

## **STATEMENT OF ADDITIONAL INFORMATION**

**May 1, 2018**

**PACIFIC PORTFOLIOS<sup>®</sup> FOR CHASE**

**SEPARATE ACCOUNT A**

Pacific Portfolios (the “Contract”) is a variable annuity contract offered by Pacific Life Insurance Company (“Pacific Life”).

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 Pacific Life 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 Insurance Company  
Mailing address: P.O. Box 2378  
Omaha, Nebraska 68103-2378  
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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, the asset-based Administrative Fee and the deduction of the applicable withdrawal charge, but does not reflect any charges for applicable premium taxes and/or any other taxes, any optional Rider charge, any non-recurring fees or charges, or any increase in the Risk Charge for an optional Death Benefit Rider. The Annual Fee is also taken into account, assuming an average Contract Value of \$45,000. 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.

Total returns may also be shown for the same periods that do not take into account the withdrawal charge or the Annual Fee.

### *Non-Standardized Total Returns*

We may also calculate non-standardized total returns which may or may not reflect any Annual Fee, withdrawal charges, 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: [(Base Period Return + 1) (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 the 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 or any non-recurring fees or charges, but do reflect a deduction for the Annual Fee, the Risk Charge, and the asset-based Administrative Fee and assume an average Contract Value of \$45,000.

#### *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 and the Annual Fee (assuming an average Contract Value of \$45,000), but does not reflect any withdrawal charge, 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.

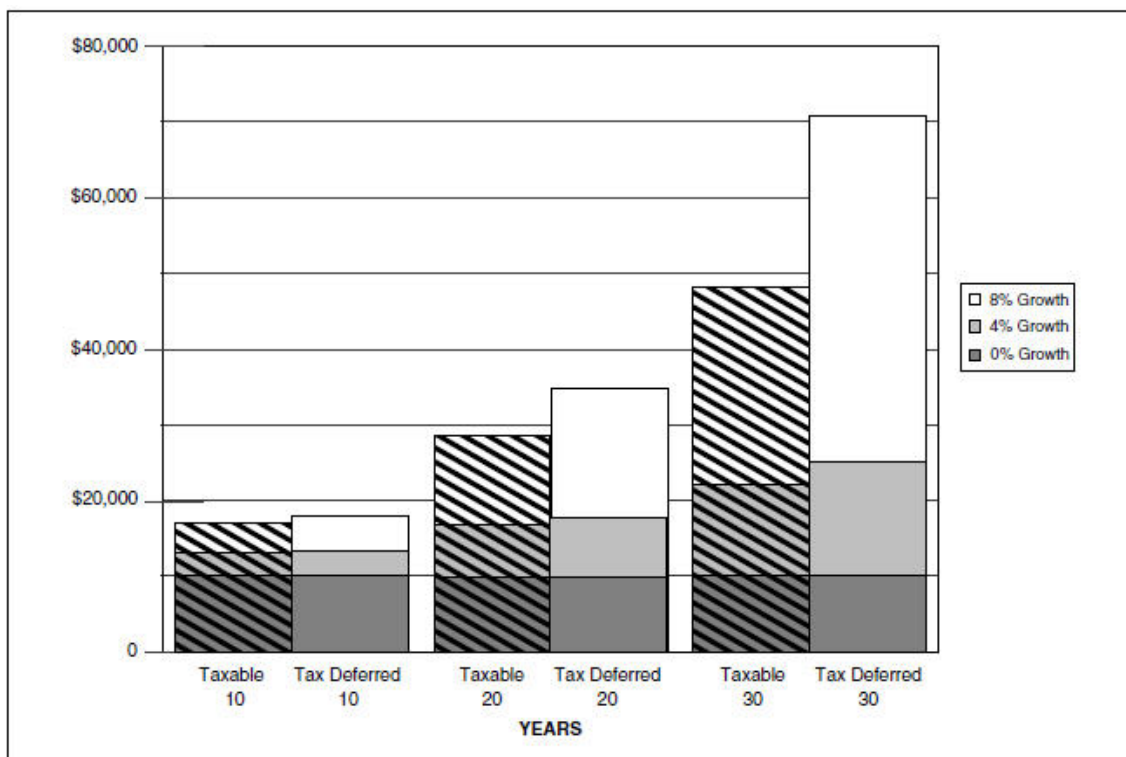
The chart shows a single Purchase Payment of \$10,000, assuming hypothetical annual returns of 0%, 4% and 8%, compounded annually, and a tax rate of 32%. The values shown for the taxable investment do not include any deduction for management fees or other expenses but assume that taxes are deducted annually from investment returns. The values shown for the variable annuity do not reflect the Risk Charge, and the asset-based Administrative Fee and the Annual Fee (assuming an average Contract Value of \$45,000), any withdrawal charge, 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 subsidiary, 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 state insurance departments 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 \$275,141, \$466,718 and \$342,720 respectively, of which \$0 was retained.

PSD or an affiliate pays various sales compensation to broker-dealers that solicit applications for the Contracts. PSD or an affiliate also may provide reimbursement for other expenses associated with the promotion and solicitation of applications for the Contracts. Your financial advisor typically receives a portion of the compensation that is payable to his or her broker-dealer in connection with the Contract, depending on the agreement between your financial advisor and his or her firm. Pacific Life is not involved in determining that compensation arrangement, which may present its own incentives or conflicts. You may ask your financial advisor how he/she will personally be compensated for the transaction.

Under certain circumstances where PSD pays lower initial commissions, certain broker-dealers that solicit applications for Contracts may be paid an ongoing persistency trail commission (sometimes called a residual). The mix of Purchase Payment-based versus trail commissions varies depending upon our agreement with the selling

broker-dealer and the commission option selected by your financial advisor or broker-dealer. Certain broker-dealers may also 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 Purchase Payment-based, trail commissions and 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 0.30% and trailing compensation based on Account Value generally does not exceed 0.15% on an annual basis. Such additional compensation may give Pacific Life 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 Pacific Life 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, Infinex 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 Pacific Life 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 Pacific Life and its affiliates. Other persons may also attend all or a portion of any such conferences or meetings, including directors, officers and employees of Pacific Life, 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 Pacific Life or PSD. Additional expenses and promotional items may be paid for by Pacific Life 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, Pacific Life 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).

As explained in the Prospectus, the Annual Fee, if applicable, will be charged proportionately against your Investment Options. Assessments against your Variable Investment Options are assessed against your Variable Account Value through the automatic debit of Subaccount Units; the Annual Fee decreases the number of Subaccount Units attributed to your Contract but does not alter the Unit Value for any Subaccount.



## **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 and in any fixed option, 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 Annual Fees, any optional Rider charge, and/or withdrawal charge, and 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 5% 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 \$5.79 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 \$579.00.

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 1.25% and the Administrative Fee at an annual rate of 0.15%. 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 5% each year during the payout of your annuity; thus 5% 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.

