

# ANNUAL REPORT



## ***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, 2014 and 2013 and for the years ended December 31, 2014, 2013 and 2012 (the “**Audited GAAP Financial Statements**”).

Dated: April 29, 2015

## 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 \$508 million aggregate principal amount remained outstanding as of December 31, 2014. 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. Suzan Merren and Ms. Rachel Fisher. 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, 2014 prepared in conformity with GAAP. The information as of December 31, 2014 in this table is derived from the audited GAAP financial statements of PLF as of December 31, 2014 and 2013 and for the years ended December 31, 2014, 2013 and 2012.

	<b>December 31, 2014</b>
<b>Debt:</b>	
Debt.....	<u>\$ 508,357,640</u>
Total Debt .....	<u>508,357,640</u>
<b>Equity:</b>	
Share capital .....	1,000
Retained earnings.....	24,706
Accumulated other comprehensive income.....	—
Total Equity .....	<u>25,706</u>
<b>Total capitalization.....</b>	<b><u>\$ 508,383,346</u></b>

### **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, 2014. During January and March 2015, \$414 million of the funding agreements matured. Other than as described herein, there have been no recent developments having a material effect on PLF or its business since December 31, 2014. 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.

With the exception of the funding agreement maturities mentioned above, there are currently no indications that the business of PLF will change between the date of this report and June 30, 2015.

## 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, 2014, and contains a fair review of that period.

Dated: April 29, 2015

/s/ Suzan Merren  
Suzan Merren  
Director

/s/ Rachel Fisher  
Rachel Fisher  
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, 2014 and 2013 (other than "life insurance in force" and "employees" included in "Other Data") and for the years ended December 31, 2014, 2013 and 2012 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, 2012 (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.

Consolidated Statements of Operations Data:	Years Ended December 31,		
	2014	2013	2012
	(in millions)		
Revenues:			
Policy fees and insurance premiums .....	\$ 3,414	\$ 3,365	\$ 3,324
Net investment income .....	2,408	2,290	2,281
Net realized investment gain (loss).....	(597)	586	(349)
Other than temporary impairments .....	(24)	(27)	(63)
Investment advisory fees .....	376	351	298
Aircraft leasing revenue .....	796	736	660
Other income .....	259	253	237
Total revenues .....	<u>6,632</u>	<u>7,554</u>	<u>6,388</u>
Benefits and Expenses:			
Policy benefits paid or provided .....	2,650	2,366	2,444
Interest credited to policyholder account balances .....	1,203	1,248	1,252
Commission expenses .....	398	1,354	648
Operating and other expenses .....	<u>1,759</u>	<u>1,784</u>	<u>1,601</u>
Total benefits and expenses .....	<u>6,010</u>	<u>6,752</u>	<u>5,945</u>
Income before provision (benefit) for income taxes..	622	802	443
Provision (benefit) for income taxes .....	<u>102</u>	<u>131</u>	<u>(67)</u>
Net income .....	520	671	510
Less: net (income) loss attributable to the noncontrolling interest .....	3	(19)	(68)
Net income attributable to the Company .....	<u>\$ 523</u>	<u>\$ 652</u>	<u>\$ 442</u>

<b>Consolidated Statements of Financial Condition:</b>	<b>December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(\$ in millions)</b>		
<b>Assets:</b>			
Investments .....	\$ 54,822	\$ 49,860	\$ 49,546
Cash and cash equivalents .....	3,220	2,000	2,256
Restricted cash .....	266	314	294
Deferred policy acquisition costs .....	4,742	4,214	4,329
Aircraft leasing portfolio, net .....	7,817	7,296	6,760
Other assets .....	2,985	3,117	3,305
Separate account assets .....	60,625	60,864	55,302
<b>Total assets .....</b>	<b><u>\$ 134,477</u></b>	<b><u>\$ 127,665</u></b>	<b><u>\$ 121,792</u></b>
<b>Liabilities and Equity:</b>			
<b>Liabilities:</b>			
Policyholder account balances .....	\$ 39,169	\$ 36,751	\$ 34,983
Future policy benefits .....	13,200	10,444	11,105
Debt .....	8,331	7,826	7,765
Other liabilities .....	3,410	2,932	3,069
Separate account liabilities .....	60,625	60,864	55,302
<b>Total liabilities .....</b>	<b><u>124,735</u></b>	<b><u>118,817</u></b>	<b><u>112,224</u></b>
<b>Equity:</b>			
Common stock .....	30	30	30
Paid-in capital .....	982	982	982
Retained earnings .....	7,264	6,941	6,489
Accumulated other comprehensive income .....	1,362	858	1,648
<b>Total stockholder's equity .....</b>	<b><u>9,638</u></b>	<b><u>8,811</u></b>	<b><u>9,149</u></b>
Noncontrolling interest .....	104	37	419
<b>Total equity .....</b>	<b><u>9,742</u></b>	<b><u>8,848</u></b>	<b><u>9,568</u></b>
<b>Total liabilities and equity .....</b>	<b><u>\$ 134,477</u></b>	<b><u>\$ 127,665</u></b>	<b><u>\$ 121,792</u></b>
<b>Other Data:</b>			
Life insurance in force .....	<u>\$ 497,607</u>	<u>\$ 299,256</u>	<u>\$ 296,620</u>
Employees .....	<u>2,937</u>	<u>2,743</u>	<u>2,699</u>

## **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 in the U.S. 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, 2014, 2013 and 2012, the Company had \$134.5 billion, \$127.7 billion and \$121.8 billion, respectively, in total assets, and total stockholder's equity of \$9.6 billion, \$8.8 billion and \$9.1 billion, respectively. Life insurance in force was \$497.6 billion, \$299.3 billion and \$296.6 billion as of December 31, 2014, 2013 and 2012, respectively. The increase in life insurance in force in 2014 was primarily attributable to a large reinsurance transaction of a block of in force individual life insurance of approximately \$200 billion from Reinsurance Group of America in December 2014. Net income attributable to the Company was \$523 million for the year ended December 31, 2014 as compared to \$652 million for the year ended December 31, 2013 and \$442 million for the year ended December 31, 2012.

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.

The Life Insurance segment provides a broad range of life insurance products through multiple distribution channels operating in primarily 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, 2014 and 2013, the Life Insurance segment represented 28% of the Company's total assets.

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, sold through multiple distribution sources. Distribution channels include independent planners, financial institutions and national/regional wirehouses. As of December 31, 2014 and 2013, this segment represented 61% of the Company's total assets.

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, 2014, 265 owned and managed aircraft. As of December 31, 2014 and 2013, 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 in 2011 (which is referred to as "**PL Retro**") and international reinsurance the Company has assumed from Pacific Life Re Limited ("**PLRL**"), a wholly owned subsidiary of Pacific LifeCorp incorporated in the United Kingdom. PL Retro assumes mortality risks from other life reinsurers, with a small amount of morbidity risk as part of larger treaties. PL Retro serves clients primarily in the U.S., Canada and Europe. PLRL provides reinsurance products and services to insurance and annuity providers in the United Kingdom and Ireland, and, through its Singapore branch, to insurers in selected Asian markets. As of December 31, 2014 and 2013, 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. The Corporate and Other segment 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.

### **Principal Subsidiaries and Affiliates**

ACG was founded in 1989 and comprises the Company's Aircraft Leasing segment. ACG's business focuses on acquiring, managing and trading commercial jet aircraft, and leasing such 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, 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. 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.



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**”) is a wholly owned subsidiary of Pacific Life that serves as the investment adviser for the Pacific Select Fund, an investment vehicle provided to Pacific Life’s variable life insurance policyholders and variable annuity contract owners, and the Pacific Life Funds, the investment vehicle for Pacific Life’s mutual fund products. Effective January 2015, the Pacific Life Funds changed its name to Pacific Funds Series Trust. PLFA charges advisory and other fees based primarily upon the net asset value of the underlying portfolios.

Pacific Global Advisors LLC (“**PGA**”), is a wholly owned subsidiary of Pacific Life that specializes in customized investment, risk management and termination solutions for pension plans and other institutional investors. In April 2015, the Company signed a definitive agreement to sell PGA.

PLRL is an indirect wholly owned subsidiary of Pacific Life Re Holdings LLC, which is a direct wholly owned subsidiary of Pacific LifeCorp. PLRL’s principal products are protection and annuity products, which are provided to insurance and annuity providers in the United Kingdom and Ireland, and, through its Singapore branch, to insurers in selected Asian markets. Protection products are generally term insurance products mostly linked to home mortgages, covering death, critical illness or disability, or income protection risks all typically reinsured on a risk premium basis. Annuity products support pension funds and insurance companies to manage longevity risk, and the specific risk of higher-than-expected pension or annuity payments. PLRL’s Asia branch offers protection products similar to those offered by PLRL in the United Kingdom and Ireland in selected Asian markets but with more emphasis on personal accident business.

Pacific Life Reinsurance Company II Limited (“**PLRC**”), is an exempt life reinsurance insurance company domiciled in Barbados and wholly owned by Pacific Life. PLRC was formed to reinsure new non-U.S. life retrocession business written beginning January 1, 2013. PLRC also reinsures non-U.S. life retrocession business that is novated in connection with the Reinsurance segment business.

Pacific Life cedes certain statutory reserves to affiliated special purpose financial insurance companies and affiliated captive reinsurance companies that are supported by a combination of cash, invested and other assets and third-party letters of credit or note facilities. As of December 31, 2014, Pacific Life’s total statutory reserve credit was \$1,702 million, of which \$1,160 million was supported by third-party letters of credit and note facilities. As of December 31, 2013, Pacific Life’s total statutory reserve credit was \$1,570 million, of which \$1,051 million was supported by third-party letters of credit and note facilities.

Pacific Life utilizes affiliated reinsurers to mitigate the statutory capital impact of NAIC Model Regulation “Valuation of Life Insurance Policies” (“**Regulation XXX**”) and NAIC Actuarial Guideline 38 on the Company’s UL products with flexible duration no lapse guarantee rider (“**FDNLGR**”) benefits. Pacific Alliance Reinsurance Company of Vermont (“**PAR Vermont**”) and Pacific Baleine Reinsurance Company (“**PBRC**”) are Vermont based special purpose financial insurance companies subject to regulatory supervision by the Vermont Department of Financial Regulation (“**Vermont Department**”). PAR Vermont and PBRC are wholly owned subsidiaries of Pacific Life and accredited authorized reinsurers in Nebraska. PAR Vermont was formed in 2007 and PBRC was formed in August 2013. Pacific Life cedes certain level term life insurance to PBRC and FDNLGR benefits to PAR Vermont and PBRC. In 2011, Pacific Life entered into an excess of loss indemnity reinsurance agreement with Pacific Alliance Excess Reinsurance Company (“**PAX Re**”), a pure captive insurance company subject to regulatory supervision by the Vermont Department and wholly owned by Pacific LifeCorp. Reinsurance ceded to PAR Vermont is net of the reinsurance ceded to PAX Re. Pacific Life does not receive statutory reserve credit for reinsurance ceded to PAX Re. Economic reserves, as defined in the PAR Vermont and PBRC reinsurance agreements, are supported by cash and invested and other assets, including funds withheld at Pacific Life.

Reserves in excess of the economic reserves held at PAR Vermont are supported by a letter of credit agreement provided by a highly rated bank, which has a maximum commitment amount of \$843 million

and a 20 year term expiring October 2031. The letter of credit agreement is non-recourse to Pacific LifeCorp or any of its affiliates, other than PAR Vermont. The letter of credit has been approved as an admissible asset by the Vermont Department for PAR Vermont statutory accounting. As of December 31, 2014, the letter of credit amounted to \$623 million and was held in a trust with Pacific Life as beneficiary. PAR Vermont admitted \$619 million and \$556 million as an asset in its statutory financial statements as of December 31, 2014 and 2013, respectively.

Reserves in excess of the economic reserves held at PBRC are supported by a note facility with a maximum commitment amount of \$400 million. This facility is non-recourse to Pacific Life or any of its affiliates, other than PBRC. Through this facility, PBRC issued a surplus note with a maturity date of December 2043 and received a note receivable in return with a maturity date of December 2038. The note receivable is credit enhanced by a highly rated third-party reinsurer for 20 years with a five year extension. The note receivable has been approved as an admissible asset by the Vermont Department for PBRC statutory accounting. As of December 31, 2014 and 2013, the note receivable amounted to \$111 million and \$100 million, respectively, and was held in a trust with Pacific Life as beneficiary. PBRC admitted \$111 million and \$65 million as an asset in its statutory financial statements as of December 31, 2014 and 2013, respectively.

Pacific Life has reinsurance agreements with Pacific Life Reinsurance (Barbados) Ltd. ("**PLRB**"), an exempt life reinsurance company domiciled in Barbados and wholly owned by Pacific LifeCorp. The underlying reinsurance is comprised of coinsurance and yearly renewable term ("**YRT**") treaties. Pacific Life retroceded the majority of the underlying YRT U.S. treaties on a 100% coinsurance with funds withheld basis to PLRB ("**PLRB Agreement**"). The PLRB Agreement is accounted for under deposit accounting for U.S. GAAP and as reinsurance under statutory accounting principles. The statutory accounting reserve credit is supported by cash, funds withheld at Pacific Life and a \$430 million letter of credit issued to PLRB by highly rated third-party banks for the benefit of Pacific Life. In connection with the acquisition and reinsurance arrangements between Pacific Life and PLRB, Pacific LifeCorp entered into a capital maintenance agreement and has also agreed to honor PLRB's obligations to the letter of credit provider in the event of default.

In 2012, the Company formed Pacific Annuity Reinsurance Company ("**PARC**"), a captive reinsurance company subject to regulatory supervision by the Arizona Department of Insurance. 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 ceded 5% of its inforce variable annuity business to PARC, after third-party reinsurance, and ceded 5% of new business issued thereafter. PARC is a wholly owned subsidiary of Pacific LifeCorp.

## **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, 2014 compared to the Year Ended December 31, 2013***

Net income attributable to the Company was \$523 million during 2014 as compared to \$652 million for 2013. The decrease in net income was primarily the result of mark-to-market losses in the Retirement Solutions segment related to variable annuity guaranteed living benefit rider guarantees (net of reinsurance, hedges, and deferred policy acquisition costs ("**DAC**")), due to the lower level of interest rates in 2014 compared to mark-to-market gains in the prior year from the higher level of interest rates in 2013. Also contributing to lower net income in 2014 were losses in the Life Insurance segment from unfavorable mortality spread due to higher direct claims and negative impact from changes in actuarial assumptions and models. Partially offsetting these decreases were lower losses from the Company's macro hedge program, as all equity put option and interest rate macro hedges were terminated in 2014, and strong private equity investment performance in the Corporate and Other segment. Additionally, in 2014 the Retirement Solutions segment had higher asset based fee and spread margins and gains from changes in actuarial assumptions and models. See discussion of the consolidated statement of operations line items below.

Policy fees and insurance premiums increased \$49 million for 2014 to \$3,414 million as compared to \$3,365 million for 2013. Policy fees consist of cost-of-insurance charges, expense loads, surrender charges and other fees related to products. This slight increase was primarily attributable to higher fees and premiums in the Reinsurance segment during 2014. Also contributing to the slight increase was higher asset-based fee income due to higher assets under management, partially offset by a decrease in sales of life contingent payout annuities in the Retirement Solutions segment. The slight increase was also partially offset by lower unearned revenue reserve amortization in the Life Insurance segment.

Net investment income increased from \$2,290 million in 2013 to \$2,408 million in 2014. The increase in 2014 was primarily due to an increase in fixed maturity securities and mortgage loan investments that generated higher investment income and an increase in private equity valuations due to continued improvement in the equity markets.

Net realized investment loss for 2014 amounted to \$597 million compared to a net realized investment gain of \$586 million for 2013. Net realized investment losses in 2014 were the result of mark-to-market losses related to variable annuity guaranteed living benefits in the Retirement Solutions segment (net of reinsurance, hedges and rider policy fees), primarily due to lower interest rates during 2014 as compared to net gains in the prior year from higher interest rates during 2013. These losses were partially offset by lower losses in 2014 from the Company's macro hedge program, as all equity put option and interest rate macro hedges were terminated in 2014 in the Corporate and Other segment and the impact of mark-to-market gains from a portfolio of fair value options securities purchased in 2014 by the Retirement Solutions segment. 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 impairment ("**OTTI**") losses amounted to \$24 million in 2014 as compared to \$27 million in 2013 mainly due to lower credit losses as a result of the Company's strong investment portfolio and investment performance. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of OTTI.

Investment advisory fees increased \$25 million to \$376 million in 2014 from \$351 million in 2013. This increase was primarily attributable to higher average assets under management in the Retirement Solutions segment driven by continued strong equity returns.

Aircraft leasing revenue increased \$60 million to \$796 million in 2014 from \$736 million in 2013. This increase was primarily the result of the net addition of aircraft to the consolidated portfolio.

Other income increased \$6 million to \$259 million in 2014 from \$253 million in 2013. Other income increased in the Retirement Solutions and Life Insurance segments in 2014 due to increased service and other fees driven by higher average assets under management. This increase was partially offset by lower other income in the Corporate and Other segment in 2014 as compared to 2013 due to the Company's receipt of a non-recurring claims settlement in 2013.

Policy benefits paid or provided increased \$284 million to \$2,650 million for 2014 from \$2,366 million for 2013. This increase was primarily attributable to an increase in death and other benefit payments in the Life Insurance and Reinsurance segments, partly offset by lower dividends to policyholders. This increase was also partially offset by smaller year over year reserve increases in the Retirement Solutions segment driven by lower payout annuity sales.

Interest credited to policyholder account balances decreased slightly to \$1,203 million for 2014 from \$1,248 million for 2013. This decrease of \$45 million was primarily attributable to the continued run-off of certain corporate products such as guaranteed interest contracts ("**GICs**") and funding agreements in the Corporate and Other segment. The decrease was partially offset by an increase in policyholder account values in the Life Insurance segment and an increase in the average fixed account annuity reserves in the Retirement Solutions segment.

