and appropriate. Externally priced securities for which estimated fair value measurement inputs are not sufficiently transparent, such as securities valued based on broker quotations, have been classified as Level 3. Internally valued securities, including adjusted prices received from independent third parties, where significant management assumptions have been utilized in determining estimated fair value, have been classified as Level 3. Securities categorized as Level 1 consist primarily of investments in mutual funds.

The Company applies controls over the valuation process. Prices are reviewed and approved by the Company's professional credit analysts that have industry expertise and considerable knowledge of the issuers. Management performs validation checks to determine the completeness and reasonableness of the pricing information, which include, but are not limited to, changes from identified pricing sources, significant or unusual price fluctuations above predetermined tolerance levels from the prior period, and back-testing of estimated fair values against prices of actual trades. A group comprised of the Company's investment accountants, portfolio managers and analysts and risk managers meet to discuss any unusual items above the tolerance levels that may have been identified in the pricing review process. These items are investigated, further analysis is performed and resolutions are appropriately documented.

OTHER INVESTMENTS

Other investments include non-marketable equity securities that do not have readily determinable estimated fair values. Certain significant inputs used in determining the estimated fair value of these equities are based on management assumptions or contractual terms with another party that cannot be readily observable in the market. These non-marketable equity securities are classified as Level 3 assets.

Also included in other investments are the securities of the 40 Act Funds, which are valued using the same methodology as described above for fixed maturity, equity and trading securities.

DERIVATIVE INSTRUMENTS

Derivative instruments are reported at estimated fair value using pricing valuation models, which utilize market data inputs or independent broker quotations. The Company calculates the estimated fair value of derivatives using market standard valuation methodologies for interest rate swaps, equity options, and credit default swaps and baskets. Internal models are used to value the equity total return swaps. The derivatives are valued using mid-market inputs that are predominantly observable in the market. Inputs include, but are not limited to, interest swap rates, foreign currency forward and spot rates, credit spreads and correlations, interest volatility, equity volatility and equity index levels. On a monthly basis, the Company performs an analysis on derivative valuations, which includes both quantitative and qualitative analysis. Examples of procedures performed include, but are not limited to, review of pricing statistics and trends, analyzing the impacts of changes in the market environment, and review of changes in market value for each derivative. Internally calculated fair values are reviewed and compared to external broker fair values for reasonableness by both risk managers and investment accountants.

Excluding embedded derivatives, as of December 31, 2012, 99% of derivatives based upon notional values were priced by valuation models. The remaining derivatives were priced by broker quotations. In accordance with the Codification's Fair Value Measurements and Disclosures Topic, a credit valuation analysis was performed for all derivative positions to measure the risk that the counterparties to the transaction will be unable to perform under the contractual terms (nonperformance risk) and was determined to be immaterial as of December 31, 2012.

Derivative instruments classified as Level 2 primarily include interest rate, currency and certain credit default swaps. The derivative valuations are determined using pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data, primarily interest swap rates, interest rate volatility and foreign currency forward and spot rates.

Derivative instruments classified as Level 3 include complex derivatives, such as equity options and swaps and certain credit default swaps. Also included in Level 3 classification are embedded derivatives in certain insurance and reinsurance contracts. These derivatives are valued using pricing models, which utilize both observable and unobservable inputs, primarily interest rate volatility, equity volatility and equity index levels, and, to a lesser extent, broker quotations. A derivative instrument containing Level 1 or Level 2 inputs will be classified as a Level 3 financial instrument in its entirety if it has at least one significant Level 3 input.

The Company utilizes derivative instruments to manage the risk associated with certain assets and liabilities. However, the derivative instrument may not be classified within the same estimated fair value hierarchy level as the associated assets and liabilities. Therefore, the realized and unrealized gains and losses on derivatives reported in Level 3 may not reflect the offsetting impact of the realized and unrealized gains and losses of the associated assets and liabilities.

VARIABLE ANNUITY GLB EMBEDDED DERIVATIVES

Estimated fair values for variable annuity GLB and related reinsurance embedded derivatives are calculated based upon significant unobservable inputs using internally developed models because active, observable markets do not exist for those items. As a result, variable annuity GLB and related reinsurance embedded derivatives are categorized as Level 3. Below is a description of the Company's estimated fair value methodologies for these embedded derivatives.

Estimated fair value is calculated as an aggregation of estimated fair value and additional risk margins including Behavior Risk Margin, Mortality Risk Margin and Credit Standing Adjustment. The resulting aggregation is reconciled or calibrated, if necessary, to market information that is, or may be, available to the Company, but may not be observable by other market participants. Each of the components described below are unobservable in the market place and requires subjectivity by the Company in determining their value.

- Behavior Risk Margin: This component adds a margin that market participants would require for the risk that the Company's assumptions about policyholder behavior used in the estimated fair value model could differ from actual experience. This component includes assumptions about withdrawal utilization and lapse rates.

- Mortality Risk Margin: This component adds a margin in mortality assumptions, both for decrements for policyholders with GLBs, and for expected payout lifetimes in guaranteed minimum withdrawal benefits.

- Credit Standing Adjustment: This component makes an adjustment that market participants would make to reflect the chance that GLB obligations or the GLB reinsurance recoverables will not be fulfilled (nonperformance risk).

SEPARATE ACCOUNT ASSETS

Separate account assets are reported at estimated fair value as a summarized total on the consolidated statements of financial condition. The estimated fair value of separate account assets is based on the estimated fair value of the underlying assets. Separate account assets are primarily invested in mutual funds, but also have investments in fixed maturity, short-term securities and hedge funds.

Level 1 assets includes mutual funds that are valued based on reported net asset values provided by fund managers daily and can be redeemed without restriction. Management performs validation checks to determine the reasonableness of the pricing information, which include, but are not limited to, price fluctuations above predetermined thresholds from the prior day and validation against similar funds or indices. Variances are investigated, further analysis is performed and resolutions are appropriately documented.

Level 2 assets include fixed maturity and short-term securities similar in nature to the fixed maturity and equity securities available for sale of the Company. The pricing methodology and valuation controls are the same as those previously described in fixed maturity, equity and trading securities.

Level 3 assets are primarily hedge funds that invest in multiple strategies to diversify risks, for which estimated fair value is not readily determinable as the estimated fair value measurement inputs are not sufficiently transparent for the underlying investments. The fair values have been estimated using the net asset values obtained daily from the fund managers. These funds can be redeemed as long as there is no restriction in place. Certain funds are restricted from redemption for a period of one year following the anniversary of each investment made to the underlying fund. The redemption frequency (if currently eligible) for these funds is monthly (50%), quarterly (30%), annually (14%) or semi-annually (6%) and the redemption notice period ranges from 5-120 days. Unfunded commitments are zero as of December 31, 2012.

