

## **STATEMENT OF ADDITIONAL INFORMATION**

**May 1, 2018**

**PACIFIC ODYSSEY<sup>®</sup>**

**SEPARATE ACCOUNT A**

**(Offered before October 1, 2013)**

Pacific Odyssey (the “Contract”) is a variable annuity contract offered by Pacific Life & Annuity Company (“PL&A”).

This Statement of Additional Information (“SAI”) is not a Prospectus and should be read in conjunction with the Contract’s Prospectus, dated May 1, 2018, and any supplement thereto, which is available without charge upon written or telephone request to PL&A or by visiting our website at [www.pacificlife.com](http://www.pacificlife.com). Terms used in this SAI have the same meanings as in the Prospectus, and some additional terms are defined particularly for this SAI. This SAI is incorporated by reference into the Contract’s Prospectus.

Pacific Life & Annuity Company

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## PERFORMANCE

From time to time, our reports or other communications to current or prospective Contract Owners or our advertising or other promotional material may quote the performance (yield and total return) of a Subaccount. Quoted results are based on past performance and reflect the performance of all assets held in that Subaccount for the stated time period. **Quoted results are neither an estimate nor a guarantee of future investment performance, and do not represent the actual experience of amounts invested by any particular Contract Owner.**

### Total Returns

A Subaccount may advertise its “average annual total return” over various periods of time. “Total return” represents the average percentage change in value of an investment in the Subaccount from the beginning of a measuring period to the end of that measuring period. “Annualized” total return assumes that the total return achieved for the measuring period is achieved for each full year period. “Average annual” total return is computed in accordance with a standard method prescribed by the SEC, and is also referred to as “standardized return.”

#### *Average Annual Total Return*

To calculate a Subaccount’s average annual total return for a specific measuring period, we first take a hypothetical \$1,000 investment in that Subaccount, at its applicable Subaccount Unit Value (the “initial payment”) and we compute the ending redeemable value of that initial payment at the end of the measuring period based on the investment experience of that Subaccount (“full withdrawal value”). The full withdrawal value reflects the effect of all recurring fees and charges applicable to a Contract Owner under the Contract, including the Risk Charge, and the asset-based Administrative Fee, but does not reflect any charges for applicable premium taxes and/or any other taxes, any non-recurring fees or charges, any increase in the Risk Charge for an optional Death Benefit Rider, or any optional Rider charge. The redeemable value is then divided by the initial payment and this quotient is raised to the  $365/N$  power (N represents the number of days in the measuring period), and 1 is subtracted from this result. Average annual total return is expressed as a percentage.

$$T = (ERV/P)^{(365/N)} - 1$$

where T = average annual total return

ERV = ending redeemable value

P = hypothetical initial payment of \$1,000

N = number of days

Average annual total return figures will be given for recent 1-, 3-, 5- and 10-year periods (if applicable), and may be given for other periods as well (such as from commencement of the Subaccount’s operations, or on a year-by-year basis).

When considering “average” total return figures for periods longer than one year, it is important to note that the relevant Subaccount’s annual total return for any one year in the period might have been greater or less than the average for the entire period.

#### *Aggregate Total Return*

A Subaccount may use “aggregate” total return figures along with its “average annual” total return figures for various periods; these figures represent the cumulative change in value of an investment in the Subaccount for a specific period. Aggregate total returns may be shown by means of schedules, charts or graphs and may indicate subtotals of the various components of total return. The SEC has not prescribed standard formulas for calculating aggregate total return.

#### *Non-Standardized Total Returns*

We may also calculate non-standardized total returns which may or may not reflect any increases in Risk Charge for an optional Death Benefit Rider, charges for premium taxes and/or any other taxes, any optional Rider charge, or any non-recurring fees or charges.

Standardized return figures will always accompany any non-standardized returns shown.

## **Yields**

### *Fidelity® VIP Government Money Market Subaccount*

The “yield” (also called “current yield”) of the Fidelity® VIP Government Money Market Subaccount is computed in accordance with a standard method prescribed by the SEC. The net change in the Subaccount’s Unit Value during a seven-day period is divided by the Unit Value at the beginning of the period to obtain a base rate of return. The current yield is generated when the base rate is “annualized” by multiplying it by the fraction 365/7; that is, the base rate of return is assumed to be generated each week over a 365-day period and is shown as a percentage of the investment. The “effective yield” of the Fidelity® VIP Government Money Market Subaccount is calculated similarly but, when annualized, the base rate of return is assumed to be reinvested. The effective yield will be slightly higher than the current yield because of the compounding effect of this assumed reinvestment.

The formula for effective yield is:  $[(\text{Base Period Return} + 1) (\text{To the power of } 365/7)] - 1$ .

Realized capital gains or losses and unrealized appreciation or depreciation of the assets of the underlying Fidelity® VIP Government Money Market Portfolio are not included in the yield calculation. Current yield and effective yield do not reflect any deduction of charges for any applicable premium taxes and/or any other taxes, any increase in the Risk Charge for an optional Death Benefit Rider, any optional Rider charge, but do reflect a deduction for the Risk Charge and the asset-based Administrative Fee.

### *Other Subaccounts*

“Yield” of the other Subaccounts is computed in accordance with a different standard method prescribed by the SEC. The net investment income (investment income less expenses) per Subaccount Unit earned during a specified one-month or 30-day period is divided by the Subaccount Unit Value on the last day of the specified period. This result is then annualized (that is, the yield is assumed to be generated each month or each 30-day period for a year), according to the following formula, which assumes semi-annual compounding:

$$\text{YIELD} = 2 * [ (\frac{a-b}{c*d} + 1)^6 - 1 ]$$

where: a = net investment income earned during the period by the Portfolio attributable to the Subaccount.

b = expenses accrued for the period (net of reimbursements).

c = the average daily number of Subaccount Units outstanding during the period that were entitled to receive dividends.

d = the Unit Value of the Subaccount Units on the last day of the period.

The yield of each Subaccount reflects the deduction of all recurring fees and charges applicable to the Subaccount, such as the Risk Charge, and the asset-based Administrative Fee, but does not reflect any charge for applicable premium taxes and/or any other taxes, increase in the Risk Charge for an optional Death Benefit Rider, any optional Rider charge, or any non-recurring fees or charges.

The Subaccounts’ yields will vary from time to time depending upon market conditions, the composition of each Portfolio and operating expenses of the Fund allocated to each Portfolio. Consequently, any given performance quotation should not be considered representative of the Subaccount’s performance in the future. Yield should also be considered relative to changes in Subaccount Unit Values and to the relative risks associated with the investment policies and objectives of the various Portfolios. In addition, because performance will fluctuate, it may not provide a basis for comparing the yield of a Subaccount with certain bank deposits or other investments that pay a fixed yield or return for a stated period of time.

## **Performance Comparisons and Benchmarks**

In advertisements and sales literature, we may compare the performance of some or all of the Subaccounts to the performance of other variable annuity issuers in general and to the performance of particular types of variable annuities investing in mutual funds, or series of mutual funds, with investment objectives similar to each of the Subaccounts. This performance may be presented as averages or rankings compiled by Lipper Analytical Services,

Inc. (“Lipper”), or Morningstar, Inc. (“Morningstar”), which are independent services that monitor and rank the performance of variable annuity issuers and mutual funds in each of the major categories of investment objectives on an industry-wide basis. Lipper’s rankings include variable life issuers as well as variable annuity issuers. The performance analyses prepared by Lipper and Morningstar rank such issuers on the basis of total return, assuming reinvestment of dividends and distributions, but do not take sales charges, redemption fees or certain expense deductions at the separate account level into consideration. In addition, Morningstar prepares risk adjusted rankings, which consider the effects of market risk on total return performance. We may also compare the performance of the Subaccounts with performance information included in other publications and services that monitor the performance of insurance company separate accounts or other investment vehicles. These other services or publications may be general interest business publications such as *The Wall Street Journal*, *Barron’s*, *Business Week*, *Forbes*, *Fortune*, and *Money*.

In addition, our reports and communications to Contract Owners, advertisements, or sales literature may compare a Subaccount’s performance to various benchmarks that measure the performance of a pertinent group of securities widely regarded by investors as being representative of the securities markets in general or as being representative of a particular type of security. We may also compare the performance of the Subaccounts with that of other appropriate indices of investment securities and averages for peer universes of funds or data developed by us derived from such indices or averages. Unmanaged indices generally assume the reinvestment of dividends or interest but do not generally reflect deductions for investment management or administrative costs and expenses.

### *Tax Deferred Accumulation*

In reports or other communications to you or in advertising or sales materials, we may also describe the effects of tax-deferred compounding on the Separate Account’s investment returns or upon returns in general. These effects may be illustrated in charts or graphs and may include comparisons at various points in time of returns under the Contract or in general on a tax-deferred basis with the returns on a taxable basis. Different tax rates may be assumed.

In general, individuals who own annuity contracts are not taxed on increases in the value under the annuity contract until some form of distribution is made from the contract (Non-Natural Persons as Owners may not receive tax deferred accumulation). Thus, the annuity contract will benefit from tax deferral during the accumulation period, which generally will have the effect of permitting an investment in an annuity contract to grow more rapidly than a comparable investment under which increases in value are taxed on a current basis. The following chart illustrates this benefit by comparing accumulation under a variable annuity contract with accumulations from an investment on which gains are taxed on a current ordinary income basis.

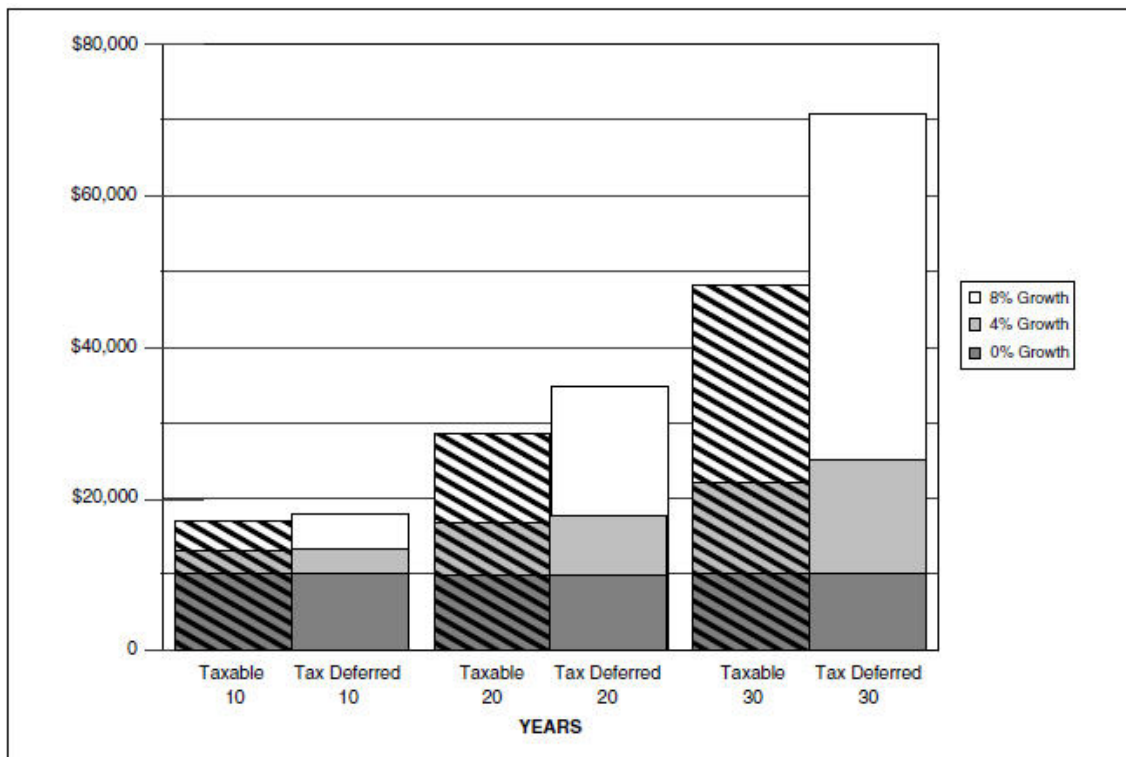
The chart shows a single Purchase Payment of \$10,000, assuming hypothetical annual returns of 0%, 4% and 8%, compounded annually, and a tax rate of 32%. The values shown for the taxable investment do not include any deduction for management fees or other expenses but assume that taxes are deducted annually from investment returns. The values shown for the variable annuity do not reflect the Risk Charge, and the asset-based Administrative Fee, any charge for applicable premium taxes and/or any other taxes, increase in the Risk Charge for an optional Death Benefit Rider, any optional Rider charge, or any underlying Fund expenses.

If above expenses and fees were taken into account, they would reduce the investment return shown for both the taxable investment and the hypothetical variable annuity contract. In addition, these values assume that you do not surrender the Contract or make any withdrawals until the end of the period shown. The chart assumes a full withdrawal, at the end of the period shown, of all Contract Value and the payment of taxes at the 32% rate on the amount in excess of the Purchase Payment.

The rates of return illustrated are hypothetical and are not an estimate or guarantee of performance. Actual tax rates may vary for different assets (*e.g.* capital gains and qualifying dividend income) and taxpayers from that illustrated. Withdrawals by and distributions to Contract Owners who have not reached age 59½ may be subject to a tax penalty of 10%.

## Power of Tax Deferral

\$10,000 investment at annual rates of return of 0%, 4% and 8%, taxed @ 32%



## DISTRIBUTION OF THE CONTRACTS

### Pacific Select Distributors, LLC (PSD)

Pacific Select Distributors, LLC, our affiliate, acts as the distributor of the Contracts and offers the Contracts on a continuous basis. PSD is located at 700 Newport Center Drive, Newport Beach, California 92660. PSD is registered as a broker-dealer with the SEC and is a member of FINRA. We pay PSD for acting as distributor under a Distribution Agreement. We and PSD enter into selling agreements with broker-dealers whose financial advisors are authorized by the Superintendent of the New York State Department of Financial Services to solicit applications for the Contracts. The aggregate amount of underwriting commissions paid to PSD for 2017, 2016 and 2015 with regard to this Contract was \$0.

PSD or an affiliate does not pay sales compensation to broker-dealers that solicit applications for the Contracts. However, PSD or an affiliate may provide reimbursement for other expenses associated with the promotion and solicitation of applications for the Contracts. You may ask your financial advisor how he/she will personally be compensated for the transaction.

Certain broker-dealers may be paid an amount under a persistency program which will be based on assets under management and duration of contracts. The amount under the persistency program for a financial advisor is not expected to exceed 0.25% of their total assets under management.

In addition to the persistency program described above, we and/or an affiliate may pay additional cash compensation from our own resources in connection with the promotion and solicitation of applications for the Contracts by some, but not all, broker-dealers. The range of additional cash compensation based on Purchase Payments generally does not exceed 0.20% and trailing compensation based on Account Value generally does not exceed 0.15% on an annual basis. Such additional compensation may give PL&A greater access to financial advisors of the broker-dealers that receive such compensation. While this greater access provides the opportunity for training and other educational programs so that your financial advisor may serve you better, this additional compensation also may afford PL&A a “preferred” status at the recipient broker-dealer and provide some other marketing benefit such as website

placement, access to financial advisor lists, extra marketing assistance or other heightened visibility and access to the broker-dealer's sales force that otherwise influences the way that the broker-dealer and the financial advisor market the Contracts.