Commission expenses for 2014 decreased \$956 million to \$398 million compared to \$1,354 million in 2013. 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 mark-to-market value of variable annuity guaranteed living benefits (net of reinsurance, hedges and rider policy fees) in the Retirement Solutions segment. The decrease in commission expenses was primarily due to a decrease in DAC amortization from the Retirement Solution segment as a result of negative amortization in 2014 compared to positive amortization in 2013 due to the previously mentioned change in mark-to-market value of the variable annuity guaranteed living benefits, partially offset by an increase in trail commissions. The Life Insurance segment also contributed to part of the decrease in commission expenses due to decreased DAC amortization.

Operating and other expenses for 2014 decreased by \$25 million to \$1,759 million as compared to \$1,784 million in 2013. The Aircraft Leasing segment had lower expenses of \$9 million primarily due to decreases in aircraft maintenance and transition expenses, partially offset by higher aircraft impairment expenses on older aircraft. Operating and other expenses in the Corporate and Other segment decreased primarily due to lower interest expense as a result of a one-time expense incurred in the first quarter of 2013 in connection with a tender offer that resulted in the retirement of \$323 million of the Company's 9.25% \$1.0 billion surplus notes and lower subsidiary operating expenses.

The provision for income taxes for 2014 amounted to \$102 million compared to \$131 million for 2013. This decrease in tax expense was primarily due to lower taxable income in 2014. The taxes in 2014 and in 2013 were lower than the statutory rate primarily due to the separate account dividends received deductions, other tax credits, and the reduction of Aircraft Leasing segment deferred tax liabilities.

#### ***Year Ended December 31, 2013 compared to the Year Ended December 31, 2012***

Net income attributable to the Company was \$652 million during 2013 as compared to \$442 million for 2012. The increase in net income was primarily the result of mark-to-market gains in the Retirement Solutions segment on variable annuity guaranteed living benefits (net of reinsurance, hedges and amortization of DAC) resulting principally from an increase in risk free rates during 2013 and a much smaller tightening of credit spreads in 2013 compared to 2012. The Company had increased earnings from higher asset based fees in the Retirement Solutions segment and mortality gains in the Reinsurance segment, however these were partially offset by increased macro equity and interest rate hedge losses,

lower realized real estate and other investment gains, and lower Aircraft Leasing segment tax benefits in 2013. See the discussion of the consolidated statement of operations line items below.

Policy fees and insurance premiums increased \$41 million for 2013 to \$3,365 million as compared to \$3,324 million for 2012. Policy fees consist of cost-of-insurance charges, expense loads, surrender charges and other fees related to products. This increase was primarily from an increase in the percent of premium loads, cost of insurance charges and higher surrender charges in the Life Insurance segment, partially offset by lower sales of the life contingent payout annuities in the Retirement Solutions segment.

Net investment income increased slightly from \$2,281 million in 2012 to \$2,290 million in 2013. The increase in 2013 as compared to 2012 was primarily due to an increase in invested assets that generated higher investment income and income received from credit recoveries during the year.

Net realized investment gain for 2013 amounted to \$586 million compared to a loss of \$349 million for 2012. The primary reason for the increased net realized investment gain was mark-to-market gains in the Retirement Solutions segment related to variable annuity guaranteed living benefits (net of reinsurance, hedges and rider policy fees) in 2013 as compared to net losses in 2012. These net gains were partially offset by higher net losses in 2013 as compared to 2012 related to the macro equity hedges and macro interest rate hedges in the Corporate and Other segment. Additionally, realized investment gains were lower in 2013. Other derivative losses were also higher in 2013. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of net realized investment gain (loss).

OTTI losses decreased to \$27 million in 2013 as compared to \$63 million in 2012 mainly due to improvements in the overall credit environment and housing market during 2013 resulting in lower losses from the residential mortgage-backed securities ("**RMBS**") holdings from the prior year. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on the components of OTTI.

Investment advisory fees increased \$53 million to \$351 million in 2013 from \$298 million in 2012. This increase was primarily attributable to higher average assets under management and a 10 basis point increase in advisory fees from Pacific Select Fund effective in May 2013.

Aircraft leasing revenue increased \$76 million to \$736 million in 2013 from \$660 million in 2012. This increase was primarily the result of net aircraft additions to the consolidated portfolio.

Other income was \$253 million in 2013 as compared to \$237 million in 2012, an increase of \$16 million primarily due to the Retirement Solutions segment's increased service fees and other miscellaneous fees driven by higher average assets under management.

Policy benefits paid or provided decreased \$78 million to \$2,366 million for 2013 from \$2,444 million for 2012. The decrease was primarily related to the Retirement Solutions segment due to lower sales and thus smaller increases in life contingent payout annuity reserves, partially offset by an increase in death benefit payments. The decrease was also attributable to improved mortality experience by the Reinsurance segment and the natural unwind of reserves for the retrocession business. These decreases were partially offset by increased death benefits paid and a decrease in the amount of reinsurance recoveries received on the related benefits in the Life Insurance segment.

Interest credited to policyholder account balances remained consistent, decreasing slightly to \$1,248 million for 2013 from \$1,252 million for 2012.

Commission expenses for 2013 increased \$706 million to \$1,354 million compared to \$648 million in 2012. 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 mark-to-market value of variable annuity guaranteed living benefits (net of reinsurance, hedges and rider policy fees) in the Retirement Solutions

segment. The commission expenses increase in 2013 as compared to 2012 was due to higher rider-related gains driving DAC amortization expense in the Retirement Solutions segment and increased DAC amortization in the Life Insurance segment due primarily to a revision to gross profits based on experience.

Operating and other expenses for 2013 increased by \$183 million to \$1,784 million as compared to \$1,601 million in 2012. Retirement Solutions segment operating and other expenses increased \$19 million due to higher non-deferrable acquisition costs driven by higher sales. Operating and other expenses in the Life Insurance segment increased \$15 million due to increased temporary help due to staffing vacancies and increased medical fees. The Aircraft Leasing segment had an increase of \$85 million in operating expenses primarily due to an increase in expenses resulting from an increase in aircraft impairment charges, higher aircraft depreciation as a result of an increase in the number of consolidated aircraft, and higher interest expense due to increased outstanding debt and lower gains from debt repurchases. Operating and other expense in the Corporate and Other segment increased \$56 million primarily due to increased interest expense from a one-time cost incurred in the first quarter of 2013 in connection with a tender offer that resulted in the retirement of \$323 million of the \$1.0 billion outstanding of the Company's 9.25% surplus notes.

The provision (benefit) for income taxes for 2013 amounted to \$131 million compared to (\$67) million for 2012. This increase in tax expense was primarily due to higher taxable income in 2013 and a nonrecurring deferred tax liability basis tax benefit adjustment in the Aircraft Leasing segment in 2012. The taxes in 2013 and in 2012 were lower than the statutory rate primarily due to the separate account dividends received deductions, other tax credits, and the 2012 reduction of Aircraft Leasing segment deferred tax liabilities previously noted.

### **Assets**

As of December 31, 2014, the Company had total assets of \$134.5 billion as compared to \$127.7 billion as of December 31, 2013. The Company had an increase in total investments of \$5.0 billion, cash and cash equivalents of \$1.2 billion, DAC of \$0.5 billion, and the aircraft leasing portfolio, net of \$0.5 billion, which contributed to the increase in total assets from December 31, 2013 to December 31, 2014. These increases were partially offset by a decrease of \$0.2 billion in separate account assets, and a decrease of \$0.1 million in other assets from December 31, 2013 to December 31, 2014. See the Audited GAAP Financial Statements included in this Annual Report for additional information on investments.

As of December 31, 2013, the Company had total assets of \$127.7 billion as compared to \$121.8 billion as of December 31, 2012. The Company had an increase in separate account assets of \$5.6 billion, increases of \$0.3 billion in total investments and an increase in the aircraft leasing portfolio, net of \$0.5 billion, which contributed to the increase in total assets from December 31, 2012 to December 31, 2013. These increases were partially offset by a decrease of \$0.3 billion in cash and cash equivalents, and a decrease of \$0.2 million in other assets from December 31, 2012 to December 31, 2013.

### **Liabilities**

As of December 31, 2014, the Company had total liabilities of \$124.7 billion as compared to \$118.8 billion as of December 31, 2013. This increase in total liabilities was due to an increase in policyholder account balances of \$2.4 billion, future policy benefits of \$2.8 billion, debt of \$0.5 billion and other liabilities of \$0.5 billion from December 31, 2013 to December 31, 2014. These increases were partially offset by a decrease of \$0.2 billion in separate account liabilities. See the Audited GAAP Financial Statements included elsewhere in this Annual Report for additional information on liabilities.

As of December 31, 2013, the Company had total liabilities of \$118.8 billion as compared to \$112.2 billion as of December 31, 2012. This increase in total liabilities was partially a result of an increase in separate account liabilities of \$5.6 billion from December 31, 2012 to December 31, 2013. The increase in total liabilities was also due to an increase in policyholder account balances of \$1.8 billion. These increases were partially offset by a decrease of \$0.7 billion in future policy benefits.

## 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 increased \$1.2 billion during 2014 as compared to a decrease of \$256 million during 2013 and a decrease of \$573 million during 2012.

Net cash provided by operating activities was \$3,833 million during 2014, \$3,478 million during 2013 and \$3,555 million during 2012. 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 \$3,965 million during 2014, \$3,917 million during 2013 and \$3,905 million in 2012. Net cash used in investing activities was slightly higher in 2014 as compared to 2013 primarily due to purchases of fair value option securities, fundings of commercial mortgage-backed securities ("**CMBS**") variable interest entity ("**VIE**") mortgage loans and no proceeds from the sale of real estate in 2014, partially offset by lower purchases and higher sales of fixed maturity and equity securities, and higher repayments of mortgage loans. Net cash used in investing activities was slightly higher in 2013 as compared to 2012 primarily due to higher maturities and repayments of fixed maturity and equity securities, partially offset by lower sales of fixed maturity and equity securities in 2013 as compared to 2012. 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 provided by (used in) financing activities was \$1,352 million during 2014, \$183 million during 2013 and (\$223) million in 2012. The increase in net cash provided by financing activities in 2014 as compared to 2013 primarily related to the net change in short-term debt, issuance of CMBS VIE debt, and lower payments with respect to long-term debt and surplus notes. The increase in cash provided by financing activities from 2012 to 2013 was due to higher policyholder account balance deposits, lower policyholder account balance withdrawals and higher issuances of long-term debt. This was partially offset by the change in short-term debt, partial retirement of the Company's \$1.0 billion surplus notes and higher dividends paid to Pacific LifeCorp.

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 ("**NE DOI**") 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 NE DOI 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 NE DOI 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 2014 statutory results, Pacific Life could pay \$668 million in ordinary dividends or distributions during 2015, 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 2014, 2013 and 2012, Pacific Life paid dividends as determined on a statutory accounting basis to Pacific LifeCorp of \$200 million, \$200 million and \$133 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. 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. ACG meets its liquidity needs to fund future aircraft commitments by accessing the debt and capital markets through various channels, including the domestic U.S. bank loan market, the issuance of asset-backed debt instruments, European Export Credit Agency ("**European ECA**") and U.S. Export-Import Bank ("**Ex-Im Bank**") guaranteed loans and the issuance of various corporate debt instruments. See the discussion below for more information about ACG's sources of liquidity.



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

	<b>December 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Amount</b>	<b>% of Total</b>	<b>Amount</b>	<b>% of Total</b>
	<b>(\$ in millions)</b>			
Subject to discretionary withdrawal:				
With fair value adjustment .....	\$ 5,522	8%	\$ 5,463	8%
At book value less current surrender charge of 5% or more .....	794	1%	1,150	1%
At fair value.....	<u>50,268</u>	<u>72%</u>	<u>50,798</u>	<u>74%</u>
Total with adjustment or at fair value.....	56,584	81%	57,411	83%
At book value without adjustment.....	5,282	8%	4,668	7%
Not subject to discretionary withdrawal .....	<u>7,876</u>	<u>11%</u>	<u>6,940</u>	<u>10%</u>
Total (gross) .....	69,742	<u>100%</u>	69,019	<u>100%</u>
Reinsurance ceded.....	<u>6</u>		<u>13</u>	
Total (net) .....	<u>\$69,736</u>		<u>\$69,006</u>	

As noted in the table above, as of December 31, 2014 and 2013, 8% and 7%, respectively, of these liabilities were subject to withdrawal at book value without adjustment. The other 92% and 93% of these liabilities 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.

Pacific Life 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%. All future payments of interest and principal on these surplus notes can be made only with the prior approval of the NE DOI.

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%. In January 2013, the Company, with the approval of the NE DOI, exercised its early redemption right for its 9.25% surplus notes and repurchased and retired \$323 million of the original \$1 billion outstanding. The partial retirement of the 9.25% surplus notes was accounted for as an extinguishment of debt and the related amortization of deferred gains of \$112 million and the premium paid of \$155 million were recognized in interest expense during the year ended December 31, 2013. As of December 31, 2014 and 2013, Pacific Life had \$677 million of these surplus notes outstanding. 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 NE DOI for such optional redemption, and all future payments of interest and principal on these surplus notes can be made only with the prior approval of the NE DOI.

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 NE DOI approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for \$450 million with net cash proceeds of \$494 million. The original issue discount of \$6 million is being amortized over the life of the surplus note. 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 NE DOI. 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 NE DOI 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% surplus notes discussed above.

The Company's principal source of liquidity to meet unexpected cash outflows is its portfolio of liquid assets, which includes short-term money market investments and public bonds. As discussed in more detail above, as a matter of policy, the Company includes provisions in many of its products that reduce the likelihood of withdrawal. A substantial portion of its liabilities is not subject to surrender, or can be surrendered only after deduction of a charge or market value adjustment.

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, 2014, 2013 and 2012. 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 October 2019. This facility had no debt outstanding as of December 31, 2014, 2013 and 2012. As of December 31, 2014, 2013 and 2012, and for the years ended December 31, 2014, 2013 and 2012, 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 reverse repurchase lines of credit as of December 31, 2014, 2013 and 2012.

Pacific Life is a member of the Federal Home Loan Bank ("FHLB") of Topeka. Pacific Life is eligible to receive advances from the FHLB of Topeka based on a percentage of Pacific Life's statutory general account assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of Topeka requirements, debt covenant restrictions and insurance law and regulations. The Company had estimated available eligible collateral of \$1.3 billion as of December 31, 2014. Interest is at variable or fixed rates. There was no debt outstanding with the FHLB of Topeka as of December 31, 2014, 2013 and 2012.

PL&A is a member of the FHLB of San Francisco. PL&A is eligible to receive advances from the FHLB of San Francisco based on a percentage of PL&A's net admitted assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of San Francisco requirements and insurance law and regulations. PL&A had estimated available eligible collateral of \$55 million as of December 31, 2014. Interest is at variable or fixed rates. As of December 31, 2014, 2013 and 2012, 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 asset-backed securities 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 \$1,105 million borrowing capacity. Interest on these loans is at variable rates, payable monthly. The facilities expire in October 2018. There was \$266 million, \$20 million and \$292 million outstanding in connection with ACG's revolving credit agreements as of December 31, 2014, 2013 and 2012, respectively. These credit agreements are recourse only to ACG.

### ***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 2014 statutory results, PL&A could pay \$38 million in dividends to Pacific Life in 2015 without prior regulatory approval. During the years ended December 31, 2014 and 2013, PL&A paid a dividend to Pacific Life of \$35 million in each year. PL&A did not pay any dividends to Pacific Life during the year ended December 31, 2012.

### ***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 and fluctuation in the mark-to-market value of variable annuity guaranteed minimum living 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 statutory reserves and impact of Regulation XXX and Actuarial Guidance 38;
- new accounting rules or changes to existing accounting rules;
- the NAIC's and regulators' increased focus on life insurers' use of captive reinsurance companies and the effect that changes in insurance laws may have in affecting the Company's use of captive reinsurance companies in the future;
- 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. Pacific Life's financial strength ratings and outlook as of the date of this Annual Report are set forth in the chart below.

<b><u>Rating Agency</u></b>	<b><u>Rating</u></b>	<b><u>Rating Structure</u></b>	<b><u>Ratings Outlook</u></b>
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, 2014, the Company had over 2,900 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,  
2014 and 2013 and for the years ended December 31, 2014, 2013 and 2012**

Independent Auditors' Report .....	F-3
Balance Sheets .....	F-4
Statements of Operations and Retained Earnings .....	F-5
Statements of Cash Flows .....	F-6
Notes to Financial Statements .....	F-7

**Audited GAAP Consolidated Financial Statements of Pacific Life Insurance Company as  
of December 31, 2014 and 2013 and for the years ended December 31, 2014, 2013  
and 2012**

Independent Auditors' Report.....	F-13
Consolidated Statements of Financial Condition .....	F-14
Consolidated Statements of Operations .....	F-15
Consolidated Statements of Comprehensive Income (Loss).....	F-16
Consolidated Statements of Equity .....	F-17
Consolidated Statements of Cash Flows .....	F-18
Notes to Consolidated Financial Statements .....	F-20

**AUDITED GAAP FINANCIAL STATEMENTS OF  
PACIFIC LIFE FUNDING, LLC  
AS OF DECEMBER 31, 2014 AND 2013 AND  
FOR THE YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012**



## 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, 2014 and 2013, and the related statements of operations and retained earnings and cash flows for each of the three years in the period ended December 31, 2014 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

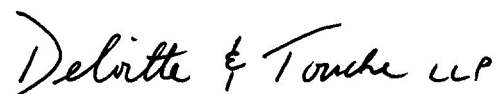
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014 in accordance with accounting principles generally accepted in the United States of America.