LEVEL 3 RECONCILIATION

The tables below present reconciliations of the beginning and ending balances of the Level 3 financial assets and liabilities, net, that have been measured at estimated fair value on a recurring basis using significant unobservable inputs.

| | January 1, 2012 | Total Gains or Losses Included in Earnings | Total Gains or Losses Included in OCI | Transfers In to Level 3 [1] | Transfers Out of Level 3 [1] | Purchases | Sales | Settlements | December 31, 2012 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | *(In Millions)* | | | | |
| Obligations of states and political subdivisions | $9 | | | $32 | ($9) | | | | $32 |
| Foreign governments | 81 | | $8 | 4 | (31) | | | ($4) | 58 |
| Corporate securities | 1,617 | $19 | 87 | 939 | (512) | $357 | ($105) | (189) | 2,213 |
| RMBS | 1,036 | (25) | 182 | 2 | (1,085) | 7 | (5) | (104) | 8 |
| CMBS | 251 | 1 | 11 | | (189) | 4 | (10) | (42) | 26 |
| Collateralized debt obligations | 111 | 24 | 7 | | | | (24) | (1) | 117 |
| Other asset-backed securities | 296 | 3 | 18 | 29 | (73) | 136 | | (42) | 367 |
| Total fixed maturity securities | 3,401 | 22 | 313 | 1,006 | (1,899) | 504 | (144) | (382) | 2,821 |
| Perpetual preferred securities | 26 | (4) | 15 | | (4) | | (16) | | 17 |
| Other equity securities | | | 4 | | | | | | 4 |
| Total equity securities | 26 | (4) | 19 | - | (4) | - | (16) | - | 21 |
| Trading securities | 35 | | | 2 | | 30 | (6) | (10) | 51 |
| Other investments | 54 | 2 | | | | | | (44) | 12 |
| Derivatives, net: | | | | | | | | | |
| Equity derivatives | 505 | (424) | | | | | | 92 | 173 |
| Embedded derivatives | (1,775) | 86 | | | | (58) | | 119 | (1,628) |
| Other | (23) | 5 | | | | | | (5) | (23) |
| Total derivatives | (1,293) | (333) | - | - | - | (58) | - | 206 | (1,478) |
| Separate account assets [2] | 113 | 7 | | 2 | | 30 | (24) | | 128 |
| Total | $2,336 | ($306) | $332 | $1,010 | ($1,903) | $506 | ($190) | ($230) | $1,555 |

| | January 1, 2011 | Total Gains or Losses Included in Earnings | Included in OCI | Transfers In and/or Out of Level 3 [1] | Purchases | Sales | Settlements | December 31, 2011 |
|---|---|---|---|---|---|---|---|---|
| | | | | *(In Millions)* | | | | |
| Obligations of states and political subdivisions | $39 | | $3 | ($33) | | | | $9 |
| Foreign governments | 70 | | | 14 | | | ($3) | 81 |
| Corporate securities | 1,628 | ($6) | 14 | (2) | $366 | ($164) | (219) | 1,617 |
| RMBS | 1,068 | (66) | 55 | 141 | 17 | (12) | (167) | 1,036 |
| CMBS | 254 | | 3 | | 47 | | (53) | 251 |
| Collateralized debt obligations | 115 | 3 | (2) | | | | (5) | 111 |
| Other asset-backed securities | 280 | 2 | 7 | 2 | 31 | | (26) | 296 |
| Total fixed maturity securities | 3,454 | (67) | 80 | 122 | 461 | (176) | (473) | 3,401 |
| Perpetual preferred securities | 12 | | | 14 | | | | 26 |
| Other equity securities | 1 | | | (1) | | | | - |
| Total equity securities | 13 | - | - | 13 | - | - | - | 26 |
| Trading securities | 66 | | | (2) | 20 | (4) | (45) | 35 |
| Other investments | 173 | 34 | (12) | | 2 | (143) | | 54 |
| Derivatives, net: | | | | | | | | |
| Foreign currency and interest rate swaps | 4 | | | (4) | | | | - |
| Equity derivatives | 220 | 121 | | | 81 | | 83 | 505 |
| Embedded derivatives | (593) | (1,167) | | | (52) | | 37 | (1,775) |
| Other | (18) | (4) | | (1) | | | | (23) |
| Total derivatives | (387) | (1,050) | - | (5) | 29 | - | 120 | (1,293) |
| Separate account assets [2] | 100 | 2 | | 1 | 11 | | (1) | 113 |
| Total | $3,419 | ($1,081) | $68 | $129 | $523 | ($323) | ($399) | $2,336 |

(1) Transfers in and/or out are recognized at the end of each quarterly reporting period.

(2) Included in earnings of separate account assets are realized/unrealized gains (losses) that are offset by corresponding amounts in separate account liabilities, which results in a net zero impact on earnings for the Company.

During the year ended December 31, 2012, RMBS transfers out of Level 3 were due to increased trading activity during the year which resulted in more market observable inputs to estimate fair value. Other transfers out of Level 3 were generally due to the use of market observable inputs in valuation methodologies, including the utilization of pricing service information. The transfers into Level 3 were primarily attributable to the decreased availability and use of market observable inputs to estimate fair value. During the year ended December 31, 2012, the Company did not have any transfers between Levels 1 and 2.

During the year ended December 31, 2011, the Company transferred $884 million of fixed maturity securities out of Level 2 and into Level 3, and transferred $762 million of fixed maturity securities out of Level 3 and into Level 2. The net transfers into Level 3 were primarily attributable to the decreased availability and use of market observable inputs to estimate fair value. During the year ended December 31, 2011, the Company did not have any transfers between Level 1 and Level 2.

Amounts included in earnings of Level 3 financial assets and liabilities are as follows:

| | Net Investment Income | Net Realized Investment Gain (Loss) | OTTI | Operating and Other Expenses | Total |
|---|---|---|---|---|---|
| December 31, 2012: | | | (In Millions) | | |
| Corporate securities | $19 | $7 | ($7) | | $19 |
| RMBS | (2) | | (23) | | (25) |
| CMBS | | 1 | | | 1 |
| Collateralized debt obligations | 2 | 22 | | | 24 |
| Other asset-backed securities | 3 | | | | 3 |
| Total fixed maturity securities | 22 | 30 | (30) | | 22 |
| Perpetual preferred securities | | (4) | | | (4) |
| Total equity securities | | (4) | | | (4) |
| Other investments | 2 | | | | 2 |
| Equity derivatives | | (424) | | | (424) |
| Embedded derivatives | | 86 | | | 86 |
| Other | | 13 | | ($8) | 5 |
| Total derivatives | | (325) | | (8) | (333) |
| Separate account assets | | 7 | | | 7 |
| Total | $24 | ($292) | ($30) | ($8) | ($306) |

| | Net Investment Income | Net Realized Investment Gain (Loss) | OTTI | Operating and Other Expenses | Total |
|---|---|---|---|---|---|
| December 31, 2011: | | | (In Millions) | | |
| Corporate securities | $17 | | ($23) | | ($6) |
| RMBS | 4 | $4 | (74) | | (66) |
| Collateralized debt obligations | 3 | | | | 3 |
| Other asset-backed securities | 2 | | | | 2 |
| Total fixed maturity securities | 26 | 4 | (97) | | (67) |
| Other investments | | 34 | | | 34 |
| Equity derivatives | | 121 | | | 121 |
| Embedded derivatives | | (1,167) | | | (1,167) |
| Other | | (1) | | ($3) | (4) |
| Total derivatives | | (1,047) | | (3) | (1,050) |
| Separate account assets | | 2 | | | 2 |
| Total | $26 | ($1,007) | ($97) | ($3) | ($1,081) |

The table below represents the net amount of total gains or losses for the period, attributable to the change in unrealized gains (losses) relating to assets and liabilities classified as Level 3 that were still held at the end of the reporting period.

| | Years Ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | *(In Millions)* | |
| Derivatives, net: [1] | | |
| Equity derivatives | ($264) | $216 |
| Embedded derivatives | 95 | (1,165) |
| Other | 12 | (1) |
| Total derivatives | (157) | (950) |
| Separate account assets [2] | 13 | 2 |
| Total | ($144) | ($948) |

(1) Amounts are recognized in net realized investment gain (loss).