*Example:* Assume the net investment performance of a Subaccount is at a rate of 5.00% per year (after deduction of the 1.25% Risk Charge and the 0.15% Administrative Fee). The Subaccount Unit Value for that Subaccount would increase at a rate of 5.00% per year, but the Subaccount Annuity Unit Value would not increase (or decrease) at all. The net investment factor for that 5% return [1.05] is then divided by the factor for the 5% assumed investment return [1.05] and 1 is subtracted from the result to determine the adjusted rate of change in Subaccount Annuity Unit Value:

$$\frac{1.05}{1.05} = 1; 1 - 1 = 0; 0 \times 100\% = 0\%.$$

If the net investment performance of a Subaccount’s assets is at a rate less than 5.00% per year, the Subaccount Annuity Unit Value will decrease, even if the Subaccount Unit Value is increasing.

*Example:* Assume the net investment performance of a Subaccount is at a rate of 2.60% per year (after deduction of the 1.25% Risk Charge and the 0.15% 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 2.29% per year. The net investment factor for that 2.6% return [1.026] is then divided by the factor for the 5% assumed investment return [1.05] and 1 is subtracted from the result to determine the adjusted rate of change in Subaccount Annuity Unit Value:

$$\frac{1.026}{1.05} = 0.9771; 0.9771 - 1 = -0.0229; -0.0229 \times 100\% = -2.29\%.$$

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. 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 full redemption would be the present value of any remaining guaranteed variable payments at the assumed investment return. Any applicable withdrawal charge will be deducted from the present value as if you made a full withdrawal, or if applicable, a partial withdrawal. For purposes of calculating the withdrawal charge and Free Withdrawal amount, it will be assumed that the Contract was never converted to provide annuity payments and any prior variable annuity payments in that Contract Year will be treated as if they were partial withdrawals from the Contract (see the **CHARGES, FEES AND DEDUCTIONS—Withdrawal Charge** section in the Prospectus). **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.** For example, assume that a Contract was issued with a single investment of \$10,000 and in Contract Year 4 the Owner elects to receive variable annuity payments under Annuity Option 4. In Contract Year 5, the Owner elects to make a partial redemption of \$5,000. The withdrawal charge as a percentage of the Purchase Payments with an age of 5 years is 3%. Assuming the Free Withdrawal amount immediately prior to the partial redemption is \$300, the withdrawal charge for the partial redemption will be \$141  $((\$5,000 - \$300) * 3\%)$ . No withdrawal charge will be imposed on a redemption if:

- the Annuity Option is elected as the form of payments of death benefit proceeds, or
- the Annuitant dies before the period certain has ended and the Beneficiary requests a redemption of the variable annuity payments.

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**

The GIO's or any fixed option(s) are not available in connection with portfolio rebalancing. 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, DCA Plus, and the earnings sweep at the same time.

The GIO's or any fixed option(s) may not be used as the target Investment Option under any systematic transfer programs. In addition, the GIO's may not be used as a source Investment Option under any systematic transfer programs.

### *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 (excluding any GIOs) 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 an Account Value. 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. The GIOs are not available for preauthorized withdrawals.

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.

Pre-authorized withdrawals are subject to the same withdrawal charges as are other withdrawals and each 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. This loan rate may vary by state.

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. Your GIO Value is not available to secure your loan.

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, subject to certain state limitations. 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),
- 100% of your Contract Value excluding your GIO value, 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 and any withdrawal charge 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 and any withdrawal charge 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 the withdrawal charge and 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**

Pacific Life's consolidated 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 Pacific Life 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 Pacific Life 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 consolidated financial statements of Pacific Life Insurance Company and Subsidiaries 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 Insurance 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 INSURANCE COMPANY  
AND SUBSIDIARIES**

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



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## **INDEPENDENT AUDITORS' REPORT**

Pacific Life Insurance Company and Subsidiaries:

We have audited the accompanying consolidated financial statements of Pacific Life Insurance Company and Subsidiaries (the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for each of the three years in the period ended December 31, 2017 and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

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

### **Auditors' Responsibility**

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pacific Life Insurance Company and Subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their 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 8, 2018

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

| <i>(In Millions)</i>   | December 31,     |                  |
|--|------------------|------------------|
|  | 2017             | 2016             |
| <b>ASSETS</b>  |                  |                  |
| Investments:   |                  |                  |
| Fixed maturity securities available for sale, at estimated fair value            | \$47,460         | \$43,247         |
| Equity securities available for sale, at estimated fair value                    | 82               | 100              |
| Fair value option securities (includes VIE assets of \$621 and \$0)              | 1,182            | 529              |
| Mortgage loans (includes VIE assets of \$1,800 and \$1,800)                      | 13,558           | 12,175           |
| Policy loans   | 7,681            | 7,437            |
| Other investments (includes VIE assets of \$397 and \$278)                       | 3,637            | 2,693            |
| <b>TOTAL INVESTMENTS</b>   | <b>73,600</b>    | <b>66,181</b>    |
| Cash and cash equivalents (includes VIE assets of \$66 and \$7)                  | 2,639            | 1,360            |
| Restricted cash  | 211              | 188              |
| Deferred policy acquisition costs  | 4,693            | 4,509            |
| Aircraft, net  | 7,834            | 7,855            |
| Other assets (includes VIE assets of \$6 and \$4)                                | 4,465            | 3,525            |
| Separate account assets  | 61,456           | 57,426           |
| <b>TOTAL ASSETS</b>  | <b>\$154,898</b> | <b>\$141,044</b> |
| <b>LIABILITIES AND EQUITY</b>  |                  |                  |
| Liabilities:   |                  |                  |
| Policyholder account balances  | \$48,765         | \$44,907         |
| Future policy benefits   | 16,895           | 15,162           |
| Debt (includes VIE debt of \$1,658 and \$1,560)                                  | 10,251           | 9,156            |
| Fair value option debt (includes VIE debt of \$462 and \$0)                      | 462              |                  |
| Other liabilities (includes VIE liabilities of \$108 and \$5)                    | 4,174            | 3,685            |
| Separate account liabilities   | 61,456           | 57,426           |
| <b>TOTAL LIABILITIES</b>   | <b>142,003</b>   | <b>130,336</b>   |
| Commitments and contingencies (Note 18)  |                  |                  |
| Stockholder's Equity:  |                  |                  |
| Common stock - \$50 par value; 600,000 shares authorized, issued and outstanding | 30               | 30               |
| Paid-in capital  | 1,023            | 1,019            |
| Retained earnings  | 9,534            | 8,625            |
| Accumulated other comprehensive income   | 1,613            | 909              |
| <b>Total Stockholder's Equity</b>  | <b>12,200</b>    | <b>10,583</b>    |
| Noncontrolling interests   | 695              | 125              |
| <b>TOTAL EQUITY</b>  | <b>12,895</b>    | <b>10,708</b>    |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$154,898</b> | <b>\$141,044</b> |

The abbreviation VIE above means variable interest entity.