April 23, 2015

*Pacific Life Funding, LLC*

BALANCE SHEETS  
(Expressed in United States Dollars)

(In Thousands)	December 31,	
	2014	2013
<b>ASSETS</b>		
Cash	\$26	\$26
Funding Agreements	508,358	604,041
Accrued interest receivable	17,692	20,358
<b>TOTAL ASSETS</b>	<b>\$526,076</b>	<b>\$624,425</b>
<b>LIABILITIES AND MEMBER'S EQUITY</b>		
Liabilities:		
Notes payable	\$508,358	\$604,041
Accrued interest payable	17,692	20,358
<b>TOTAL LIABILITIES</b>	<b>526,050</b>	<b>624,399</b>
Member's Equity:		
Share capital	1	1
Retained earnings	25	25
<b>TOTAL MEMBER'S EQUITY</b>	<b>26</b>	<b>26</b>
<b>TOTAL LIABILITIES AND MEMBER'S EQUITY</b>	<b>\$526,076</b>	<b>\$624,425</b>

See Notes to Financial Statements

*Pacific Life Funding, LLC*

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

(In Thousands)	Years Ended December 31,		
	2014	2013	2012
<b>INCOME</b>			
Interest on Funding Agreements	\$23,587	\$37,499	\$45,925
Foreign exchange gain on Funding Agreements	0	0	33,325
Foreign exchange gain on notes payable	41,864	22,717	0
<b>TOTAL INCOME</b>	<b>65,451</b>	<b>60,216</b>	<b>79,250</b>
<b>EXPENSES</b>			
Interest on notes payable	23,587	37,499	45,925
Foreign exchange loss on Funding Agreements	41,864	22,717	0
Foreign exchange loss on notes payable	0	0	33,325
<b>TOTAL EXPENSES</b>	<b>65,451</b>	<b>60,216</b>	<b>79,250</b>
<b>NET INCOME</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>RETAINED EARNINGS, BEGINNING OF YEAR</b>	<b>\$25</b>	<b>\$25</b>	<b>\$25</b>
Net income	0	0	0
<b>RETAINED EARNINGS, END OF YEAR</b>	<b>\$25</b>	<b>\$25</b>	<b>\$25</b>

See Notes to Financial Statements

*Pacific Life Funding, LLC*

STATEMENTS OF CASH FLOWS  
(Expressed in United States Dollars)

<i>(In Thousands)</i>	Years Ended December 31,		
	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$0	\$0	\$0
Adjustments to reconcile net income to net cash provided by operating activities:			
Change in accrued interest receivable	2,666	6,917	(911)
Change in accrued interest payable	(2,666)	(6,917)	911
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from maturities of Funding Agreements	53,819	291,408	28,560
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>53,819</b>	<b>291,408</b>	<b>28,560</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Redemption of notes payable	(53,819)	(291,408)	(28,560)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(53,819)</b>	<b>(291,408)</b>	<b>(28,560)</b>
<b>NET CHANGE IN CASH</b>	<b>0</b>	<b>0</b>	<b>0</b>
Cash, beginning of year	26	26	26
<b>CASH, END OF YEAR</b>	<b>\$26</b>	<b>\$26</b>	<b>\$26</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>			
Interest paid	\$26,253	\$44,416	\$45,014

See Notes to Financial Statements

*Pacific Life Funding, LLC*

NOTES TO FINANCIAL STATEMENTS  
(Expressed in United States Dollars)

**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. MaplesFS Limited (formerly known as 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).

**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, 2014 through April 23, 2015, the date the financial statements were available to be issued. During January and March 2015, \$413,524 thousand of the Funding Agreements and notes payable matured and were redeemed. Other than the event noted above, there are no additional events subsequent to December 31, 2014 that require adjustment to or disclosure in the financial statements.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents, if any, 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, 2014, 2013 and 2012, Pacific Life paid \$107 thousand, \$98 thousand and \$125 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 January 2015 to February 2021.

The following schedules detail the notes payable outstanding as of December 31, 2014 and 2013. 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, 2014:

<u>Issue</u>	<u>Currency</u>	Principal Denominated in <u>Currency of Issuance</u> <i>(In Thousands)</i>	<u>Maturity</u>	<u>Interest Rate</u>	<u>Principal</u> <sup>(1)</sup>	Foreign Currency <u>Gains (Losses)</u> <i>(\$ In Thousands)</i>	<u>Carrying Value</u>
Series 67 Tranche 1	GBP	200,000	1/20/2015	5.13 %	\$375,000	(\$63,148)	\$311,852
Series 68 Tranche 1	HKD	200,000	1/26/2015	4.28 %	25,664	126	25,790
Series PLF012 Tranche 1	EUR	10,000	3/15/2015	3.80 %	12,860	(759)	12,101
Series 39 Tranche 1	GBP	25,000	12/7/2015	5.81 %	35,500	3,481	38,981
Series PLF031 Tranche 1	EUR	1,350	12/15/2015	3.80 %	1,580	54	1,634
Series PLF019 Tranche 1	EUR	5,016	6/15/2017	4.00 %	6,340	(271)	6,069
Series 11 Tranche 1	EUR	36,500	3/12/2019	4.70 %	40,880	3,287	44,167
Series 36 Tranche 1	EUR	29,000	9/29/2020	3 mth EURIBOR + .37%	25,418	9,673	35,091
Series 40 Tranche 1	EUR	27,000	2/5/2021	3 mth EURIBOR + .43%	25,313	7,360	32,673
TOTAL					<u>\$548,555</u>	<u>(\$40,197)</u>	<u>\$508,358</u>

<sup>(1)</sup> U.S. dollar equivalent at issuance.

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

December 31, 2013:

<u>Issue</u>	<u>Currency</u>	Principal Denominated in <u>Currency of Issuance</u> <i>(In Thousands)</i>	<u>Maturity</u>	<u>Interest Rate</u>	<u>Principal</u> <sup>(1)</sup>	Foreign Currency <u>Gains (Losses)</u> <i>(\$ In Thousands)</i>	<u>Carrying Value</u>
Series PLF003 Tranche 1	EUR	25,358	2/15/2014	4.00 %	\$33,219	\$1,723	\$34,942
Series 66 Tranche 1	HKD	160,000	7/31/2014	5.00 %	20,600	35	20,635
Series 67 Tranche 1	GBP	200,000	1/20/2015	5.13 %	375,000	(43,748)	331,252
Series 68 Tranche 1	HKD	200,000	1/26/2015	4.28 %	25,664	129	25,793
Series PLF012 Tranche 1	EUR	10,000	3/15/2015	3.80 %	12,860	919	13,779
Series 39 Tranche 1	GBP	25,000	12/7/2015	5.81 %	35,500	5,906	41,406
Series PLF031 Tranche 1	EUR	1,350	12/15/2015	3.80 %	1,580	281	1,861
Series PLF019 Tranche 1	EUR	5,016	6/15/2017	4.00 %	6,340	572	6,912
Series 11 Tranche 1	EUR	36,500	3/12/2019	4.70 %	40,880	9,415	50,295
Series 36 Tranche 1	EUR	29,000	9/29/2020	3 mth EURIBOR + .37%	25,418	14,542	39,960
Series 40 Tranche 1	EUR	27,000	2/5/2021	3 mth EURIBOR + .43%	25,313	11,893	37,206
TOTAL					\$602,374	\$1,667	\$604,041

<sup>(1)</sup> U.S. dollar equivalent at issuance.



## 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:

	<u>December 31, 2014</u>	
	Carrying Amount	Estimated Fair Value
	<u>(In Thousands)</u>	
Assets:		
Funding Agreements (Note 4)	\$508,358	\$513,131
Liabilities:		
Notes payable (Note 4)	508,358	513,131

	<u>December 31, 2013</u>	
	Carrying Amount	Estimated Fair Value
	<u>(In Thousands)</u>	
Assets:		
Funding Agreements (Note 4)	\$604,041	\$614,217
Liabilities:		
Notes payable (Note 4)	604,041	614,217

## 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, 2014 and 2013, one thousand ordinary shares had been issued at par to MaplesFS Limited.

---

**AUDITED GAAP CONSOLIDATED FINANCIAL STATEMENTS OF  
PACIFIC LIFE INSURANCE COMPANY  
AS OF DECEMBER 31, 2014 AND 2013 AND  
FOR THE YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012**

## 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, 2014 and 2013, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for each of the three years in the period ended December 31, 2014 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

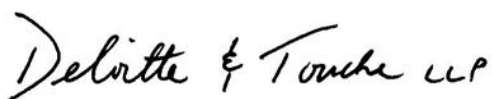
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable 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, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in accordance with accounting principles generally accepted in the United States of America.



March 6, 2015

*Pacific Life Insurance Company and Subsidiaries*

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

<i>(In Millions)</i>	December 31, 2014	2013
<b>ASSETS</b>		
Investments:		
Fixed maturity securities available for sale, at estimated fair value	\$35,662	\$32,466
Equity securities available for sale, at estimated fair value	131	137
Fair value option securities	563	
Mortgage loans (includes VIE assets of \$750 and \$0)	9,327	8,454
Policy loans	7,234	7,155
Other investments (includes VIE assets of \$118 and \$81)	1,905	1,648
<b>TOTAL INVESTMENTS</b>	<b>54,822</b>	<b>49,860</b>
Cash and cash equivalents (includes VIE assets of \$7 and \$8)	3,220	2,000
Restricted cash (includes VIE assets of \$123 and \$194)	266	314
Deferred policy acquisition costs	4,742	4,214
Aircraft, net (includes VIE assets of \$869 and \$1,398)	7,817	7,296
Other assets (includes VIE assets of \$30 and \$22)	2,985	3,117
Separate account assets	60,625	60,864
<b>TOTAL ASSETS</b>	<b>\$134,477</b>	<b>\$127,665</b>
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Policyholder account balances	\$39,169	\$36,751
Future policy benefits	13,200	10,444
Debt (includes VIE debt of \$1,079 and \$659)	8,331	7,826
Other liabilities (includes VIE liabilities of \$201 and \$280)	3,410	2,932
Separate account liabilities	60,625	60,864
<b>TOTAL LIABILITIES</b>	<b>124,735</b>	<b>118,817</b>
Commitments and contingencies (Note 18)		
Stockholder's Equity:		
Common stock - \$50 par value; 600,000 shares authorized, issued and outstanding	30	30
Paid-in capital	982	982
Retained earnings	7,264	6,941
Accumulated other comprehensive income	1,362	858
<b>Total Stockholder's Equity</b>	<b>9,638</b>	<b>8,811</b>
Noncontrolling interest	104	37
<b>TOTAL EQUITY</b>	<b>9,742</b>	<b>8,848</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$134,477</b>	<b>\$127,665</b>

The abbreviation VIE above means variable interest entity.

See Notes to Consolidated Financial Statements

*Pacific Life Insurance Company and Subsidiaries*

CONSOLIDATED STATEMENTS OF OPERATIONS

(In Millions)	Years Ended December 31,		
	2014	2013	2012
<b>REVENUES</b>			
Policy fees and insurance premiums	\$3,414	\$3,365	\$3,324
Net investment income	2,408	2,290	2,281
Net realized investment gain (loss)	(597)	586	(349)
OTTI, consisting of \$28, \$33 and \$116 in total, net of \$4, \$6 and \$53 recognized in OCI	(24)	(27)	(63)
Investment advisory fees	376	351	298
Aircraft leasing revenue	796	736	660
Other income	259	253	237
<b>TOTAL REVENUES</b>	<b>6,632</b>	<b>7,554</b>	<b>6,388</b>
<b>BENEFITS AND EXPENSES</b>			
Policy benefits paid or provided	2,650	2,366	2,444
Interest credited to policyholder account balances	1,203	1,248	1,252
Commission expenses	398	1,354	648
Operating and other expenses	1,759	1,784	1,601
<b>TOTAL BENEFITS AND EXPENSES</b>	<b>6,010</b>	<b>6,752</b>	<b>5,945</b>
 INCOME BEFORE PROVISION (BENEFIT) FOR INCOME TAXES	 622	 802	 443
Provision (benefit) for income taxes	102	131	(67)
 Net income	 520	 671	 510
Less: net (income) loss attributable to the noncontrolling interest	3	(19)	(68)
 <b>NET INCOME ATTRIBUTABLE TO THE COMPANY</b>	 <b>\$523</b>	 <b>\$652</b>	 <b>\$442</b>

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

*Pacific Life Insurance Company and Subsidiaries*

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In Millions)	Years Ended December 31,		
	2014	2013	2012
<b>NET INCOME</b>	<b>\$520</b>	<b>\$671</b>	<b>\$510</b>
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on derivatives and securities available for sale, net:			
Unrealized holding gain (loss) arising during period	525	(754)	698
Reclassification adjustment for gain (loss) included in net income	(16)	(42)	(55)
Unrealized gain (loss) on derivatives and securities available for sale, net	509	(796)	643
Foreign currency translation adjustments and other	(5)	6	2
Other comprehensive income (loss)	504	(790)	645
Comprehensive income (loss)	1,024	(119)	1,155
Less: comprehensive (income) loss attributable to the noncontrolling interest	3	(19)	(69)
<b>COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO THE COMPANY</b>	<b>\$1,027</b>	<b>(\$138)</b>	<b>\$1,086</b>

See Notes to Consolidated Financial Statements

*Pacific Life Insurance Company and Subsidiaries*

CONSOLIDATED STATEMENTS OF EQUITY

					Accumulated Other Comprehensive Income (Loss)		Total Stockholder's Equity	Noncontrolling Interest	Total Equity
	Common Stock	Paid-in Capital	Retained Earnings	Available for Sale, Net	Unrealized Gain (Loss) On Derivatives and Securities	Other, Net			
<i>(In Millions)</i>									
<b>BALANCES, JANUARY 1, 2012</b>	<b>\$30</b>	<b>\$982</b>	<b>\$6,177</b>	<b>\$1,018</b>	<b>(\$14)</b>		<b>\$8,193</b>	<b>\$334</b>	<b>\$8,527</b>
Comprehensive income:									
Net income			442				442	68	510
Other comprehensive income				643		1	644	1	645
Total comprehensive income							1,086	69	1,155
Dividend to parent			(130)				(130)		(130)
Change in equity of noncontrolling interest								16	16
<b>BALANCES, DECEMBER 31, 2012</b>	<b>30</b>	<b>982</b>	<b>6,489</b>	<b>1,661</b>	<b>(13)</b>		<b>9,149</b>	<b>419</b>	<b>9,568</b>
Comprehensive loss:									
Net income			652				652	19	671
Other comprehensive income (loss)				(796)		6	(790)		(790)
Total comprehensive loss							(138)	19	(119)
Dividend to parent			(200)				(200)		(200)
Change in equity of noncontrolling interest								(21)	(21)
Deconsolidation of VIEs (See Other in Note 4)								(380)	(380)
<b>BALANCES, DECEMBER 31, 2013</b>	<b>30</b>	<b>982</b>	<b>6,941</b>	<b>865</b>	<b>(7)</b>		<b>8,811</b>	<b>37</b>	<b>8,848</b>
Comprehensive income:									
Net income (loss)			523				523	(3)	520
Other comprehensive income (loss)				509		(5)	504		504
Total comprehensive income (loss)							1,027	(3)	1,024
Dividend to parent			(200)				(200)		(200)
Change in equity of noncontrolling interest								70	70
<b>BALANCES, DECEMBER 31, 2014</b>	<b>\$30</b>	<b>\$982</b>	<b>\$7,264</b>	<b>\$1,374</b>	<b>(\$12)</b>		<b>\$9,638</b>	<b>\$104</b>	<b>\$9,742</b>

See Notes to Consolidated Financial Statements

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Millions)	Years Ended December 31,		
	2014	2013	2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$520	\$671	\$510
Adjustments to reconcile net income to net cash provided by operating activities:			
Net accretion on fixed maturity securities	(85)	(82)	(119)
Depreciation and amortization	450	438	389
Deferred income taxes	55	118	(70)
Net realized investment (gain) loss	597	(586)	349
Other than temporary impairments	24	27	63
Net change in deferred policy acquisition costs	(622)	352	(199)
Interest credited to policyholder account balances	1,203	1,248	1,252
Net change in future policy benefits	1,789	1,069	1,574
Other operating activities, net	(98)	223	(194)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>3,833</b>	<b>3,478</b>	<b>3,555</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Fixed maturity and equity securities available for sale:			
Purchases	(5,638)	(5,909)	(6,018)
Sales	1,535	1,279	2,446
Maturities and repayments	2,410	2,640	2,076
Purchases of fair value option securities	(498)		
Repayments of mortgage loans	917	602	644
Fundings of mortgage loans and real estate	(1,243)	(1,345)	(1,157)
Funding of CMBS VIE mortgage loan	(750)		
Proceeds from sale of real estate		405	443
Net change in policy loans	(79)	(157)	(186)
Change in restricted cash	48	(20)	(14)
Terminations of derivative instruments, net	9	(35)	188
Proceeds from nonhedging derivative settlements	64	86	129
Payments for nonhedging derivative settlements	(344)	(628)	(688)
Net change in collateral received or pledged	131	(136)	(546)
Purchases of and advance payments on aircraft	(1,068)	(1,143)	(1,388)
Proceeds from sale of aircraft	266	380	284
Other investing activities, net	275	64	(118)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(3,965)</b>	<b>(3,917)</b>	<b>(3,905)</b>

(Continued)

The abbreviation CMBS VIE above means commercial mortgage-backed security VIE.