(2) Included in earnings of separate account assets are realized/unrealized gains (losses) that are offset by corresponding amounts in separate account liabilities, which results in a net zero impact on earnings for the Company.

The following table presents certain quantitative information on significant unobservable inputs used in the fair value measurement for Level 3 assets and liabilities as of December 31, 2012 (*$ In Millions*).

| | Estimated Fair Value December 31, 2012 Asset (Liability) | Predominant Valuation Method | Significant Unobservable Inputs | Range (Weighted Average) |
|---|---|---|---|---|
| Obligations of states and political subdivisions | $32 | Discounted cash flow | Spread (1) | 162-390 (366) |
| Foreign governments | 58 | Discounted cash flow | Spread (1) | 40-191 (176) |
| Corporate securities | 2,213 | Discounted cash flow | Spread (1) | 53-2,313 (302) |
| | | Collateral value (2) | Collateral value | 17-93 (67) |
| | | Market pricing | Quoted prices (4) | 67-137 (110) |
| RMBS | 8 | Discounted cash flow | Prepayment rate | 9% |
| | | | Default rate | 6% |
| | | | Severity | 64% |
| | | | Discount rate | 30% |
| | | | Spread (1) | 452 |
| CMBS | 26 | Discounted cash flow | Prepayment rate | 0% |
| | | | Default rate | 1% |
| | | | Severity | 30% |
| | | | Spread (1) | 178-262 (194) |
| Collateralized debt obligations | 117 | Market pricing | Quoted prices (4) | 24-100 (85) |
| Other asset-backed securities | 367 | Discounted cash flow | Spread (1) | 75-656 (202) |
| | | Market pricing | Quoted prices (4) | 69-113 (101) |
| | | Cap at call price | Call price | 100 |
| Perpetual preferred securities | 17 | Discounted cash flow | Discount rate | 20% |
| Other equity securities | 4 | Market comparable companies | EBITDA (5) multiple | 4x |
| Trading securities | 51 | Market pricing | Quoted prices (4) | 99-113 (102) |
| Other investments | 12 | Redemption value (3) | Redemption value | 100 |
| Equity derivatives | 173 | Option pricing model | Equity volatility | 15%-32% |
| Embedded derivatives | (1,628) | Option pricing techniques | Equity volatility | 15%-35% |
| | | | Mortality: | |
| | | | Ages 0-40 | 0%-0.15% |
| | | | Ages 41-60 | 0.06%-0.49% |
| | | | Ages 61-120 | 0.43%-100% |
| | | | Mortality improvement | 0.20%-1.40% |
| | | | Withdrawal utilization | 0%-80% |
| | | | Lapse rates | 1.00%-100% |
| | | | Credit standing adjustment | 0.44%-1.71% |
| Other derivatives | (23) | Market pricing | Quoted prices (4) | |
| Separate account assets | 128 | Net asset value | | |
| Total | $1,555 | | | |

[1] Range and weighted average are presented in basis points over the benchmark interest rate curve and include adjustments attributable to illiquidity premiums, expected duration, structure and credit quality.

[2] Valuation based on the Company's share of estimated fair values of the underlying assets held in the trusts.

[3] Represents FHLB common stock that is valued at the contractual amount that will be received upon redemption.

[4] Independent broker quotations were used in the determination of estimated fair value.

[5] The abbreviation EBITDA means earnings before interest, taxes, depreciation and amortization.

NONRECURRING FAIR VALUE MEASUREMENTS

Certain assets are measured at estimated fair value on a nonrecurring basis and are not included in the tables presented above. The amounts below relate to certain investments measured at estimated fair value during the year and still held at the reporting date.

| | Year Ended December 31, 2012 | | | Year Ended December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Carrying Value Prior to Measurement | Estimated Fair Value After Measurement | Impairment | Carrying Value Prior to Measurement | Estimated Fair Value After Measurement | Impairment |
| | | | *(In Millions)* | | | |
| Mortgage loans | $292 | $284 | ($8) | $8 | $3 | ($5) |
| Real estate investments | | | | 8 | 7 | (1) |
| Aircraft | 112 | 96 | (16) | 51 | 36 | (15) |

MORTGAGE LOANS

The impairment loss in 2012 related to three loans. One loan had a carrying value prior to measurement of $285 million and recorded a $4 million loss when the loan was returned to the Company through a deed in lieu of foreclosure process, and was held as a real estate investment as of December 31, 2012. The other two loans had a carrying value prior to measurement of $7 million and are still held as mortgage loans as of December 31, 2012. The impaired investments in 2011 related to two commercial mortgage loans, which were foreclosed on in April 2012. The estimated fair value after measurement was based on the underlying real estate collateral of the two loans. These loans are classified as Level 3 assets.

REAL ESTATE INVESTMENTS

The impaired investment in 2011 related to one real estate property. This investment is classified as a Level 3 asset.

AIRCRAFT

ACG evaluates carrying values of aircraft generally quarterly or based upon changes in market and other physical and economic conditions that indicate the carrying amount of the aircraft may not be recoverable. ACG will record impairments to recognize a loss in the value of the aircraft when management believes that, based on future estimated undiscounted cash flows, the recoverability of ACG's investment in an aircraft has been impaired. The fair value is based on the present value of the future cash flows, which can include contractual lease payments, projected future lease payments, projected sales prices as well as a disposition value. Projected future lease payments are based upon current contracted lease rates for similar aircraft and industry trends. The disposition value reflects an aircrafts estimated residual value or estimated sales price. The cash flows are based on unobservable inputs and classified as Level 3 assets.

The Company did not have any other nonfinancial assets or liabilities measured at fair value on a nonrecurring basis resulting from impairments as of December 31, 2012 and 2011. The Company has not made any changes in the valuation methodologies for nonfinancial assets and liabilities.