See Notes to Consolidated Financial Statements

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

| <i>(In Millions)</i>  | Years Ended December 31, |              |              |
|---|--------------------------|--------------|--------------|
|   | 2017                     | 2016         | 2015         |
| <b>REVENUES</b>   |                          |              |              |
| Policy fees and insurance premiums  | \$4,347                  | \$4,108      | \$4,179      |
| Net investment income   | 2,840                    | 2,587        | 2,557        |
| Net realized investment gain  | 48                       | 110          | 234          |
| OTTI, consisting of \$11, \$53 and \$102 in total, net of \$0, \$11 and \$6 recognized in OCI | (11)                     | (42)         | (96)         |
| Investment advisory fees  | 300                      | 294          | 353          |
| Aircraft leasing revenue  | 898                      | 1,018        | 833          |
| Other income  | 314                      | 379          | 260          |
| <b>TOTAL REVENUES</b>   | <b>8,736</b>             | <b>8,454</b> | <b>8,320</b> |
| <b>BENEFITS AND EXPENSES</b>  |                          |              |              |
| Policy benefits paid or provided  | 3,463                    | 3,182        | 3,249        |
| Interest credited to policyholder account balances  | 1,383                    | 1,306        | 1,250        |
| Commission expenses   | 769                      | 953          | 1,200        |
| Operating and other expenses  | 2,145                    | 2,023        | 1,870        |
| <b>TOTAL BENEFITS AND EXPENSES</b>  | <b>7,760</b>             | <b>7,464</b> | <b>7,569</b> |
| <b>INCOME BEFORE PROVISION (BENEFIT) FOR INCOME TAXES</b>                                     | <b>976</b>               | <b>990</b>   | <b>751</b>   |
| Provision (benefit) for income taxes  | (384)                    | 207          | 149          |
| <b>Net income</b>   | <b>1,360</b>             | <b>783</b>   | <b>602</b>   |
| Less: net (income) loss attributable to noncontrolling interests                              | (6)                      | (26)         | 2            |
| <b>NET INCOME ATTRIBUTABLE TO THE COMPANY</b>   | <b>\$1,354</b>           | <b>\$757</b> | <b>\$604</b> |

The abbreviation OTTI above means other than temporary impairment losses.

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

See Notes to Consolidated Financial Statements

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| <i>(In Millions)</i>   | Years Ended December 31, |       |        |
|--|--------------------------|-------|--------|
|  | 2017                     | 2016  | 2015   |
| <b>NET INCOME</b>  | \$1,360                  | \$783 | \$602  |
| 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   | 467                      | 220   | (710)  |
| Reclassification adjustment for (gain) loss included in net income                           | (56)                     | 5     | 41     |
| Gain (loss) on derivatives and unrealized gain (loss) on securities available for sale, net  | 411                      | 225   | (669)  |
| Other, net   | 8                        | (4)   | (5)    |
| Other comprehensive income (loss)  | 419                      | 221   | (674)  |
| Comprehensive income (loss)  | 1,779                    | 1,004 | (72)   |
| Less: comprehensive (income) loss attributable to noncontrolling interests                   | (6)                      | (26)  | 2      |
| <b>COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO THE COMPANY</b>                               | \$1,773                  | \$978 | (\$70) |

See Notes to Consolidated Financial Statements

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF EQUITY

| (In Millions)  | Common<br>Stock | Paid-in<br>Capital | Retained<br>Earnings | Accumulated Other<br>Comprehensive Income |  | Total<br>Stockholder's<br>Equity | Noncontrolling<br>Interests | Total<br>Equity |
|--|-----------------|--------------------|----------------------|---|--|----------------------------------|-----------------------------|-----------------|
|  |                 |                    |                      | Available for<br>Sale, Net                | Gain (Loss) On<br>Derivatives and<br>Unrealized<br>Gain (Loss) On<br>Securities<br>Other,<br>Net |                                  |                             |                 |
| <b>BALANCES, JANUARY 1, 2015</b>                     | <b>\$30</b>     | <b>\$982</b>       | <b>\$7,264</b>       | <b>\$1,374</b>                            | <b>(\$12)</b>  | <b>\$9,638</b>                   | <b>\$104</b>                | <b>\$9,742</b>  |
| Comprehensive loss:                                  |                 |                    |                      |   |  |                                  |                             |                 |
| Net income (loss)                                    |                 |                    | 604                  |   |  | 604                              | (2)                         | 602             |
| OCI  |                 |                    |                      | (669)                                     | (5)  | (674)                            |                             | (674)           |
| Total comprehensive loss                             |                 |                    |                      |   |  | (70)                             | (2)                         | (72)            |
| Assumption of noncontrolling interest (Note 7)       |                 | 30                 |                      |   |  | 30                               | (30)                        | —               |
| Change in equity of noncontrolling interests         |                 |                    |                      |   |  |                                  | 16                          | 16              |
| <b>BALANCES, DECEMBER 31, 2015</b>                   | <b>30</b>       | <b>1,012</b>       | <b>7,868</b>         | <b>705</b>                                | <b>(17)</b>  | <b>9,598</b>                     | <b>88</b>                   | <b>9,686</b>    |
| Comprehensive income:                                |                 |                    |                      |   |  |                                  |                             |                 |
| Net income   |                 |                    | 757                  |   |  | 757                              | 26                          | 783             |
| OCI  |                 |                    |                      | 225                                       | (4)  | 221                              |                             | 221             |
| Total comprehensive income                           |                 |                    |                      |   |  | 978                              | 26                          | 1,004           |
| Assumption of noncontrolling interest (Note 7)       |                 | 7                  |                      |   |  | 7                                | (7)                         | —               |
| Change in equity of noncontrolling interests         |                 |                    |                      |   |  |                                  | 18                          | 18              |
| <b>BALANCES, DECEMBER 31, 2016</b>                   | <b>30</b>       | <b>1,019</b>       | <b>8,625</b>         | <b>930</b>                                | <b>(21)</b>  | <b>10,583</b>                    | <b>125</b>                  | <b>10,708</b>   |
| Comprehensive income:                                |                 |                    |                      |   |  |                                  |                             |                 |
| Net income   |                 |                    | 1,354                |   |  | 1,354                            | 6                           | 1,360           |
| OCI  |                 |                    |                      | 411                                       | 8  | 419                              |                             | 419             |
| Total comprehensive income                           |                 |                    |                      |   |  | 1,773                            | 6                           | 1,779           |
| Dividend to parent                                   |                 |                    | (160)                |   |  | (160)                            |                             | (160)           |
| Reclassification of deferred tax<br>effects (Note 1) |                 |                    | (285)                | 289                                       | (4)  |                                  |                             |                 |
| Partial sale of subsidiary (Note 1)                  |                 | 4                  |                      |   |  | 4                                | 587                         | 591             |
| Change in equity of noncontrolling interests         |                 |                    |                      |   |  |                                  | (23)                        | (23)            |
| <b>BALANCES, DECEMBER 31, 2017</b>                   | <b>\$30</b>     | <b>\$1,023</b>     | <b>\$9,534</b>       | <b>\$1,630</b>                            | <b>(\$17)</b>  | <b>\$12,200</b>                  | <b>\$695</b>                | <b>\$12,895</b> |