See Notes to Consolidated Financial Statements



*Pacific Life Insurance Company and Subsidiaries*

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Millions)	Years Ended December 31,		
	2014	2013	2012
(Continued)			
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Policyholder account balances:			
Deposits	\$5,900	\$6,223	\$5,453
Withdrawals	(4,957)	(5,894)	(6,224)
Net change in short-term debt	248	(272)	292
Issuance of long-term debt	147	1,661	1,130
Issuance of CMBS VIE debt	676		
Partial retirement of surplus notes		(478)	
Payments of long-term debt	(532)	(836)	(761)
Dividend to parent	(200)	(200)	(130)
Other financing activities, net	70	(21)	17
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>1,352</b>	<b>183</b>	<b>(223)</b>
Net change in cash and cash equivalents	1,220	(256)	(573)
Cash and cash equivalents, beginning of year	2,000	2,256	2,829
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$3,220</b>	<b>\$2,000</b>	<b>\$2,256</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>			
Income taxes paid (received), net	(\$250)	\$160	\$154
Interest paid	\$324	\$294	\$291

See Notes to Consolidated Financial Statements

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. 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. 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 (OTTI) losses 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 reinsurance transactions
- Litigation and other contingencies

Certain reclassifications have been made to the 2013 and 2012 consolidated financial statements to conform to the 2014 consolidated financial statement presentation.

The Company has evaluated events subsequent to December 31, 2014 through March 6, 2015, the date the consolidated financial statements were available to be issued, and has concluded that no events have occurred that require disclosure or adjustment to the consolidated financial statements.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-02, which modifies the Accounting Standards Codification's (Codification) Comprehensive Income Topic. This ASU requires enhanced reporting of amounts reclassified out of accumulated other comprehensive income (AOCI) either on the face of the consolidated financial statements or in the notes to the consolidated financial statements. Nonpublic entities are required to report the effects of reclassifications on net income for annual reporting periods and to report information about the amounts reclassified out of AOCI by

component for each reporting period for interim and annual reporting periods. The Company adopted this ASU in 2014 and has included the required annual disclosure in Note 13.

Effective January 1, 2013, the Company adopted ASU 2011-11 as modified by ASU 2013-01 issued by the FASB, which modifies the Codification's Balance Sheet Topic. This new guidance clarifies the scope of disclosures about offsetting assets and liabilities and had no impact on the Company's consolidated financial statements.

## 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 other comprehensive income (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 or management has decided to sell the security, 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, 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).

During the third quarter of 2014, the Company elected the fair value option (FVO) method of accounting for a newly acquired portfolio of U.S. Government securities. The Company elected the FVO in order to report the investments at estimated fair value with changes in the estimated fair value of these securities recognized in net realized investment gain (loss). This accounting treatment will provide a partial offset to the impact of interest rate movements.

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, hedge funds, 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). Partnerships, joint venture interests and hedge funds are recorded under the cost or equity method of accounting, except those held by sponsored investment funds (Note 4). As a practical expedient, consolidated investment companies estimate the fair value of interests in the portfolio funds using the net asset value per share as determined by the respective investment manager. The changes in estimated fair value for these assets are recognized in net investment income. 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 recognized in net realized investment gain (loss).

Real estate investments are carried at depreciated cost, net of write-downs, or, for real estate acquired in satisfaction of debt, at estimated fair value at the date of acquisition. 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 is 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 for a hedging relationship 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 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). 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 a hedge, the change in estimated fair value of the derivative is recorded in net realized investment gain (loss).

The periodic cash flows for all derivatives designated as a hedge 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 a hedge, 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 either net investment income, interest credited to policyholder account balances, or operating and other expenses 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 either net investment income, interest credited to policyholder account balances, or operating and other expenses 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.

During reporting periods of negative actual gross profits (AGPs), DAC amortization may be negative, which would result in an increase to the DAC balance. 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, expenses, interest spreads, and mortality margins. The Company's long-term assumption for the underlying separate account investment return ranges from 6.75% to 7.75% depending on the product. 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, NET

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 was \$101 million as of December 31, 2014 and 2013. There were no goodwill impairments recognized during the years ended December 31, 2014, 2013 and 2012.

## 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 ranged from 0.1% to 9.4%.

## FUTURE POLICY BENEFITS

Annuity reserves, which primarily consist of group retirement, structured settlement and immediate 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 0.1% 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 10). All other GLB guarantees are accounted for as embedded derivatives (Note 8).

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 composed of benefit reserves and additional liabilities. Benefit 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. Additional liabilities are held for certain insurance benefit features that have amounts assessed in a manner that is expected to result in profits in earlier years and subsequent losses. The additional liability is valued using a range of scenarios, rather than a single set of best estimate assumptions, which are consistent with assumptions used in estimated gross profits for purposes of amortizing capitalized acquisition costs.

As of December 31, 2014 and 2013, 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. The Company may also identify and implement actuarial modeling refinements to projection models that may result in increases and decreases to the liability for future policy benefits. 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.

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. Amounts receivable and payable to reinsurers are offset for account settlement purposes for contracts where the right of offset exists, with net reinsurance receivables included in other assets and net reinsurance payables included in other liabilities. Reinsurance receivables and payables may include balances due from reinsurance companies for paid and unpaid losses.

## 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 and other funds. Effective January 2015, the Pacific Life Funds changed its name to Pacific Funds Series Trust. 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 are generally accounted for as operating leases and are structured as triple net leases whereby the lessee is responsible for maintaining the aircraft and paying operational, maintenance and insurance expenses. The aircraft leases require payment in U.S. dollars. Aircraft leasing revenue is recognized ratably over the term of the lease agreements. Aviation Capital Group Corp. (ACG) has three capital leases in the amount of \$50 million as of December 31, 2014, which are included in other assets. ACG is a wholly owned subsidiary of Pacific Life engaged in the acquisition and leasing of commercial aircraft.

## 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 and the combined California franchise tax return of PMHC and are allocated tax expense or benefit based principally on the effect of including their operations in these returns under a tax sharing agreement. Certain of the Company's non-insurance subsidiaries also file separate state tax returns, if necessary. Generally, a life insurance company cannot be treated as an includable corporation in a consolidated return with nonlife companies unless it has been a member of the affiliated group for five taxable years. For this reason, the Company's life insurance companies meeting this criterion file separate Federal income tax returns. Some of the Company's non-U.S. subsidiaries are subject to tax in Singapore and other jurisdictions. 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. The Company does not record gain contingencies.

## 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 zero and \$64 million as of December 31, 2014 and 2013, 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 used 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.

Pacific Life had no permitted practices as of December 31, 2014. During 2014, Pacific Life had two permitted practices approved by the Director of the NE DOI. Under the first permitted practice, Pacific Life utilized book value accounting for certain guaranteed separate account funding agreements. The underlying separate account assets were 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). During 2014, the outstanding separate account funding agreements were called and the related separate accounts were closed, which terminated the permitted practice as of June 30, 2014. The second permitted practice was transitional in nature and ran for the period beginning January 1, 2014 through December 30, 2014. This permitted practice allowed Pacific Life time to bring its Working Capital Finance Programs (WCFP) into full compliance with Statement of Statutory Accounting Principles (SSAP) No. 105, *Working Capital Finance Investments* (WCFI). As of December 31, 2014, all of Pacific Life's WCFP are in full compliance with SSAP No. 105. As of December 31, 2013, a prior permitted practice relating to WCFI expired on January 1, 2014 with the issuance of SSAP No. 105.

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 \$61 million and \$54 million as of December 31, 2014 and 2013, 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, 2014 and 2013, the reserve for synthetic GICs using the NAIC SAP basis was zero.



## STATUTORY NET INCOME AND SURPLUS

Statutory net income of Pacific Life was \$635 million, \$521 million and \$962 million for the years ended December 31, 2014, 2013 and 2012, respectively. Statutory capital and surplus of Pacific Life was \$7,172 million and \$6,503 million as of December 31, 2014 and 2013, respectively.

## AFFILIATED REINSURANCE

Pacific Life cedes certain statutory reserves to affiliated special purpose financial insurance companies and affiliated captive reinsurance companies that are supported by a combination of cash, invested and other assets and third-party letters of credit or note facilities. As of December 31, 2014, Pacific Life's total statutory reserve credit was \$1,702 million, of which \$1,160 million was supported by third-party letters of credit and note facilities. As of December 31, 2013, Pacific Life's total statutory reserve credit was \$1,570 million, of which \$1,051 million was supported by third-party letters of credit and note facilities, as described below.

Pacific Life utilizes affiliated reinsurers to mitigate the statutory capital impact of NAIC Model Regulation "Valuation of Life Insurance Policies" (Regulation XXX) and NAIC Actuarial Guideline 38 on the Company's UL products with flexible duration no lapse guarantee rider (FDNLGR) benefits. Pacific Alliance Reinsurance Company of Vermont (PAR Vermont) and Pacific Baileine Reinsurance Company (PBRC) are Vermont based special purpose financial insurance companies subject to regulatory supervision by the Vermont Department of Financial Regulation (Vermont Department). PAR Vermont and PBRC are wholly owned subsidiaries of Pacific Life and accredited authorized reinsurers in Nebraska. PAR Vermont was formed in 2007 and PBRC was formed in August 2013. Pacific Life cedes certain level term life insurance to PBRC and FDNLGR benefits to PAR Vermont and PBRC. In 2011, Pacific Life entered into an excess of loss indemnity reinsurance agreement with Pacific Alliance Excess Reinsurance Company (PAX Re), a pure captive insurance company subject to regulatory supervision by the Vermont Department and wholly owned by Pacific LifeCorp. Reinsurance ceded to PAR Vermont is net of the reinsurance ceded to PAX Re. Pacific Life does not receive statutory reserve credit for reinsurance ceded to PAX Re. Economic reserves, as defined in the PAR Vermont and PBRC reinsurance agreements, are supported by cash and invested and other assets, including funds withheld at Pacific Life.

Reserves in excess of the economic reserves held at PAR Vermont are supported by a letter of credit agreement provided by a highly rated bank, which has a maximum commitment amount of \$843 million and a 20 year term expiring October 2031. The letter of credit agreement is non-recourse to Pacific LifeCorp or any of its affiliates, other than PAR Vermont. The letter of credit has been approved as an admissible asset by the Vermont Department for PAR Vermont statutory accounting. As of December 31, 2014, the letter of credit amounted to \$623 million and was held in a trust with Pacific Life as beneficiary. PAR Vermont admitted \$619 million and \$556 million as an asset in its statutory financial statements as of December 31, 2014 and 2013, respectively.

Reserves in excess of the economic reserves held at PBRC are supported by a note facility with a maximum commitment amount of \$400 million. This facility is non-recourse to Pacific Life or any of its affiliates, other than PBRC. Through this facility, PBRC issued a surplus note with a maturity date of December 2043 and received a note receivable in return with a maturity date of December 2038. The note receivable is credit enhanced by a highly rated third-party reinsurer for 20 years with a five year extension. The note receivable has been approved as an admissible asset by the Vermont Department for PBRC statutory accounting. As of December 31, 2014 and 2013, the note receivable amounted to \$111 million and \$100 million, respectively, and was held in a trust with Pacific Life as beneficiary. PBRC admitted \$111 million and \$65 million as an asset in its statutory financial statements as of December 31, 2014 and 2013, respectively.

Pacific Life has reinsurance agreements with Pacific Life Reinsurance (Barbados) Ltd. (PLRB), an exempt life reinsurance company domiciled in Barbados and wholly owned by Pacific LifeCorp. The underlying reinsurance is comprised of coinsurance and YRT treaties. Pacific Life retroceded the majority of the underlying YRT U.S. treaties on a 100% coinsurance with funds withheld basis to PLRB (PLRB Agreement). The PLRB Agreement is accounted for under deposit accounting for U.S. GAAP and as reinsurance under statutory accounting principles. The statutory accounting reserve credit is supported by cash, funds withheld at Pacific Life and a \$430 million letter of credit issued to PLRB by highly rated third-party banks for the benefit of Pacific Life. In connection with the acquisition and reinsurance arrangements between Pacific Life and PLRB, Pacific LifeCorp entered into a capital maintenance agreement and has also agreed to honor PLRB's obligations to the letter of credit provider in the event of default.

In 2012, the Company formed Pacific Annuity Reinsurance Company (PARC), a captive reinsurance company subject to regulatory supervision by the Arizona Department of Insurance. 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 ceded 5% of its inforce variable annuity business to PARC, after third-party reinsurance, and ceded 5% of new business issued thereafter. PARC is a wholly owned subsidiary of Pacific LifeCorp.

## 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, 2014 and 2013, Pacific Life, Pacific Life & Annuity Company (PL&A), an Arizona domiciled life insurance company, PAR Vermont, and PBRC all exceeded the minimum risk-based capital requirements.

## 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 2014 statutory results, Pacific Life could pay \$668 million in dividends in 2015 to Pacific LifeCorp without prior approval from the NE DOI, subject to the notification requirement. During the years ended December 31, 2014, 2013 and 2012, Pacific Life paid dividends as determined on an NAIC SAP basis to Pacific LifeCorp of \$200 million, \$200 million and \$133 million, respectively.

The payment of dividends by PL&A to Pacific Life is subject to restrictions set forth in the State of Arizona insurance laws. These laws, which were revised in July 2014, require (i) notification to the Arizona Department of Insurance (AZ DOI) for the declaration and payment of any dividend and (ii) approval by the AZ DOI for accumulated dividends within the preceding twelve months that exceed the lesser of 10% of statutory surplus as regards to policyholders as of the preceding December 31 or statutory net gain from operations for the preceding twelve months ended December 31. Based on this limitation and 2014 statutory results, PL&A could pay \$38 million in dividends to Pacific Life in 2015 without prior regulatory approval. During the years ended December 31, 2014 and 2013, PL&A paid a dividend to Pacific Life of \$35 million each year. No dividends were paid during 2012.

## 3. CLOSED BLOCK

In connection with the Company's conversion to a mutual holding company structure, an arrangement known as a closed block (the Closed Block) was created for the exclusive benefit of certain individual life insurance policies that had an experience based dividend scale in 1997. The Closed Block was designed to give reasonable assurance to holders of the Closed Block policies that policy dividends would not change.

Assets that support the Closed Block, which are primarily included in fixed maturity securities and policy loans, amounted to \$265 million and \$271 million as of December 31, 2014 and 2013, respectively. Liabilities allocated to the Closed Block, which are primarily included in future policy benefits, amounted to \$269 million and \$284 million as of December 31, 2014 and 2013, respectively. The net contribution to income from the Closed Block was \$3 million, zero and \$2 million for the years ended December 31, 2014, 2013 and 2012, 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, 2014 and 2013, (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*):

	Consolidated VIEs			Non-consolidated VIEs	
	Consolidated Assets	Consolidated Liabilities	Maximum Exposure to Loss	Net Carrying Amount	Maximum Exposure to Loss
<u>December 31, 2014:</u>					
Aircraft securitizations	\$1,022	\$602	\$438		
Sponsored investment funds	125	2	123		
Commercial mortgage-backed securities	750	676	74		
Other				\$101	\$101
Asset-backed securities				54	54
Total	<u>\$1,897</u>	<u>\$1,280</u>	<u>\$635</u>	<u>\$155</u>	<u>\$155</u>
<u>December 31, 2013:</u>					
Aircraft securitizations	\$1,614	\$939	\$698		
Sponsored investment funds	89		89		
Other				\$88	\$88
Asset-backed securities				67	67
Total	<u>\$1,703</u>	<u>\$939</u>	<u>\$787</u>	<u>\$155</u>	<u>\$155</u>

#### AIRCRAFT SECURITIZATIONS

During each of the years 2000, 2003 and 2005, ACG sponsored one financial asset securitization secured by aircraft. Each of these transactions was classified as a VIE as the total equity investment at risk was insufficient to finance its activities without additional subordinated support. ACG receives ongoing compensation for its role as the remarketing and administrative agent and for various aircraft-related services.

During 2014, all of the outstanding debt associated with the securitization sponsored in 2003 was retired. Absent the cash flow requirements associated with the debt, the total equity at risk is sufficient to finance the activities of the 2003 securitization and it no longer qualifies as a VIE. However, the Company consolidates the assets and liabilities of the 2003 securitization, which remained in a wholly owned subsidiary of ACG.

The 2000 and 2005 securitization transactions continue to individually meet the definition of a VIE. ACG is the primary beneficiary of the 2005 securitization because it owns 100% of the equity and has a controlling financial interest in this VIE. As such, the 2005 securitization is included in the consolidated financial statements of the Company. Non-recourse debt consolidated by the Company was \$401 million and \$659 million as of December 31, 2014 and 2013, respectively (Note 11). The Company does not consolidate the 2000 securitization because ACG is not the primary beneficiary. As of December 31, 2014 and 2013, the Company's carrying amount of the 2000 securitization was zero and thus its maximum exposure to loss was zero.

#### SPONSORED INVESTMENT FUNDS

The Company has undertaken an initiative leveraging internal expertise to bring new investment strategies/products to sophisticated institutional investors and qualified institutional buyers. Structured as limited partnerships, the Company has provided the initial cash and noncash investments to "seed" these products for the purpose of refining the investment strategies and developing a performance history. Based on the design and operation of the limited partnership arrangements, the Company concluded that these legal entities are subject to consolidation under the variable interest rules and that the Company is the primary beneficiary. It is anticipated that the Company will continue to maintain a controlling interest in some, but not all, of the limited partnerships. The Company will reevaluate its standing as the primary beneficiary on a quarterly basis. Short-term non-recourse debt consolidated by the Company was \$2 million as of December 31, 2014 (Note 11). The Company's unfunded commitment to the limited partnerships was \$119 million and \$94 million as of December 31, 2014 and 2013, respectively.

## COMMERCIAL MORTGAGE-BACKED SECURITY

In August 2014, Pacific Life purchased a 10% interest in a commercial mortgage-backed security trust secured by a single commercial real estate property (CMBS VIE). The trust is classified as a VIE as the total equity investment at risk was insufficient to permit the entity to finance its activities without additional subordinated support. The Company has determined that it is the primary beneficiary of the VIE due to the significant control over the collateral the Company has in the event of a default and has consolidated the VIE into the consolidated financial statements of the Company. Non-recourse debt consolidated by the Company was \$676 million as of December 31, 2014 (Note 11). The Company's maximum exposure to loss is equal to the carrying amount of its beneficial interest in the VIE of \$74 million as of December 31, 2014.