As of December 31, 2017, the following firms have arrangements in effect with the Distributor pursuant to which the firm is entitled to receive a revenue sharing payment:

American Portfolios Financial Services Inc., Bancwest Investment Services Inc., Bok Financial Securities Inc, Caderet, Grant & Co., Cambridge Investment Research Inc, Citizens Securities Inc, C U N A Brokerage Services Inc., C U S O Financial Services LP, Capital One Investing, Cetera Advisors LLC, Cetera Advisors Network LLC, Cetera Financial Institutions, Cetera Financial Specialists, Citigroup Global Markets Inc., CMS Investment Resources LLC, Commonwealth Financial Network, B B V A Securities Inc., Edward D. Jones & Co., LP, Ensemble Financial Services Inc., The Enterprise Securities Co., Essex Financial Services Inc., F S C Securities Corporation, Fifth Third Securities Inc., Financial Advisors, First Allied Securities Inc., First Citizens Investor, First Heartland Capital Inc., FTB Advisors Inc., Frost Brokerage Services Inc, Geneos Wealth Management Inc., Girard Securities, Hancock Investment Services, Horan Securities Inc., Independent Financial Group, Infindex Investments Inc., Invest Financial Corporation, Investacorp Inc., Investment Centers of America Inc., Investment Professionals Inc., J J B Hilliard, Jacques Financial LLC, Janney Montgomery Scott Inc., Key Investment Services LLC, Kestra Investment Services, KMS Financial Service, L P L Financial LLC, Lincoln Financial Advisors Corp., Lincoln Financial Securities Corp., M & T Securities Inc., M Holdings Securities Inc., M M L Investors Services Inc., Meridian Financial Group Inc., Morgan Stanley & Co. Incorporated, Mutual Of Omaha Investor Services Inc., National Planning Corporation, Navy Federal Brokerage, NEXT Financial Group Inc., Oppenheimer & CO. Inc, Park Avenue Securities LLC., Packerland Brokerage, People's Securities, ProEquities Inc., Questar Capital Corporation, R B C Capital Markets Corporation, Raymond James & Associates Inc., Raymond James Financial Services Inc., Robert W Baird & Company Inc., Royal Alliance Associates Inc., S I I Investments Inc., Sagepoint Financial Inc., Santander Securities LLC, Securian Financial Services Inc., Securities America Inc., Securities Service Network, Signator Investors Inc., Sorrento Pacific Financial LLC, Stephens Inc., Stifel Nicolaus & Company Inc., Summit Brokerage Services Inc., SWBC Investment Services LLC, The Huntington Bank, The Huntington Investment, Transamerica Financial Advisors Inc., Triad Advisors Inc., U B S Financial Services Inc., U S Bancorp Investments Inc., Unionbank Investment Services LLC, United Planners' Financial Services of America, VOYA Financial Advisors, W L Lyons Inc., Wells Fargo Advisors LLC, Wells Fargo Investments LLC, Wescom Financial Services LLC, Woodbury Financial Services Inc.

We or our affiliates may also pay override payments, expense allowances and reimbursements, bonuses, wholesaler fees, and training and marketing allowances. Such payments may offset the broker-dealer's expenses in connection with activities that it is required to perform, such as educating personnel and maintaining records. Financial advisors may also receive non-cash compensation, such as expense-paid educational or training seminars involving travel within and outside the U.S. or promotional merchandise.

All of the compensation described in this section, and other compensation or benefits provided by us or our affiliates, may be more or less than the overall compensation on similar or other products and may influence your financial advisor or broker-dealer to present this Contract over other investment options. You may ask your financial advisor about these potential conflicts of interest and how he/she and his/her broker-dealer are compensated for selling the Contract.

Portfolio Managers of the underlying Portfolios available under this Contract may from time to time bear all or a portion of the expenses of conferences or meetings sponsored by PL&A or PSD that are attended by, among others, representatives of PSD, who would receive information and/or training regarding the Fund's Portfolios and their management by the Portfolio Managers in addition to information regarding the variable annuity and/or life insurance products issued by PL&A and its affiliates. Other persons may also attend all or a portion of any such conferences or meetings, including directors, officers and employees of PL&A, officers and trustees of Pacific Select Fund, and spouses/guests of the foregoing. The Pacific Select Fund Board of Trustees may hold meetings concurrently with such a conference or meeting. The Pacific Select Fund pays for the expenses of the meetings of its Board of Trustees, including the pro rata share of expenses for attendance by the Trustees at the concurrent conferences or meetings sponsored by PL&A or PSD. Additional expenses and promotional items may be paid for by PL&A and/or Portfolio Managers. PSD serves as the Pacific Select Fund Distributor.

## THE CONTRACTS AND THE SEPARATE ACCOUNT

Pursuant to Commodity Futures Trading Commission Rule 4.5, PL&A has claimed an exclusion from the definition of the term “commodity pool operator” under the Commodity Exchange Act. Therefore, it is not subject to registration or regulation as a commodity pool operator under the Commodity Exchange Act.

### Calculating Subaccount Unit Values

The Unit Value of the Subaccount Units in each Variable Investment Option is computed at the close of the New York Stock Exchange, which is usually 4:00 p.m. Eastern time on each Business Day. The initial Unit Value of each Subaccount was \$10 on the Business Day the Subaccount began operations. At the end of each Business Day, the Unit Value for a Subaccount is equal to:

$$Y \times Z$$

where (Y) = the Unit Value for that Subaccount as of the end of the preceding Business Day; and

(Z) = the Net Investment Factor for that Subaccount for the period (a “valuation period”) between that Business Day and the immediately preceding Business Day.

The “Net Investment Factor” for a Subaccount for any valuation period is equal to:

$$(A \div B) - C$$

where (A) = the “per share value of the assets” of that Subaccount as of the end of that valuation period, which is equal to:  $a+b+c$

where (a) = the net asset value per share of the corresponding Portfolio shares held by that Subaccount as of the end of that valuation period;

(b) = the per share amount of any dividend or capital gain distributions made by the Fund for that Portfolio during that valuation period; and

(c) = any per share charge (a negative number) or credit (a positive number) for any income taxes or other amounts set aside during that valuation period as a reserve for any income and/or any other taxes which we determine to have resulted from the operations of the Subaccount or Contract, and/or any taxes attributable, directly or indirectly, to Investments;

(B) = the net asset value per share of the corresponding Portfolio shares held by the Subaccount as of the end of the preceding valuation period; and

(C) = a factor that assesses against the Subaccount net assets for each calendar day in the valuation period, the basic Risk Charge plus the Administrative Fee and any applicable increase in the Risk Charge (see the **CHARGES, FEES AND DEDUCTIONS** section in the Prospectus).

### Variable Annuity Payment Amounts

The following steps show how we determine the amount of each variable annuity payment under your Contract.

#### *First: Pay Applicable Premium Taxes*

When you convert any portion of your Net Contract Value into annuity payments, you must pay any applicable charge for premium taxes and/or other taxes on your Contract Value (unless applicable law requires those taxes to be paid at a later time). We assess this charge by reducing your Account Value proportionately, relative to your Account Value in each Subaccount in an amount equal to the aggregate amount of the charges. The remaining amount of your available Net Contract Value may be used to provide variable annuity payments. Alternatively, your remaining available Net Contract Value may be used to provide fixed annuity payments, or it may be divided to provide both fixed and variable annuity payments. You may also choose to withdraw some or all of your remaining Net Contract Value less any applicable optional Rider charge, less any charges for premium taxes and/or other taxes without converting this amount into annuity payments.



### *Second: The First Variable Payment*

We begin by referring to your Contract's Option Table for your Annuity Option (the "Annuity Option Table"). The Annuity Option Table allows us to calculate the dollar amount of the first variable annuity payment under your Contract, based on the amount applied toward the variable annuity. The number that the Annuity Option Table yields will be based on the Annuitant's age (and, in certain cases, sex) and assumes a 4% rate of return, as described in more detail below.

*Example:* Assume a man is 65 years of age at his Annuity Date and has selected a lifetime annuity with monthly payments guaranteed for 10 years. According to the Annuity Option Table, this man should receive an initial monthly payment of \$5.20 for every \$1,000 of his Contract Value (reduced by applicable charges) that he will be using to provide variable payments. Therefore, if his Contract Value after deducting applicable fees and charges is \$100,000 on his Annuity Date and he applies this entire amount toward his variable annuity, his first monthly payment will be \$520.00.

You may choose any other Annuity Option Table that assumes a different rate of return which we offer at the time your Annuity Option is effective.

### *Third: Subaccount Annuity Units*

For each Subaccount, we use the amount of the first variable annuity payment under your Contract attributed to each Subaccount to determine the number of Subaccount Annuity Units that will form the basis of subsequent payment amounts. First, we use the Annuity Option Table to determine the amount of that first variable payment for each Subaccount. Then, for each Subaccount, we divide that amount of the first variable annuity payment by the value of one Subaccount Annuity Unit (the "Subaccount Annuity Unit Value") as of the end of the Annuity Date to obtain the number of Subaccount Annuity Units for that particular Subaccount. The number of Subaccount Annuity Units used to calculate subsequent payments under your Contract will not change unless exchanges of Annuity Units are made, (or if the Joint and Survivor Annuity Option is elected and the Primary Annuitant dies first) but the value of those Annuity Units will change daily, as described below.

### *Fourth: The Subsequent Variable Payments*

The amount of each subsequent variable annuity payment will be the sum of the amounts payable based on each Subaccount. The amount payable based on each Subaccount is equal to the number of Subaccount Annuity Units for that Subaccount multiplied by their Subaccount Annuity Unit Value at the end of the Business Day in each payment period you elected that corresponds to the Annuity Date.

Each Subaccount's Subaccount Annuity Unit Value, like its Subaccount Unit Value, changes each day to reflect the net investment results of the underlying investment vehicle, as well as the assessment of the Risk Charge at an annual rate of 0.15% and the Administrative Fee at an annual rate of 0.25%. In addition, the calculation of Subaccount Annuity Unit Value incorporates an additional factor; as discussed in more detail below, this additional factor adjusts Subaccount Annuity Unit Values to correct for the Option Table's implicit assumed annual investment return on amounts applied but not yet used to furnish annuity benefits. Any increase in your Risk Charge for an optional death benefit rider is not charged after the Annuity Date.

Different Subaccounts may be selected for your Contract before and after your Annuity Date, subject to any restrictions we may establish. Currently, you may exchange Subaccount Annuity Units in any Subaccount for Subaccount Annuity Units in any other Subaccount(s) up to four times in any twelve month period after your Annuity Date. The number of Subaccount Annuity Units in any Subaccount may change due to such exchanges. Exchanges following your Annuity Date will be made by exchanging Subaccount Annuity Units of equivalent aggregate value, based on their relative Subaccount Annuity Unit Values.

### *Understanding the "Assumed Investment Return" Factors*

The Annuity Option Table incorporates a number of implicit assumptions in determining the amount of your first variable annuity payment. As noted above, the numbers in the Annuity Option Table reflect certain actuarial assumptions based on the Annuitant's age, and, in some cases, the Annuitant's sex. In addition, these numbers assume that the amount of your Contract Value that you convert to a variable annuity will have a positive net investment return of 4% each year during the payout of your annuity; thus 4% is referred to as an "assumed investment return."

The Subaccount Annuity Unit Value for a Subaccount will increase only to the extent that the investment performance of that Subaccount exceeds the Risk Charge, the Administrative Fee, and the assumed investment return. The Subaccount Annuity Unit Value for any Subaccount will generally be less than the Subaccount Unit Value for that same Subaccount, and the difference will be the amount of the assumed investment return factor.

*For example:* Assume the net investment performance of a Subaccount is at a rate of 4.00% per year (after deduction of the 0.15% Risk Charge and the 0.25% Administrative Fee). The Subaccount Unit Value for that Subaccount would increase at a rate of 4.00% per year, but the Subaccount Annuity Unit Value would not increase (or decrease) at all. The net investment factor for that 4% return [1.04] is then divided by the factor for the 4% assumed investment return [1.04] and 1 is subtracted from the result to determine the adjusted rate of change in Subaccount Annuity Unit Value:

$$\frac{1.04}{1.04} = 1; 1 - 1 = 0; 0 \times 100\% = 0\%.$$

If the net investment performance of a Subaccount's assets is at a rate less than 4.00% per year, the Subaccount Annuity Unit Value will decrease, even if the Subaccount Unit Value is increasing.

*For example:* Assume the net investment performance of a Subaccount is at a rate of 2.60% per year (after deduction of the 0.15% Risk Charge and the 0.25% Administrative Fee). The Subaccount Unit Value for that Subaccount would increase at a rate of 2.60% per year, but the Subaccount Annuity Unit Value would decrease at a rate of 1.35% per year. The net investment factor for that 2.6% return [1.026] is then divided by the factor for the 4% assumed investment return [1.04] and 1 is subtracted from the result to determine the adjusted rate of change in Subaccount Annuity Unit Value:

$$\frac{1.026}{1.04} = 0.9865; 0.9865 - 1 = -0.0135; -0.0135 \times 100\% = -1.35\%.$$

The assumed investment return will always cause increases in Subaccount Annuity Unit Values to be somewhat less than if the assumption had not been made, will cause decreases in Subaccount Annuity Unit Values to be somewhat greater than if the assumption had not been made, and will (as shown in the example above) sometimes cause a decrease in Subaccount Annuity Unit Values to take place when an increase would have occurred if the assumption had not been made. If we had assumed a higher investment return in our Annuity Option tables, it would produce annuities with larger first payments, but the increases in subaccount annuity payments would be smaller and the decreases in subsequent annuity payments would be greater; a lower assumed investment return would produce annuities with smaller first payments, and the increases in subsequent annuity payments would be greater and the decreases in subsequent annuity payments would be smaller.

## **Redemptions of Remaining Guaranteed Variable Payments Under Options 2 and 4**

If variable payments are elected under Annuity Options 2 and 4 (Life with Period Certain and Period Certain Only, respectively), you may redeem all remaining guaranteed variable payments after the Annuity Date (for more information about Annuity Options, see **ANNUITIZATION – Choosing your Annuity Option** in the Prospectus). Also, under Option 4, partial redemptions of remaining guaranteed variable payments after the Annuity Date are available. **If you elect to redeem all remaining guaranteed variable payments in a single sum, we will not make any additional variable annuity payments during the remaining guaranteed period after the redemption.** If Annuity Option 2 was elected and the Annuitant is alive at the end of the guaranteed period, annuity payments will resume until the Annuitant's death. The amount available upon a full redemption would be the present value of any remaining guaranteed variable payments at the assumed investment return. **If you have a Qualified Contract, there may be adverse tax implications if you elect to redeem any remaining variable payments in a single sum. Work with your tax advisor before making such an election.**

The variable payment amount we use in calculating the present value is determined by summing an amount for each Subaccount, which we calculate by multiplying your Subaccount Annuity Units by the Annuity Unit Value next computed after we receive your redemption request. This variable payment amount is then discounted at the

assumed investment return from each future Annuity Payment date that falls within the payment guaranteed period. The sum of these discounted remaining variable payment amounts is the present value of remaining guaranteed variable payments.

If you elect to redeem all remaining guaranteed variable payments in a single sum, we will not make any additional variable annuity payments during the remaining guaranteed period after the redemption.

If you elect to redeem a portion of the remaining guaranteed variable payments in a single sum, we will reduce the number of Annuity Units for each Subaccount by the same percentage as the partial redemption value bears to the amount available upon a full redemption.

Redemption of remaining guaranteed variable payments will not affect the amount of any fixed annuity payments.

### **Corresponding Dates**

If any transaction or event under your Contract is scheduled to occur on a “corresponding date” that does not exist in a given calendar period, the transaction or event will be deemed to occur on the following Business Day. In addition, as stated in the Prospectus, any event scheduled to occur on a day that is not a Business Day will occur on the next succeeding Business Day.

*Example:* If your Contract is issued on February 29 in year 1 (a leap year), your Contract Anniversary in years 2, 3 and 4 will be on March 1.