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

See Notes to Consolidated Financial Statements



Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

| <i>(In Millions)</i>  | Years Ended December 31, |                |                |
|---|--------------------------|----------------|----------------|
|   | 2017                     | 2016           | 2015           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                          |                |                |
| Net income  | \$1,360                  | \$783          | \$602          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                |                |
| Net accretion on fixed maturity securities  | (46)                     | (50)           | (70)           |
| Depreciation and amortization   | 426                      | 418            | 466            |
| Deferred income taxes   | (643)                    | 123            | 113            |
| Net realized investment gain  | (48)                     | (110)          | (234)          |
| Other than temporary impairments  | 11                       | 42             | 96             |
| Net change in deferred policy acquisition costs                                   | (246)                    | 78             | 290            |
| Interest credited to policyholder account balances                                | 1,383                    | 1,306          | 1,250          |
| Net change in future policy benefits  | 1,369                    | 1,398          | 1,274          |
| Other operating activities, net   | 341                      | (107)          | 348            |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>                                  | <b>3,907</b>             | <b>3,881</b>   | <b>4,135</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                          |                |                |
| Fixed maturity and equity securities available for sale:                          |                          |                |                |
| Purchases   | (6,685)                  | (7,510)        | (7,340)        |
| Sales   | 994                      | 805            | 552            |
| Maturities and repayments   | 2,767                    | 2,697          | 2,120          |
| Purchases of fair value option securities   | (673)                    |                |                |
| Repayments of mortgage loans  | 295                      | 410            | 863            |
| Fundings of mortgage loans and real estate  | (2,318)                  | (1,934)        | (1,750)        |
| Funding of CMBS VIE mortgage loan   |                          |                | (1,050)        |
| Net change in policy loans  | (244)                    | (106)          | (97)           |
| Terminations of derivative instruments, net                                       | 400                      | 137            | 159            |
| Proceeds from nonhedging derivative settlements                                   | 105                      | 120            | 135            |
| Payments for nonhedging derivative settlements                                    | (584)                    | (583)          | (295)          |
| Net change in cash collateral received or pledged                                 | 86                       | 74             | (68)           |
| Purchases of and advance payments on aircraft                                     | (2,134)                  | (1,241)        | (1,306)        |
| Proceeds from sale of aircraft  | 732                      | 954            | 168            |
| Other investing activities, net   | (108)                    | (42)           | 132            |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>                                      | <b>(7,367)</b>           | <b>(6,219)</b> | <b>(7,777)</b> |

*(Continued)*

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

See Notes to Consolidated Financial Statements

Pacific Life Insurance Company and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

| <i>(In Millions)</i>  | Years Ended December 31, |                |                |
|---|--------------------------|----------------|----------------|
|   | 2017                     | 2016           | 2015           |
| <i>(Continued)</i>  |                          |                |                |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                   |                          |                |                |
| Policyholder account balances:                                |                          |                |                |
| Deposits  | \$6,843                  | \$6,727        | \$6,075        |
| Withdrawals   | (4,735)                  | (4,751)        | (5,419)        |
| Net change in short-term debt and revolving credit facilities | (687)                    | 546            | 227            |
| Issuance of long-term debt                                    | 2,871                    | 504            | 1,041          |
| Issuance of CMBS VIE debt                                     |                          |                | 845            |
| Partial retirement of surplus notes                           | (906)                    | (80)           |                |
| Payments of long-term debt                                    | (295)                    | (1,345)        | (828)          |
| Issuance of fair value option debt                            | 460                      |                |                |
| Net change in cash collateral for loaned securities           | 640                      | 23             | 161            |
| Dividend to parent  | (160)                    |                |                |
| Partial sale of subsidiary (Note 1)                           | 591                      |                |                |
| Other financing activities, net                               | 117                      | 229            | 165            |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>              | <b>4,739</b>             | <b>1,853</b>   | <b>2,267</b>   |
| Net change in cash and cash equivalents                       | 1,279                    | (485)          | (1,375)        |
| Cash and cash equivalents, beginning of year                  | 1,360                    | 1,845          | 3,220          |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>                 | <b>\$2,639</b>           | <b>\$1,360</b> | <b>\$1,845</b> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>      |                          |                |                |
| Income taxes paid (received), net                             | \$249                    | \$97           | (\$99)         |
| Interest paid   | \$372                    | \$393          | \$376          |

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

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

ORGANIZATION AND DESCRIPTION OF BUSINESS

Pacific Life Insurance Company (Pacific Life) was established in 1868 and is domiciled in the State of Nebraska as a stock life insurance company. Pacific Life is an indirect subsidiary of Pacific Mutual Holding Company (PMHC), a Nebraska mutual holding company, and a wholly owned subsidiary of Pacific LifeCorp, an intermediate Delaware stock holding company. Pacific Life and its subsidiaries and affiliates have primary business operations consisting of life insurance, annuities, mutual funds, aircraft leasing and reinsurance.

BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

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

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

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

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

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

During the first quarter of 2017, Pacific Life formed a wholly owned limited liability company (LLC), Pacific Life Aviation Holdings LLC (PLAH). During March 2017, Pacific Life contributed 100% of its stock ownership of Aviation Capital Group Corp. and its subsidiaries to PLAH. Effective March 31, 2017, Aviation Capital Group Corp. was converted to an LLC named Aviation Capital Group LLC (ACG). ACG is engaged in the acquisition and leasing of commercial aircraft.

In December 2017, TC Skyward Aviation U.S., Inc., a Delaware corporation (the Investor) and direct subsidiary of Tokyo Century Corporation, a Japanese corporation, purchased a 20% member interest in ACG. At the request of ACG and subject to certain conditions, the Investor has also agreed to provide up to \$600 million of additional equity capital to ACG through December 2020 in exchange for additional member interest in ACG. If the Investor owns less than 30% membership interest in ACG after December 2020, the Investor has the right, subject to certain conditions, to purchase additional interests up to an amount of 30% of the membership interests of ACG.

Certain reclassifications have been made to the 2016 and 2015 consolidated financial statements to conform to the 2017 consolidated financial statement presentation.

The Company has evaluated events subsequent to December 31, 2017 through March 8, 2018, the date the consolidated financial statements were available to be issued and has concluded that no events have occurred that require disclosure or adjustment to the consolidated financial statements.