## OTHER

Other consists primarily of limited partnerships (the Funds) which invest in private equity investments. Prior to June 30, 2013, the Company consolidated the Funds as the primary beneficiary since it held a controlling financial interest in the Funds. As of June 30, 2013, the Company determined itself not to be the primary beneficiary since it no longer held a controlling financial interest in the Funds. As such, the Funds were no longer included in the consolidated financial statements on a prospective basis. No gain or loss was recognized on the deconsolidation of the Funds as the underlying assets were carried at fair value. After the deconsolidation the Company's investment in the Funds is accounted for under the equity method and reported in other investments. 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 interests. As of December 31, 2014 and 2013, the maximum exposure to loss for the retained interest was \$65 million and \$61 million, respectively, and the Company's unfunded commitment to the Funds was \$53 million and \$63 million, respectively. In addition, as of December 31, 2014, the Company had an unfunded commitment related to another investment of \$11 million.

## 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 most significant 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. The Company's maximum exposure to loss is limited to the amount of its carrying value. See Note 6 for the carrying amount and estimated fair value of the structured security investments. The Company's carrying value of limited partnerships was \$727 million and \$796 million as of December 31, 2014 and 2013, respectively. The Company's unfunded commitment to the limited partnerships was \$362 million and \$333 million as of December 31, 2014 and 2013, respectively.

## 5. DEFERRED POLICY ACQUISITION COSTS

Components of DAC are as follows:

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Balance, January 1	\$4,214	\$4,329	\$4,264
Additions:			
Capitalized during the year	608	621	486
Amortization:			
Allocated to commission expenses	15	(955)	(261)
Allocated to operating expenses	(1)	(18)	(26)
Total amortization	14	(973)	(287)
Allocated to OCI	(94)	237	(134)
Balance, December 31	\$4,742	\$4,214	\$4,329

During the years ended December 31, 2014, 2013 and 2012, the Company revised certain assumptions to develop EGPs for its products subject to DAC amortization. This resulted in decreases in DAC amortization expense of \$39 million, \$43 million and \$42 million for the years ended December 31, 2014, 2013 and 2012, respectively. The revised EGPs also resulted in decreased URR amortization of \$128 million, \$6 million and \$25 million for the years ended December 31, 2014, 2013 and 2012, respectively.

The capitalized sales inducement balance included in the DAC asset was \$667 million and \$597 million as of December 31, 2014 and 2013, respectively.

## 6. 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 12 for information on the Company's estimated fair value measurements and disclosure.

	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
<i>(In Millions)</i>				
<u>December 31, 2014:</u>				
U.S. Government	\$47	\$9		\$56
Obligations of states and political subdivisions	853	164		1,017
Foreign governments	591	70	\$2	659
Corporate securities	27,275	2,592	148	29,719
RMBS	2,597	150	43	2,704
CMBS	626	32	1	657
Collateralized debt obligations	54	16		70
Other asset-backed securities	717	64	1	780
Total fixed maturity securities	<u>\$32,760</u>	<u>\$3,097</u>	<u>\$195</u>	<u>\$35,662</u>
Perpetual preferred securities	\$127	\$7	\$9	\$125
Other equity securities	1	5		6
Total equity securities	<u>\$128</u>	<u>\$12</u>	<u>\$9</u>	<u>\$131</u>

	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
<i>(In Millions)</i>				
<u>December 31, 2013:</u>				
U.S. Government	\$79	\$5	\$1	\$83
Obligations of states and political subdivisions	854	63	18	899
Foreign governments	672	48	12	708
Corporate securities	24,603	1,692	425	25,870
RMBS	3,311	166	72	3,405
CMBS	733	20	18	735
Collateralized debt obligations	68	15		83
Other asset-backed securities	624	61	2	683
Total fixed maturity securities	<u>\$30,944</u>	<u>\$2,070</u>	<u>\$548</u>	<u>\$32,466</u>
Perpetual preferred securities	\$130	\$17	\$15	\$132
Other equity securities		5		5
Total equity securities	<u>\$130</u>	<u>\$22</u>	<u>\$15</u>	<u>\$137</u>

The Company has investments in perpetual preferred securities that are issued primarily by European financial institutions. The net carrying amount and estimated fair value of the available for sale perpetual preferred securities was \$241 million and \$242 million, respectively, as of December 31, 2014. Included in these amounts are perpetual preferred securities carried in trusts with a net carrying amount and estimated fair value of \$114 million and \$117 million, respectively, that are held in fixed maturity securities available for sale and included in the tables above in corporate securities.

The net carrying amount and estimated fair value of fixed maturity securities available for sale as of December 31, 2014, 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		Estimated Fair Value
		Gains	Losses	
	<i>(In Millions)</i>			
Due in one year or less	\$910	\$30	\$1	\$939
Due after one year through five years	6,192	584	29	6,747
Due after five years through ten years	12,280	676	87	12,869
Due after ten years	9,384	1,545	33	10,896
	28,766	2,835	150	31,451
Mortgage-backed and asset-backed securities	3,994	262	45	4,211
Total fixed maturity securities	\$32,760	\$3,097	\$195	\$35,662

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	Gross	
		Estimated Fair Value	Unrealized Losses
		<i>(In Millions)</i>	
<u>December 31, 2014:</u>			
Foreign governments	3	\$18	\$2
Corporate securities	412	3,493	148
RMBS	80	630	43
CMBS	10	91	1
Other asset-backed securities	12	60	1
Total fixed maturity securities	517	4,292	195
Perpetual preferred securities	4	36	9
Other investments	2	14	1
Total other investments	6	50	10
Total	523	\$4,342	\$205

	Less than 12 Months			12 Months or Greater		
	Number	Gross		Number	Gross	
		Estimated Fair Value	Unrealized Losses		Estimated Fair Value	Unrealized Losses
		<i>(In Millions)</i>			<i>(In Millions)</i>	
<u>December 31, 2014:</u>						
Foreign governments				3	\$18	\$2
Corporate securities	229	\$1,512	\$55	183	1,981	93
RMBS	26	193	3	54	437	40
CMBS				10	91	1
Other asset-backed securities				12	60	1
Total fixed maturity securities	255	1,705	58	262	2,587	137
Perpetual preferred securities				4	36	9
Other investments	2	14	1			
Total other investments	2	14	1	4	36	9
Total	257	\$1,719	\$59	266	\$2,623	\$146



	Total		
		Estimated	Gross Unrealized
	Number	Fair Value	Losses
		(In Millions)	
<u>December 31, 2013:</u>			
U.S. Government	2	\$31	\$1
Obligations of states and political subdivisions	14	184	18
Foreign governments	20	171	12
Corporate securities	733	7,308	425
RMBS	141	1,109	72
CMBS	29	405	18
Other asset-backed securities	23	122	2
Total fixed maturity securities	962	9,330	548
Perpetual preferred securities	5	39	15
Other investments	5	11	1
Total other investments	10	50	16
Total	972	\$9,380	\$564

	Less than 12 Months			12 Months or Greater		
		Gross			Gross	
	Estimated	Unrealized		Estimated	Unrealized	
Number	Fair Value	Losses		Number	Fair Value	Losses
	(In Millions)			(In Millions)		
<u>December 31, 2013:</u>						
U.S. Government	2	\$31	\$1			
Obligations of states and political subdivisions	13	158	13	1	\$26	\$5
Foreign governments	19	147	11	1	24	1
Corporate securities	656	6,567	343	77	741	82
RMBS	72	462	8	69	647	64
CMBS	25	377	15	4	28	3
Other asset-backed securities	23	122	2			
Total fixed maturity securities	810	7,864	393	152	1,466	155
Perpetual preferred securities				5	39	15
Other investments				5	11	1
Total other investments	-	-	-	10	50	16
Total	810	\$7,864	\$393	162	\$1,516	\$171

The Company has evaluated fixed maturity securities available for sale 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, 2014.

Rating	Net	Estimated Fair Value	Rating as % of	Vintage Breakdown				
	Carrying Amount		Net Carrying Amount	2004 and Prior	2005	2006	2007	2008 and Thereafter
	(\$ In Millions)							
Prime RMBS:								
AAA	\$50	\$50	4%					4%
AA	11	11	1%	1%				
A	35	36	2%	2%				
BAA	140	148	10%	8%	2%			
BA and below	1,143	1,166	83%	16%	38%	24%	5%	
Total	\$1,379	\$1,411	100%	27%	40%	24%	5%	4%
Alt-A RMBS:								
AAA	\$2	\$2	1%	1%				
AA	28	29	6%	5%	1%			
A	2	2	1%		1%			
BAA	52	55	12%	7%	5%			
BA and below	351	333	80%	13%	15%	22%	30%	
Total	\$435	\$421	100%	26%	22%	22%	30%	0%
Sub-prime RMBS:								
AAA	\$14	\$14	7%	7%				
BAA	23	23	11%	11%				
BA and below	171	169	82%	72%	9%	1%		
Total	\$208	\$206	100%	90%	9%	1%	0%	0%
CMBS:								
AAA	\$89	\$94	14%	3%				11%
AA	158	172	25%	8%				17%
A	232	238	37%					37%
BA and below	147	153	24%					24%
Total	\$626	\$657	100%	11%	0%	0%	0%	89%

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, 2014, no assets are pledged as collateral. As of December 31, 2014, the Company holds FHLB of Topeka stock with an estimated fair value of \$1 million and is recorded in other investments.

PL&A is a member of FHLB of San Francisco. As of December 31, 2014, no assets are pledged as collateral. As of December 31, 2014, PL&A holds FHLB of San Francisco stock with an estimated fair value of \$5 million and is recorded in other investments.

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Fixed maturity securities	\$1,629	\$1,550	\$1,506
Equity securities	5	27	12
Mortgage loans	451	434	437
Real estate	102	120	129
Policy loans	202	201	204
Partnerships and joint ventures	165	137	164
Other	21	10	11
Gross investment income	2,575	2,479	2,463
Investment expense	167	189	182
Net investment income	\$2,408	\$2,290	\$2,281

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Fixed maturity securities:			
Gross gains on sales	\$47	\$70	\$161
Gross losses on sales	(14)	(7)	(8)
Total fixed maturity securities	33	63	153
Equity securities:			
Gross gains on sales	7	34	12
Gross losses on sales			(4)
Total equity securities	7	34	8
FVO securities and trading securities	69	2	12
Real estate	(1)	77	147
Variable annuity GLB embedded derivatives	(706)	1,144	119
Variable annuity GLB policy fees	199	195	229
Variable annuity derivatives - total return swaps	(96)	(469)	(588)
Variable annuity derivatives - futures	(96)	(43)	
Fixed indexed annuity embedded derivatives	(27)	(13)	(16)
Fixed indexed annuity derivatives - futures	21		
Equity put options	(32)	(359)	(427)
Synthetic GIC policy fees	44	42	42
Foreign currency and interest rate swaps	26	(96)	81
Forward starting interest rate swaps			(79)
Indexed universal life embedded derivatives	(136)	(153)	(21)
Indexed universal life derivatives - call options	126	154	31
Other	(28)	8	(40)
Total	(\$597)	\$586	(\$349)

The tables below summarize the OTTI by investment type:

	Recognized in Earnings	Included in OCI	Total
<u>Year ended December 31, 2014:</u>			
	<i>(In Millions)</i>		
Corporate securities <sup>(1)</sup>	\$2		\$2
RMBS	5	\$4	9
Perpetual preferred securities	2		2
OTTI - fixed maturity and equity securities	9	4	13
Mortgage loans	14		14
Real estate	1		1
Total OTTI	\$24	\$4	\$28

<u>Year ended December 31, 2013:</u>			
Corporate securities	\$11		\$11
RMBS	7	\$6	13
OTTI - fixed maturity securities	18	6	24
Real estate	9		9
Total OTTI	\$27	\$6	\$33

<u>Year ended December 31, 2012:</u>			
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

<sup>(1)</sup> Represents OTTI recorded 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,	
	2014	2013
	<i>(In Millions)</i>	
Cumulative credit loss, January 1	\$217	\$240
Additions for credit impairments recognized on:		
Securities previously other than temporarily impaired	4	5
Securities not previously other than temporarily impaired	1	2
Total additions	5	7
Reductions for credit impairments previously recognized on:		
Securities due to an increase in expected cash flows and time value of cash flows	(5)	(5)
Securities sold	(29)	(25)
Total subtractions	(34)	(30)
Cumulative credit loss, December 31	\$188	\$217

The tables below present 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	Non-OTTI	
	Investments	Investments	Total
	(In Millions)		
<u>December 31, 2014:</u>			
Foreign governments		\$2	\$2
Corporate securities		148	148
RMBS	\$34	9	43
CMBS		1	1
Other asset-backed securities		1	1
Total fixed maturity securities	\$34	\$161	\$195
Perpetual preferred securities		\$9	\$9
Total equity securities	-	\$9	\$9
<u>December 31, 2013:</u>			
U.S. Government		\$1	\$1
Obligations of states and political subdivisions		18	18
Foreign governments		12	12
Corporate securities		425	425
RMBS	\$53	19	72
CMBS		18	18
Other asset-backed securities		2	2
Total fixed maturity securities	\$53	\$495	\$548
Perpetual preferred securities		\$15	\$15
Total equity securities	-	\$15	\$15

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Available for sale securities:			
Fixed maturity	\$1,380	(\$1,897)	\$1,434
Equity	(4)	11	52
Total available for sale securities	\$1,376	(\$1,886)	\$1,486

Trading securities, included in other investments, totaled \$224 million and \$188 million as of December 31, 2014 and 2013, respectively. The cumulative net unrealized gains on trading securities held as of December 31, 2014 and 2013 were \$14 million and \$13 million, respectively. Net unrealized gains recognized in net realized investment gain (loss) on trading securities still held at the reporting date were \$1 million, \$2 million and \$6 million as of December 31, 2014, 2013 and 2012, respectively.

The change in estimated fair value of FVO securities is recorded in net realized investment gain (loss) and was \$66 million for the year ended December 31, 2014. Interest income earned from FVO securities is recorded in net investment income and was \$8 million for the year ended December 31, 2014.

As of December 31, 2014 and 2013, fixed maturity securities of \$12 million were on deposit with state insurance departments to satisfy regulatory requirements.

Mortgage loans totaled \$9,327 million and \$8,454 million as of December 31, 2014 and 2013, respectively. Mortgage loans are collateralized by commercial properties primarily located throughout the U.S. As of December 31, 2014, \$1,692 million, \$1,575 million, \$1,367 million, \$1,133 million and \$1,092 million were located in New York, California, Washington, District of Columbia, and Texas, respectively. Included in the December 31, 2014 amount for New York is \$750 million consolidated from the CMBS VIE (Note 4). As of December 31, 2014, \$351 million and \$209 million were located in Canada and the United Kingdom (UK), respectively. The Company did not have any mortgage loans with accrued interest more than 180 days past due as of December 31, 2014 or 2013. As of December 31, 2014, 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 a No Concern category or one of three levels: Level 1 Minimal Credit Concern, Level 2 Moderate Credit Concern and Level 3 Significant Credit Concern. Loans in No Concern 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.

Level 1 loans are experiencing negative market pressure and outlook due to economic factors. Financial covenants may have been triggered due to declines in performance. Credit profile and/or borrower sponsorship remain stable but require monitoring. Near term (6 months or less) maturity requires monitoring due to negative trends. No impairment loss concerns exist under current conditions, however some possibility of loss may exist under stressed scenarios or changes in sponsorship financial strength.

Level 2 loans are experiencing significant or prolonged negative market pressure and uncertain outlook due to economic factors; financial covenants may have been triggered due to declines in performance and/or borrower may have requested covenant relief. Loan credit profile, borrower sponsorship and/or collateral value may have declined or give cause for concern. Near term maturity (12 months or less) coupled with negative market conditions, property performance and value and/or borrower stability result in increased refinance risk.

Level 3 loans are experiencing prolonged and/or severe negative market trends, declines in collateral performance and value, and/or borrower financial difficulties exist. Borrower may have asked for modification of loan terms. Without additional capital infusion and/or acceptable modification to existing loan terms, default is likely and foreclosure the probable alternative. Impairment loss is possible depending on current fair market value of the collateral. This category includes loans in default and previously impaired restructured loans that underperform despite modified terms and /or for which future loss is probable.

Loans classified as Level 2 or Level 3 are placed on a watch list and monitored weekly. Loans that have been identified as Level 3 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. See Note 12.

As of December 31, 2014, there were six loans with a book value of \$62 million that were considered impaired. As the estimated fair value of the collateral on three of these loans was lower than their carrying amount, an impairment loss of \$18 million was recorded. No impairment loss was recorded on the other three loans since the estimated fair value of the collateral was higher than their carrying amount. Separately, one loan totaling \$40 million was returned to the Company through a deed in lieu of foreclosure process and became a real estate property investment.

As of December 31, 2013, there were two loans with a book value of \$6 million that were considered impaired. As the estimated fair value of the collateral on these loans was higher than their carrying amount, no impairment loss was recorded.