The carrying amount and estimated fair value of the Company's financial instruments that are not carried at fair value under the Codification's Financial Instruments Topic are as follows:

| | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (In Millions) | | | |
| Assets: | | | | |
| Mortgage loans | $7,726 | $8,579 | $7,596 | $7,818 |
| Policy loans | 6,998 | 6,998 | 6,812 | 6,812 |
| Other investments | 215 | 248 | 193 | 218 |
| Cash and cash equivalents | 2,256 | 2,256 | 2,829 | 2,829 |
| Restricted cash | 294 | 294 | 280 | 280 |
| Liabilities: | | | | |
| Funding agreements and GICs (1) | 2,584 | 2,822 | 4,284 | 4,632 |
| Annuity and deposit liabilities | 10,313 | 10,313 | 9,162 | 9,162 |
| Short-term debt | 292 | 292 | | |
| Long-term debt | 7,473 | 7,551 | 7,152 | 7,072 |

(1) Balance excludes embedded derivatives that are included in the fair value hierarchy level tables above.

The following methods and assumptions were used to estimate the fair value of these financial instruments as of December 31, 2012 and 2011:

MORTGAGE LOANS

The estimated fair value of the mortgage loan portfolio is determined by discounting the estimated future cash flows, using current rates that are applicable to similar credit quality, property type and average maturity of the composite portfolio.

POLICY LOANS

Policy loans are not separable from their associated insurance contract and bear no credit risk since they do not exceed the contract's cash surrender value, making these assets fully secured by the cash surrender value of the contracts. Therefore, the carrying amount of the policy loans is a reasonable approximation of their fair value.

OTHER INVESTMENTS

Included in other investments are private equity investments in which the estimated fair value is based on the ownership percentage of the underlying equity of the investments.

CASH AND CASH EQUIVALENTS

The carrying values approximate fair values due to the short-term maturities of these instruments.

RESTRICTED CASH

The carrying values approximate fair values due to the short-term maturities of these instruments.

FUNDING AGREEMENTS AND GICs

The estimated fair value of funding agreements and GICs is estimated using the rates currently offered for deposits of similar remaining maturities.

ANNUITY AND DEPOSIT LIABILITIES

Annuity and deposit liabilities primarily includes policyholder deposits and accumulated credited interest. The estimated fair value of annuity and deposit liabilities approximates carrying value based on an analysis of discounted future cash flows with maturities similar to the product portfolio liabilities.

DEBT

The carrying amount of short-term debt is a reasonable estimate of its fair value because the interest rates are variable and based on current market rates. The estimated fair value of long-term debt is based on market quotes, except for VIE debt and non-recourse debt, for which the carrying amounts are reasonable estimates of their fair values because the interest rate approximates current market rates.

15. OTHER COMPREHENSIVE INCOME

The Company displays comprehensive income and its components on the consolidated statements of comprehensive income and consolidated statements of equity. The disclosure of the gross components of other comprehensive income and related taxes are as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Unrealized gain (loss) on derivatives and securities available for sale, net: | | | |
| Gross holding gain (loss): | | | |
| Securities available for sale | $1,592 | $1,054 | $1,272 |
| Derivatives | 25 | (9) | 15 |
| Income tax expense | (567) | (365) | (438) |
| Reclassification adjustment: | | | |
| Sale of securities available for sale - net realized investment gain | (161) | (106) | (139) |
| OTTI recognized on securities available for sale | 55 | 137 | 75 |
| Derivatives - net investment income | (4) | 22 | |
| Derivatives - net realized investment gain | | (18) | |
| Derivatives - interest credited | 25 | 48 | 24 |
| Income tax expense (benefit) | 30 | (29) | (1) |
| Allocation of holding gain to DAC | (134) | (77) | (185) |
| Allocation of holding (gain) loss to future policy benefits | (409) | (54) | 41 |
| Income tax expense | 191 | 52 | 44 |
| Unrealized gain on derivatives and securities available for sale, net | 643 | 655 | 708 |
| Other, net: | | | |
| Holding gain (loss) on other securities | | (12) | 9 |
| Income tax (expense) benefit | | 4 | (4) |
| Net unrealized gain (loss) on other securities | - | (8) | 5 |
| Other, net of tax | 2 | (4) | (3) |
| Other, net | 2 | (12) | 2 |
| Total other comprehensive income, net | $645 | $643 | $710 |

## 16. REINSURANCE

Reinsurance receivables and payables generally include amounts related to claims, reserves and reserve related items. Reinsurance receivables, included in other assets, were $633 million and $507 million as of December 31, 2012 and 2011, respectively. Reinsurance payables, included in other liabilities, were $220 million and $146 million as of December 31, 2012 and 2011, respectively.

The components of insurance premiums presented in the consolidated statements of operations are as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Direct premiums | $1,255 | $1,051 | $626 |
| Reinsurance assumed [1] | 561 | 256 | 122 |
| Reinsurance ceded [2] | (328) | (325) | (339) |
| Insurance premiums | $1,488 | $982 | $409 |

[1] Included are $23 million, $18 million and $11 million of assumed premiums from Pacific Life Re Limited (PLR), an affiliate of the Company and a wholly owned subsidiary of Pacific LifeCorp, for the years ended December 31, 2012, 2011 and 2010, respectively. PLR is incorporated in the United Kingdom (UK) and provides reinsurance to insurance and annuity providers in the UK, Ireland and to insurers in selected markets in Asia. Also included for the year ended December 31, 2010 is $59 million of assumed premiums from Pacific Alliance Reinsurance Ltd. (PAR Bermuda), a Bermuda-based life reinsurance company wholly owned by Pacific LifeCorp until October 2010 when 100% of the reinsurance was novated to PAR Vermont.

[2] Included is $21 million of reinsurance ceded to PAR Bermuda for the years ended December 31, 2010.

Pacific Annuity Reinsurance Company (PARC) is organized and licensed as an Arizona domiciled captive reinsurance company and is subject to regulatory supervision by the Arizona Department of Insurance. PARC was initially formed as a wholly owned subsidiary of Pacific Life. On December 28, 2012, Pacific Life distributed all of PARC's outstanding shares of common stock as a dividend to Pacific LifeCorp of $60 million.

PARC was formed to reinsure benefits provided by variable annuity contracts and contract rider guarantees issued by Pacific Life. Base annuity contracts are reinsured on a modified coinsurance basis and the contract guarantees are reinsured on a coinsurance with funds withheld basis. On December 1, 2012, the effective date of the reinsurance agreement, Pacific Life initially ceded 5% of its existing variable annuity business to PARC and ceded 5% of new business issued thereafter.

## 17. EMPLOYEE BENEFIT PLANS

### PENSION PLANS

Pacific Life maintains supplemental employee retirement plans (SERPs) for certain eligible employees. As of December 31, 2012 and 2011, the projected benefit obligation was $50 million and $46 million, respectively. The fair value of plan assets as of December 31, 2012 and 2011 was zero.