## 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.

The Company has elected the fair value option (FVO) method of accounting for a portfolio of U.S. Government securities and broadly syndicated bank loans. The Company elected the FVO in order to report the investments at estimated fair value with changes in the estimated fair value of these securities recognized in net realized investment gain. This accounting treatment for the U.S. Government securities will provide a partial offset to the impact of interest rate movements. The Company has elected the FVO for debt issued from a collateralized loan obligation (CLO) that is classified as a VIE. The debt and broadly syndicated bank loans were designated as FVO to reduce the impact of market value changes from the CLO on the consolidated financial statements. See Notes 4 and 11.

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 private equity partnerships and joint ventures, hedge funds, real estate investments, derivative instruments, non-marketable equity securities, low income housing investments qualifying for tax credits (LIHTC), trading securities, and securities of consolidated investment funds that operate under the Investment Company Act of 1940 (40 Act Funds). Investments in private equity partnerships, joint venture interests and hedge funds are recorded under the cost or equity method of accounting, except those held by consolidated sponsored investment funds (Note 4). As a practical expedient, consolidated investment funds estimate the fair value of interests in the portfolio funds using the net asset value per share as determined by the respective investment manager. The changes in estimated fair value for these assets are recognized in net investment income. Non-marketable equity securities are carried at estimated fair value with unrealized gains or losses recognized in OCI. Trading securities and the securities of the 40 Act Funds are reported at estimated fair value with changes in estimated fair value recognized in net realized investment gain.

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.

Real estate investments are carried at depreciated cost, net of write-downs. For real estate acquired in satisfaction of debt, cost represents fair value at the date of acquisition. Real estate investments are evaluated for impairment based on the future estimated undiscounted cash flows expected to be received during the estimated holding period. When the future estimated undiscounted cash flows are less than the current carrying amount of the property (gross cost less accumulated depreciation), the property is considered impaired and is written-down to its estimated fair value.

Investments in LIHTC are recorded under the effective interest method since they meet certain requirements, including a projected positive yield based solely on guaranteed credits. The amortization of the original investment and the tax credits are recorded in the provision for income taxes. See Note 15.

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. If the derivative is designated as a fair value hedge, changes in the estimated fair value of the hedging derivative, including amounts measured as ineffectiveness, and changes in the estimated fair value of the hedged item related to the designated risk being hedged, are reported in net realized investment gain. The change in estimated value of the hedged item associated with the risk being hedged is reflected as an adjustment to the carrying amount of the hedged item. For derivative instruments not designated as a hedge, the change in estimated fair value of the derivative is recorded in net realized investment gain.

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 assets, these amounts are included in net investment income. For derivatives that are hedging liabilities, these amounts are included in interest credited to policyholder account balances or interest expense, which is included in

operating and other expenses. For derivatives not designated as a hedge, the periodic cash flows are reflected in net realized investment gain 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, net realized investment gain, interest credited to policyholder account balances, or operating and other expenses when the forecasted transactions affect earnings. Upon termination of a fair value hedging relationship, the accumulated adjustment to the carrying amount of the hedged item is amortized into either net investment income, interest credited to policyholder account balances, or operating and other expenses over its remaining life.

#### CASH AND CASH EQUIVALENTS

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

#### RESTRICTED CASH

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

#### DEFERRED POLICY ACQUISITION COSTS

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

For universal life (UL), variable annuities and other investment-type contracts, acquisition costs are 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.

## AIRCRAFT, NET

The Company records aircraft and other aircraft components at cost less accumulated depreciation. Cost consists of the acquisition price, including interest capitalized during the construction period of a new aircraft, and major additions and modifications. Depreciation to estimated residual values is computed using the straight-line method over the estimated useful life of the aircraft, which is generally 25 years from the date of manufacture. Major improvements to aircraft are capitalized as incurred and depreciated over the shorter of the remaining useful life of the aircraft or the useful life of the improvement. The Company evaluates the carrying amount of aircraft quarterly or based upon changes in market and other physical and economic conditions that indicate the carrying amount of the aircraft may not be recoverable. The Company will record impairments to recognize a loss in the value of the aircraft when management believes that, based on future estimated undiscounted cash flows, the recoverability has been impaired.

## GOODWILL

Goodwill represents the excess of acquisition costs over the fair value of net assets acquired. Goodwill is not amortized but is reviewed for impairment at least annually or more frequently if events occur or circumstances indicate that the goodwill might be impaired. Goodwill is included in other assets and was \$63 million as of December 31, 2017 and 2016. There were no goodwill impairments recognized during the years ended December 31, 2017, 2016 and 2015.

## POLICYHOLDER ACCOUNT BALANCES

Policyholder account balances on UL and certain investment-type contracts, such as funding agreements, are valued using the retrospective deposit method and are equal to accumulated account values, which consist of deposits received, plus interest credited, less withdrawals and assessments. Other investment-type contracts such as payout annuities without life contingencies are valued using a prospective method that estimates the present value of future contract cash flows at the assumed credited or contract rate. Interest credited to these contracts ranged from 0.1% to 10.7%.

## FUTURE POLICY BENEFITS

Annuity reserves, which primarily consist of group retirement, structured settlement and immediate annuities with life contingencies, are equal to the present value of estimated future payments using pricing assumptions, as applicable, for interest rates, mortality, morbidity, retirement age and expenses. Interest rates used in establishing such liabilities ranged from 0.8% to 11.0%.

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 10). All other GLB guarantees are accounted for as embedded derivatives (Note 8).

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

Life insurance reserves are composed of benefit reserves and additional liabilities. Benefit reserves are valued using the net level premium method on the basis of actuarial assumptions appropriate at policy issue. Mortality and persistency assumptions are generally based on the Company's experience, which, together with interest and expense assumptions, include a margin for possible unfavorable deviations. Interest rate assumptions ranged from 3.0% to 9.3%. Future dividends for participating business are provided for in the liability for future policy benefits. Additional liabilities are held for certain insurance benefit features that have amounts assessed in a manner that is expected to result in profits in earlier years and subsequent losses. The additional liability is valued using a range of scenarios, rather than a single set of best estimate assumptions, which are consistent with assumptions used in estimated gross profits for purposes of amortizing capitalized acquisition costs.

As of December 31, 2017 and 2016, participating experience rated policies paying dividends represent less than 1% of direct life insurance in force.

Estimates of future policy benefit reserves and liabilities are continually reviewed and, as experience develops, are adjusted as necessary. The Company may also identify and implement actuarial modeling refinements to projection models that may result in increases and decreases to the liability for future policy benefits. Such changes in estimates are included in earnings for the period in which such changes occur.

## REINSURANCE

The Company has ceded reinsurance agreements with other insurance companies to limit potential losses, reduce exposure arising from larger risks, 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 (YRT) arrangements with this producer group's reinsurance company. The ceding of risk does not discharge the Company from its primary obligations to contract owners. To the extent that the assuming companies become unable to meet their obligations under reinsurance contracts, the Company remains 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 and non-traditional longevity reinsurance. Reinsurance agreements related to nontraditional longevity reinsurance are assumed from Pacific Life Re Limited (PLRL), an affiliate of the Company and a wholly owned subsidiary of Pacific LifeCorp. PLRL is incorporated in the United Kingdom (UK) and provides reinsurance to insurance and annuity providers in the UK, Ireland, Australia and to insurers in select markets in Asia. Non-traditional longevity reinsurance provides protection to retirement plans and insurers of such plans against changes in mortality improvement. With a non-traditional longevity reinsurance transaction, the Company agrees with another party to exchange a predefined benefit and the realized benefit for a premium.