The following tables set forth mortgage loan credit levels as of December 31, 2014 and 2013 (\$ In Millions):

December 31, 2014										
Property Type	<u>No Credit Concern</u>		<u>Level 1</u> <u>Minimal Credit Concern</u>		<u>Level 2</u> <u>Moderate Credit Concern</u>		<u>Level 3</u> <u>Significant Credit Concern</u>		<u>Total</u>	
	Weighted		Weighted		Weighted		Weighted		Weighted	
	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average
	Amount	DCR	Amount	DCR	Amount	DCR	Amount	DCR	Amount	DCR
Apartment	\$573	1.67	\$164	1.07	\$46	0.95			\$783	1.50
Golf course	11	2.45	158	1.03	19	1.41	\$1	1.04	189	1.15
Hotel/Lodging	905	1.96							905	1.96
Industrial							18	0.95	18	0.95
Mobile home park	117	2.29							117	2.29
Office	3,869	2.09					25	0.05	3,894	2.08
Office - VIE	750	3.11							750	3.11
Resort	479	3.24							479	3.24
Retail	1,168	1.89							1,168	1.89
Construction	1,024								1,024	
Total										
mortgage loans	\$8,896	2.19	\$322	1.05	\$65	1.08	\$44	0.44	\$9,327	2.12

December 31, 2013										
Property Type	<u>No Credit Concern</u>		<u>Level 1</u> <u>Minimal Credit Concern</u>		<u>Level 2</u> <u>Moderate Credit Concern</u>		<u>Level 3</u> <u>Significant Credit Concern</u>		<u>Total</u>	
	Weighted		Weighted		Weighted		Weighted		Weighted	
	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average
	Amount	DCR	Amount	DCR	Amount	DCR	Amount	DCR	Amount	DCR
Apartment	\$530	1.51	\$230	1.24	\$86	0.81			\$846	1.37
Golf course	152	1.46	61	0.95	3	1.32			216	1.31
Hotel/Lodging	694	1.81							694	1.81
Industrial	95	2.01	21	0.81					116	1.79
Mobile home park	103	2.17							103	2.17
Office	3,913	2.04	77	1.12	37	(0.14)			4,027	2.00
Resort	786	2.72							786	2.72
Retail	992	2.10							992	2.10
Construction	674								674	
Total										
mortgage loans	\$7,939	2.05	\$389	1.15	\$126	0.55			\$8,454	1.98

Real estate investments totaled \$329 million and \$227 million as of December 31, 2014 and 2013, respectively. As of December 31, 2014, there were four properties with a book value prior to measurement of \$10 million that were considered impaired and an impairment loss of \$1 million was recognized as the fair value of these properties was lower than their carrying value. As of December 31, 2013, there were four properties with a book value prior to measurement of \$20 million that were considered impaired and an impairment loss of \$9 million was recognized as the fair value of these properties was lower than their carrying value. See Note 12. The Company had no real estate investment impairments during the year ended December 31, 2012.

## 7. AIRCRAFT, NET

Aircraft, net, consisted of the following:

	December 31,	
	2014	2013
	<i>(In Millions)</i>	
Aircraft	\$8,453	\$6,857
Aircraft consolidated from VIEs	1,307	2,227
	9,760	9,084
Accumulated depreciation	1,943	1,788
Aircraft, net	\$7,817	\$7,296

Included in the table below are six 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 \$27 million, \$22 million and \$15 million for the years ended December 31, 2014, 2013 and 2012, respectively. These aircraft were sold to third-parties and subsequently leased back with lease maturity dates of 2023 through 2025. See Note 18 for the future lease commitments and minimum rentals to be received related to these sale leaseback transactions.

As of December 31, 2014, domestic and foreign future minimum rentals scheduled to be received under the noncancelable portion of leases are as follows *(In Millions)*:

	2015	2016	2017	2018	2019	Thereafter
Domestic	\$116	\$112	\$100	\$92	\$90	\$350
Foreign	653	596	530	467	380	947
Total leases	\$769	\$708	\$630	\$559	\$470	\$1,297

As of December 31, 2014 and 2013, aircraft with a carrying amount of \$3,462 million and \$4,103 million, respectively, were assigned as collateral to debt (Notes 4 and 11).

During the years ended December 31, 2014, 2013 and 2012, ACG recognized aircraft impairments of \$37 million, \$28 million and \$16 million, respectively, which are included in operating and other expenses. See Note 12.

The Company had nine and five aircraft not subject to a signed lease or sales commitment in the portfolio as of December 31, 2014 and 2013, respectively.

During the years ended December 31, 2014, 2013 and 2012, ACG recognized pre-tax gains on the sale of aircraft of \$8 million, \$7 million and \$12 million, respectively, which are included in other income. Aircraft held for sale totaled \$65 million and \$94 million as of December 31, 2014 and 2013, respectively, and are included in aircraft, net.

See Note 18 for future aircraft purchase commitments.

## 8. 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, futures 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 statements 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.

#### DERIVATIVES NOT DESIGNATED AS HEDGING

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.

GLBs on variable annuity contracts issued between January 1, 2007 and March 31, 2009 are partially reinsured by third party reinsurers. 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. The Company also reinsures certain variable annuity contracts with guaranteed minimum benefits to an affiliated reinsurer.

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 based upon the S&P 500 Index (S&P 500) and the EAFE (Europe, Australia, Asia, and Far East) Index and exchange-traded equity futures 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 return of the S&P 500 and EAFE indices in the form of a payment or receipt, depending on whether the return relative to the index on trade date is positive or negative. In exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the values of which are determined by the different classes of equity securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market value of those contracts. The Company enters into exchange-traded futures with regulated futures commission merchants that are members of the exchange. The Company also utilizes interest rate swaps to manage interest rate risk in variable annuity GLBs.

The Company offers a fixed indexed annuity product where interest is credited to the policyholder's account balance based on equity index changes. A policyholder may allocate the contract's net accumulated value to one or a combination of the following: fixed return account at a guaranteed interest rate to be no less than 1% for a specified period of time, one or two year S&P 500 indexed account with caps, or one or two year global index account with caps. The indexed products contain embedded derivatives. The Company utilizes exchange-traded equity futures to economically hedge the credit paid to the policyholder on the underlying equity index.

The Company also uses equity put options to hedge equity and credit risks. These equity put options involve the exchange of either an upfront payment or periodic fixed rate payments for the return, at the end of the option agreement, of the equity index below a specified strike price.

The Company issues synthetic GICs to Employee Retirement Income Security Act of 1974 (ERISA) qualified defined contribution employee benefit plans (ERISA Plan) that are considered embedded derivatives. 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. 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 or floating 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 economically hedges are the Euro, British Pound, Canadian Dollar, Japanese Yen, and Singapore Dollar.

Interest rate swaps are used by the Company 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.

The Company offers indexed universal life (IUL) 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 9% to 12%, one year global indexed account currently capped at 12%, two year S&P 500 indexed account currently capped at 32%, or five year S&P 500 indexed account. The indexed products contain embedded derivatives.

The Company utilizes call options (IUL derivatives) to hedge the credit paid to the policy on the underlying index for its IUL insurance products. These options are contracts to buy the index at a predetermined time at a contracted price. The contracts are 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 are recognized in net realized investment gain (loss).

The Company had the following outstanding derivatives not designated as a hedge:

	Notional Amount	
	December 31,	
	2014	2013
	<i>(In Millions)</i>	
Variable annuity GLB embedded derivatives	\$33,717	\$35,920
Variable annuity derivatives - total return swaps	1,445	1,471
Variable annuity derivatives - futures	758	416
Variable annuity derivatives - interest rate swaps	135	132
Fixed indexed annuity embedded derivatives	1,622	1,071
Fixed indexed annuity derivatives - futures	152	
Equity put options		2,889
Synthetic GICs	21,587	21,698
Foreign currency and interest rate swaps	2,721	3,254
IUL embedded derivatives	2,421	1,675
IUL derivatives	2,519	1,617
Other	345	330

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. Notional amounts for variable annuity GLB embedded derivatives represent deposits into variable annuity contracts covered by embedded derivative riders as a measurement of volume. 13.1% and 13.0% of these notional amounts are reinsured by third-party reinsurers as of December 31, 2014 and 2013, respectively. 4.1% of these notional amounts are reinsured by an affiliated reinsurer as of December 31, 2014 and 2013.

The following table summarizes amounts recognized in net realized investment gain (loss) for derivatives not designated as a hedge. 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 \$288 million, \$554 million and \$680 million for the years ended December 31, 2014, 2013 and 2012, respectively, which are recognized in net realized investment gain (loss).

	Amount of Gain (Loss) Recognized in Income on Derivatives		
	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Variable annuity derivatives - total return swaps	\$27	(\$96)	(\$96)
Equity put options	(23)	(259)	(319)
Foreign currency and interest rate swaps	1	(75)	(45)
Forward starting interest rate swaps			(79)
IUL derivatives	206	208	74
Other		2	38
Embedded derivatives:			
Variable annuity GLB embedded derivatives	(706)	1,144	119
Fixed indexed annuity embedded derivatives	(27)	(13)	(16)
IUL embedded derivatives	(136)	(153)	(21)
Other	(2)	(2)	(5)
Total	(\$660)	\$756	(\$350)

#### DERIVATIVES DESIGNATED AS CASH FLOW HEDGES

The Company primarily utilizes foreign currency and interest rate swaps to manage its exposure to variability in cash flows due to changes in foreign currencies and in benchmark interest rates. These cash flows include those associated with existing assets and liabilities. The maximum length of time over which the Company is hedging its exposure to variability in future cash flows for forecasted transactions did not exceed 7 years.

The Company had outstanding foreign currency and interest rate swaps designated as cash flow hedges with notional amounts of \$453 million and \$818 million as of December 31, 2014 and 2013, respectively. The Company had gains recognized in OCI for changes in estimated fair value of foreign currency and interest rate swaps designated as cash flow hedges of \$18 million, \$42 million and \$27 million for the years ended December 31, 2014, 2013 and 2012, respectively. These amounts do not include the periodic net settlements of the derivatives. For the years ended December 31, 2014, 2013 and 2012, all of the hedged forecasted transactions for outstanding cash flow hedges were determined to be probable of occurring.

Hedge ineffectiveness related to cash flow hedges was \$1 million, zero and zero for the years ended December 31, 2014, 2013, and 2012, 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 were zero, zero and (\$4) million for the years ended December 31, 2014, 2013 and 2012, respectively. Over the next twelve months, the Company anticipates that \$8 million of deferred losses on derivative instruments in AOCI will be reclassified to earnings consistent with when the hedged forecasted transaction affects earnings.

#### DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES

The Company had no fair value hedges as of December 31, 2014 and 2013.

## 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 12 for information on the Company's estimated fair value measurements and disclosure.

	Asset Derivatives Estimated Fair Value		Liability Derivatives Estimated Fair Value	
	December 31,		December 31,	
	2014	2013	2014	2013
	(In Millions)		(In Millions)	
Derivatives designated as hedging instruments:				
Foreign currency and interest rate swaps	\$3	(1)	\$22	\$39 (5)
Total derivatives designated as hedging instruments	3	-	22	39
Derivatives not designated as hedging instruments:				
Variable annuity derivatives - total return swaps	3	(1)	8	5 (1)
	3	(5)	4	42 (5)
Variable annuity derivatives - interest rate swaps	2	(1)	3	9 (1)
				8 (5)
Equity put options				20 (1)
				83 (5)
Foreign currency and interest rate swaps	34	\$30 (1)	20	27 (1)
	32	58 (5)	133	182 (5)
IUL derivatives	146	67 (1)		
	48	94 (5)		
Other		1 (5)		
Embedded derivatives:				
Variable annuity GLB embedded derivatives (including reinsurance contracts)	204	(2)	1,274	355 (3)
				4 (2)
				5 (5)
Fixed indexed annuity embedded derivatives			110	61 (4)
IUL embedded derivatives			278	220 (4)
Other			3	(4)
			4	2 (5)
Total derivatives not designated as hedging instruments	472	250	1,837	1,023
Total derivatives	\$475	\$250	\$1,859	\$1,062

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 \$132 million and \$47 million as of December 31, 2014 and 2013, 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 \$61 million and \$107 million as of December 31, 2014 and 2013, 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. Net exposure to the counterparty is calculated as the estimated fair value of all derivative positions with the counterparty, net of income or

expense accruals and cash collateral paid or received. If the net exposure to the counterparty is positive, the amount is reflected in other investments, whereas, if the net exposure to the counterparty is negative, the estimated fair value is included in other liabilities.

As of December 31, 2014 and 2013, the Company had also accepted collateral, consisting of various securities, with an estimated fair value of \$24 million and \$12 million, respectively, which are held in separate custodial accounts and are not recorded in the consolidated statements of financial condition. The Company is permitted by contract to sell or repledge this collateral and as of December 31, 2014 and 2013, none of the collateral had been repledged. As of December 31, 2014 and 2013, the Company provided collateral in the form of various securities with an estimated fair value of \$5 million, which are included in fixed maturity securities. The counterparties are permitted by contract to sell or repledge this collateral.

#### OFFSETTING ASSETS AND LIABILITIES

The following table reconciles the net amount of derivative assets and liabilities reported in the consolidated statements of financial condition (excluding embedded derivatives) subject to master netting arrangements after the offsetting of collateral. Gross amounts include income or expense accruals. Gross amounts offset include cash collateral received or pledged limited to the gross estimated fair value of recognized derivative assets or liabilities, net of accruals. Excess cash collateral received or pledged is not included in the tables due to the foregoing limitation. Gross amounts not offset include asset collateral received or pledged limited to the gross estimated fair value of recognized derivative assets and liabilities.

	Gross Amounts of Recognized Assets/Liabilities <sup>(1)</sup>	Gross Amounts Offset <sup>(2)</sup>	Net Amounts	Gross Amounts Not Offset - Asset Collateral	Net Amounts
	<i>(In Millions)</i>				
<u>December 31, 2014:</u>					
Derivative assets	\$233	(\$191)	\$42	(\$23)	\$19
Derivative liabilities	202	(89)	113		113
<u>December 31, 2013:</u>					
Derivative assets	\$235	(\$215)	\$20	(\$12)	\$8
Derivative liabilities	430	(268)	162		162

<sup>(1)</sup> As of December 31, 2014 and 2013, derivative assets include expense accruals of \$38 million and \$14 million, respectively, and derivative liabilities include expense accruals of \$12 million and \$15 million, respectively.

<sup>(2)</sup> As of December 31, 2014 and 2013, the Company received excess cash collateral of \$4 million and \$5 million, respectively, which is not included in the table and provided no excess cash collateral.

#### CREDIT EXPOSURE AND CREDIT RISK RELATED CONTINGENT FEATURES

The Company is exposed to credit-related losses in the event of nonperformance by counterparties to over the counter (OTC) derivatives. The Company attempts to manage credit risk 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.

For OTC derivative transactions, the Company enters into legally enforceable master agreements which provide for the netting of payments and receipts with a single counterparty. The net position with each counterparty is calculated as the aggregate estimated fair value of all derivative instruments with each counterparty, net of income or expense accruals and collateral paid or received. These master agreements also specify 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.

The Company's credit exposure is measured on a counterparty basis as the net positive aggregate estimated fair value, net of accrued income or expenses and collateral received, if any. The Company's credit exposure for OTC derivatives as of December 31, 2014 was \$19 million. The maximum exposure to any single counterparty was \$9 million at December 31, 2014. All of the Company's credit exposure from derivative contracts is with investment grade counterparties.

The Company's collateral arrangements include credit-contingent provisions that provide for a reduction of collateral 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 were in a liability position on December 31, 2014, was \$80 million for which the Company has posted collateral of \$26 million. If certain of the Company's financial strength ratings were to fall one notch as of December 31, 2014, the Company would have been required to post an additional \$22 million of collateral to its counterparties.

The OTC master agreements 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 if one of the rating agencies were to cease 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, 2014, the Company's financial strength ratings were above the specified level.

## 9. POLICYHOLDER LIABILITIES

### POLICYHOLDER ACCOUNT BALANCES

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

	December 31,	
	2014	2013
	<i>(In Millions)</i>	
UL	\$24,920	\$23,424
Annuity and deposit liabilities	13,420	11,921
Funding agreements	714	906
GICs	115	500
Total	<u>\$39,169</u>	<u>\$36,751</u>

### FUTURE POLICY BENEFITS

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

	December 31,	
	2014	2013
	<i>(In Millions)</i>	
Annuity reserves	\$7,725	\$6,671
Policy benefits payable	2,206	1,690
Variable annuity GLB embedded derivatives	1,274	355
Life insurance	833	705
URR	818	615
Closed Block liabilities	266	283
Other	78	125
Total	<u>\$13,200</u>	<u>\$10,444</u>

## 10. 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 8.

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.

The Company offers 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,	
	2014	2013
	(\$ In Millions)	
<b>Return of net deposits</b>		
Separate account value	\$53,187	\$53,620
Net amount at risk <sup>(1)</sup>	581	529
Average attained age of contract holders	65 years	64 years
<b>Anniversary contract value</b>		
Separate account value	\$15,206	\$15,895
Net amount at risk <sup>(1)</sup>	536	487
Average attained age of contract holders	66 years	66 years
<b>Minimum return</b>		
Separate account value	\$995	\$1,059
Net amount at risk <sup>(1)</sup>	406	389
Average attained age of contract holders	70 years	69 years

<sup>(1)</sup> 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,		December 31,	
	2014	2013	2014	2013
	GMIB		GMWBL	
	(\$ In Millions)		(\$ In Millions)	
Separate account value	\$2,027	\$2,262	\$5,220	\$4,364
Average attained age of contract holders	61 years	60 years	65 years	64 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,		December 31,		December 31,	
	2014	2013	2014	2013	2014	2013
	GMDB		GMIB		GMWBL	
	(In Millions)		(In Millions)		(In Millions)	
Balance, beginning of year			\$18	\$46	\$11	\$5
Changes in reserves	\$15	\$13	10	(25)	10	6
Benefits paid	(10)	(13)	(3)	(3)		
Balance, end of year	\$5	\$ -	\$25	\$18	\$21	\$11

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

	December 31,	
	2014	2013
	(In Millions)	
<b>Asset type</b>		
Equity	\$32,496	\$31,742
Bonds	17,143	17,990
Money market	259	281
Other	3,495	3,753
Total separate account value	\$53,393	\$53,766



## 11. DEBT

Debt consists of the following:

	December 31,	
	2014	2013
	<i>(In Millions)</i>	
Short-term debt:		
Credit facility recourse only to ACG	\$266	\$20
Other VIE debt (Note 4)	2	
Total short-term debt	<u>\$268</u>	<u>\$20</u>
Long-term debt:		
Surplus notes	\$1,771	\$1,771
Deferred gains from derivative hedging activities	277	287
Non-recourse long-term debt:		
Debt recourse only to ACG	4,525	4,665
ACG non-recourse debt	307	333
Other non-recourse debt	106	91
ACG VIE debt (Note 4)	401	659
CMBS VIE debt (Note 4)	676	
Total long-term debt	<u>\$8,063</u>	<u>\$7,806</u>

### SHORT-TERM DEBT

Pacific Life maintains a \$700 million commercial paper program. There was no commercial paper debt outstanding as of December 31, 2014 and 2013. In addition, Pacific Life has a bank revolving credit facility of \$400 million maturing in October 2019 that will serve as a back-up line of credit to the commercial paper program. Interest is at variable rates. This facility had no debt outstanding as of December 31, 2014 and 2013. As of and during the year ended December 31, 2014, 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 reverse repurchase lines of credit as of December 31, 2014 and 2013.