The Company incurred a net pension expense for the SERP as detailed in the following table:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Components of the net periodic pension expense: | | | |
| Service cost - benefits earned during the year | $2 | $2 | $2 |
| Interest cost on projected benefit obligation | 2 | 2 | 2 |
| Amortization of net loss, net obligations and prior service cost | | 1 | 1 |
| Net periodic pension expense | $4 | $5 | $5 |

Significant plan assumptions:

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Weighted-average assumptions used to determine benefit obligations for the SERP: | | |
| Discount rate | 3.30% | 4.00% |
| Salary rate | 4.50% | 4.50% |

The salary rate used to determine the net periodic pension expense for the SERP was 4.50% for the years ended December 31, 2012, 2011 and 2010.

Pacific Life's expected SERP contribution payments are as follows for the years ending December 31 *(In Millions)*:

| 2013 | 2014 | 2015 | 2016 | 2017 | 2018-2022 |
|---|---|---|---|---|---|
| $5 | $5 | $5 | $4 | $4 | $21 |

RETIREMENT INCENTIVE SAVINGS PLAN

Pacific Life provides a Retirement Incentive Savings Plan (RISP) covering all eligible employees of Pacific LifeCorp and certain of its subsidiaries. The RISP matches 75% of each employee's contributions, up to a maximum of 6% of eligible employee compensation in cash. Contributions made by the Company to the RISP, including the matching contribution, amounted to $31 million, $28 million and $27 million for the years ended December 31, 2012, 2011 and 2010, respectively, and are included in operating expenses.

POSTRETIREMENT BENEFITS

Pacific Life provides a defined benefit health care plan and a defined benefit life insurance plan (the Plans) that provide postretirement benefits for all eligible retirees and their dependents. Generally, qualified employees may become eligible for these benefits if they have reached normal retirement age, have been covered under Pacific Life's policy as an active employee for a minimum continuous period prior to the date retired, and have an employment date before January 1, 1990. The Plans contain cost-sharing features such as deductibles and coinsurance, and require retirees to make contributions, which can be adjusted annually. Pacific Life's commitment to qualified employees who retire after April 1, 1994 is limited to specific dollar amounts. Pacific Life reserves the right to modify or terminate the Plans at any time. As in the past, the general policy is to fund these benefits on a pay-as-you-go basis.

The net periodic postretirement benefit cost for each of the years ended December 31, 2012, 2011 and 2010 was $1 million. As of December 31, 2012 and 2011, the accumulated benefit obligation was $20 million and $23 million, respectively. The fair value of the plan assets as of December 31, 2012 and 2011 was zero.

The discount rate used in determining the accumulated postretirement benefit obligation was 3.50% and 4.25% for 2012 and 2011, respectively.

Benefit payments for the year ended December 31, 2012 amounted to $2 million. The expected benefit payments are as follows for the years ending December 31 *(In Millions)*:

| 2013 | 2014 | 2015 | 2016 | 2017 | 2018-2022 |
|---|---|---|---|---|---|
| $2 | $2 | $2 | $2 | $2 | $8 |

OTHER PLANS

The Company has deferred compensation plans that permit eligible employees to defer portions of their compensation and earn interest on the deferred amounts. The interest rate is determined quarterly. The compensation that has been deferred has been accrued and the primary expense related to this plan, other than compensation, is interest on the deferred amounts. The Company also has performance-based incentive compensation plans for its employees.

## 18. INCOME TAXES

The provision (benefit) for income taxes is as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Current | $3 | $5 | $7 |
| Deferred | (70) | 75 | 53 |
| Provision (benefit) for income taxes from continuing operations | (67) | 80 | 60 |
| Benefit from income taxes from discontinued operations | | (4) | |
| Total | ($67) | $76 | $60 |

A reconciliation of the provision for income taxes from continuing operations based on the Federal corporate statutory tax rate of 35% to the provision (benefit) for income taxes from continuing operations reflected in the consolidated financial statements is as follows:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | *(In Millions)* | | |
| Provision for income taxes at the statutory rate | $155 | $253 | $202 |
| Separate account dividends received deduction | (98) | (95) | (106) |
| Nonrecurring deferred tax liability basis adjustment | (58) | | |
| Singapore Transfer | (23) | (32) | (17) |
| LIHTC and foreign tax credits | (16) | (17) | (18) |
| Internal Revenue Service settlement | | (7) | |
| Other | (27) | (22) | (1) |
| Provision (benefit) for income taxes from continuing operations | ($67) | $80 | $60 |

The nonrecurring deferred tax liability basis adjustment is a noncash tax benefit relating to aircraft depreciation.

ACG transfers aircraft assets and related liabilities to foreign subsidiaries and affiliates in Singapore (collectively referred to as the Singapore Transfer). The Singapore Transfer reduced the provision for income taxes for the year ended December 31, 2012, 2011 and 2010 by $23 million, $32 million and $17 million, respectively, primarily due to the reversal of deferred taxes related to basis differences in the interest transferred. U.S. income taxes have not been recognized on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that are essentially permanent in duration. This amount becomes taxable upon a repatriation of assets from the subsidiary or a sale or liquidation of the subsidiary.

It is the practice and intention of the Company to reinvest the earnings of its non-U.S. subsidiaries in those operations. In addition to those basis differences transferred during 2012 and 2011, as of December 31, 2012, the Company has not made a provision for U.S. or additional foreign withholding taxes on approximately $11 million of foreign subsidiary undistributed earnings that are essentially permanent in duration. Generally, such amounts become subject to U.S. taxation upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of deferred tax liability related to investments in these foreign subsidiaries.

A reconciliation of the changes in the unrecognized tax benefits is as follows (*In Millions*):

| | |
|---|---|
| Balance at January 1, 2010 | $14 |
| Additions and deletions | |
| Balance at December 31, 2010 | 14 |
| Additions and deletions | (14) |
| Balance at December 31, 2011 | - |
| Additions and deletions | |
| Balance at December 31, 2012 | $ - |

During the year ended December 31, 2011, the Company effectively settled $14 million of the gross uncertain tax position related to separate account Dividends Received Deductions (DRD), which resulted in the realization of $7 million of tax benefits. All realized tax benefits and related interest are recognized as a discrete item that will impact the effective tax rate in the accounting period in which the uncertain tax position is ultimately settled.

No unrecognized tax benefits will be realized over the next twelve months.

During the years ended December 31, 2012, 2011 and 2010, the Company paid an insignificant amount of interest and penalties to state tax authorities.

The net deferred tax liability, included in other liabilities, is comprised of the following tax effected temporary differences:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | *(In Millions)* | |
| Deferred tax assets: | | |
| Policyholder reserves | $660 | $349 |
| Investment valuation | 573 | 590 |
| Tax net operating loss carryforwards | 453 | 510 |
| Tax credit carryforwards | 335 | 313 |
| Deferred compensation | 62 | 57 |
| Aircraft maintenance reserves | 11 | 13 |
| Dividends to policyholders | 8 | 8 |
| Other | 18 | 16 |
| Total deferred tax assets | 2,120 | 1,856 |
| Deferred tax liabilities: | | |
| DAC | (1,241) | (1,156) |
| Depreciation | (700) | (671) |
| Hedging | (159) | (116) |
| Partnership income | (77) | (63) |
| Reinsurance | (34) | (20) |
| Other | (126) | (117) |
| Total deferred tax liabilities | (2,337) | (2,143) |
| Net deferred tax liability from continuing operations | (217) | (287) |
| Unrealized gain on derivatives and securities available for sale | (871) | (525) |
| Minimum pension liability and other adjustments | (8) | (8) |
| Net deferred tax liability | ($1,096) | ($820) |

The tax net operating loss carryforwards relate to Federal tax losses incurred in 2001 through 2012 with a 20-year carryforward for non-life losses and a 15-year carryforward for life losses, and California tax losses incurred in 2004 through 2012 with a ten-year carryforward.