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 terminations and recapture gains are recorded in other income.

## REVENUES, BENEFITS AND EXPENSES

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

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



Aircraft leases are generally accounted for as operating leases and are structured as triple net leases whereby the lessee is responsible for maintaining the aircraft and paying operational, maintenance and insurance expenses. The aircraft leases require payment in U.S. dollars. Aircraft leasing revenue is recognized on a straight-line basis over the term of the lease agreements. The Company has capital leases in the amount of \$333 million and \$254 million as of December 31, 2017 and 2016, respectively, which are included in other assets.

#### DEPRECIATION AND AMORTIZATION

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

#### INCOME TAXES

The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements. Under this method, the Company determines deferred tax assets and liabilities on the basis of the differences between the consolidated financial statement and tax bases of assets and liabilities by using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company recognizes deferred tax assets to the extent that these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If the Company determines that it would be able to realize deferred tax assets in the future in excess of their net recorded amount, the Company would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

The Company records uncertain tax positions in accordance with the Accounting Standards Codification's (Codification) Income Taxes Topic on the basis of a two-step process in which (1) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

The Company recognizes interest and penalties related to unrecognized tax benefits in the provision (benefit) for income taxes in the consolidated statements of operations. Accrued interest and penalties are included in other liabilities in the consolidated statements of financial condition.

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

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 15.

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

## 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 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 \$285 million of deferred tax effects from AOCI to retained earnings as of December 31, 2017. See the consolidated statements of equity and Notes 13 and 15.

## 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 consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18 that provides guidance on the classification and presentation of changes in restricted cash on the statement of cash flows. This ASU will require companies to include restricted cash within cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years and will be applied retrospectively. Adoption will change the Company's presentation of restricted cash on the consolidated statements of cash flows with the inclusion of the restricted cash balance in the beginning and ending cash and cash equivalents balance and the elimination of the restricted cash activity in net cash provided by financing activities.

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 consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 that provides guidance on leasing transactions. The new guidance requires a lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current guidance, leases would be classified as finance or operating leases. However, unlike current guidance, the new guidance will require both types of leases to be recognized on the consolidated statements of financial condition by the lessee. Lessor accounting will remain largely unchanged from current guidance except for certain targeted changes. The new guidance will also require new qualitative and quantitative disclosures. This ASU is effective for fiscal years beginning after December 15, 2019 and interim periods within

those fiscal years, and requires a modified retrospective transition approach which includes a number of optional practical expedients. Early adoption is permitted. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01 that amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The new guidance changes the current accounting guidance related to (i) the classification and measurement of certain equity investments, (ii) the presentation of changes in the fair value of financial liabilities measured under the fair value option that are due to instrument-specific credit risk, and (iii) certain disclosures associated with the fair value of financial instruments. Under the guidance, the change which most significantly impacts the Company is that equity securities currently classified as available for sale will be measured at fair value through net income instead of OCI. Additionally, investments in private equity partnerships and joint ventures currently accounted for under the cost method will also be measured at fair value. This ASU is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years and will be applied prospectively with a cumulative effect adjustment to the beginning retained earnings balance. The Company's equity securities available for sale, except for those accounted for using the equity method, will be presented on the consolidated statements of financial condition at fair value with changes in fair value reported in net realized investment gain. Upon adoption, the estimated impact is expected to increase retained earnings by \$19 million, net of tax.

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 consolidated financial statements.

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

### STATUTORY ACCOUNTING PRACTICES

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

The NE DOI has a prescribed accounting practice for certain synthetic guaranteed interest contract (GIC) reserves that differs from National Association of Insurance Commissioners (NAIC) *Accounting Practices and Procedures Manual* (NAIC SAP). The NE DOI reserve method is based on an annual accumulation of 30% of the contract fees on synthetic GICs and is subject to a maximum of 150% of the annualized contract fees. This reserve amounted to \$59 million and \$63 million as of December 31, 2017 and 2016, respectively, and has been recorded by Pacific Life. The NAIC SAP basis for this reserve equals the excess, if any, of the value of guaranteed contract liabilities over the market value of the assets in the segregated portfolio less deductions based on asset valuation reserve factors. As of December 31, 2017 and 2016, the reserve for synthetic GICs using the NAIC SAP basis was zero.

### STATUTORY NET INCOME AND SURPLUS

Statutory net income of Pacific Life was \$1,201 million, \$850 million and \$520 million for the years ended December 31, 2017, 2016 and 2015, respectively. Statutory capital and surplus of Pacific Life was \$9,313 million and \$8,548 million as of December 31, 2017 and 2016, respectively.

### AFFILIATED REINSURANCE

Pacific Life cedes certain statutory reserves to affiliated special purpose financial insurance companies and affiliated captive reinsurance companies that are supported by a combination of cash, invested and other assets and third-party letters of credit or note facilities. As of December 31, 2017, Pacific Life's total statutory reserve credit was \$2,224 million, of which \$1,450 million was

supported by third-party letters of credit and note facilities. As of December 31, 2016, Pacific Life's total statutory reserve credit was \$2,081 million, of which \$1,347 million was supported by third-party letters of credit and note facilities, as described below.

Pacific Life utilizes affiliated reinsurers to mitigate the statutory capital impact of NAIC Model Regulation "Valuation of Life Insurance Policies" (Regulation XXX) and NAIC Actuarial Guideline 38 on the Company's UL products with flexible duration no lapse guarantee rider (FDNLGR) benefits. Pacific Alliance Reinsurance Company of Vermont (PAR Vermont) and Pacific Baleine Reinsurance Company (PBRC) are Vermont based special purpose financial insurance companies subject to regulatory supervision by the Vermont Department of Financial Regulation (Vermont Department). PAR Vermont and PBRC are wholly owned subsidiaries of Pacific Life and accredited authorized reinsurers in Nebraska. Pacific Life cedes certain level term life insurance to PBRC and FDNLGR benefits to PAR Vermont and PBRC. Reinsurance ceded to PAR Vermont is net of the reinsurance ceded under an excess of loss reinsurance agreement with a commercial reinsurer. Economic reserves, as defined in the PAR Vermont and PBRC reinsurance agreements, are supported by cash and invested and other assets, including funds withheld at Pacific Life.