*Example:* If your Annuity Date is July 31, and you select monthly annuity payments, the payments received will be based on valuations made on July 31, August 31, October 1 (for September), October 31, December 1 (for November), December 31, January 31, March 1 (for February), March 31, May 1 (for April), May 31 and July 1 (for June).

### **Age and Sex of Annuitant**

The Contracts generally provide for sex-distinct annuity income factors in the case of life annuities. Statistically, females tend to have longer life expectancies than males; consequently, if the amount of annuity payments is based on life expectancy, they will ordinarily be higher if an annuitant is male than if an annuitant is female. Certain states’ regulations prohibit sex-distinct annuity income factors, and Contracts issued in those states will use unisex factors. In addition, Contracts issued in connection with certain Qualified Plans are required to use unisex factors.

We may require proof of your Annuitant’s age and/or sex before or after commencing annuity payments. If the age or sex (or both) of your Annuitant are incorrectly stated in your Contract, we will correct the amount payable to equal the amount that the annuitized portion of the Contract Value under that Contract would have purchased for your Annuitant’s correct age and sex. If we make the correction after annuity payments have started, and we have made overpayments based on the incorrect information, we will deduct the amount of the overpayment, with interest as stated in your Contract, from any payments due then or later; if we have made underpayments, we will add the amount, with interest as stated in your Contract, of the underpayments to the next payment we make after we receive proof of the correct age and/or sex.

Additionally, we may require proof of the Annuitant’s or Owner’s age before any payments associated with the Death Benefit provisions of your Contract are made. If the age or sex of the Annuitant is incorrectly stated in your Contract, we will base any payment associated with the Death Benefit provisions on your Contract on the Annuitant’s or Owner’s correct age or sex.

### **Systematic Transfer Programs**

If you are using the earnings sweep, you may also use portfolio rebalancing only if you selected the Fidelity® VIP Government Money Market Subaccount. You may not use dollar cost averaging and the earnings sweep at the same time.

#### *Dollar Cost Averaging*

When you request dollar cost averaging, you are authorizing us to make periodic reallocations of your Contract Value without waiting for any further instruction from you. You may request to begin or stop dollar cost averaging at any time prior to your Annuity Date; the effective date of your request will be the day we receive notice from you In Proper Form. Your request may specify the date on which you want your first transfer to be made. Your first

transfer may not be made until 30 days after your Contract Date, and if you specify an earlier date, your first transfer will be delayed until one calendar month after the date you specify. If you request dollar cost averaging on your application for your Contract and you fail to specify a date for your first transfer, your first transfer will be made one period after your Contract Date (that is, if you specify monthly transfers, the first transfer will occur 30 days after your Contract Date; quarterly transfers, 90 days after your Contract Date; semi-annual transfers, 180 days after your Contract Date; and if you specify annual transfers, the first transfer will occur on your Contract Anniversary). If you stop dollar cost averaging, you must wait 30 days before you may begin this option again. Currently, we are not enforcing the 30 day waiting periods but we reserve the right to enforce such waiting periods in the future. We will provide at least a 30 day prior notice before we enforce the 30 day waiting periods.

Your request to begin dollar cost averaging must specify the Investment Option you wish to transfer money from (your “source account”). You may choose any one Investment Option as your source account. The Account Value of your source account must be at least \$5,000 for you to begin dollar cost averaging. Currently, we are not enforcing the minimum Account Value but we reserve the right to enforce such minimum amounts in the future. We will provide at least a 30 day prior notice before we enforce the minimum Account Value requirement.

Your request to begin dollar cost averaging must also specify the amount and frequency of your transfers. You may choose monthly, quarterly, semiannual or annual transfers. The amount of your transfers may be specified as a dollar amount or a percentage of your source Account Value; however, each transfer must be at least \$250. Currently, we are not enforcing the minimum transfer amount but we reserve the right to enforce such minimum amounts in the future. We will provide at least a 30 day prior notice before we enforce the minimum transfer amount. Dollar cost averaging transfers are not subject to the same requirements and limitations as other transfers.

Finally, your request must specify the Variable Investment Option(s) you wish to transfer amounts to (your “target account(s)”). If you select more than one target account, your dollar cost averaging request must specify how transferred amounts should be allocated among the target accounts. Your source account may not also be a target account.

Your dollar cost averaging transfers will continue until the earlier of:

- your request to stop dollar cost averaging is effective,
- your source Account Value is zero,
- your transfer amount is greater than the source Account Value, or
- your Annuity Date.

If, as a result of a dollar cost averaging transfer, your source Account Value falls below any minimum Account Value we may establish, we have the right, at our option, to transfer that remaining Account Value to your target account(s) on a proportionate basis relative to your most recent allocation instructions. We may change, terminate or suspend the dollar cost averaging option at any time.

### *Portfolio Rebalancing*

Portfolio rebalancing allows you to maintain the percentage of your Contract Value allocated to each Variable Investment Option at a pre-set level prior to annuitization.

For example, you could specify that 30% of your Contract Value should be in Subaccount A, 40% in Subaccount B, and 30% in Subaccount C.

Over time, the variations in each Subaccount’s investment results will shift this balance of these Subaccount Value allocations. If you elect the portfolio rebalancing feature, we will automatically transfer your Subaccount Value back to the percentages you specify.

You may choose to have rebalances made quarterly, semi-annually or annually. Any Investment Options not selected for portfolio rebalancing will not be rebalanced.

Procedures for selecting portfolio rebalancing are generally the same as those discussed in detail above for selecting dollar cost averaging: You may make your request at any time prior to your Annuity Date and it will be effective when we receive it In Proper Form. If you stop portfolio rebalancing, you must wait 30 days to begin again. Currently, we are not enforcing the 30-day waiting period but we reserve the right to enforce such waiting period in the future. If you request rebalancing on your application but do not specify a date for the first rebalance, it will

occur one period after your Contract Date, as described above under Dollar Cost Averaging. We may change, terminate or suspend the portfolio rebalancing feature at any time. Portfolio rebalancing will stop on the Annuity Date.

### *Earnings Sweep*

An earnings sweep automatically transfers the earnings from the Fidelity® VIP Government Money Market Subaccount (the “sweep option”) to one or more other Variable Investment Options (your “target option(s)”). The Account Value of your sweep option will be required to be at least \$5,000 when you elect the earnings sweep. Currently, we are not enforcing the minimum Account Value but we reserve the right to enforce such minimum amounts in the future. We will provide at least a 30 day prior notice before we enforce the minimum Account Value requirement.

You may choose to have earnings sweeps occur monthly, quarterly, semi-annually or annually until you annuitize. At each earnings sweep, we will automatically transfer your accumulated earnings attributable to your sweep option for the previous period proportionately to your target option(s). That is, if you select a monthly earnings sweep, we will transfer the sweep option earnings from the preceding month; if you select a semi-annual earnings sweep, we will transfer the sweep option earnings accumulated over the preceding 6 months. Earnings sweep transfers are not subject to the same requirements and limitations as other transfers.

To determine the earnings, we take the change in the sweep option’s Account Value during the sweep period, add any withdrawals or transfers out of the sweep option Account that occurred during the sweep period, and subtract any allocations to the sweep option Account during the sweep period. The result of this calculation represents the “total earnings” for the sweep period.

If, during the sweep period, you withdraw or transfer amounts from the sweep option Account, we assume that earnings are withdrawn or transferred before any other Account Value. Therefore, your “total earnings” for the sweep period will be reduced by any amounts withdrawn or transferred during the sweep option period. The remaining earnings are eligible for the sweep transfer.

Procedures for selecting the earnings sweep are generally the same as those discussed in detail above for selecting dollar cost averaging and portfolio rebalancing: You may make your request at any time and it will be effective when we receive In Proper Form. If you stop the earnings sweep, you must wait 30 days to begin again. Currently, we are not enforcing the 30 day waiting period but we reserve the right to enforce such waiting period in the future. We will provide at least a 30 day prior notice before we enforce the 30 day waiting period. If you request the earnings sweep on your application but do not specify a date for the first sweep, it will occur one period after your Contract Date, as described above under Dollar Cost Averaging.

If, as a result of an earnings sweep transfer, your source Account Value falls below \$500, we have the right, at our option, to transfer that remaining Account Value to your target account(s) on a proportionate basis relative to your most recent allocation instructions. We may change, terminate or suspend the earnings sweep option at any time.

### **Pre-Authorized Withdrawals**

You may specify a dollar amount for your pre-authorized withdrawals, or you may specify a percentage of your Contract Value or living benefit rider, if applicable. You may direct us to make your pre-authorized withdrawals from one or more specific Investment Options. If you do not give us these specific instructions, amounts will be deducted proportionately from your Account Value in each Investment Option.

Procedures for selecting pre-authorized withdrawals are generally the same as those discussed in detail above for selecting dollar cost averaging, portfolio rebalancing, and earnings sweeps: You may make your request at any time and it will be effective when we receive it In Proper Form. If you stop the pre-authorized withdrawals, you must wait 30 days to begin again. Currently, we are not enforcing the 30-day waiting period but we reserve the right to enforce such waiting period in the future. We will provide at least a 30 day prior notice before we enforce the 30-day waiting period.

Each pre-authorized withdrawal is subject to any applicable charge for premium taxes and/or other taxes, to federal income tax on its taxable portion, and, if you have not reached age 59½, may be subject to a 10% federal tax penalty.

## **More on Federal Tax Issues**

Section 817(h) of the Code provides that the investments underlying a variable annuity must satisfy certain diversification requirements. Details on these diversification requirements generally appear in the Fund SAIs. We believe the underlying Variable Investment Options for the Contract meet these requirements. On March 7, 2008, the Treasury Department issued Final Regulations under Section 817(h). These Final Regulations do not provide guidance concerning the extent to which you may direct your investments to particular divisions of a separate account. Such guidance may be included in regulations or revenue rulings under Section 817(d) relating to the definition of a variable contract. We reserve the right to make such changes as we deem necessary or appropriate to ensure that your Contract continues to qualify as an annuity for tax purposes. Any such changes will apply uniformly to affected Contract Owners and will be made with such notice to affected Contract Owners as is feasible under the circumstances.

For a variable life insurance contract or a variable annuity contract to qualify for tax deferral, assets in the separate accounts supporting the contract must be considered to be owned by the insurance company and not by the contract owner. Under current U.S. tax law, if a contract owner has excessive control over the investments made by a separate account, or the underlying fund, the contract owner will be taxed currently on income and gains from the account or fund. In other words, in such a case of “investor control” the contract owner would not derive the tax benefits normally associated with variable life insurance or variable annuities.

Generally, according to the IRS, there are two ways that impermissible investor control may exist. The first relates to the design of the contract or the relationship between the contract and a separate account or underlying fund. For example, at various times, the IRS has focused on, among other factors, the number and type of investment choices available pursuant to a given variable contract, whether the contract offers access to funds that are available to the general public, the number of transfers that a contract owner may make from one investment option to another, and the degree to which a contract owner may select or control particular investments.

With respect to this first aspect of investor control, we believe that the design of our contracts and the relationship between our contracts and the Portfolios satisfy the current view of the IRS on this subject, such that the investor control doctrine should not apply. However, because of some uncertainty with respect to this subject and because the IRS may issue further guidance on this subject, we reserve the right to make such changes as we deem necessary or appropriate to reduce the risk that your contract might not qualify as a life insurance contract or as an annuity for tax purposes.

The second way that impermissible investor control might exist concerns your actions. Under case law and IRS guidance, you may not select or control particular investments, other than choosing among broad investment choices such as selecting a particular Portfolio. You may not select or direct the purchase or sale of a particular investment of a Separate Account, a Subaccount (or Variable Investment Option), or a Portfolio. All investment decisions concerning the Separate Accounts and the Subaccounts must be made by us, and all investment decisions concerning the underlying Portfolios must be made by the portfolio manager for such Portfolio in his or her sole and absolute discretion, and not by the contract owner. Furthermore, you may not enter into an agreement or arrangement with a portfolio manager of a Portfolio or communicate directly or indirectly with such a portfolio manager or any related investment officers concerning the selection, quality, or rate of return of any specific investment or group of investments held by a Portfolio, and you may not enter into any such agreement or arrangement or have any such communication with us or the investment advisor of a Portfolio.

Finally, the IRS may issue additional guidance on the investor control doctrine, which might further restrict your actions or features of the variable contract. Such guidance could be applied retroactively. If any of the rules outlined above are not complied with, the IRS may seek to tax you currently on income and gains from a Portfolio such that you would not derive the tax benefits normally associated with variable life insurance or variable annuities. Although highly unlikely, such an event may have an adverse impact on the fund and other variable contracts. We urge you to consult your own tax advisor with respect to the application of the investor control doctrine.

### *Loans*

Certain Owners of Qualified Contracts may borrow against their Contracts. Otherwise loans from us are not permitted. You may request a loan from us, using your Contract Value as your only security if your Qualified Contract:

- is not subject to Title 1 of ERISA,

- is issued under Section 403(b) of the Code, and
- permits loans under its terms (a “Loan Eligible Plan”).

You will be charged interest on your Contract Debt at a fixed annual rate equal to 5%. The amount held in the Loan Account to secure your loan will earn a return equal to an annual rate of 3%. The net amount of interest you pay on your loan will be 2% annually.

Interest charges accrue on your Contract Debt daily, beginning on the effective date of your loan. Interest earned on the Loan Account Value accrue daily beginning on the day following the effective date of the loan, and those earnings will be transferred once a year to your Investment Options in accordance with your most recent allocation instructions.

We may change these loan provisions to reflect changes in the Code or interpretations thereof. **We urge you to consult with a qualified tax advisor prior to effecting any loan transaction under your Contract.**

If you purchase any optional living benefit rider (including any and all previous, current, and future versions), taking a loan while an optional living benefit rider is in effect will terminate your Rider. If you have an existing loan on your Contract, you should carefully consider whether an optional living benefit rider is appropriate for you.

### *Tax and Legal Matters*

The tax and ERISA rules relating to Contract loans are complex and in many cases unclear. For these reasons, and because the rules vary depending on the individual circumstances, these loans are processed by your Plan Administrator. **We urge you to consult with a qualified tax advisor prior to effecting any loan transaction under your Contract.**

Generally, interest paid on your loan under a 403(b) tax-sheltered annuity will be considered non-deductible “personal interest” under Section 163(h) of the Code, to the extent the loan comes from and is secured by your pre-tax contributions, even if the proceeds of your loan are used to acquire your principal residence.

### *Loan Procedures*

Your loan request must be submitted on the appropriate request form. You may submit a loan request 30 days after your Contract Date and before your Annuity Date. However, before requesting a new loan, you must wait 30 days after the last payment of a previous loan. If approved, your loan will usually be effective as of the end of the Business Day on which we receive all necessary documentation In Proper Form. We will normally forward proceeds of your loan to you within 7 calendar days after the effective date of your loan.

In order to secure your loan, on the effective date of your loan, we will transfer an amount equal to the principal amount of your loan into an account called the “Loan Account.” The Loan Account is held under the General Account. To make this transfer, we will transfer amounts proportionately from your Investment Options based on your Account Value in each Investment Option.

As your loan is repaid, a portion, corresponding to the amount of the repayment of any amount then held as security for your loan, will be transferred from the Loan Account back into your Investment Options relative to your most recent allocation instructions.

A transfer from the Loan Account back into your Investment Options following a loan repayment is not considered a transfer under the transfer limitations as stated in the **HOW YOUR PURCHASE PAYMENTS ARE ALLOCATED – Transfers and Market-timing Restrictions** section in the Prospectus.

### *Loan Terms*

You may have only one loan outstanding at any time. The minimum loan amount is \$1,000. Your Contract Debt at the effective date of your loan may not exceed the *lesser* of:

- 50% of the amount available for withdrawal under this Contract (see the **WITHDRAWALS – Optional Withdrawals – Amount Available for Withdrawal** section in the Prospectus), or
- \$50,000 less your highest outstanding Contract Debt during the 12-month period immediately preceding the effective date of your loan.