The tax credit carryforwards relate to LIHTC, foreign tax credits, and alternative minimum tax (AMT) credits generated from 2000 to 2012. The LIHTC begin to expire in 2020. The foreign tax credits begin to expire in 2016. Foreign tax credits, LIHTC and tax net operating loss carryforwards of $193 million expire between 2016 and 2022. AMT credits and tax net operating loss carryforwards of $28 million possess no expiration date. The remainder will expire between 2023 and 2032.

The Codification's Income Taxes Topic requires the reduction of deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not that a portion or all of the deferred tax assets will not be realized. Based on management's assessment, it is more likely than not that the Company's deferred tax assets will be realized through future taxable income, including the reversal of deferred tax liabilities.

The Company files income tax returns in U.S. Federal and various state jurisdictions. The Company is under continuous audit by the Internal Revenue Service (IRS) and is audited periodically by some state taxing authorities. The IRS has completed audits of the Company's tax returns through the tax year ended December 31, 2008, and is auditing the Company's tax returns for the tax years December 31, 2009 and 2010. The Company does not expect the current Federal audits to result in any material assessments. The State of California concluded audits for tax years 2003 and 2004 without material assessment.

## 19. SEGMENT INFORMATION

The Company has four operating segments: Life Insurance, Retirement Solutions, Aircraft Leasing and Reinsurance. These segments are managed separately and have been identified based on differences in products and services offered. All other activity is included in the Corporate and Other segment.

The Life Insurance segment provides a broad range of life insurance products through multiple distribution channels operating in the upper income and corporate markets. Principal products include UL, indexed universal life, VUL, survivor life, interest sensitive whole life, corporate-owned life insurance and traditional products such as whole life and term life. Distribution channels include regional life offices, marketing organizations, broker-dealer firms, wirehouses and M Financial, an association of independently owned and operated insurance and financial producers.

The Retirement Solutions segment's principal products include variable and fixed annuity products, mutual funds, and structured settlement and group retirement annuities, which are offered through multiple distribution channels. Distribution channels include independent planners, financial institutions and national/regional wirehouses.

The Aircraft Leasing segment offers aircraft leasing to the airline industry throughout the world and provides brokerage and asset management services to other third-parties.

The Reinsurance segment primarily includes the domestic retrocession business, which was acquired in August 2011 (Note 5). Also included in the Reinsurance segment is international reinsurance the Company has assumed from PLR.

The Corporate and Other segment consists of assets and activities, which support the Company's operating segments. Included in these support activities is the management of investments, certain entity level hedging activities and other expenses and other assets not directly attributable to the operating segments. The Corporate and Other segment also includes several operations that do not qualify as operating segments and the elimination of intersegment transactions. Discontinued operations (Note 6) are also included in the Corporate and Other segment.

The Company uses the same accounting policies and procedures to measure segment net income (loss) and assets as it uses to measure its consolidated net income (loss) and assets. Net investment income and net realized investment gain (loss) are allocated based on invested assets purchased and held as is required for transacting the business of that segment. Overhead expenses are allocated based on services provided. Interest expense is allocated based on the short-term borrowing needs of the segment and is included in net investment income. The provision (benefit) for income taxes is allocated based on each segment's actual tax provision (benefit).

Certain segments are allocated equity based on formulas determined by management and receive a fixed interest rate of return on interdivision debentures supporting the allocated equity. The debenture amount is reflected as investment expense in net investment income in the Corporate and Other segment and as investment income in the operating segments.

The Company generates the majority of its revenues and net income from customers located in the U.S. As of December 31, 2012 and 2011, the Company had foreign investments with an estimated fair value of $9.8 billion and $8.2 billion, respectively. Aircraft leased to foreign customers were $5.8 billion and $5.3 billion as of December 31, 2012 and 2011, respectively. Revenues derived from any customer did not exceed 10% of consolidated total revenues for the years ended December 31, 2012, 2011 and 2010.

The following segment information is as of and for the year ended December 31, 2012:

| | Life Insurance | Retirement Solutions | Aircraft Leasing | Reinsurance | Corporate and Other | Total |
|---|---|---|---|---|---|---|
| REVENUES | | | *(In Millions)* | | | |
| Policy fees and insurance premiums | $925 | $1,894 | | $505 | | $3,324 |
| Net investment income | 1,012 | 914 | | 14 | $341 | 2,281 |
| Net realized investment gain (loss) | 34 | (290) | ($5) | | (88) | (349) |
| OTTI | (20) | (14) | | | (29) | (63) |
| Investment advisory fees | 23 | 240 | | | 35 | 298 |
| Aircraft leasing revenue | | | 660 | | | 660 |
| Other income | 12 | 166 | 24 | 4 | 31 | 237 |
| Total revenues | 1,986 | 2,910 | 679 | 523 | 290 | 6,388 |
| BENEFITS AND EXPENSES | | | | | | |
| Policy benefits | 457 | 1,535 | | 452 | | 2,444 |
| Interest credited | 765 | 294 | | | 193 | 1,252 |
| Commission expenses | 222 | 405 | | 21 | | 648 |
| Operating expenses | 313 | 404 | 124 | 24 | 109 | 974 |
| Depreciation of aircraft | | | 299 | | | 299 |
| Interest expense | | | 196 | | 132 | 328 |
| Total benefits and expenses | 1,757 | 2,638 | 619 | 497 | 434 | 5,945 |
| Income (loss) before provision (benefit) for income taxes | 229 | 272 | 60 | 26 | (144) | 443 |
| Provision (benefit) for income taxes | 63 | (4) | (63) | 9 | (72) | (67) |
| Net income (loss) | 166 | 276 | 123 | 17 | (72) | 510 |
| Less: net income attributable to the noncontrolling interest | | | (4) | | (64) | (68) |
| Net income (loss) attributable to the Company | $166 | $276 | $119 | $17 | ($136) | $442 |
| Total assets | $33,837 | $73,180 | $7,957 | $647 | $6,171 | $121,792 |
| DAC | 1,046 | 3,221 | | 62 | | 4,329 |
| Separate account assets | 6,223 | 49,079 | | | | 55,302 |
| Policyholder and contract liabilities | 23,839 | 19,398 | | 268 | 2,583 | 46,088 |
| Separate account liabilities | 6,223 | 49,079 | | | | 55,302 |