Pacific Life is eligible to receive advances from the FHLB of Topeka based on a percentage of Pacific Life's statutory general account assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of Topeka requirements, debt covenant restrictions and insurance law and regulations. The Company had estimated available eligible collateral of \$1.3 billion as of December 31, 2014. Interest is at variable or fixed rates. The Company had no debt outstanding with the FHLB of Topeka as of December 31, 2014 and 2013.

PL&A is eligible to receive advances from the FHLB of San Francisco based on a percentage of PL&A's net admitted assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of San Francisco requirements and insurance law and regulations. PL&A had estimated available eligible collateral of \$55 million as of December 31, 2014. Interest is at variable or fixed rates. PL&A had no debt outstanding with the FHLB of San Francisco as of December 31, 2014 and 2013.

As of December 31, 2014, ACG has revolving credit agreements with banks for a \$1,105 million borrowing capacity. Interest on these loans is at variable rates, payable monthly and was 1.9% as of December 31, 2014 and 2013. The facilities expire in October 2018. There was \$266 million and \$20 million outstanding in connection with these revolving credit agreements as of December 31, 2014 and 2013, respectively. These credit agreements are recourse only to ACG.

### LONG-TERM DEBT

On January 22, 2013, Pacific Life, with the approval of the NE DOI, exercised its early redemption right for its 9.25% surplus notes and repurchased and retired \$323 million, of the original \$1 billion outstanding. The partial retirement of the 9.25% surplus notes

was accounted for as an extinguishment of debt and the related amortization of deferred gains (see below) of \$112 million and the premium paid of \$155 million were recognized in interest expense during the year ended December 31, 2013. As of December 31, 2014 and 2013, Pacific Life had \$677 million of surplus notes outstanding 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 NE DOI 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 NE DOI. Pacific Life had entered into interest rate swaps converting the 9.25% surplus notes to variable rate notes. The interest rate swaps were designated as fair value hedges of these surplus notes. In 2011, the interest rate swaps were terminated and deferred gains of \$364 million as of the termination date were recorded as an increase to the carrying amount of these surplus notes and are being amortized as a reduction to interest expense over the remaining life of these surplus notes using the effective interest method. The resulting effective interest rate of these surplus notes is 6.4%. Total unamortized deferred gains were \$234 million and \$239 million as of December 31, 2014 and 2013, respectively.

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 NE DOI. Pacific Life had entered into interest rate swaps converting these surplus notes to variable rate notes. 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. In 2011, the interest rate swaps were terminated and deferred gains of \$56 million as of the termination date were recorded as an increase to the carrying amount of these surplus notes and are being amortized over the remaining life of these surplus notes using the effective interest method. The resulting effective interest rate of these surplus notes is 4.0%. Total unamortized deferred gains were \$43 million and \$48 million as of December 31, 2014 and 2013, respectively.

The NE DOI 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 NE DOI. The internal surplus note matures on February 5, 2020.

In January 2013, the NE DOI approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for \$500 million with net cash proceeds of \$494 million. The original issue discount of \$6 million is being amortized over the life of this surplus note. 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%. All future payments of interest and principal on the internal surplus note can be made only with the prior approval of the NE DOI. 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 4.1% as of December 31, 2014 and 0.5% to 4.2% as of December 31, 2013. As of December 31, 2014, \$1,512 million was outstanding on these loans with maturities ranging from 2016 to 2024. As of December 31, 2013, \$1,682 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 1.2% to 7.2% as of December 31, 2014 and 2.0% to 7.2% as of December 31, 2013. As of December 31, 2014, \$3,013 million was outstanding on these notes and loans with maturities ranging from 2015 to 2023. As of December 31, 2013, \$2,983 million was outstanding on these notes and loans. These notes and loans are recourse only to ACG.

ACG has a secured facility to finance aircraft. Interest on this facility accrues at variable rates, is payable monthly and was 3.6% as of December 31, 2014 and 2013. As of December 31, 2014, \$307 million was outstanding on this facility that matures in 2017. As of December 31, 2013, \$333 million was outstanding on this facility. This facility is 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, 2014 and 2013. Variable rates were 2.4% as of December 31, 2014 and 2013. As of December 31, 2014, there was \$106 million outstanding on these loans with maturities ranging from 2015 to 2019. As of December 31, 2013, there was \$91 million outstanding on these loans. 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				Total
	Debt	ACG	Other		
	Recourse	Non-recourse	Non-recourse		
	Notes	Only to ACG	Debt	Debt	
<u>Years Ending December 31:</u>	<i>(In Millions)</i>				
2015		\$400	\$138	\$25	\$563
2016		822	101	21	944
2017		574	68	26	668
2018		777		1	778
2019		170		33	203
Thereafter	\$1,771	2,048			3,819
Total	\$1,771	\$4,791	\$307	\$106	\$6,975

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

## 12. 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, 2014 and 2013.

	Level 1	Level 2	Level 3	Gross Derivatives Estimated Fair Value	Netting Adjustments <sup>(1)</sup>	Total
(In Millions)						
December 31, 2014:						
Assets:						
U.S. Government		\$56				\$56
Obligations of states and political subdivisions		988	\$29			1,017
Foreign governments		603	56			659
Corporate securities		27,903	1,816			29,719
RMBS		2,690	14			2,704
CMBS		653	4			657
Collateralized debt obligations			70			70
Other asset-backed securities		492	288			780
Total fixed maturity securities	-	33,385	2,277	-	-	35,662
Perpetual preferred securities		125				125
Other equity securities	\$2		4			6
Total equity securities	2	125	4	-	-	131
FVO securities		563				563
Trading securities	74	145	5			224
Other investments	2	158	30			190
Derivatives:						
Foreign currency and interest rate swaps		71		\$71	(\$55)	16
Equity derivatives			200	200	(59)	141
Embedded derivatives			204	204		204
Total derivatives	-	71	404	475	(114)	361
Separate account assets <sup>(2)</sup>	60,254	112	208			60,574
Total	\$60,332	\$34,559	\$2,928	\$475	(\$114)	\$97,705
Liabilities:						
Derivatives:						
Foreign currency and interest rate swaps		\$178		\$178	(\$55)	\$123
Equity derivatives			\$12	12	(59)	(47)
Embedded derivatives			1,669	1,669		1,669
Total	-	\$178	\$1,681	\$1,859	(\$114)	\$1,745

				Gross Derivatives Estimated Fair Value	Netting Adjustments <sup>(1)</sup>	Total
	Level 1	Level 2	Level 3			
	(In Millions)					
<u>December 31, 2013:</u>						
Assets:						
U.S. Government		\$83				\$83
Obligations of states and political subdivisions		852	\$47			899
Foreign governments		631	77			708
Corporate securities		24,221	1,649			25,870
RMBS		3,312	93			3,405
CMBS		725	10			735
Collateralized debt obligations			83			83
Other asset-backed securities		369	314			683
Total fixed maturity securities	-	30,193	2,273	-	-	32,466
Perpetual preferred securities		132				132
Other equity securities			5			5
Total equity securities	-	132	5	-	-	137
Trading securities	\$74	111	3			188
Other investments	2	28	12			42
Derivatives:						
Foreign currency and interest rate swaps		88		\$88	(\$94)	(6)
Equity derivatives			161	161	(119)	42
Embedded derivatives					(4)	(4)
Other		1		1	(1)	-
Total derivatives	-	89	161	250	(218)	32
Separate account assets <sup>(2)</sup>	60,542	107	174			60,823
Total	\$60,618	\$30,660	\$2,628	\$250	(\$218)	\$93,688
Liabilities:						
Derivatives:						
Foreign currency and interest rate swaps		\$265		\$265	(\$94)	\$171
Equity derivatives			\$150	150	(119)	31
Embedded derivatives			647	647	(4)	643
Other				-	(1)	(1)
Total	-	\$265	\$797	\$1,062	(\$218)	\$844

<sup>(1)</sup> 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.

<sup>(2)</sup> 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, FVO AND TRADING SECURITIES

The estimated fair values of fixed maturity securities available for sale, equity securities available for sale, FVO 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. 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 pricing 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 independent 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 unusual 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 value. 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, FVO and trading securities.

Hedge funds and investments in limited partnerships held by sponsored investment funds, for which estimated fair value is not readily determinable are also included in other investments. The fair values have been estimated using the net asset values obtained from the fund managers. Level 2 assets include hedge funds that can be fully redeemed at net asset value at the determination date with a notice period of 90 days or less. Level 3 assets include hedge funds which will never have the ability to redeem at the net asset value of the investment or may be redeemable at a future date due to a restriction. Also included in Level 3 are the investments in limited partnerships due to an inability to voluntarily redeem such interests in the near term at net asset value per share.

## 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 analyses. Examples of procedures performed include, but are not limited to, review of pricing statistics and trends, analysis of the impacts of changes in the market environment, and review of changes in market value for each derivative by both risk managers and investment accountants. Internally calculated fair values are reviewed and compared to external broker fair values for reasonableness.

Excluding embedded derivatives, as of December 31, 2014, 99% of OTC 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, 2014.

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, total return swaps, and certain credit default swaps. Also included in Level 3 classification are embedded derivatives in certain insurance, reinsurance and synthetic GIC 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 2 inputs will be classified as a Level 3 financial instrument in its entirety if it has at least one significant Level 3 input.

## 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 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 securities. The pricing methodology and valuation controls are the same as those previously described in fixed maturity securities available for sale.

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. Unfunded commitments are zero as of December 31, 2014.



## 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, 2014	Total Gains or Losses		Transfers In to Level 3 <sup>(1)</sup>	Transfers Out of Level 3 <sup>(1)</sup>	Purchases	Sales	Settlements	December 31, 2014
		Included in Earnings	Included in OCI						
	<i>(In Millions)</i>								
Obligations of states and political subdivisions	\$47		\$4		(\$21)			(\$1)	\$29
Foreign governments	77		4	\$1	(37)	\$15		(4)	56
Corporate securities	1,649	\$31	46	241	(288)	362	(\$61)	(164)	1,816
RMBS	93	(1)	4	15	(65)	19	(46)	(5)	14
CMBS	10				(5)			(1)	4
Collateralized debt obligations	83	4						(17)	70
Other asset-backed securities	314	3	5	3	(48)	101		(90)	288
Total fixed maturity securities	2,273	37	63	260	(464)	497	(107)	(282)	2,277
Other equity securities	5		(1)						4
Total equity securities	5	-	(1)	-	-	-	-	-	4
Trading securities	3			2	(5)	23	(18)		5
Other investments	12					26		(8)	30
Derivatives, net:									
Equity derivatives <sup>(2)</sup>	11	209						(32)	188
Embedded derivatives <sup>(3)</sup>	(647)	(872)				(130)		184	(1,465)
Total derivatives	(636)	(663)	-	-	-	(130)	-	152	(1,277)
Separate account assets <sup>(4)</sup>	174	12		1		40	(19)		208
Total	\$1,831	(\$614)	\$62	\$263	(\$469)	\$456	(\$144)	(\$138)	\$1,247

	January 1, 2013	Total Gains or Losses Included in Earnings	Included in OCI	Transfers In to Level 3 <sup>(1)</sup>	Transfers Out of Level 3 <sup>(1)</sup>	Purchases	Sales	Settlements	December 31, 2013
					(In Millions)				
Obligations of states and political subdivisions	\$32		(\$9)	\$28	(\$4)				\$47
Foreign governments	58		(5)	28				(\$4)	77
Corporate securities	2,213	\$18	(59)	231	(708)	\$252	(\$73)	(225)	1,649
RMBS	8		2	94	(23)	14		(2)	93
CMBS	26		(1)	7	(20)			(2)	10
Collateralized debt obligations	117	3	8					(45)	83
Other asset-backed securities	367	4	(10)	7	(70)	59		(43)	314
Total fixed maturity securities	2,821	25	(74)	395	(825)	325	(73)	(321)	2,273
Perpetual preferred securities	17	32	(5)				(44)		-
Other equity securities	4		1						5
Total equity securities	21	32	(4)	-	-	-	(44)	-	5
Trading securities	51	1			(37)	3	(1)	(14)	3
Other investments	12								12
Derivatives, net:									
Equity derivatives	173	(175)						13	11
Embedded derivatives	(1,628)	970				(97)		108	(647)
Other	(23)	23							-
Total derivatives	(1,478)	818	-	-	-	(97)	-	121	(636)
Separate account assets <sup>(4)</sup>	128	10				58	(22)		174
Total	\$1,555	\$886	(\$78)	\$395	(\$862)	\$289	(\$140)	(\$214)	\$1,831

<sup>(1)</sup> Transfers in and/or out are recognized at the end of each quarter.

<sup>(2)</sup> Excludes derivative net settlements of (\$214) million in 2014 that are recorded in net realized investment gain (loss).

<sup>(3)</sup> Excludes embedded derivative policy fees of \$243 million in 2014 that are recorded in net realized investment gain (loss).

<sup>(4)</sup> 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, 2014 and 2013, transfers into Level 3 were primarily attributable to the decreased availability and use of market observable inputs to estimate fair value. The 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. During the years ended December 31, 2014 and 2013, the Company did not have any significant transfers between Levels 1 and 2.

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

	Net Investment Income	Net Realized Investment Gain (Loss)	OTTI (In Millions)	Operating and Other Expenses	Total
<u>Year Ended December 31, 2014:</u>					
Corporate securities	\$24	\$9	(\$2)		\$31
RMBS		(1)			(1)
Collateralized debt obligations	4				4
Other asset-backed securities	3				3
Total fixed maturity securities	31	8	(2)	-	37
Equity derivatives		209			209
Embedded derivatives		(872)			(872)
Total derivatives	-	(663)	-	-	(663)
Separate account assets		12			12
Total	\$31	(\$643)	(\$2)	-	(\$614)
	Net Investment Income	Net Realized Investment Gain (Loss)	OTTI (In Millions)	Operating and Other Expenses	Total
<u>Year Ended December 31, 2013:</u>					
Corporate securities	\$14	\$8	(\$4)		\$18
Collateralized debt obligations	3				3
Other asset-backed securities	4				4
Total fixed maturity securities	21	8	(4)	-	25
Perpetual preferred securities		32			32
Total equity securities	-	32	-	-	32
Trading securities		1			1
Equity derivatives		(175)			(175)
Embedded derivatives		970			970
Other				\$23	23
Total derivatives	-	795	-	23	818
Separate account assets		10			10
Total	\$21	\$846	(\$4)	\$23	\$886

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,	
	2014	2013
	<i>(In Millions)</i>	
Other Investments	\$1	
Derivatives, net: <sup>(1)</sup>		
Equity derivatives	154	(\$97)
Embedded derivatives	(830)	1,025
Total derivatives	(676)	928
Separate account assets <sup>(2)</sup>	10	9
Total	(\$665)	\$937

<sup>(1)</sup> Amounts are recognized in net realized investment gain (loss).

<sup>(2)</sup> 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, 2014 (\$ In Millions).

	Estimated Fair Value Asset (Liability)	Predominant Valuation Method	Significant Unobservable Inputs	Range (Weighted Average)
Obligations of states and political subdivisions	\$29	Discounted cash flow	Spread <sup>(1)</sup>	279-303 (296)
Foreign governments	56	Discounted cash flow	Spread <sup>(1)</sup>	210-270 (247)
		Market pricing	Quoted prices <sup>(2)</sup>	111
Corporate securities	1,816	Discounted cash flow	Spread <sup>(1)</sup>	42-768 (260)
		Collateral value <sup>(3)</sup>	Collateral value	45-119 (87)
		Market pricing	Quoted prices <sup>(2)</sup>	67-112 (98)
		Cap at call price	Call price	100
RMBS	14	Discounted cash flow	Prepayment rate	15%
			Default rate	3%
			Severity	30%
			Spread <sup>(1)</sup>	275
CMBS	4	Discounted cash flow	Prepayment rate	0%
			Default rate	1%
			Severity	30%
			Spread <sup>(1)</sup>	126-520 (230)
Collateralized debt obligations	70	Market pricing	Quoted prices <sup>(2)</sup>	90
Other asset-backed securities	288	Discounted cash flow	Spread <sup>(1)</sup>	56-358 (137)
		Market pricing	Quoted prices <sup>(2)</sup>	73-117 (100)
		Cap at call price	Call price	100
Other equity securities	4	Market comparable companies	EBITDA <sup>(4)</sup> multiple	4X
Trading securities	5	Market pricing	Quoted prices <sup>(2)</sup>	101-107 (104)
Other investments	30	Redemption value <sup>(5)</sup>	Redemption value	100
		Net asset value		
Equity derivatives	188	Option pricing model	Equity volatility	17% - 58% (21%)
Embedded derivatives <sup>(6)</sup>	(1,465)	Option pricing techniques	Equity volatility	17% - 58%
			Mortality:	
			Ages 0-40	0.01% - 0.07%
			Ages 41-60	0.06% - 0.49%
			Ages 61-120	0.40% - 100%
			Mortality improvement	0% - 1.50%
			Withdrawal utilization	0% - 80%
			Lapse rates	0.35% - 100%
			Credit standing adjustment	0.44% - 1.41%
Separate account assets	208	Net asset value		
Total	<u>\$1,247</u>			

- (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) Independent third-party quotations and broker quotations were used in the determination of estimated fair value.
- (3) Valuation based on the Company's share of estimated fair values of the underlying assets held in the trusts.
- (4) The abbreviation EBITDA means earnings before interest, taxes, depreciation and amortization.
- (5) Represents FHLB common stock that is valued at the contractual amount that will be received upon redemption.
- (6) This liability consists of embedded derivatives from variable annuity GLBs, fixed indexed annuity products and IUL insurance products. Since the valuation methodology for the embedded derivatives uses a range of inputs that vary at the contract level over the cash flow projection period, presenting a range, rather than weighted average, is more representative of the unobservable input used in the valuation.