You should refer to the terms of your particular Loan Eligible Plan for any additional loan restrictions. If you have other loans outstanding pursuant to other Loan Eligible Plans, the amount you may borrow may be further restricted. We are not responsible for making any determination (including loan amounts permitted) or any interpretation with respect to your Loan Eligible Plan.

### *Repayment Terms*

Your loan, including principal and accrued interest, generally must be repaid in quarterly installments. An installment will be due in each quarter on the date corresponding to the effective date of your loan, beginning with the first such date following the effective date of your loan. See the **FEDERAL TAX ISSUES – Qualified Contracts – Loans** section in the Prospectus.

*Example:* On May 1, we receive your loan request, and your loan is effective. Your first quarterly payment will be due on August 1.

Adverse tax consequences may result if you fail to meet the repayment requirements for your loan. You must repay principal and interest of any loan in substantially equal payments over the term of the loan. Generally, the term of the loan will be 5 years from the effective date of the loan. However, if you have certified to us that your loan proceeds are to be used to acquire a principal residence for yourself, you may request a loan term of 30 years. In either case, however, you must repay your loan prior to your Annuity Date. If you elect to annuitize (or withdraw) your Net Contract Value while you have an outstanding loan, we will deduct any Contract Debt from your Contract Value at the time of the annuitization (or withdrawal) to repay the Contract Debt.

You may prepay your entire loan at any time. If you do so, we will bill you for any unpaid interest that has accrued through the date of payoff. Your loan will be considered repaid only when the interest due has been paid. Subject to any necessary approval of state insurance authorities, while you have Contract Debt outstanding, we will treat all payments you send us as Investments unless you specifically indicate that your payment is a loan repayment or include your loan payment notice with your payment. To the extent allowed by law, any loan repayments in excess of the amount then due will be applied to the principal balance of your loan. Such repayments will not change the due dates or the periodic repayment amount due for future periods. If a loan repayment is in excess of the principal balance of your loan, any excess repayment will be refunded to you. Repayments we receive that are less than the amount then due will be returned to you, unless otherwise required by law.

If we have not received your full payment by its due date, we will declare the entire remaining loan balance in default. At that time, we will send written notification of the amount needed to bring the loan back to a current status. You will have 60 days from the date on which the loan was declared in default (the “grace period”) to make the required payment.

If the required payment is not received by the end of the grace period, the defaulted loan balance plus accrued interest will be withdrawn from your Contract Value, *if amounts under your Contract are eligible for distribution*. In order for an amount to be eligible for distribution from a TSA funded by salary reductions you must meet one of five triggering events. The triggering events are:

- attainment of age 59½,
- severance from employment,
- death,
- disability, and
- financial hardship (with respect to contributions only, not income or earnings on these contributions).

If those amounts are not eligible for distribution, the defaulted loan balance plus accrued interest will be considered a Deemed Distribution and will be withdrawn when such Contract Values become eligible. In either case, the Distribution or the Deemed Distribution will be considered a currently taxable event, and may be subject to a 10% federal tax penalty.

If there is a Deemed Distribution under your Contract and to the extent allowed by law, any future withdrawals will first be applied as repayment of the defaulted Contract Debt, including accrued interest and charges for applicable taxes. Any amounts withdrawn and applied as repayment of Contract Debt will first be withdrawn from your Loan Account, and then from your Investment Options on a proportionate basis relative to the Account Value in each



Investment Option. If you have an outstanding loan that is in default, the defaulted Contract Debt will be considered a withdrawal for the purpose of calculating any Death Benefit Amount and/or Guaranteed Minimum Death Benefit.

The terms of any such loan are intended to qualify for the exception in Code Section 72(p)(2) so that the distribution of the loan proceeds will not constitute a distribution that is taxable to you. To that end, these loan provisions will be interpreted to ensure and maintain such tax qualification, despite any other provisions to the contrary. Subject to any regulatory approval, we reserve the right to amend your Contract to reflect any clarifications that may be needed or are appropriate to maintain such tax qualification or to conform any terms of our loan arrangement with you to any applicable changes in the tax qualification requirements. We will send you a copy of any such amendment. If you refuse such an amendment, it may result in adverse tax consequences to you.

### **Safekeeping of Assets**

We are responsible for the safekeeping of the assets of the Separate Account. These assets are held separate and apart from the assets of our General Account and our other separate accounts.

## **FINANCIAL STATEMENTS**

PL&A's financial statements as of December 31, 2017 and 2016 and for each of the three years in the period ended December 31, 2017 are included in this SAI. The financial statements of Separate Account A of PL&A as of December 31, 2017 and for each of the periods presented are incorporated by reference in this SAI from the Annual Report of Separate Account A dated December 31, 2017. These financial statements should be considered only as bearing on the ability of PL&A to meet its obligations under the Contracts and not as bearing on the investment performance of the assets held in the Separate Account.

## **INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM AND INDEPENDENT AUDITORS**

The financial statements of Pacific Life & Annuity Company as of December 31, 2017 and 2016 and for each of the three years in the period ended December 31, 2017 have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report appearing herein, and is included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The financial statements of Separate Account A of Pacific Life & Annuity Company as of December 31, 2017 and for each of the periods presented have been audited by Deloitte & Touche LLP, independent registered public accounting firm, as stated in their report included in the Annual Report of Separate Account A dated December 31, 2017, which is incorporated by reference in this Registration Statement. Such financial statements and financial statement schedules have been so incorporated in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The business address of Deloitte & Touche LLP is 695 Town Center Drive, Costa Mesa, CA 92626.

## **PACIFIC LIFE & ANNUITY COMPANY**

Financial Statements as of December 31, 2017 and 2016  
and for the years ended December 31, 2017, 2016 and 2015  
and Independent Auditors' Report

## INDEPENDENT AUDITORS' REPORT

Pacific Life & Annuity Company:

We have audited the accompanying financial statements of Pacific Life & Annuity Company (the "Company"), which comprise the statements of financial condition as of December 31, 2017 and 2016, and the related statements of operations, comprehensive income, stockholder's equity, and cash flows for each of the three years in the period ended December 31, 2017 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 & Annuity Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

March 16, 2018

Pacific Life & Annuity Company

STATEMENTS OF FINANCIAL CONDITION

<i>(In Thousands)</i>	December 31,	
	2017	2016
<b>ASSETS</b>		
Investments:		
Fixed maturity securities available for sale, at estimated fair value	\$4,050,084	\$3,641,197
Equity securities available for sale, at estimated fair value	1,898	3,071
Mortgage loans	449,621	465,753
Policy loans	7,521	6,251
Other investments	17,003	20,103
<b>TOTAL INVESTMENTS</b>	<b>4,526,127</b>	<b>4,136,375</b>
Cash and cash equivalents	90,845	81,174
Deferred policy acquisition costs	134,071	125,255
Accrued investment income	44,954	42,441
Other assets	32,088	22,962
Separate account assets	2,921,740	2,643,068
<b>TOTAL ASSETS</b>	<b>\$7,749,825</b>	<b>\$7,051,275</b>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>		
Liabilities:		
Future policy benefits	\$2,340,995	\$2,203,192
Policyholder account balances	1,693,483	1,453,227
Other liabilities	47,142	41,379
Separate account liabilities	2,921,740	2,643,068
<b>TOTAL LIABILITIES</b>	<b>7,003,360</b>	<b>6,340,866</b>
Commitments and contingencies (Note 13)		
Stockholder's Equity:		
Common stock - \$1 par value; 5 million shares authorized;		
2.9 million shares issued and outstanding	2,900	2,900
Paid-in capital	134,577	134,577
Retained earnings	438,769	446,516
Accumulated other comprehensive income	170,219	126,416
<b>TOTAL STOCKHOLDER'S EQUITY</b>	<b>746,465</b>	<b>710,409</b>
<b>TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY</b>	<b>\$7,749,825</b>	<b>\$7,051,275</b>

See Notes to Financial Statements

Pacific Life & Annuity Company

STATEMENTS OF OPERATIONS

<i>(In Thousands)</i>	Years Ended December 31,		
	2017	2016	2015
<b>REVENUES</b>			
Policy fees	\$64,497	\$61,731	\$58,759
Insurance premiums	61,778	62,559	49,153
Net investment income	209,751	200,075	202,621
Net realized investment gain (loss)	(4,591)	(3,986)	10,771
Other than temporary impairments	(103)		(2,845)
Other income	2,369	3,321	2,470
<b>TOTAL REVENUES</b>	<b>333,701</b>	<b>323,700</b>	<b>320,929</b>
<b>BENEFITS AND EXPENSES</b>			
Policy benefits paid or provided	170,953	165,138	155,299
Interest credited to policyholder account balances	48,875	42,346	40,597
Commission expenses	26,860	33,719	36,457
Operating expenses	20,361	18,023	17,489
<b>TOTAL BENEFITS AND EXPENSES</b>	<b>267,049</b>	<b>259,226</b>	<b>249,842</b>
<b>INCOME BEFORE PROVISION FOR INCOME TAXES</b>	<b>66,652</b>	<b>64,474</b>	<b>71,087</b>
Provision for income taxes	4,295	17,200	19,111
<b>NET INCOME</b>	<b>\$62,357</b>	<b>\$47,274</b>	<b>\$51,976</b>

See Notes to Financial Statements

Pacific Life & Annuity Company

STATEMENTS OF COMPREHENSIVE INCOME

<i>(In Thousands)</i>	Years Ended December 31,		
	2017	2016	2015
<b>NET INCOME</b>	\$62,357	\$47,274	\$51,976
Other comprehensive income (loss), net of tax:			
Gain (loss) on derivatives and unrealized gain (loss) on securities available for sale, net:			
Unrealized holding gain (loss) arising during period	14,552	(19,592)	(25,129)
Reclassification adjustment for (gain) loss included in net income	(853)	(347)	392
Gain (loss) on derivatives and unrealized gain (loss) on securities available for sale, net	13,699	(19,939)	(24,737)
<b>COMPREHENSIVE INCOME</b>	\$76,056	\$27,335	\$27,239

See Notes to Financial Statements

Pacific Life & Annuity Company

STATEMENTS OF STOCKHOLDER'S EQUITY

<i>(In Thousands)</i>	Common Stock	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
<b>BALANCES, JANUARY 1, 2015</b>	<b>\$2,900</b>	<b>\$134,577</b>	<b>\$423,266</b>	<b>\$171,092</b>	<b>\$731,835</b>
Comprehensive income (loss):					
Net income			51,976		51,976
OCI: loss on derivatives and unrealized loss on securities available for sale, net				(24,737)	(24,737)
Total comprehensive income					27,239
Dividend to parent			(37,000)		(37,000)
<b>BALANCES, DECEMBER 31, 2015</b>	<b>2,900</b>	<b>134,577</b>	<b>438,242</b>	<b>146,355</b>	<b>722,074</b>
Comprehensive income (loss):					
Net income			47,274		47,274
OCI: loss on derivatives and unrealized loss on securities available for sale, net				(19,939)	(19,939)
Total comprehensive income					27,335
Dividend to parent			(39,000)		(39,000)
<b>BALANCES, DECEMBER 31, 2016</b>	<b>2,900</b>	<b>134,577</b>	<b>446,516</b>	<b>126,416</b>	<b>710,409</b>
Comprehensive income:					
Net income			62,357		62,357
OCI: loss on derivatives and unrealized gain on securities available for sale, net				13,699	13,699
Total comprehensive income					76,056
Reclassification of deferred tax effects (Note 1)			(30,104)	30,104	
Dividend to parent			(40,000)		(40,000)
<b>BALANCES, DECEMBER 31, 2017</b>	<b>\$2,900</b>	<b>\$134,577</b>	<b>\$438,769</b>	<b>\$170,219</b>	<b>\$746,465</b>

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

See Notes to Financial Statements

Pacific Life & Annuity Company

STATEMENTS OF CASH FLOWS

<i>(In Thousands)</i>	Years Ended December 31,		
	2017	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$62,357	\$47,274	\$51,976
Adjustments to reconcile net income to net cash provided by operating activities:			
Net accretion on fixed maturity securities	(591)	(716)	(2,625)
Deferred income taxes	(8,510)	370	2,620
Net realized investment (gain) loss	4,591	3,986	(10,771)
Other than temporary impairments	103		2,845
Net change in deferred policy acquisition costs	(10,166)	(1,811)	4,257
Interest credited to policyholder account balances	48,875	42,346	40,597
Net change in future policy benefits	29,076	29,008	26,014
Other operating activities, net	7,053	5,191	13,427
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>132,788</b>	<b>125,648</b>	<b>128,340</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Fixed maturity and equity securities available for sale:			
Purchases	(414,843)	(347,308)	(218,348)
Sales	23,991	26,452	14,141
Maturities and repayments	122,436	118,598	116,473
Repayments of mortgage loans	16,617	25,015	24,915
Fundings of mortgage loans		(40,000)	(402)
Terminations of derivative instruments, net	4,086	413	561
Proceeds from nonhedging derivative settlements	559	3,739	4,655
Payments for nonhedging derivative settlements	(26,180)	(25,168)	(8,714)
Net change in cash collateral received or pledged	406	(279)	(1,582)
Other investing activities, net	(1,265)	(237)	(188)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(274,193)</b>	<b>(238,775)</b>	<b>(68,489)</b>

*(Continued)*

See Notes to Financial Statements



Pacific Life & Annuity Company

STATEMENTS OF CASH FLOWS

<i>(In Thousands)</i>	Years Ended December 31,		
	2017	2016	2015
<i>(Continued)</i>			
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Policyholder account balances:			
Deposits	\$407,481	\$378,806	\$198,320
Withdrawals	(216,405)	(214,389)	(222,886)
Dividend to parent	(40,000)	(39,000)	(37,000)
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>151,076</b>	<b>125,417</b>	<b>(61,566)</b>
Net change in cash and cash equivalents	9,671	12,290	(1,715)
Cash and cash equivalents, beginning of year	81,174	68,884	70,599
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$90,845</b>	<b>\$81,174</b>	<b>\$68,884</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>			
Income taxes paid, net	\$16,182	\$26,810	\$7,671

See Notes to Financial Statements

*Pacific Life & Annuity Company*

NOTES TO FINANCIAL STATEMENTS

**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

ORGANIZATION AND DESCRIPTION OF BUSINESS

Pacific Life & Annuity Company (the Company or PL&A) is a stock life insurance company domiciled in the state of Arizona and a wholly owned subsidiary of Pacific Life Insurance Company (Pacific Life), a stock life insurance company domiciled in the state of Nebraska. The Company offers variable universal life (VUL) insurance, universal life (UL) insurance, term insurance, structured settlement annuities, and variable and fixed annuities. The Company is licensed to sell certain of its products in the state of New York.

BASIS OF PRESENTATION

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The Company prepares its regulatory financial statements based on accounting practices prescribed or permitted by the Insurance Department of the State of Arizona (AZ DOI). These financial statements materially differ from those filed with regulatory authorities (Note 2).

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
- The fair value of and accounting for derivatives
- The capitalization and amortization of deferred policy acquisition costs (DAC)
- The liability for future policy benefits
- Income taxes
- Reinsurance transactions
- Litigation and other contingencies

The Company has evaluated events subsequent to December 31, 2017 through March 16, 2018, the date the financial statements were available to be issued and has concluded that no events have occurred that require disclosure or adjustment to the 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). Amortization of premium and accretion of discount on fixed maturity securities is recorded using the effective interest method. For mortgage-backed and asset-backed securities, the determination of effective yield is 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.

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.

The Company's available for sale securities are assessed for OTTI, if impaired. 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 determined that it is more likely than not going to be required to sell the security prior to recovery, the OTTI 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 minimum 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).