The following segment information is as of and for the year ended December 31, 2011:

| | Life Insurance | Retirement Solutions | Aircraft Leasing | Reinsurance | Corporate and Other | Total |
|---|---|---|---|---|---|---|
| REVENUES | | | *(In Millions)* | | | |
| Policy fees and insurance premiums | $1,182 | $1,701 | | $198 | | $3,081 |
| Net investment income | 954 | 818 | | 4 | $410 | 2,186 |
| Net realized investment gain (loss) | 83 | (1,076) | ($3) | | 335 | (661) |
| OTTI | (38) | (33) | | | (82) | (153) |
| Investment advisory fees | 22 | 233 | | | 13 | 268 |
| Aircraft leasing revenue | | | 607 | | | 607 |
| Other income | 13 | 159 | 48 | 3 | 3 | 226 |
| Total revenues | 2,216 | 1,802 | 652 | 205 | 679 | 5,554 |
| BENEFITS AND EXPENSES | | | | | | |
| Policy benefits | 429 | 1,343 | | 179 | | 1,951 |
| Interest credited | 736 | 302 | | | 280 | 1,318 |
| Commission expenses | 428 | (313) | | 6 | 1 | 122 |
| Operating expenses | 311 | 357 | 99 | 18 | 113 | 898 |
| Depreciation of aircraft | | | 255 | | | 255 |
| Interest expense | | | 194 | | 94 | 288 |
| Total benefits and expenses | 1,904 | 1,689 | 548 | 203 | 488 | 4,832 |
| Income from continuing operations before provision (benefit) for income taxes | 312 | 113 | 104 | 2 | 191 | 722 |
| Provision (benefit) for income taxes | 98 | (55) | (7) | 1 | 43 | 80 |
| Income from continuing operations | 214 | 168 | 111 | 1 | 148 | 642 |
| Discontinued operations, net of taxes | | | | | (9) | (9) |
| Net income | 214 | 168 | 111 | 1 | 139 | 633 |
| Less: net income attributable to the noncontrolling interest from continuing operations | | | (6) | | (65) | (71) |
| Net income attributable to the Company | $214 | $168 | $105 | $1 | $74 | $562 |
| Total assets | $30,975 | $66,124 | $7,389 | $568 | $8,565 | $113,621 |
| DAC | 991 | 3,203 | | 70 | | 4,264 |
| Separate account assets | 5,698 | 45,752 | | | | 51,450 |
| Policyholder and contract liabilities | 22,400 | 16,926 | | 244 | 4,289 | 43,859 |
| Separate account liabilities | 5,698 | 45,752 | | | | 51,450 |

The following segment information is for the year ended December 31, 2010:

| | Life Insurance | Retirement Solutions | Aircraft Leasing | Reinsurance | Corporate and Other | Total |
|---|---|---|---|---|---|---|
| REVENUES | | | *(In Millions)* | | | |
| Policy fees and insurance premiums | $1,092 | $1,265 | | $10 | | $2,367 |
| Net investment income | 924 | 748 | | | $450 | 2,122 |
| Net realized investment gain (loss) | 55 | (73) | ($2) | | (74) | (94) |
| OTTI | (21) | (10) | | | (82) | (113) |
| Investment advisory fees | 21 | 224 | | | | 245 |
| Aircraft leasing revenue | | | 591 | | | 591 |
| Other income | 11 | 141 | 57 | 2 | 19 | 230 |
| Total revenues | 2,082 | 2,295 | 646 | 12 | 313 | 5,348 |
| BENEFITS AND EXPENSES | | | | | | |
| Policy benefits | 432 | 923 | | (4) | | 1,351 |
| Interest credited | 700 | 282 | | | 335 | 1,317 |
| Commission expenses | 355 | 480 | | | 1 | 836 |
| Operating expenses | 285 | 355 | 60 | | 65 | 765 |
| Depreciation of aircraft | | | 241 | | | 241 |
| Interest expense | | | 178 | | 84 | 262 |
| Total benefits and expenses | 1,772 | 2,040 | 479 | (4) | 485 | 4,772 |
| Income (loss) before provision (benefit) for income taxes | 310 | 255 | 167 | 16 | (172) | 576 |
| Provision (benefit) for income taxes | 97 | (16) | 41 | 6 | (68) | 60 |
| Net income (loss) | 213 | 271 | 126 | 10 | (104) | 516 |
| Less: net income attributable to the noncontrolling interest | | | (9) | | (41) | (50) |
| Net income (loss) attributable to the Company | $213 | $271 | $117 | $10 | ($145) | $466 |

## 20. TRANSACTIONS WITH AFFILIATES

PLFA serves as the investment adviser for the Pacific Select Fund, an investment vehicle provided to the Company's variable life insurance policyholders and variable annuity contract owners, and the Pacific Life Funds, the investment vehicle for the Company's mutual fund products. Investment advisory and other fees are based primarily upon the net asset value of the underlying portfolios. These fees, included in investment advisory fees and other income, amounted to $305 million, $294 million and $291 million for the years ended December 31, 2012, 2011 and 2010, respectively. In addition, Pacific Life and PLFA provides certain support services to the Pacific Select Fund, the Pacific Life Funds and other affiliates based on an allocation of actual costs. These fees amounted to $13 million, $10 million and $8 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Additionally, the Pacific Select Fund and Pacific Life Funds have service and other plans whereby the funds pay PSD, as distributor of the fund, a service fee in connection with services rendered to or procured for shareholders of the fund or their variable annuity and life insurance contract owners. These services may include, but are not limited to, payment of compensation to broker-dealers, including PSD itself, and other financial institutions and organizations, which assist in providing any of the services. For the years ended December 31, 2012, 2011 and 2010, PSD received $119 million, $115 million and $100 million, respectively, in service and other fees from the Pacific Select Fund and Pacific Life Funds, which are recorded in other income.

ACG has derivative swap contracts with Pacific LifeCorp as the counterparty. The notional amounts total $1.3 billion as of December 31, 2012 and 2011. The estimated fair values of the derivatives were net liabilities of $81 million and $78 million as of December 31, 2012 and 2011, respectively.

## 21. COMMITMENTS AND CONTINGENCIES

### COMMITMENTS

The Company has outstanding commitments that may be funded to make investments primarily in fixed maturity securities, mortgage loans, limited partnerships and other investments, as follows *(In Millions)*:

| | |
|---|---|
| Years Ending December 31: | |
| 2013 | $636 |
| 2014 through 2015 | 803 |
| 2016 through 2017 | 259 |
| 2018 and thereafter | 69 |
| Total | $1,767 |

The Company leases office facilities under various operating leases, which in most, but not all cases, are noncancelable. Rent expense, which is included in operating and other expenses, in connection with these leases was $11 million, $10 million and $9 million for the years ended December 31, 2012, 2011 and 2010, respectively. Aggregate minimum future commitments are as follows *(In Millions)*:

| | |
|---|---|
| Years Ending December 31: | |
| 2013 | $9 |
| 2014 through 2017 | 12 |
| 2018 and thereafter | 5 |
| Total | $26 |

ACG has sold four aircraft on lease to U.S. airlines via sale leaseback transactions. ACG is committed to these operating leases with maturities ranging from 2023 to 2025. This aircraft lease expense is included in operating and other expenses.