Reserves in excess of the economic reserves held at PAR Vermont are supported by a letter of credit agreement provided by a highly rated bank, which has a maximum commitment amount of \$843 million and a 20 year term expiring October 2031. The letter of credit agreement is non-recourse to Pacific LifeCorp or any of its affiliates, other than PAR Vermont. The letter of credit has been approved as an admissible asset by the Vermont Department for PAR Vermont statutory accounting. As of December 31, 2017 and 2016, the letter of credit amounted to \$767 million and \$730 million, respectively, and was held in a trust with Pacific Life as beneficiary. PAR Vermont admitted \$767 million and \$730 million as assets in its statutory financial statements as of December 31, 2017 and 2016, respectively.

Reserves in excess of the economic reserves held at PBRC are supported by a note facility with a maximum commitment amount of \$1.6 billion. This facility is non-recourse to Pacific Life or any of its affiliates, other than PBRC. Through this facility, PBRC issued a surplus note with a maturity date of December 2046 and received a note receivable in return with a maturity date of December 2041. The note receivable is credit enhanced by a highly rated third-party reinsurer for 22 years with a three year extension. The note receivable has been approved as an admissible asset by the Vermont Department for PBRC statutory accounting. As of December 31, 2017 and 2016, the note receivable amounted to \$263 million and \$210 million, respectively, and was held in a trust with Pacific Life as beneficiary. PBRC admitted \$263 million and \$210 million as an asset in its statutory financial statements as of December 31, 2017 and 2016, respectively.

Pacific Life has reinsurance agreements with Pacific Life Reinsurance (Barbados) Ltd. (PLRB), an exempt life reinsurance company domiciled in Barbados and wholly owned by Pacific LifeCorp. The underlying reinsurance is comprised of coinsurance and YRT treaties. Pacific Life retroceded the majority of the underlying YRT U.S. treaties on a 100% coinsurance with funds withheld basis to PLRB (PLRB Agreement). The PLRB Agreement is accounted for under deposit accounting for U.S. GAAP and as reinsurance under statutory accounting principles. The statutory accounting reserve credit is supported by cash, funds withheld at Pacific Life and a \$420 million letter of credit issued to PLRB by a highly rated bank for the benefit of Pacific Life, which expires August 2021. In connection with the reinsurance arrangements between Pacific Life and PLRB, Pacific LifeCorp entered into a capital maintenance agreement.

Pacific Annuity Reinsurance Company (PARC) is a captive reinsurance company subject to regulatory supervision by the Arizona Department of Insurance and wholly owned by Pacific LifeCorp. PARC was formed to reinsure benefits provided by variable annuity contracts and contract rider guarantees issued by Pacific Life. Base annuity contracts are reinsured on a modified coinsurance basis and the contract guarantees are reinsured on a coinsurance with funds withheld basis. In December 2012, the effective date of the reinsurance agreement, Pacific Life ceded 5% of its inforce variable annuity business to PARC, after third-party reinsurance, and ceded 5% of new business issued thereafter.

## RISK-BASED CAPITAL

Risk-based capital is a method developed by the NAIC to measure the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. The formulas for determining the amount of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Additionally, certain risks are required to be measured using actuarial cash flow modeling techniques, subject to formulaic minimums. The adequacy of a company's actual capital is measured by a comparison to the risk-based capital results. Companies below minimum risk-based capital requirements are classified within certain levels, each of which requires specified corrective action. As of December 31, 2017 and 2016, Pacific Life, Pacific Life & Annuity Company (PL&A), an Arizona domiciled life insurance company wholly owned by Pacific Life, PAR Vermont, and PBRC all exceeded the minimum risk-based capital requirements.

## DIVIDEND RESTRICTIONS

The payment of dividends by Pacific Life to Pacific LifeCorp is subject to restrictions set forth in the State of Nebraska insurance laws. These laws require (i) notification to the NE DOI for the declaration and payment of any dividend and (ii) approval by the NE DOI for accumulated dividends within the preceding twelve months that exceed the greater of 10% of statutory policyholder surplus as of the preceding December 31 or statutory net gain from operations for the preceding twelve months ended December 31. Generally, these restrictions pose no short-term liquidity concerns for Pacific LifeCorp. Based on these restrictions and 2017 statutory results, Pacific Life could pay \$784 million in dividends in 2018 to Pacific LifeCorp without prior approval from the NE DOI, subject to the notification requirement. During the year ended December 31, 2017, Pacific Life paid dividends to Pacific LifeCorp of \$160 million. Pacific Life did not pay any dividends to Pacific LifeCorp during the years ended December 31, 2016 and 2015.

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 Arizona Department of Insurance (AZ DOI) for the declaration and payment of any dividend and (ii) approval by the AZ DOI for accumulated dividends within the preceding twelve months that exceed the lesser of 10% of statutory surplus as regards to policyholders as of the preceding December 31 or statutory net gain from operations for the preceding twelve months ended December 31. Based on this limitation and 2017 statutory results, PL&A could pay \$40 million in dividends to Pacific Life in 2018 without prior regulatory approval. During the years ended December 31, 2017, 2016 and 2015, PL&A paid dividends to Pacific Life of \$40 million, \$39 million and \$37 million, respectively.

### 3. CLOSED BLOCK

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

Assets that support the Closed Block, which are primarily included in fixed maturity securities and policy loans, amounted to \$250 million and \$246 million as of December 31, 2017 and 2016, respectively. Liabilities allocated to the Closed Block, which are primarily included in future policy benefits, amounted to \$254 million and \$252 million as of December 31, 2017 and 2016, respectively. The net contribution to income from the Closed Block was \$3 million, \$3 million and zero for the years ended December 31, 2017, 2016 and 2015, respectively.

#### 4. VARIABLE INTEREST ENTITIES

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

##### CONSOLIDATED VIEs

The following table presents, as of December 31, 2017 and 2016, the assets and liabilities, which the Company has consolidated because it is the primary beneficiary:

|                                       | Assets               | Liabilities    |
|---------------------------------------|----------------------|----------------|
| <u>December 31, 2017:</u>             | <i>(In Millions)</i> |                |
| Commercial mortgage-backed securities | \$1,805              | \$1,525        |
| CLO and warehousing facility          | 681                  | 612            |
| Sponsored investment funds            | 380                  | 72             |
| Other                                 | 24                   | 19             |
| Total                                 | <u>\$2,890</u>       | <u>\$2,228</u> |
| <br>                                  |                      |                |
| <u>December 31, 2016:</u>             |                      |                |
| Commercial mortgage-backed securities | \$1,804              | \$1,524        |
| Sponsored investment funds            | 260                  | 22             |
| Other                                 | 25                   | 19             |
| Total                                 | <u>\$2,089</u>       | <u>\$1,565</u> |

##### COMMERCIAL MORTGAGE-BACKED SECURITIES

The Company has purchased significant interests in multiple commercial mortgage-backed security trusts secured by commercial real estate properties (CMBS VIE). The trusts are classified as VIEs as they have no total equity investment at risk and while no future equity infusions should be required to permit the entities to continue their activities, accounting guidance requires trusts with no equity at risk to be classified as VIEs. The Company has determined that it is the primary beneficiary of the VIEs due to the significant control over the collateral the Company has in the event of a default and has consolidated the VIEs into the consolidated financial statements of the Company. The assets of the CMBS VIE can only be used to settle their respective liabilities, and the Company is not responsible for any principal or interest shortfalls. The Company's exposure is limited to its investment of \$279 million as of December 31, 2017 and 2016. Non-recourse debt consolidated by the Company was \$1,521 million as of December 31, 2017 and 2016 (included in CMBS VIE debt in Note 11).