Mortgage loans on real estate are carried at their unpaid principal balance, net of deferred origination fees and write-downs. Interest is recognized and discounts and deferred origination fees are amortized to interest income using the effective interest method based on the contractual life of the mortgage loan. The method of recognizing interest or amortization income is based on the contractual life of the mortgage loan. 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 mortgage loan. When the fair value of 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 investments in partnerships and joint ventures, derivative instruments, and non-marketable equity securities. Investments in partnership and joint venture interests are recorded under the cost or equity method of accounting. Non-marketable equity securities are carried at estimated fair value with unrealized gains or losses recognized in OCI.

Cost method investments are assessed for impairment. An impairment occurs if it is probable that the Company will not be able to recover the carrying amount of the investment and is written down to its estimated fair value.

All derivatives, whether designated in 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). 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 investments, these amounts are included in net investment income. 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 reclassified into earnings into either net investment income or net realized investment gain (loss) when the forecasted transactions affect earnings.

#### 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 money market securities.

#### 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 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. The capitalized sales inducement balance included in the DAC asset was \$7.6 million and \$7.4 million as of December 31, 2017 and 2016, respectively.

For UL, variable annuities and other investment-type contracts, acquisition costs are generally 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, 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 7.50% 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 at least annually to ensure that the unamortized balance does not exceed expected recoverable EGPs.

Components of DAC are as follows:

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Balance, January 1	\$125,255	\$124,345	\$122,649
Additions:			
Capitalized during the year	18,477	17,167	16,174
Amortization:			
Allocated to commission expenses	(7,767)	(14,841)	(19,762)
Allocated to operating expenses	(544)	(515)	(669)
Total amortization	(8,311)	(15,356)	(20,431)
Allocated to OCI	(1,350)	(901)	5,953
Balance, December 31	\$134,071	\$125,255	\$124,345

#### FUTURE POLICY BENEFITS

Annuity reserves, which primarily consist of structured settlement annuities with life contingencies, are equal to the present value of estimated future payments using pricing assumptions, as applicable, for interest rates, mortality, morbidity, retirement age and expenses. Interest rates used in establishing such liabilities ranged from 1.1% to 8.8%.

The Company offers 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 6). All other GLB guarantees are accounted for as embedded derivatives (Note 4).

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 unearned revenue reserves (URR), and recognized in revenue over the expected life of the contract using the same methods and assumptions used to amortize DAC. Unearned revenue related to certain unrealized components in OCI, primarily unrealized gains and losses on securities available for sale, is recorded to equity through OCI.

Life insurance reserves are valued using the net level premium method on the basis of actuarial assumptions appropriate at policy issue. Mortality and persistency assumptions are generally based on the Company's experience, which, together with interest and expense assumptions, include a margin for possible unfavorable deviations. Interest rate assumptions ranged from 3.0% to 7.7%.

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.

#### POLICYHOLDER ACCOUNT BALANCES

Policyholder account balances on UL and certain investment-type contracts 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 1.0% to 7.7%.

## REINSURANCE

The Company has ceded reinsurance agreements with other insurance companies to limit potential losses, reduce exposure arising from larger risks, and provide additional capacity for future growth. 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 arrangements with this 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 liable. The Company evaluates the financial strength and stability of each reinsurer prior to 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.

The Company has assumed reinsurance agreements with other insurance companies, which primarily include traditional life reinsurance.

The Company utilizes reinsurance accounting 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, 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. Reinsurance receivables, included in other assets, were \$4.4 million and \$0.7 million as of December 31, 2017 and 2016, respectively. Reinsurance payables, included in other liabilities, were \$3.0 million and \$3.1 million as of December 31, 2017 and 2016, respectively. Amounts receivable and payable are offset for account settlement purposes for contracts where the right of offset exists.

The components of insurance premiums are as follows:

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Direct premiums	\$57,094	\$58,908	\$45,700
Reinsurance assumed	8,777	8,162	7,607
Reinsurance ceded	(4,093)	(4,511)	(4,154)
Insurance premiums	<u>\$61,778</u>	<u>\$62,559</u>	<u>\$49,153</u>

## REVENUES, BENEFITS AND EXPENSES

Premiums from annuity contracts with life contingencies 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 for 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.

## INCOME TAXES

The Company is taxed as a life insurance company for Federal income tax purposes and is included in the consolidated Federal income tax return of its ultimate parent, Pacific Mutual Holding Company (PMHC). The Company is allocated tax expense or benefit based principally on the effect of including its operations in the consolidated return under a tax sharing agreement. Amounts payable under the tax sharing agreement as of December 31, 2017 and 2016 were \$2.4 million and \$1.0 million and are included in other liabilities. 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 bases. 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.

On December 22, 2017, tax reform legislation formally known as the Tax Cuts and Jobs Act (the Act) was enacted, which significantly revised the U.S. corporate income tax system. See Note 9.

## CONTINGENCIES

The Company evaluates all identified contingent matters on an individual basis. A loss is recorded if the contingent matter is 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 variable life contracts. 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 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.

## 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 material effect on the estimated fair value amounts.

## RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02. This ASU permits retrospective reclassification of certain tax effects from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Act. This ASU is effective for fiscal years beginning after December 15, 2018, however early adoption is permitted for financial statements that have not yet been issued. The Company early adopted this ASU and reclassified \$30.1 million of deferred tax effects from AOCI to retained earnings as of December 31, 2017. See the statements of stockholder's equity and Notes 8 and 9.

## FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

In August 2017, the FASB issued targeted improvements to accounting for hedging activities, ASU 2017-12. The objective of this guidance is to improve the financial reporting of hedging relationships to better portray the economic results of a company's risk management activities in its financial statements and make certain targeted improvements simplify the application of the hedge accounting guidance. The new guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. The amended presentations and disclosure guidance is required to be applied prospectively. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on its financial statements.

In June 2016, the FASB issued ASU 2016-13 that provides guidance on measurement of credit losses on financial instruments. This ASU replaces the incurred loss impairment methodology with one that reflects expected credit losses. The measurement of expected credit losses should be based on historical loss information, current conditions, and reasonable and supportable forecasts. The guidance also requires enhanced disclosures. This ASU is effective for fiscal years beginning after December 15, 2020 and interim periods within those fiscal years with a cumulative-effect adjustment to retained earnings under a modified-retrospective approach. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on its financial statements.

In May 2014, the FASB issued ASU 2014-09, a new revenue recognition standard. The new guidance will supersede nearly all existing revenue recognition guidance under U.S. GAAP; however, it will not impact the accounting for insurance contracts, leases, financial instruments and guarantees. For those contracts that are impacted by the new guidance, the guidance will require an entity to recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years and will be applied under a modified retrospective approach. Early adoption is not permitted. The Company is currently evaluating the impact of this guidance on its financial statements.

## **2. STATUTORY FINANCIAL INFORMATION AND DIVIDEND RESTRICTIONS**

### STATUTORY ACCOUNTING PRACTICES

The Company prepares its regulatory financial statements in accordance with statutory accounting practices prescribed or permitted by the AZ 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, establishing future policy benefit liabilities using different actuarial assumptions, as well as the valuation of investments and certain assets and accounting for deferred income taxes on a different basis. The Company does not have any permitted statutory accounting practices.

### STATUTORY NET INCOME AND SURPLUS

Statutory net income of the Company was \$46.0 million, \$41.2 million and \$53.7 million for the years ended December 31, 2017, 2016 and 2015, respectively. Statutory capital and surplus of the Company was \$540.6 million and \$539.4 million as of December 31, 2017 and 2016, respectively.

### RISK-BASED CAPITAL

Risk-based capital is a method developed by the National Association of Insurance Commissioners 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, 2017 and 2016, the Company exceeded the minimum risk-based capital requirements.

### DIVIDEND RESTRICTIONS

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 require (i) notification to the 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 2017 statutory results, the Company could pay \$40.3 million in dividends to Pacific Life in 2018 without prior regulatory approval. During the years ended December 31, 2017, 2016 and 2015, the Company paid dividends to Pacific Life of \$40 million, \$39 million and \$37 million, respectively.



### 3. 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 available for sale represents amortized cost adjusted for OTTI recognized in earnings. The net carrying amount of equity securities available for sale represents cost adjusted for OTTI. See Note 7 for information on the Company's estimated fair value measurements and disclosure.

	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
<i>(In Thousands)</i>				
<u>December 31, 2017:</u>				
U.S. Government	\$9,082	\$325	\$91	\$9,316
Obligations of states and political subdivisions	302,952	81,432	25	384,359
Foreign governments	39,558	2,875	418	42,015
Corporate securities	3,026,030	403,088	8,638	3,420,480
Residential mortgage-backed securities	105,443	5,588	483	110,548
Commercial mortgage-backed securities	52,953	3,040	137	55,856
Other asset-backed securities	27,325	375	190	27,510
Total fixed maturity securities	<u>\$3,563,343</u>	<u>\$496,723</u>	<u>\$9,982</u>	<u>\$4,050,084</u>
Perpetual preferred securities	\$1,819	\$79		\$1,898
Total equity securities	<u>\$1,819</u>	<u>\$79</u>	<u>—</u>	<u>\$1,898</u>

	Net Carrying Amount	Gross Unrealized		Estimated Fair Value
		Gains	Losses	
<i>(In Thousands)</i>				
<u>December 31, 2016:</u>				
U.S. Government	\$8,980	\$285	\$65	\$9,200
Obligations of states and political subdivisions	303,940	59,667	503	363,104
Foreign governments	37,619	3,170	2,014	38,775
Corporate securities	2,732,003	300,056	21,309	3,010,750
Residential mortgage-backed securities	133,580	6,879	1,398	139,061
Commercial mortgage-backed securities	44,626	3,592		48,218
Other asset-backed securities	32,140	266	317	32,089
Total fixed maturity securities	<u>\$3,292,888</u>	<u>\$373,915</u>	<u>\$25,606</u>	<u>\$3,641,197</u>
Perpetual preferred securities	\$2,034	\$582		\$2,616
Other equity securities	301	154		455
Total equity securities	<u>\$2,335</u>	<u>\$736</u>	<u>—</u>	<u>\$3,071</u>

The net carrying amount and estimated fair value of fixed maturity securities available for sale as of December 31, 2017, 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	Gross Unrealized		Estimated Fair Value
	Carrying Amount	Gains	Losses	
		<i>(In Thousands)</i>		
Due in one year or less	\$40,402	\$1,978	\$13	\$42,367
Due after one year through five years	511,803	27,015	1,439	537,379
Due after five years through ten years	974,798	54,057	4,561	1,024,294
Due after ten years	1,850,619	404,670	3,159	2,252,130
	<u>3,377,622</u>	<u>487,720</u>	<u>9,172</u>	<u>3,856,170</u>
Mortgage-backed and asset-backed securities	185,721	9,003	810	193,914
Total fixed maturity securities	<u>\$3,563,343</u>	<u>\$496,723</u>	<u>\$9,982</u>	<u>\$4,050,084</u>

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.

	Total		
	Number	Estimated Fair Value	Gross Unrealized Losses
	<i>(In Thousands)</i>		
<u>December 31, 2017:</u>			
U.S. Government	3	\$5,991	\$91
Obligations of states and political subdivisions	1	2,374	25
Foreign governments	1	12,258	418
Corporate securities	44	287,985	8,638
Residential mortgage-backed securities	15	36,445	483
Commercial mortgage-backed securities	1	8,323	137
Other asset-backed securities	4	17,672	190
Total fixed maturity securities	<u>69</u>	<u>\$371,048</u>	<u>\$9,982</u>

	Less than 12 Months			12 Months or Greater		
	Number	Estimated Fair Value	Gross Unrealized Losses	Number	Estimated Fair Value	Gross Unrealized Losses
	<i>(In Thousands)</i>			<i>(In Thousands)</i>		
<u>December 31, 2017:</u>						
U.S. Government	2	\$713	\$5	1	\$5,278	\$86
Obligations of states and political subdivisions	1	2,374	25			
Foreign governments				1	12,258	418
Corporate securities	18	104,347	1,582	26	183,638	7,056
Residential mortgage-backed securities	4	3,678	49	11	32,767	434
Commercial mortgage-backed securities	1	8,323	137			
Other asset-backed securities	1	4,962	38	3	12,710	152
Total fixed maturity securities	<u>27</u>	<u>\$124,397</u>	<u>\$1,836</u>	<u>42</u>	<u>\$246,651</u>	<u>\$8,146</u>

	Total		
	Number	Gross Estimated Fair Value	Gross Unrealized Losses
<i>(In Thousands)</i>			
<u>December 31, 2016:</u>			
U.S. Government	1	\$5,300	\$65
Obligations of states and political subdivisions	1	29,497	503
Foreign governments	1	10,676	2,014
Corporate securities	81	531,820	21,309
Residential mortgage-backed securities	20	55,309	1,398
Other asset-backed securities	4	22,190	317
Total fixed maturity securities	108	\$654,792	\$25,606

	Less than 12 Months			12 Months or Greater		
	Number	Estimated Fair Value	Gross Unrealized Losses	Number	Estimated Fair Value	Gross Unrealized Losses
<i>(In Thousands)</i>						
<u>December 31, 2016:</u>						
U.S. Government	1	\$5,300	\$65			
Obligations of states and political subdivisions	1	29,497	503			
Foreign governments				1	\$10,676	\$2,014
Corporate securities	67	455,680	18,083	14	76,140	3,226
Residential mortgage-backed securities	7	35,234	782	13	20,075	616
Other asset-backed securities	4	22,190	317			
Total fixed maturity securities	80	\$547,901	\$19,750	28	\$106,891	\$5,856

The gross unrealized losses on available for sale securities in the tables above decreased from \$25.6 million as of December 31, 2016 to \$10.0 million as of December 31, 2017. The decrease is primarily due to interest rate and credit spread movements.

The Company has evaluated fixed maturity securities available for sale 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 Company evaluates its interests in variable interest entities (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. As of December 31, 2017 and 2016, the Company has no VIEs it consolidates in the financial statements. As part of normal investment activities, the Company will make passive investments in structured securities for which it is not the sponsor and thus does not consolidate as a VIE as the Company is not the primary beneficiary. The structured security investments include residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and other asset-backed securities which are reported in fixed maturities securities available for sale. The Company also has a real estate fund investment, which is reported in other investments, in which the Company holds a variable interest but does not consolidate because it is not the primary beneficiary. The Company's maximum exposure to loss for these investments is limited to its net carrying amount.

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

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Fixed maturity securities	\$181,677	\$173,045	\$169,573
Equity securities	130	130	131
Mortgage loans	26,820	26,374	31,396
Policy loans	206	187	168
Partnerships and joint ventures	4,379	3,889	4,897
Other	853	863	722
Gross investment income	214,065	204,488	206,887
Investment expense	4,314	4,413	4,266
Net investment income	\$209,751	\$200,075	\$202,621

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

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Fixed maturity securities:			
Gross gains on sales	\$591	\$1,156	\$486
Gross losses on sales	(67)	(899)	(115)
Total fixed maturity securities	524	257	371
Equity securities:			
Gross gains on sales	495		517
Gross losses on sales	(13)		
Total equity securities	482	—	517
Variable annuity GLB embedded derivatives	7,640	5,376	(270)
Variable annuity GLB policy fees	11,920	12,057	12,856
Variable annuity derivatives - total return swaps	(11,117)	(4,220)	(893)
Variable annuity derivatives - futures	(13,997)	(17,505)	(2,978)
Foreign currency and interest rate swaps	(150)	38	1,247
Life indexed account embedded derivatives	(1,445)	(412)	338
Life indexed account derivatives - call options	1,719	419	(373)
Other	(167)	4	(44)
Net realized investment gain (loss)	(\$4,591)	(\$3,986)	\$10,771

The tables below summarize the OTTI by investment type:

	Recognized in Earnings	Included in OCI	Total
<i>(In Thousands)</i>			
<u>Year Ended December 31, 2017:</u>			
Other investments	\$103		\$103
Total OTTI	\$103	—	\$103
<u>Year Ended December 31, 2015:</u>			
Corporate securities	\$2,743		\$2,743
OTTI - fixed maturity securities	2,743	—	2,743
Other investments	102		102
Total OTTI	\$2,845	—	\$2,845

The Company had no OTTI for the year ended December 31, 2016.