## 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, 2014			Year Ended December 31, 2013		
	Carrying Value Prior to Measurement	Estimated Fair Value After Measurement	Impairment	Carrying Value Prior to Measurement	Estimated Fair Value After Measurement	Impairment
<i>(In Millions)</i>						
Mortgage loans	\$62	\$44	(\$18)			
Real estate investments	10	9	(1)	\$20	\$11	(\$9)
Aircraft	203	166	(37)	226	198	(28)

## MORTGAGE LOANS

The impairment loss (gross of reinsurance of \$4 million) related to three loans that are still held as mortgage loans as of December 31, 2014. The estimated fair value after measurement was based on the underlying real estate collateral net of estimated costs to sell. These loans were classified as Level 3 assets.

## REAL ESTATE INVESTMENTS

The impairment loss related to four real estate investments as of December 31, 2014 and 2013. The investments are classified as Level 3 assets.

## AIRCRAFT

ACG evaluates carrying values of aircraft 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 records impairments to recognize a loss in the value of aircraft when management believes that, based on future undiscounted estimated 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, and projected sales prices, as well as disposition value. The disposition value reflects an aircraft's estimated residual value or estimated sales price. The cash flows are based on unobservable inputs and have been classified as Level 3.

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, 2014 and 2013. 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:

	<u>December 31, 2014</u>		<u>December 31, 2013</u>	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	<i>(In Millions)</i>			
Assets:				
Mortgage loans	\$9,327	\$10,031	\$8,454	\$8,796
Policy loans	7,234	7,234	7,155	7,155
Other investments	199	238	195	227
Cash and cash equivalents	3,220	3,220	2,000	2,000
Restricted cash	266	266	314	314
Liabilities:				
Funding agreements and GICs	829	881	1,406	1,467
Annuity and deposit liabilities	13,420	13,420	11,921	11,921
Short-term debt	268	268	20	20
Long-term debt	8,063	8,643	7,806	8,128

The following methods and assumptions were used to estimate the fair value of these financial instruments as of December 31, 2014 and 2013:

#### 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 net asset value 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.

## 13. OTHER COMPREHENSIVE INCOME (LOSS)

The Company displays comprehensive income (loss) and its components on the consolidated statements of comprehensive income (loss) and consolidated statements of equity. The balance of and changes in each component of AOCI attributable to the Company are as follows:

	Unrealized Gain (Loss) on Securities Available for Sale, Net	Unrealized Gain (Loss) on Derivatives <sup>(1)</sup>	Other, Net	Total Accumulated Other Comprehensive Income (Loss)
	<i>(In Millions)</i>			
Balance, January 1, 2012	\$1,016	\$2	(\$14)	\$1,004
Change in OCI before reclassifications	1,049 <sup>(2)</sup>	25	1	1,075
Income tax expense	(366)	(10)		(376)
Amounts reclassified from AOCI	(106)	21		(85)
Income tax expense (benefit)	37	(7)		30
Balance, December 31, 2012	1,630	31	(13)	1,648
Change in OCI before reclassifications	(1,200) <sup>(3)</sup>	42	6	(1,152)
Income tax (expense) benefit	419	(15)		404
Amounts reclassified from AOCI	(79)	14		(65)
Income tax expense (benefit)	28	(5)		23
Balance, December 31, 2013	798	67	(7)	858
Change in OCI before reclassifications	790 <sup>(4)</sup>	18	(7)	801
Income tax (expense) benefit	(276)	(7)	2	(281)
Amounts reclassified from AOCI	(31)	6		(25)
Income tax expense (benefit)	11	(2)		9
Balance, December 31, 2014	\$1,292	\$82	(\$12)	\$1,362

<sup>(1)</sup> See Note 5 and Note 9 for information related to DAC and future policy benefits.

<sup>(2)</sup> Includes allocation of holding loss from DAC and URR of (\$134) million and (\$409) million, respectively, for the year ended December 31, 2012.

<sup>(3)</sup> Includes allocation of holding gain from DAC and URR of \$237 million and \$370 million, respectively, for the year ended December 31, 2013.

<sup>(4)</sup> Includes allocation of holding loss from DAC and URR of (\$94) million and (\$523) million, respectively, for the year ended December 31, 2014.



## RECLASSIFICATIONS FROM AOCI

The table below presents amounts reclassified from each component of AOCI and their locations on the consolidated statements of operations. Amounts are shown gross of tax.

Reclassification adjustments:	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Unrealized (gain) loss on securities available for sale, net:			
Sale of securities available for sale	(\$40) <sup>(1)</sup>	(\$97) <sup>(1)</sup>	(\$161) <sup>(1)</sup>
OTTI recognized on securities available for sale	9 <sup>(2)</sup>	18 <sup>(2)</sup>	55 <sup>(2)</sup>
Total unrealized gain on securities available for sale, net	(31)	(79)	(106)
Unrealized (gain) loss on derivatives:			
Foreign currency and interest rate swaps	3 <sup>(1)</sup>		
	(3) <sup>(3)</sup>	(2) <sup>(3)</sup>	(4) <sup>(3)</sup>
	6 <sup>(4)</sup>	16 <sup>(4)</sup>	25 <sup>(4)</sup>
Total unrealized loss on derivatives	6	14	21
Total amounts reclassified from AOCI	(\$25)	(\$65)	(\$85)

Location on the consolidated statements of operations:

<sup>(1)</sup> Net realized investment gain (loss) <sup>(2)</sup> OTTI <sup>(3)</sup> Net investment income <sup>(4)</sup> Interest credited to policyholder account balances

## 14. REINSURANCE

The accounting for reinsurance requires extensive use of assumptions and estimates, particularly related to the future performance of the underlying business and the potential impact of counterparty credit risk. The Company periodically reviews, and modifies as appropriate, the estimates and assumptions used to establish assets and liabilities relating to ceded and assumed reinsurance. Reinsurance receivables, included in other assets, were \$848 million and \$417 million as of December 31, 2014 and 2013, respectively. Reinsurance payables, included in other liabilities, were \$208 million and \$175 million as of December 31, 2014 and 2013, respectively.

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Direct premiums	\$1,035	\$1,098	\$1,255
Reinsurance assumed <sup>(1)</sup>	787	540	561
Reinsurance ceded	(377)	(356)	(328)
Insurance premiums	\$1,445	\$1,282	\$1,488

<sup>(1)</sup> Included are \$77 million, \$25 million and \$23 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, 2014, 2013 and 2012, respectively. PLR is incorporated in the UK and provides reinsurance to insurance and annuity providers in the UK, Ireland and to insurers in selected markets in Asia.

## 15. INCOME TAXES

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Current	\$47	\$13	\$3
Deferred	55	118	(70)
Provision (benefit) for income taxes	<u>\$102</u>	<u>\$131</u>	<u>(\$67)</u>

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

	Years Ended December 31,		
	2014	2013	2012
	<i>(In Millions)</i>		
Provision for income taxes at the statutory rate	\$218	\$281	\$155
Separate account dividends received deduction	(82)	(89)	(98)
Nonrecurring deferred tax liability basis adjustment			(58)
Singapore Transfer	(22)	(34)	(23)
LITC and foreign tax credits	(15)	(16)	(16)
Other	3	(11)	(27)
Provision (benefit) for income taxes	<u>\$102</u>	<u>\$131</u>	<u>(\$67)</u>

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 in Singapore (collectively referred to as the Singapore Transfer). The Singapore Transfer decreased the provision for income taxes for the year ended December 31, 2014, 2013 and 2012 by \$22 million, \$34 million and \$23 million, respectively, primarily due to the reversal of deferred tax liabilities related to basis differences in the aircraft assets 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 2014, 2013 and 2012, as of December 31, 2014, the Company has not made a provision for U.S. or additional foreign withholding taxes of approximately \$19 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.

As of December 31, 2014 and 2013, the Company had no unrecognized tax benefits. The Company does not expect any material changes in unrecognized tax benefits during the next twelve months.

During the years ended December 31, 2014, 2013 and 2012, 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,	
	2014	2013
	<i>(In Millions)</i>	
Deferred tax assets:		
Policyholder reserves	\$866	\$787
Investment valuation	589	298
Tax credit carryforwards	370	381
Tax net operating loss carryforwards	344	385
Deferred compensation	72	70
Other	102	20
Total deferred tax assets	2,343	1,941
Deferred tax liabilities:		
DAC	(1,295)	(1,100)
Depreciation	(847)	(754)
Hedging	(429)	(262)
Partnership income	(115)	(113)
Other	(47)	(47)
Total deferred tax liabilities	(2,733)	(2,276)
Net deferred tax liability	(390)	(335)
Unrealized gain on derivatives and securities available for sale	(716)	(444)
Other adjustments	(8)	(8)
Net deferred tax liability	(\$1,114)	(\$787)

The tax net operating loss carryforwards relate to Federal tax losses incurred in 2001 through 2014 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 2014 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 2014. The LIHTC begin to expire in 2020. The foreign tax credits begin to expire in 2018. Foreign tax credits, LIHTC and tax net operating loss carryforwards of \$222 million expire between 2018 and 2024. AMT credits of \$70 million possess no expiration date. The remainder will expire between 2025 and 2034.

The Codification's Income Taxes Topic requires separate footnote disclosure of the impact of foreign taxes. While the Company does have foreign operations, the results of those operations have not been separately disclosed since they are not material.

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.

PMHC files income tax returns in U.S. Federal and various state jurisdictions. PMHC 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 PMHC's tax returns through the tax year ended December 31, 2008, and is auditing PMHC's tax returns for the tax years ended December 31, 2009, 2010, 2011 and 2012. The State of California is auditing tax year 2009. The Company does not expect the current Federal and California audits to result in any material assessments.

## 16. 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 primarily the upper income and corporate markets. Principal products include UL, IUL, 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, national/regional wirehouses and a network of structured settlement brokers.

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 and international retrocession business, which assumes mortality risks from other life reinsurers. The domestic and international retrocession business serves clients primarily in the U.S., Canada and Europe.

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.

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, 2014 and 2013, the Company had foreign investments with an estimated fair value of \$10.2 billion and \$9.8 billion, respectively. Aircraft leased to foreign customers were \$6.6 billion and \$6.5 billion as of December 31, 2014 and 2013, respectively. Revenues derived from any customer did not exceed 10% of consolidated total revenues for the years ended December 31, 2014, 2013 and 2012.

The following segment information is as of and for the year ended December 31, 2014:

	Life Insurance	Retirement Solutions	Aircraft Leasing	Reinsurance	Corporate and Other	Total
REVENUES	<i>(In Millions)</i>					
Policy fees and insurance premiums	\$933	\$1,761		\$720		\$3,414
Net investment income	1,084	1,075	\$1	14	\$234	2,408
Net realized investment gain (loss)	12	(629)		(1)	21	(597)
OTTI	(4)	(8)			(12)	(24)
Investment advisory fees	27	308			41	376
Aircraft leasing revenue			796			796
Other income	20	204	24	9	2	259
Total revenues	2,072	2,711	821	742	286	6,632
BENEFITS AND EXPENSES						
Policy benefits	600	1,436		614		2,650
Interest credited	803	346			54	1,203
Commission expenses	212	166		20		398
Operating expenses	327	438	137	34	104	1,040
Depreciation of aircraft			336			336
Interest expense	6		244		133	383
Total benefits and expenses	1,948	2,386	717	668	291	6,010
Income (loss) before provision (benefit) for income taxes	124	325	104	74	(5)	622
Provision (benefit) for income taxes	33	41	12	26	(10)	102
Net income	91	284	92	48	5	520
Less: net (income) loss attributable to the noncontrolling interest			(2)		5	3
Net income attributable to the Company	\$91	\$284	\$90	\$48	\$10	\$523
Total assets	\$37,964	\$82,206	\$8,741	\$923	\$4,643	\$134,477
DAC	1,311	3,370		61		4,742
Separate account assets	7,136	53,489				60,625
Policyholder and contract liabilities	27,179	23,764		597	829	52,369
Separate account liabilities	7,136	53,489				60,625

The following segment information is as of and for the year ended December 31, 2013:

	Life Insurance	Retirement Solutions	Aircraft Leasing	Reinsurance	Corporate and Other	Total
REVENUES	(In Millions)					
Policy fees and insurance premiums	\$1,073	\$1,816		\$476		\$3,365
Net investment income	1,047	1,000	\$5	14	\$224	2,290
Net realized investment gain (loss)	27	886	1		(328)	586
OTTI	(10)	(6)			(11)	(27)
Investment advisory fees	26	288			37	351
Aircraft leasing revenue			736			736
Other income	14	190	24	9	16	253
Total revenues	2,177	4,174	766	499	(62)	7,554
BENEFITS AND EXPENSES						
Policy benefits	533	1,479		354		2,366
Interest credited	785	332			131	1,248
Commission expenses	278	1,056		20		1,354
Operating expenses	328	423	146	32	122	1,051
Depreciation of aircraft			326			326
Interest expense			232		175	407
Total benefits and expenses	1,924	3,290	704	406	428	6,752
Income (loss) before provision (benefit) for income taxes	253	884	62	93	(490)	802
Provision (benefit) for income taxes	76	220	(12)	33	(186)	131
Net income (loss)	177	664	74	60	(304)	671
Less: net (income) loss attributable to the noncontrolling interest			2		(21)	(19)
Net income (loss) attributable to the Company	\$177	\$664	\$76	\$60	(\$325)	\$652
Total assets	\$35,640	\$78,415	\$8,569	\$635	\$4,406	\$127,665
DAC	1,210	2,948		56		4,214
Separate account assets	7,024	53,840				60,864
Policyholder and contract liabilities	25,411	20,008		370	1,406	47,195
Separate account liabilities	7,024	53,840				60,864

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

	Life Insurance	Retirement Solutions	Aircraft Leasing	Reinsurance	Corporate and Other	Total
<i>(In Millions)</i>						
<b>REVENUES</b>						
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
<b>BENEFITS AND EXPENSES</b>						
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

## 17. 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 \$395 million, \$367 million and \$305 million for the years ended December 31, 2014, 2013 and 2012, 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 \$15 million, \$15 million and \$13 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Additionally, the Pacific Select Fund and Pacific Life Funds have service and other plans whereby the funds pay Pacific Select Distributors, Inc. (PSD), a wholly owned broker-dealer subsidiary of Pacific Life, 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, 2014, 2013 and 2012, PSD received \$136 million, \$131 million and \$119 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 \$877 million and \$1.1 billion as of December 31, 2014 and 2013, respectively. The estimated fair values of the derivatives were net liabilities of \$59 million and \$77 million as of December 31, 2014 and 2013, respectively.

## 18. 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)*:

<u>Years Ending December 31:</u>	
2015	\$863
2016 through 2017	858
2018 through 2019	306
2020 and thereafter	45
Total	<u>\$2,072</u>

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 \$8 million, \$9 million and \$11 million for the years ended December 31, 2014, 2013 and 2012, respectively. Aggregate minimum future office lease commitments are as follows *(In Millions)*:

<u>Years Ending December 31:</u>	
2015	\$9
2016 through 2019	31
2020 and thereafter	14
Total	<u>\$54</u>

ACG has sold six 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 six aircraft mentioned above to airlines with maturity dates ranging from 2021 to 2024 with total future rentals of \$216 million. Aggregate minimum future aircraft lease commitments are as follows *(In Millions)*:

<u>Years Ending December 31:</u>	
2015	\$20
2016 through 2017	41
2018 through 2019	41
2020 and thereafter	99
Total	<u>\$201</u>



As of December 31, 2014, ACG has commitments with major aircraft manufacturers and other third-parties to purchase aircraft at an estimated delivery price of \$6,030 million with delivery through 2021. These purchase commitments may be funded:

- up to \$224 million in less than one year,
- an additional \$1,323 million in one to three years,
- an additional \$2,438 million in three to five years, and
- an additional \$1,776 million thereafter.

As of December 31, 2014, deposits related to these agreements totaled \$269 million and are included in other assets.

Pacific Life entered into an agreement with PLR to guarantee the performance of 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, 2014 and 2013, Pacific Life earned \$3 million and \$2 million, respectively, under the agreement for its guarantee.

On January 1, 2013, Pacific Life entered into an agreement with Pacific Life Reinsurance Company II Limited (PLRC), an exempt life reinsurance company domiciled in Barbados and wholly owned by Pacific Life, to guarantee the performance of reinsurance obligations of PLRC. PLRC pays Pacific Life a fee for its guarantee.

#### 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 Dividends Received Deductions (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. The IRS issued Revenue Ruling 2014-7 that superseded Revenue Ruling 2007-54 and Revenue Ruling 2007-61. This ruling holds that the IRS will not address this issue through regulation, but defer to legislative action. Depending on legislative action, the Company could lose a substantial amount of DRD tax benefits, which could have a material adverse effect of the Company's consolidated financial statements.

#### CONTINGENCIES - OTHER

In the course of its business, the Company provides certain indemnifications related to 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 the ACG VIE securitizations (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 the ACG VIE securitizations 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 2 for discussion of contingencies related to reinsurance of statutory reserves to affiliates.

See Note 8 for discussion of contingencies related to derivative instruments.

See Note 15 for discussion of other contingencies related to income taxes.

---