ACG has subleased the four aircraft mentioned above to airlines with maturity dates ranging from 2021 to 2024 with total future rentals of $176 million.

Aggregate minimum future lease commitments are as follows (*In Millions*):

| | Minimum Future Commitments |
|---|---|
| Years Ending December 31: | |
| 2013 | $15 |
| 2014 through 2017 | 55 |
| 2018 and thereafter | 91 |
| Total | $161 |

As of December 31, 2012, ACG has commitments with major aircraft manufacturers and other third-parties to purchase aircraft at an estimated delivery price of $8,653 million with delivery from 2013 through 2021. These purchase commitments may be funded:

- up to $1,094 million in less than one year,
- an additional $1,666 million in one to three years,
- an additional $1,195 million in three to five years, and
- an additional $4,091 million thereafter.

As of December 31, 2012, deposits related to these agreements totaled $607 million and are included in other assets.

In connection with the acquisition of retrocession business as discussed in Note 5, Pacific Life entered into agreements to reinsure a block of U.S. life reinsurance business on a 100% coinsurance basis. The underlying reinsurance is comprised of coinsurance and YRT treaties. Upon closing the transaction in August 2011, Pacific Life retroceded the majority of the underlying YRT treaties on a 100% modified coinsurance basis to PLRB effective July 1, 2011 (PLRB Agreement). The PLRB Agreement is accounted for under deposit accounting under U.S. GAAP and as reinsurance under statutory accounting practices. The statutory accounting reserve credit is afforded by virtue of collateral posted by PLRB for the benefit of Pacific Life by a $430 million letter of credit issued to PLRB by third-party banks. In connection with the letter of credit agreement, Pacific LifeCorp entered into a capital maintenance agreement to ensure PLRB will have sufficient capital to meet its obligations. Additionally, certain assets related to the retrocession business have been pledged and placed in reinsurance trusts (Note 8). If the estimated fair market value of the pledged assets in these trusts fall below a minimum value, as defined in the transaction agreements, the Company is required to promptly deposit additional funds into the trusts to account for any shortfall.

The Company entered into an agreement with PLR to guarantee the performance of unaffiliated reinsurance obligations of PLR. This guarantee is secondary to a guarantee provided by Pacific LifeCorp and would only be triggered in the event of nonperformance by both PLR and Pacific LifeCorp. Management believes that any additional obligations, if any, related to the guarantee agreement are not likely to have a material adverse effect on the Company's consolidated financial statements. For the years ended December 31, 2012 and 2011, Pacific Life earned $2 million under the agreement for its guarantee.

On January 1, 2013, Pacific Life entered into an agreement with PLRC to guarantee the performance of unaffiliated reinsurance obligations of PLRC. PLRC will pay Pacific Life a fee for its guarantee.

In connection with the reinsurance of NLGR benefits ceded from Pacific Life to PAR Vermont, PAR Vermont has a credit agreement with a maximum commitment amount of $843 million and a 20 year term expiring October 2031. As of December 31, 2012, the letter of credit amounted to $495 million. The new agreement is non-recourse to Pacific LifeCorp or any of its affiliates, other than PAR Vermont.

In connection with an acquisition in 2005, ACG assumed residual value support agreements with remaining expiration dates ranging from 2013 to 2015. The gross remaining residual value exposure under these agreements was $89 million as of December 31, 2012 and 2011. As of December 31, 2012, the Company has estimated that it has no measurable liability under the remaining residual value guarantee agreements.

CONTINGENCIES - LITIGATION

The Company is a respondent in a number of legal proceedings, some of which involve allegations for extra-contractual damages. Although the Company is confident of its position in these matters, success is not a certainty and a judge or jury could rule against the Company. In the opinion of management, the outcome of such proceedings is not likely to have a material adverse effect on the Company's consolidated financial statements. The Company believes adequate provision has been made in its consolidated financial statements for all probable and estimable losses for litigation claims against the Company.

CONTINGENCIES - IRS REVENUE RULING

In 2007, the IRS issued Revenue Ruling 2007-54, which provided the IRS' interpretation of tax law regarding the computation of the DRD and Revenue Ruling 2007-61, which suspended Revenue Ruling 2007-54 and indicated the IRS would address the proper interpretation of tax law in a regulation project that is on the IRS' priority guidance plan. Although no guidance has been issued, if the IRS ultimately adopts the interpretation contained in Revenue Ruling 2007-54, the Company could lose a substantial amount of DRD tax benefits, which could have a material adverse effect on the Company's consolidated financial statements.

CONTINGENCIES - OTHER

In connection with the sale of certain broker-dealer subsidiaries (Note 6), certain indemnifications triggered by breaches of representations, warranties or covenants were provided by the Company. Also, included in the indemnifications is indemnification for certain third-party claims arising from the normal operation of these broker-dealers prior to the closing and within the nine month period following the sale. Management believes that claims, if any, against the Company related to such indemnification matters are not likely to have a material adverse effect on the Company's consolidated financial statements.

In the course of its business, the Company provides certain indemnifications related to other dispositions, acquisitions, investments, lease agreements or other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to time limitations that vary in duration, including contractual limitations and those that arise by operation of law, such as applicable statutes of limitation. Because the amounts of these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. The Company has not historically made material payments for these types of indemnifications. The estimated maximum potential amount of future payments under these obligations is not determinable due to the lack of a stated maximum liability for certain matters, and therefore, no related liability has been recorded. Management believes that judgments, if any, against the Company related to such matters are not likely to have a material adverse effect on the Company's consolidated financial statements.

Most of the jurisdictions in which the Company is admitted to transact business require life insurance companies to participate in guaranty associations, which are organized to pay contractual benefits owed pursuant to insurance policies issued by insolvent life insurance companies. These associations levy assessments, up to prescribed limits, on all member companies in a particular state based on the proportionate share of premiums written by member companies in the lines of business in which the insolvent insurer operated. The Company has not received notification of any insolvency that is expected to result in a material guaranty fund assessment.

The Asset Purchase Agreements of Aviation Trust, ACG Trust II and ACG Trust III (Note 4) provide that Pacific LifeCorp will guarantee the performance of certain obligations of ACG, as well as provide certain indemnifications, and that Pacific Life will assume certain obligations of ACG arising from the breach of certain representations and warranties under the Asset Purchase Agreements. Management believes that obligations, if any, related to these guarantees are not likely to have a material adverse effect on the Company's consolidated financial statements. The financial debt obligations of Aviation Trust, ACG Trust II and ACG Trust III are non-recourse to the Company and are not guaranteed by the Company.

In connection with the operations of certain subsidiaries, the Company has made commitments to provide for additional capital funding as may be required.

See Note 10 for discussion of contingencies related to derivative instruments.

See Note 18 for discussion of other contingencies related to income taxes.