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,	
	2017	2016
<i>(In Thousands)</i>		
Cumulative credit loss, January 1	\$2,080	\$2,117
Reductions for credit impairments previously recognized on:		
Securities due to an increase in expected cash flows and time value of cash flows	(157)	(37)
Total subtractions	(157)	(37)
Cumulative credit loss, December 31	\$1,923	\$2,080

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	Total
	Investments	Investments	
	<i>(In Thousands)</i>		
<u>December 31, 2017:</u>			
U.S. Government		\$91	\$91
Obligations of states and political subdivisions		25	25
Foreign governments		418	418
Corporate securities		8,638	8,638
RMBS	\$14	469	483
CMBS		137	137
Other asset-backed securities		190	190
Total fixed maturity securities	\$14	\$9,968	\$9,982
<u>December 31, 2016:</u>			
U.S. Government		\$65	\$65
Obligations of states and political subdivisions		503	503
Foreign governments		2,014	2,014
Corporate securities		21,309	21,309
RMBS	\$102	1,296	1,398
Other asset-backed securities		317	317
Total fixed maturity securities	\$102	\$25,504	\$25,606

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

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Available for sale securities:			
Fixed maturity	\$138,432	\$64,896	(\$209,535)
Equity	(657)	398	(259)
Total available for sale securities	\$137,775	\$65,294	(\$209,794)

As of December 31, 2017 and 2016, the Company had exposure to concentrations of credit risk of a single common credit, excluding U.S. government and its agencies, which exceeded 10% of stockholder's equity. The estimated fair value of these fixed maturity securities under one common credit is \$88.0 million and \$84.3 million, respectively.

As of December 31, 2017 and 2016, fixed maturity securities of \$6 million were on deposit with state insurance departments to satisfy regulatory requirements.

Mortgage loans totaled \$449.6 million and \$465.8 million as of December 31, 2017 and 2016, respectively. Mortgage loans are collateralized by real estate properties primarily located throughout the U.S. As of December 31, 2017, \$95 million, \$61 million, \$61 million, \$42 million and \$42 million were located in California, Washington, Texas, Massachusetts and the District of Columbia, respectively. As of December 31, 2017, \$5 million was located in Canada. There were no defaults during the years ended December 31, 2017, 2016 and 2015. The Company did not have mortgage loans with accrued interest more than 180 days past due as of December 31, 2017 and 2016.

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 Credit Concern category or one of three levels: Level 1 Minimal Credit Concern, Level 2 Moderate Credit Concern or Level 3 Significant Credit Concern. Loans in No Credit 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. As of December 31, 2017 and 2016, the Company had no loans classified as Level 2 or 3.

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.



The following tables set forth mortgage loan credit levels as of December 31, 2017 and 2016 (\$ In Thousands):

Property Type	December 31, 2017					
	No Credit Concern		Level 1 Minimal Credit Concern		Total	
	Carrying	Weighted	Carrying	Weighted	Carrying	Weighted
	Amount	Average DCR	Amount	Average DCR	Amount	Average DCR
Apartment	\$73,022	1.58	\$6,289	1.05	\$79,311	1.54
Golf course			4,632	0.52	4,632	0.52
Lodging	41,067	3.36			41,067	3.36
Office	196,781	1.78	34,951	2.02	231,732	1.82
Retail	92,879	2.00			92,879	2.00
Total mortgage loans	\$403,749	1.96	\$45,872	1.74	\$449,621	1.93

Property Type	December 31, 2016					
	No Credit Concern		Level 1 Minimal Credit Concern		Total	
	Carrying	Weighted	Carrying	Weighted	Carrying	Weighted
	Amount	Average DCR	Amount	Average DCR	Amount	Average DCR
Apartment	\$55,548	1.76	\$25,069	1.09	\$80,617	1.55
Golf course			4,650	0.72	4,650	0.72
Lodging	41,711	3.56			41,711	3.56
Office	210,001	1.77	34,955	2.22	244,956	1.84
Retail	93,819	2.04			93,819	2.04
Total mortgage loans	\$401,079	2.02	\$64,674	1.68	\$465,753	1.97

#### 4. DERIVATIVES AND HEDGING ACTIVITIES

The Company primarily utilizes derivative instruments to manage its exposure to interest rate risk, foreign currency 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, exchange-traded 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. The Company applies hedge accounting by designating derivative instruments as cash flow hedges on the inception date of the hedging relationship. At the inception of the hedging relationship, the Company formally documents its risk management objective and strategy for undertaking the hedging transaction. In this documentation, the Company specifically identifies the asset or forecasted transaction that has been designated as the 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 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.

The Company employs hedging strategies (variable annuity derivatives) to mitigate equity risk associated with GLBs. The Company utilizes total return swaps and exchange-traded equity futures based upon domestic and international equity market indices to economically hedge the equity risk of the guarantees in its variable annuity products. Total return swaps are swaps whereby the Company agrees to exchange the difference between the economic risk and reward of an equity index and a floating rate of interest, calculated by reference to an agreed upon notional amount. Cash is paid and received over the life of the contract based on the terms of the swap. 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 underlying equity indices, and to post variation margin on a daily basis in an amount equal to the change in the daily estimated fair value of those contracts.

Foreign currency interest rate swap agreements are used to convert fixed or floating rate foreign-denominated assets to U.S. dollar fixed rate assets. A foreign currency interest rate swap involves 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-upon exchange rate. There are also periodic exchanges of interest payments in the two currencies at specified intervals, calculated using agreed-upon interest rates, exchange rates, and the exchanged principal amounts. The Company enters into these agreements primarily to manage the currency risk associated with investments that are denominated in foreign currencies. The main currency that the Company economically hedges is the Canadian 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. An interest rate swap agreement involves 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 a life insurance product with indexed account options. The interest credited on the indexed accounts is a function of the underlying domestic or international equity index, subject to various caps, thresholds and participation rates. The life insurance product with indexed accounts contains an embedded derivative.

The Company utilizes call options to economically hedge the interest credited to the policyholder based upon the underlying index for its life insurance product with indexed account options. These options are contracts to buy the index at a predetermined time at a contracted price. The contracts will be net settled in cash based on differentials in the index at the time of exercise and the strike price subject to a cap, net of option premiums.

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

	Notional Amount	
	December 31,	
	2017	2016
	<i>(In Thousands)</i>	
Variable annuity GLB embedded derivatives	\$1,366,592	\$1,465,777
Variable annuity derivatives - total return swaps	61,778	62,788
Variable annuity derivatives - futures	50,221	79,071
Foreign currency and interest rate swaps	5,018	10,396
Life indexed account embedded derivatives	22,941	21,156
Life indexed account derivatives - call options	25,200	22,140
Other	7,743	3,605

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 statements of financial condition. Notional amounts generally represent those

amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps.

The following table summarizes amounts recognized in net realized investment gain (loss) for derivatives not designated as hedging instruments. Gains and losses include the changes in estimated fair value of the derivatives and amounts realized on terminations. The amounts presented do not include losses from the periodic net payments of \$25.7 million, \$21.5 million and \$4.2 million for the years ended December 31, 2017, 2016 and 2015, respectively, which are recognized in net realized investment gain (loss).

	Amount of Gain (Loss) Recognized in Income on Derivatives		
	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Variable annuity derivatives - total return swaps	(\$451)	(\$996)	(\$271)
Foreign currency and interest rate swaps	(518)	(372)	1,024
Life indexed account derivatives - call options	2,769	1,360	414
Embedded derivatives:			
Variable annuity GLB embedded derivatives	7,640	5,376	(270)
Life indexed account embedded derivatives	(1,445)	(412)	338
Other	(170)	(6)	(15)
Total	<u>\$7,825</u>	<u>\$4,950</u>	<u>\$1,220</u>

#### DERIVATIVES DESIGNATED AS CASH FLOW HEDGES

The Company utilized foreign currency and interest rate swaps to manage its exposure to variability in cash flows due to changes in foreign currencies and benchmark interest rates. The Company had no designated cash flow hedges as of December 31, 2017 and 2016.

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 for the years ended December 31, 2017, 2016 and 2015.

Over the next twelve months, the Company anticipates that \$0.3 million of deferred gains on derivative instruments in AOCI for previously designated cash flow hedges will be reclassified to earnings consistent with when the hedged forecasted transaction affects earnings.

## FINANCIAL STATEMENT IMPACT

Derivative instruments are recorded on the Company's statements of financial condition at estimated fair value and are presented as assets or liabilities based upon 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 7 for information on the Company's estimated fair value measurements and disclosure.

	Asset Derivatives		Liability Derivatives	
	Estimated Fair Value		Estimated Fair Value	
	December 31,		December 31,	
	2017	2016	2017	2016
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Derivatives not designated as hedging instruments:				
Variable annuity derivatives - total return swaps		\$160 <sup>(1)</sup>	\$507	\$663 <sup>(1)</sup>
			237	70 <sup>(4)</sup>
Foreign currency and interest rate swaps		2,207 <sup>(1)</sup>		
	\$713	1,067 <sup>(4)</sup>		
Life indexed account derivatives - call options	482	380 <sup>(1)</sup>		2 <sup>(4)</sup>
	807	466 <sup>(4)</sup>		
Embedded derivatives:				
Variable annuity GLB embedded derivatives			25,678	33,318 <sup>(2)</sup>
Life indexed account embedded derivatives			1,692	1,326 <sup>(3)</sup>
Other			2,095	828 <sup>(3)</sup>
Total derivatives not designated as hedging instruments	\$2,002	\$4,280	\$30,209	\$36,207

Location on the statements of financial condition:

<sup>(1)</sup> Other investments <sup>(2)</sup> Future policy benefits <sup>(3)</sup> Policyholder account balances <sup>(4)</sup> Other liabilities

Cash collateral received from counterparties was \$2.1 million and \$3.0 million as of December 31, 2017 and 2016, 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 \$2.5 million and \$3.8 million as of December 31, 2017 and 2016, 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.

## OFFSETTING ASSETS AND LIABILITIES

The following table reconciles the net amount of derivative assets and liabilities (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. There was no asset collateral received or pledged as of December 31, 2017 and 2016.

	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 Thousands)</i>					
<u>December 31, 2017:</u>					
Derivative assets	\$1,514	(\$1,255)	\$259		\$259
Derivative liabilities	679	(607)	72		72
<u>December 31, 2016:</u>					
Derivative assets	\$3,913	(\$3,052)	\$861		\$861
Derivative liabilities	713	(652)	61		61

<sup>(1)</sup> As of December 31, 2017 and 2016, derivative assets include expense accruals of \$0.5 million and \$0.4 million, respectively, and derivative liabilities include expense accruals of \$0.1 million and zero, respectively.

<sup>(2)</sup> As of December 31, 2017 and 2016, the Company received excess cash collateral of \$0.9 million and \$0.5 million, respectively, and provided excess cash collateral of \$0.1 million and \$0.1 million, respectively, which are not included in the table.

## 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, which are bilateral contracts between two counterparties. The Company manages credit risk by dealing with creditworthy counterparties, establishing risk control limits, executing legally enforceable master netting agreements, and obtaining collateral where appropriate. In addition, the Company evaluates the financial stability of each counterparty before entering into each agreement and throughout the period that the financial instrument is owned.

The Company's exchange-traded futures are transacted through regulated exchanges and variation margin is settled on a daily basis. Therefore, the Company has minimal exposure to credit-related losses in the event of nonperformance by counterparties. In addition, the Company is required to pledge initial margin for all futures contracts. The amount of required margin is determined by the exchange on which it is traded. The Company currently pledges cash to satisfy this collateral requirement.

For OTC derivative transactions, the Company enters into legally enforceable master netting 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. The majority of these master netting agreements include collateral arrangements with derivative counterparties, which require positions be marked to market and margined on a daily basis by the daily settlement of variation margin. The Company has minimal counterparty exposure to credit-related losses in the event of non performance by these counterparties. The remaining master netting agreements include 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 and which also include credit-contingent provisions.

The Company's credit exposure is measured on a counterparty basis as the net positive estimated fair value of all derivatives positions with the counterparty, net of income or expense accruals and cash collateral received. The Company's credit exposure for OTC derivatives as of December 31, 2017 was \$0.4 million. The maximum exposure to any single counterparty was \$0.2 million as of December 31, 2017. All of the Company's credit exposure from derivative contracts is with investment grade counterparties.

Certain of the Company's collateral arrangements for its OTC derivatives include credit-contingent provisions that provide for a reduction of collateral thresholds in the event of downgrades in the financial strength ratings, assigned by certain independent rating agencies, of the Company and/or the counterparty. If either the Company's or the counterparty's financial strength ratings were to fall below a specific investment grade credit rating, the other party to the derivative instruments could request immediate and ongoing full collateralization on derivative instruments in net liability positions. There were no OTC derivative positions with credit-risk related contingent features that were in a liability position on December 31, 2017.

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, 2017, the Company's financial strength ratings were above the specified level.

## 5. POLICYHOLDER LIABILITIES

### FUTURE POLICY BENEFITS

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

	December 31,	
	2017	2016
	<i>(In Thousands)</i>	
Structured settlement annuity liabilities	\$2,190,843	\$2,057,135
Policy benefits payable	100,578	89,464
Variable annuity GLB embedded derivatives	25,678	33,318
Life insurance	15,633	16,632
Other	8,263	6,643
Total	<u>\$2,340,995</u>	<u>\$2,203,192</u>

### POLICYHOLDER ACCOUNT BALANCES

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

	December 31,	
	2017	2016
	<i>(In Thousands)</i>	
Annuity and deposit liabilities	\$1,636,729	\$1,398,872
VUL and UL	56,754	54,355
Total	<u>\$1,693,483</u>	<u>\$1,453,227</u>

## 6. 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 4.

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 partial 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 no earlier than 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,	
	2017	2016
	<u>(\$ In Thousands)</u>	
Return of net deposits		
Separate account value	\$2,764,811	\$2,502,546
Net amount at risk <sup>(1)</sup>	851	5,281
Average attained age of contract holders	66 years	65 years
Anniversary contract value		
Separate account value	\$797,780	\$747,120
Net amount at risk <sup>(1)</sup>	517	3,609
Average attained age of contract holders	66 years	65 years

<sup>(1)</sup> Represents the amount of death benefit in excess of the current contract holder account balance as of December 31.

Information regarding GMIB and GMWBL features outstanding is as follows:

	December 31,		December 31,	
	2017	2016	2017	2016
	<u>GMIB</u>		<u>GMWBL</u>	
	<u>(\$ In Thousands)</u>		<u>(\$ In Thousands)</u>	
Separate account value	\$6,613	\$7,258	\$365,614	\$307,331
Net amount at risk <sup>(1)</sup>	519	820	7,926	15,461
Average attained age of contract holders	62 years	62 years	69 years	68 years

<sup>(1)</sup> GMIB net amount at risk represents the amount of estimated annuitization benefits in excess of the current contract holder account balance at December 31. GMWBL net amount at risk represents the protected balance, as defined, in excess of account value at December 31.

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,	
	2017	2016	2017	2016	2017	2016
	GMDB		GMIB		GMWBL	
	<i>(In Thousands)</i>		<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Balance, beginning of year	\$1,115	\$1,605	\$177	\$168	\$2,740	\$2,099
Changes in reserves	785	24	22	9	1,054	641
Benefits paid	(16)	(514)				
Balance, end of year	\$1,884	\$1,115	\$199	\$177	\$3,794	\$2,740

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

	December 31,	
	2017	2016
	<i>(In Thousands)</i>	
Asset type		
Equity	\$1,809,338	\$1,593,280
Bonds	806,546	767,034
Money market	15,717	7,435
Other	147,794	148,643
Total separate account value	\$2,779,395	\$2,516,392

## 7. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The Accounting Standards Codification's (Codification) 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 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 3 Valuations derived from valuation techniques in which one or more significant inputs are not market observable.



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, 2017 and 2016.

	Level 1	Level 2	Level 3	Gross Derivatives Estimated Fair Value	Netting Adjustments <sup>(1)</sup>	Total
<i>(In Thousands)</i>						
<u>December 31, 2017:</u>						
Assets:						
U.S. Government		\$9,316				\$9,316
Obligations of states and political subdivisions		375,215	\$9,144			384,359
Foreign governments		36,632	5,383			42,015
Corporate securities		3,331,744	88,736			3,420,480
RMBS		110,267	281			110,548
CMBS		55,856				55,856
Other asset-backed securities		27,510				27,510
Total fixed maturity securities	—	3,946,540	103,544	—	—	4,050,084
Perpetual preferred securities		1,898				1,898
Total equity securities	—	1,898	—	—	—	1,898
Other investments			4,879			4,879
Derivatives:						
Foreign currency and interest rate swaps		713		\$713	(\$713)	—
Variable annuity derivatives - total return swaps					(507)	(507)
Life indexed account derivatives - call options			1,289	1,289	(807)	482
Total derivatives	—	713	1,289	2,002	(2,027)	(25)
Separate account assets:						
Separate account assets	\$2,904,233					2,904,233
Separate account assets measured at NAV <sup>(2)</sup>						17,507
Total separate account assets carried at fair value <sup>(3)</sup>	2,904,233	—	—	—	—	2,921,740
Total	\$2,904,233	\$3,949,151	\$109,712	\$2,002	(\$2,027)	\$6,978,576
Liabilities:						
Derivatives:						
Foreign currency and interest rate swaps					(\$713)	(\$713)
Variable annuity derivatives - total return swaps			\$744	\$744	(507)	237
Life indexed account derivatives - call options					(807)	(807)
Embedded derivatives			29,465	29,465		29,465
Total	—	—	\$30,209	\$30,209	(\$2,027)	\$28,182

	Level 1	Level 2	Level 3	Gross Derivatives Estimated Fair Value	Netting Adjustments <sup>(1)</sup>	Total
<i>(In Thousands)</i>						
<u>December 31, 2016:</u>						
Assets:						
U.S. Government		\$9,200				\$9,200
Obligations of states and political subdivisions		353,353	\$9,751			363,104
Foreign governments		33,262	5,513			38,775
Corporate securities		2,895,375	115,375			3,010,750
RMBS		139,061				139,061
CMBS		48,218				48,218
Other asset-backed securities		32,089				32,089
Total fixed maturity securities	—	3,510,558	130,639	—	—	3,641,197
Perpetual preferred securities		2,616				2,616
Other equity securities	\$455					455
Total equity securities	455	2,616	—	—	—	3,071
Other investments			4,879			4,879
Derivatives:						
Variable annuity derivatives - total return swaps			160	\$160	(\$663)	(503)
Foreign currency and interest rate swaps		3,274		3,274	(1,067)	2,207
Life indexed account derivatives - call options			846	846	(466)	380
Total derivatives	—	3,274	1,006	4,280	(2,196)	2,084
Separate account assets:						
Separate account assets	2,626,797					2,626,797
Separate account assets measured at NAV <sup>(2)</sup>						16,271
Total separate account assets carried at fair value <sup>(3)</sup>	2,626,797	—	—	—	—	2,643,068
Total	\$2,627,252	\$3,516,448	\$136,524	\$4,280	(\$2,196)	\$6,294,299
Liabilities:						
Derivatives:						
Variable annuity derivatives - total return swaps			\$733	\$733	(\$663)	\$70
Foreign currency and interest rate swaps					(1,067)	(1,067)
Life indexed account derivatives - call options			2	2	(466)	(464)
Embedded derivatives			35,472	35,472		35,472
Total	—	—	\$36,207	\$36,207	(\$2,196)	\$34,011

<sup>(1)</sup> Netting adjustments represent the impact of offsetting asset and liability positions held with the same counterparty as permitted by guidance for offsetting in the Codification's Derivatives and Hedging Topic.

<sup>(2)</sup> In accordance with the Codification's Fair Value Measurement Topic 820-10, certain investments that do not have a readily determinable fair value are measured using the net asset value (NAV) per share (or its equivalent) practical expedient and have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of financial condition.

<sup>(3)</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 recorded 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. Excluded are the separate account assets measured at NAV discussed below.

As a practical expedient to value certain investments that do not have a readily determinable fair value, the Company uses the NAV to determine the fair value. The following table lists information regarding these investments as of December 31, 2017.

Asset Class	Estimated Fair Value	Redemption Frequency	Initial Lock-Up	Redemption Notice Period	Outstanding Commitment
		<i>(\$ In Thousands)</i>			
Separate account hedge funds	\$17,507	Quarterly - 100%	1 to 7 years	90 – 91 days	N/A
Total measured at NAV	\$17,507				

#### 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 AND EQUITY SECURITIES

The estimated fair values of fixed maturity securities available for sale and equity securities available for sale 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 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.

#### DERIVATIVE INSTRUMENTS

Derivative instruments are reported at estimated fair value using pricing valuation models, which utilize market data inputs or independent broker quotations or exchange prices for exchange-traded futures. The Company calculates the estimated fair value of derivatives using market standard valuation methodologies for foreign currency and interest rate swaps and equity options. 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 of 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 the market value for each derivative by both risk managers and investment accountants. Internally calculated estimated fair values are reviewed and compared to external broker fair values for reasonableness.

All of the OTC derivatives were priced by valuation models as of December 31, 2017 and 2016. A credit valuation analysis was performed for all derivative positions that are uncollateralized to measure the nonperformance risk that the counterparties to the transaction will be unable to perform under the contractual terms and was determined to be immaterial as of December 31, 2017. Nonperformance risk is the Company's market-perceived risk of its own or the counterparty's nonperformance.

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

Derivative instruments classified as Level 3 include complex derivatives, such as equity options and total return swaps. Also classified in Level 3 are embedded derivatives in certain insurance contracts. These derivatives are valued using pricing models, which utilize both observable and unobservable inputs, primarily interest rate volatility, equity volatility, equity index levels, nonperformance risk 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 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 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 will not be fulfilled (nonperformance risk).

#### SEPARATE ACCOUNT ASSETS

Separate account assets are reported at estimated fair value as a summarized total on the 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 hedge funds.

Level 1 assets include 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 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, 2017	Total Gains or Losses		Transfers Into Level 3 <sup>(1)</sup>	Transfers Out of Level 3 <sup>(1)</sup>	Purchases	Sales	Settlements	December 31, 2017
		Included in Earnings	Included in OCI						
	<i>(In Thousands)</i>								
Obligations of states and political subdivisions	\$9,751		(\$265)					(\$342)	\$9,144
Foreign governments	5,513	\$6	(136)						5,383
Corporate securities	115,375	288	1,798	\$211	(\$23,362)		(\$3,738)	(1,836)	88,736
RMBS				281					281
Other asset-backed securities			76		(76)				—
<b>Total fixed maturity securities</b>	<b>130,639</b>	<b>294</b>	<b>1,473</b>	<b>492</b>	<b>(23,438)</b>	<b>—</b>	<b>(3,738)</b>	<b>(2,178)</b>	<b>103,544</b>
Other investments	4,879								4,879
Derivatives, net: <sup>(2)</sup>									
Variable annuity derivatives									
- total return swaps	(573)	(451)						280	(744)
Life indexed account derivatives - call options	844	2,768						(2,323)	1,289
Embedded derivatives	(35,472)	6,025				(\$2,130)		2,112	(29,465)
<b>Total derivatives</b>	<b>(35,201)</b>	<b>8,342</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(2,130)</b>	<b>—</b>	<b>69</b>	<b>(28,920)</b>
<b>Total</b>	<b>\$100,317</b>	<b>\$8,636</b>	<b>\$1,473</b>	<b>\$492</b>	<b>(\$23,438)</b>	<b>(\$2,130)</b>	<b>(\$3,738)</b>	<b>(\$2,109)</b>	<b>\$79,503</b>

	January 1, 2016	Total Gains or Losses		Transfers Into Level 3 <sup>(1)</sup>	Transfers Out of Level 3 <sup>(1)</sup>			December 31, 2016
		Included in Earnings	Included in OCI		Purchases	Sales	Settlements	
					<i>(In Thousands)</i>			
Obligations of states and political subdivisions	\$10,983		(\$1,029)				(\$203)	\$9,751
Foreign governments		\$4	46	\$5,463				5,513
Corporate securities	121,322	(213)	756	11,836	(\$13,667)		(\$1,950)	115,375
Other asset-backed securities	181		54		(8,086)	\$8,000	(149)	—
Total fixed maturity securities	132,486	(209)	(173)	17,299	(21,753)	8,000	(2,099)	130,639
Other investments	4,879							4,879
Derivatives, net: <sup>(2)</sup>								
Variable annuity derivatives								
total return swaps	186	(996)					237	(573)
Life indexed account derivatives - call options	134	1,360					(650)	844
Embedded derivatives	(39,757)	4,958				(1,310)	637	(35,472)
Total derivatives	(39,437)	5,322	—	—	—	(1,310)	224	(35,201)
Total	\$97,928	\$5,113	(\$173)	\$17,299	(\$21,753)	\$6,690	(\$2,688)	\$100,317

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

<sup>(2)</sup> Excludes total return swap net settlements of (\$10.7) million and (\$3.2) million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain (loss). Excludes call option net settlements of (\$1.0) million and (\$0.9) million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain (loss). Excludes embedded derivative policy fees of \$11.9 million and \$12.1 million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain (loss).

During the years ended December 31, 2017 and 2016, 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, 2017 and 2016, 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)	Total
<u>Year Ended December 31, 2017:</u>			
		<i>(In Thousands)</i>	
Foreign government	\$6		\$6
Corporate securities	(35)	\$323	288
Total fixed maturity securities	<u>(29)</u>	<u>323</u>	<u>294</u>
Variable annuity derivatives - total return swaps		(451)	(451)
Life indexed account derivatives - call options		2,768	2,768
Embedded derivatives		6,025	6,025
Total derivatives	<u>—</u>	<u>8,342</u>	<u>8,342</u>
Total	<u>(\$29)</u>	<u>\$8,665</u>	<u>\$8,636</u>

	Net Investment Income	Net Realized Investment Gain (Loss)	Total
<u>Year Ended December 31, 2016:</u>			
		<i>(In Thousands)</i>	
Foreign governments	\$4		\$4
Corporate securities	(20)	(\$193)	(213)
Total fixed maturity securities	<u>(16)</u>	<u>(193)</u>	<u>(209)</u>
Variable annuity derivatives - total return swaps		(996)	(996)
Life indexed account derivatives - call options		1,360	1,360
Embedded derivatives		4,958	4,958
Total derivatives	<u>—</u>	<u>5,322</u>	<u>5,322</u>
Total	<u>(\$16)</u>	<u>\$5,129</u>	<u>\$5,113</u>

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

	Years Ended December 31,	
	2017	2016
		<i>(In Thousands)</i>
Derivatives, net: <sup>(1)</sup>		
Variable annuity derivatives - total return swaps	(\$770)	(\$854)
Life indexed account derivatives - call options	1,289	739
Embedded derivatives	6,800	4,999
Total derivatives	<u>\$7,319</u>	<u>\$4,884</u>

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



The following table presents certain quantitative information of significant unobservable inputs used in the fair value measurement for Level 3 assets and liabilities as of December 31, 2017 (*\$ In Thousands*).

	Estimated Fair Value Asset (Liability)	Predominant Valuation Method	Significant Unobservable Inputs	Range (Weighted Average)
Obligations of states and political subdivisions	\$9,144	Discounted cash flow	Spread <sup>(1)</sup>	419-432 (429)
Foreign governments	5,383	Discounted cash flow	Spread <sup>(1)</sup>	35
Corporate securities	88,736	Discounted cash flow	Spread <sup>(1)</sup>	106-426 (246)
RMBS	281	Market pricing	Quoted prices <sup>(2)</sup>	105
Other investments	4,879	Redemption value	Redemption value <sup>(3)</sup>	100
Variable annuity derivatives - total return swaps and life indexed account derivatives - call options	545	Option pricing model	Equity volatility	14% - 27% (17%)
Embedded derivatives <sup>(4)</sup>	(29,465)	Present value techniques	Equity volatility Mortality: Ages 0-40 Ages 41-60 Ages 61-120 Mortality improvement Withdrawal utilization Lapse rates Credit standing adjustment	13.65% - 31.19% 0.01% - 0.18% 0.06% - 0.55% 0.39% - 100% 0% - 1.50% 0% - 90% 0% - 100% 0.12% - 1.32%
Total	<u>\$79,503</u>			

<sup>(1)</sup> 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.

<sup>(2)</sup> Independent third-party quotations were used in the determination of estimated fair value.

<sup>(3)</sup> Represents Federal Home Loan Bank of San Francisco (FHLB) common stock that is valued at the contractual amount that will be received upon redemption (Note 12).

<sup>(4)</sup> This liability consists of embedded derivatives from variable annuity GLBs and life indexed account insurance products. Since the valuation methodology for 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.

The Company did not have any significant nonfinancial assets or liabilities measured at estimated fair value on a nonrecurring basis resulting from impairments as of December 31, 2017 and 2016. The Company has not made any changes in the valuation methodologies for nonfinancial assets and liabilities.

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

	December 31, 2017		December 31, 2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	<i>(In Thousands)</i>			
Assets:				
Mortgage loans	\$449,621	\$486,639	\$465,753	\$501,583
Policy loans	7,521	7,521	6,251	6,251
Other investments	179	170	370	297
Cash and cash equivalents	90,845	90,845	81,174	81,174
Liabilities:				
Annuity and deposit liabilities	1,636,729	1,636,729	1,398,872	1,398,872

The following methods and assumptions were used to estimate the fair value of these financial instruments as of December 31, 2017 and 2016:

#### 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 accounted for under the cost method of accounting. The fair value is based on the ownership percentage of the NAV of the underlying equity of the investments.

#### CASH AND CASH EQUIVALENTS

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

#### 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 amount based on an analysis of discounted future cash flows with maturities similar to the product portfolio liabilities.

## 8. OTHER COMPREHENSIVE INCOME

The Company displays comprehensive income and its components on the statements of comprehensive income and 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 <sup>(1)</sup>	Gain (Loss) on Derivatives	Other, Net	Total AOCI
	<i>(In Thousands)</i>			
Balance, January 1, 2015	\$164,134	\$6,394	\$564	\$171,092
Change in OCI before reclassifications	(38,660) <sup>(2)</sup>			(38,660)
Income tax benefit	13,531			13,531
Amounts reclassified from AOCI	1,855	(1,252)		603
Income tax expense (benefit)	(649)	438		(211)
Balance, December 31, 2015	140,211	5,580	564	146,355
Change in OCI before reclassifications	(30,128) <sup>(2)</sup>			(30,128)
Income tax benefit	10,536			10,536
Amounts reclassified from AOCI	(257)	(277)		(534)
Income tax expense	90	97		187
Balance, December 31, 2016	120,452	5,400	564	126,416
Change in OCI before reclassifications	22,374 <sup>(2)</sup>			22,374
Income tax expense	(7,822)			(7,822)
Amounts reclassified from AOCI	(1,006)	(306)		(1,312)
Income tax expense	352	107		459
Reclassification of deferred tax effects (Note 1)	28,929	1,120	55	30,104
Balance, December 31, 2017	\$163,279	\$6,321	\$619	\$170,219

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

<sup>(2)</sup> Includes allocation of holding gain (loss) from DAC and future policy benefits of (\$116,407) thousand, (\$95,679) thousand and \$172,989 thousand for the years ended December 31, 2017, 2016 and 2015, respectively.

## RECLASSIFICATIONS FROM AOCI

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

Reclassification adjustments:	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Unrealized (gain) loss on securities available for sale, net:			
Sale of securities available for sale	(\$1,006) <sup>(1)</sup>	(\$257) <sup>(1)</sup>	(\$888) <sup>(1)</sup>
OTTI recognized on securities available for sale			2,743 <sup>(2)</sup>
Total unrealized (gain) loss on securities available for sale, net	(1,006)	(257)	1,855
Gain on derivatives:			
Foreign currency and interest rate swaps			(941) <sup>(1)</sup>
	(306) <sup>(3)</sup>	(277) <sup>(3)</sup>	(311) <sup>(3)</sup>
Total gain on derivatives	(306)	(277)	(1,252)
Total amounts reclassified from AOCI	(\$1,312)	(\$534)	\$603

Location on the statements of operations:

<sup>(1)</sup> Net realized investment gain (loss) <sup>(2)</sup> OTTI <sup>(3)</sup> Net investment income

## 9. INCOME TAXES

The provision for income taxes is as follows:

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Current	\$12,805	\$16,830	\$16,491
Deferred	(8,510)	370	2,620
Provision for income taxes	\$4,295	\$17,200	\$19,111

A reconciliation of the provision for income taxes based on the Federal corporate statutory tax rate of 35% to the provision for income taxes is as follows:

	Years Ended December 31,		
	2017	2016	2015
	<i>(In Thousands)</i>		
Provision for income taxes at the statutory rate	\$23,328	\$22,566	\$24,880
Separate account dividends received deduction	(3,734)	(3,729)	(3,386)
Nontaxable investment income	(1,557)	(1,471)	(1,625)
Remeasurement of operating deferred taxes	14,412		
Remeasurement of OCI deferred taxes	(30,104)		
Other	1,950	(166)	(758)
Provision for income taxes	\$4,295	\$17,200	\$19,111

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

During the years ended December 31, 2017, 2016 and 2015, 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,	
	2017	2016
	<i>(In Thousands)</i>	
Deferred tax assets:		
Policyholder reserves	\$50,597	\$81,812
Investment valuation	13,599	25,986
Partnership investments	256	
Other	238	294
Total deferred tax assets	<u>64,690</u>	<u>108,092</u>
Deferred tax liabilities:		
Hedging	(21,026)	(30,968)
DAC	(20,486)	(30,320)
Partnership investments		(1,308)
Other	(5,831)	(8,891)
Total deferred tax liabilities	<u>(47,343)</u>	<u>(71,487)</u>
Deferred tax asset, net	17,347	36,605
Deferred taxes on OCI	(45,157)	(65,795)
Net deferred tax liability	<u>(\$27,810)</u>	<u>(\$29,190)</u>

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 IRS and is audited periodically by some state taxing authorities. The IRS is currently examining PMHC's tax returns for the years ended December 31, 2014 and 2013. The exam of the Federal tax returns through tax years ended December 31, 2012 has been completed and certain issues are under appeals. The State of California is auditing tax year ended December 31, 2009. The Company does not expect the current Federal and California audits to result in any material assessments.

On December 22, 2017, tax reform legislation formally known as the Act was enacted, which significantly revised the U.S. corporate income tax system. Among other things, the Act lowered the Federal corporate income tax rate from 35% to 21%, effective January 1, 2018 and broadened the base of taxable income, particularly with respect to the calculation of tax reserves, DAC, and the Dividends Received Deduction (DRD).

The Company has recorded the estimated effect of certain provisions of the Act in the Company's financial statements; however, the final impact of the Act may differ from these estimates. These differences could arise from changes in interpretations and assumptions the Company has made regarding the Act; guidance on the Act that may be issued; and/or Company actions that may occur as a result of the Act.

The SEC recently issued Staff Accounting Bulletin 118 (the Bulletin), addressing situations in which the accounting for income tax effects of the Act is still incomplete when financial statements must be issued. On the basis of the Bulletin, the Company is treating some effects of the Act as provisional - more specifically:

- On January 1, 2018, the Company's U.S. Federal income tax rate fell from 35% to 21%. The Company must recognize the effect of this rate change on its deferred tax assets and liabilities in the period when the change was enacted. Accordingly,

an income tax benefit of \$15.7 million has been recorded for the year ended December 31, 2017, for the estimated re-measurement of the Company's U.S. net deferred tax liabilities. This amount may change after further analysis of the provisions of the Act and implementation of tax planning responsive to the Act.

The Company is treating other effects of the Act as not yet estimated - for example, the impacts of the Global Intangible Low-Taxed Income (GILTI) and certain tax saving initiatives that could affect the Company's deferred tax balances as of the date of enactment of the Act.

The Company is treating some effects of the Act as final - more specifically:

- In February 2018, the FASB issued ASU 2018-02 which permits retrospective reclassification of certain tax effects from AOCI; therefore, the Company early adopted this ASU and reclassified \$30.1 million of deferred tax benefit from AOCI to retained earnings (see the statements stockholder's equity and Notes 1 and 8).

## 10. SEGMENT INFORMATION

The Company has two operating segments: Retirement Solutions and Life Insurance. 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 segment.

The Retirement Solutions segment's principal products include variable and fixed annuity products, and structured settlement 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 Life Insurance segment provides a broad range of life insurance products through multiple distribution channels operating in the affluent and corporate markets. Principal products include universal life, indexed universal life, variable universal life and traditional products such as whole life and term life. Distribution channels include independent producers, financial advisory networks, independent brokerage general agencies, wirehouses and M Financial, an association of independently owned and operated insurance and financial producers.

The Corporate segment consists of assets, liabilities and activities, which support the Company's operating segments. Included in these support activities is the management of investments, other expenses and other assets not directly attributable to the operating segments. The Corporate segment also includes 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 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 for income taxes is allocated based on each segment's actual tax provision.

The operating 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 segment and as net investment income in the operating segments.

The Company generates substantially all of its revenues and net income from customers located in the U.S. As of December 31, 2017 and 2016, the Company had foreign investments with an estimated fair value of \$663.2 million and \$594.0 million, respectively. Revenues derived from any customer did not exceed 10% of total revenues for the years ended December 31, 2017, 2016 and 2015.

The following is segment information as of and for the year ended December 31, 2017:

	Retirement Solutions	Life Insurance	Corporate	Total
	<i>(In Thousands)</i>			
<b>REVENUES</b>				
Policy fees	\$49,817	\$14,680		\$64,497
Insurance premiums	56,568	5,210		61,778
Net investment income	196,098	3,544	\$10,109	209,751
Net realized investment gain (loss)	(5,030)	407	32	(4,591)
OTTI			(103)	(103)
Other income	2,043	326		2,369
Total revenues	<u>299,496</u>	<u>24,167</u>	<u>10,038</u>	<u>333,701</u>
<b>BENEFITS AND EXPENSES</b>				
Policy benefits	150,981	19,972		170,953
Interest credited	46,447	2,428		48,875
Commission expenses	24,990	1,870		26,860
Operating expenses	15,306	3,075	1,980	20,361
Total benefits and expenses	<u>237,724</u>	<u>27,345</u>	<u>1,980</u>	<u>267,049</u>
Income (loss) before provision (benefit) for income taxes	61,772	(3,178)	8,058	66,652
Provision (benefit) for income taxes	5,686	(2,377)	986	4,295
Net income (loss)	<u>\$56,086</u>	<u>(\$801)</u>	<u>\$7,072</u>	<u>\$62,357</u>
Total assets	\$7,166,701	\$248,524	\$334,600	\$7,749,825
DAC	117,267	16,804		134,071
Separate account assets	2,788,205	133,535		2,921,740
Policyholder and contract liabilities	3,944,036	90,442		4,034,478
Separate account liabilities	2,788,205	133,535		2,921,740

The following is segment information as of and for the year ended December 31, 2016:

	Retirement Solutions	Life Insurance	Corporate	Total
	<i>(In Thousands)</i>			
<b>REVENUES</b>				
Policy fees	\$46,053	\$15,678		\$61,731
Insurance premiums	58,404	4,155		62,559
Net investment income	185,388	3,529	\$11,158	200,075
Net realized investment gain (loss)	(3,390)	(688)	92	(3,986)
Other income	3,021	300		3,321
<b>Total revenues</b>	<b>289,476</b>	<b>22,974</b>	<b>11,250</b>	<b>323,700</b>
<b>BENEFITS AND EXPENSES</b>				
Policy benefits	154,983	10,155		165,138
Interest credited	40,139	2,207		42,346
Commission expenses	32,091	1,628		33,719
Operating expenses	14,737	1,413	1,873	18,023
<b>Total benefits and expenses</b>	<b>241,950</b>	<b>15,403</b>	<b>1,873</b>	<b>259,226</b>
Income before provision for income taxes	47,526	7,571	9,377	64,474
Provision for income taxes	11,481	2,445	3,274	17,200
<b>Net income</b>	<b>\$36,045</b>	<b>\$5,126</b>	<b>\$6,103</b>	<b>\$47,274</b>
Total assets	\$6,480,891	\$233,145	\$337,239	\$7,051,275
DAC	109,001	16,254		125,255
Separate account assets	2,523,038	120,030		2,643,068
Policyholder and contract liabilities	3,576,338	80,081		3,656,419
Separate account liabilities	2,523,038	120,030		2,643,068



The following is segment information for the year ended December 31, 2015:

	Retirement Solutions	Life Insurance	Corporate	Total
<i>(In Thousands)</i>				
<b>REVENUES</b>				
Policy fees	\$44,910	\$13,849		\$58,759
Insurance premiums	45,344	3,809		49,153
Net investment income	187,630	3,611	\$11,380	202,621
Net realized investment gain (loss)	9,719	(36)	1,088	10,771
OTTI	(851)	(1,528)	(466)	(2,845)
Other income	2,240	256	(26)	2,470
<b>Total revenues</b>	<b>288,992</b>	<b>19,961</b>	<b>11,976</b>	<b>320,929</b>
<b>BENEFITS AND EXPENSES</b>				
Policy benefits	144,732	10,567		155,299
Interest credited	38,619	1,978		40,597
Commission expenses	35,965	492		36,457
Operating expenses	13,965	1,800	1,724	17,489
<b>Total benefits and expenses</b>	<b>233,281</b>	<b>14,837</b>	<b>1,724</b>	<b>249,842</b>
Income before provision for income taxes	55,711	5,124	10,252	71,087
Provision for income taxes	13,776	1,605	3,730	19,111
<b>Net income</b>	<b>\$41,935</b>	<b>\$3,519</b>	<b>\$6,522</b>	<b>\$51,976</b>

## 11. TRANSACTIONS WITH RELATED PARTIES

Pacific Life provides general administrative and investment management services to the Company under an administrative services agreement and product contract services under a separate services agreement. Amounts charged by Pacific Life to the Company for these services were \$20.3 million, \$17.8 million and \$16.2 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Pacific Life Fund Advisors LLC (PLFA), is the investment adviser for the Pacific Select Fund, the investment vehicle provided to the Company's variable life insurance policyholders and variable annuity contract owners, and the Pacific Funds Series Trust, the investment vehicle for Pacific Life's mutual funds products. PLFA is owned 99% by Pacific Life and 1% by the Company. Advisory fees earned and related expenses are being recognized at PLFA. Earnings from PLFA to the Company, included in net investment income, for the years ended December 31, 2017, 2016 and 2015 amounted to \$4.4 million, \$4.2 million and \$4.6 million, respectively.

Pacific Select Distributors, LLC (PSD) serves as the distributor of variable life and annuity contracts issued by the Company (Variable Products). In connection with PSD's distribution of the Variable Products, the Company incurred commission expense of \$27.0 million, \$26.0 million and \$28.3 million during the years ended December 31, 2017, 2016 and 2015, respectively. An advisory plan was adopted by the Pacific Select Fund whereby Pacific Select Fund pays PSD, a wholly owned broker-dealer subsidiary of Pacific Life, as distributor of the fund, a service fee in connection with services rendered or procured to or for shareholders of the fund or their 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, which assist in providing any of the services. From these service fees, PSD reimbursed the Company \$3.9 million, \$3.7 million and \$4.2 million, included in commission expense, for paying trail commissions on its behalf for the years ended December 31, 2017, 2016 and 2015, respectively.

The Company's structured settlement transactions are typically designed such that an affiliated assignment company assumes settlement obligations from external parties in exchange for consideration. The affiliated assignment company then funds the assumed settlement obligations by purchasing annuity contracts from PL&A. Consequently, substantially all of the Company's structured settlement annuities are sold to an affiliated assignment company. Included in the liability for future policy benefits are contracts with the affiliated assignment company with contract values of \$1,771.2 million and \$1,739.7 million as of December 31, 2017 and 2016, respectively. In addition, included in the liability for policyholder account balances are contracts with the affiliated assignment company of \$664.9 million and \$618.0 million as of December 31, 2017 and 2016, respectively. Related to these contracts, the Company received \$53.4 million, \$41.5 million and \$33.7 million of insurance premiums and paid \$107.7 million, \$106.8 million and \$102.9 million of policy benefits for the years ended December 31, 2017, 2016 and 2015, respectively.

The Company has an agreement with Pacific Life to borrow up to \$100 million at variable interest rates. The Company did not utilize this borrowing facility during 2017 and 2016.

## **12. DEBT**

The Company 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, 2017 and 2016.

The Company is eligible to receive advances from the FHLB based on a percentage of the Company's net admitted assets provided it has sufficient available eligible collateral and is in compliance with the FHLB requirements and insurance law and regulations. The Company had estimated available eligible collateral of \$71.4 million as of December 31, 2017. The Company had no debt outstanding with the FHLB as of December 31, 2017 and 2016.

## **13. COMMITMENTS AND CONTINGENCIES**

### COMMITMENTS

The Company has outstanding aggregate commitments of \$0.5 million that may be funded during 2018 to make investments in limited partnerships.

### 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 financial statements.

### CONTINGENCIES - IRS REVENUE RULING

In 2007, the IRS issued Rev. Rul. 2007-54, interpreting then-current tax law regarding the computation of the DRD. Later in 2007, the IRS issued Revenue Ruling 2007-61, suspending Rev. Rul. 2007-54 and indicating that the IRS would re-address this issue in a future regulation project. In 2014, the IRS issued Rev. Rul. 2014-7, stating that it would not address this issue through regulation, but instead would defer to legislative action. Rev. Rul. 2014-7 also expressly superseded Rev. Rul. 2007-54, and declared Rev. Rul. 2007-61 obsolete. With the enactment of the Act (Notes 1 and 9), DRD computations have been modified effective January 1, 2018. Therefore, the Company does not expect that any of the rulings described above will affect DRD computations in the future. However, in open tax years before 2018, the Company could still lose a substantial portion of its DRD claims, which could in turn have a material adverse effect on the Company's financial statements.

## CONTINGENCIES - OTHER

In the course of its business, the Company provides certain indemnifications related to dispositions, 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 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. Management believes that claims, if any, against the Company related to such indemnification matters and the Company's estimate of reasonably possible losses exceeding amounts already recognized on an aggregated basis is immaterial and are not likely to have a material adverse effect on the Company's 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.

See Note 4 for discussion of contingencies related to derivative instruments.

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