##### CLO AND WAREHOUSING FACILITY

The Company provided initial seed capital into a sponsored CLO and a warehousing facility during 2017. The Company has elected the FVO method of accounting for \$621 million of investments in the CLO and the warehousing facility as of December 31, 2017. The Company has also elected the FVO method of accounting for \$462 million of debt issued from the CLO as of December 31, 2017. The Company elected the FVO method of accounting for the investments and debt in order to measure both at fair value under a consistent methodology. This debt is secured by broadly syndicated bank loans, is non-recourse to the Company and the Company is not responsible for any principal shortfalls from the underlying collateral. Additionally, short-term non-recourse debt consolidated by the Company from the warehousing facility was \$50 million as of December 31, 2017. The line of credit associated with this debt has a borrowing capacity of \$113 million.

## SPONSORED INVESTMENT FUNDS

The Company has leveraged internal expertise to bring investment strategies/products to sophisticated institutional investors and qualified institutional buyers. Structured as limited partnerships, the Company has provided the initial investments to provide seed capital for these products for the purpose of refining the investment strategies and developing a performance history. Based on the design and operation of these entities, the Company concluded that they are subject to consolidation under the variable interest rules and that the Company is the primary beneficiary. It is anticipated that the Company will continue to maintain a controlling interest in some, but not all, of these entities. The Company reevaluates its standing as the primary beneficiary on a quarterly basis or upon the occurrence of specified events. Short-term non-recourse debt consolidated by the Company was \$69 million and \$21 million as of December 31, 2017 and 2016, respectively (included in other VIE debt in Note 11). The lines of credit associated with this debt have a \$75 million borrowing capacity. The Company's unfunded commitment to the limited partnerships was \$545 million and \$244 million as of December 31, 2017 and 2016, respectively.

## FINANCING STRUCTURES

ACG has participated in the design and formation of certain legal entities that are consolidated. These legal entities enable ACG's lenders to perfect their security interest in financing structures used to purchase, lease, and obtain financings secured by various aircraft. These legal entities have entered into loans with various third parties and financial institutions which are primarily guaranteed by ACG and supported by secondary guarantees from either the Export-Import Bank of the United States (Ex-Im) or the export credit agencies of the UK, France and/or Germany (ECA). Some of these legal entities are considered VIEs because they do not have sufficient equity at risk. Additionally, ACG bears significant risk of loss (through guarantees of the loans recourse to ACG), participates in gains through a capital lease and has the power to direct the activities that most significantly impact the economic performance of these legal entities. Therefore, it has been determined that ACG is the primary beneficiary of these VIEs.

Aircraft with these financing structures as of December 31, 2017 and 2016, totaled \$1,396 million and \$1,619 million, respectively, and are included in aircraft, net on the consolidated statements of financial condition. Also, as of December 31, 2017 and 2016, debt, recourse only to ACG, associated with these financing structures totaled \$693 million and \$886 million, respectively, and are included in debt on the consolidated statements of financial condition. See Notes 7 and 11.

## NON-CONSOLIDATED VIEs

The following table presents the carrying amount and classification of the assets, relating to VIEs in which the Company holds a variable interest but does not consolidate because it is not the primary beneficiary. The Company has determined that it is not the primary beneficiary of these VIEs because it does not have the power to direct their most significant financial activities. Also presented is the maximum exposure to loss which includes the carrying amount and any unfunded commitments assuming the commitments are fully funded.

|                           | Carrying<br>Amount   | Maximum<br>Exposure to<br>Loss |
|---------------------------|----------------------|--------------------------------|
| <u>December 31, 2017:</u> | <i>(In Millions)</i> |                                |
| Mortgage loans            | \$96                 | \$104                          |
| Private equity            | 547                  | 965                            |
| Real estate               | 147                  | 203                            |
| Other                     | 15                   | 15                             |
| Total                     | <u>\$805</u>         | <u>\$1,287</u>                 |
| <br>                      |                      |                                |
| <u>December 31, 2016:</u> |                      |                                |
| Mortgage loans            | \$88                 | \$104                          |
| Private equity            | 520                  | 989                            |
| Real estate               | 152                  | 200                            |
| Other                     | 13                   | 13                             |
| Total                     | <u>\$773</u>         | <u>\$1,306</u>                 |

### MORTGAGE LOANS

Included in mortgage loans is a non-recourse construction loan to a non-consolidated VIE.

### PRIVATE EQUITY

Private equity are limited partnership investment funds that are reported in other investments.

### REAL ESTATE

Real estate are limited partnership investments that are unconsolidated and accounted for under the equity method which are reported in other investments.

### OTHER NON-CONSOLIDATED VIEs NOT INCLUDED IN THE TABLE ABOVE

As part of normal investment activities, the Company will make passive investments in structured securities for which it is not the sponsor. The structured security investments include residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralized debt obligations, and other asset-backed securities which are reported in fixed maturities securities available for sale. The Company's maximum exposure to loss for these investments is limited to its carrying amount. See Note 6 for the net carrying amount and estimated fair value of the structured security investments.



## 5. DEFERRED POLICY ACQUISITION COSTS

Components of DAC are as follows:

|                                  | Years Ended December 31, |                |                |
|----------------------------------|--------------------------|----------------|----------------|
|                                  | 2017                     | 2016           | 2015           |
|                                  | <i>(In Millions)</i>     |                |                |
| Balance, January 1               | \$4,509                  | \$4,719        | \$4,742        |
| Additions:                       |                          |                |                |
| Capitalized during the year      | 613                      | 490            | 544            |
| Amortization:                    |                          |                |                |
| Allocated to commission expenses | (352)                    | (547)          | (806)          |
| Allocated to operating expenses  | (15)                     | (21)           | (28)           |
| Total amortization               | (367)                    | (568)          | (834)          |
| Allocated to OCI                 | (62)                     | (132)          | 267            |
| Balance, December 31             | <u>\$4,693</u>           | <u>\$4,509</u> | <u>\$4,719</u> |

During the years ended December 31, 2017, 2016 and 2015, the Company revised certain assumptions utilized to develop EGPs for its products subject to DAC amortization. This resulted in a decrease in DAC amortization expense of \$40 million for the year ended December 31, 2017 and increases of \$18 million and \$51 million for the years ended December 31, 2016 and 2015, respectively. The revised EGPs also resulted in decreased URR amortization of \$43 million and \$21 million for the years ended December 31, 2017 and 2016, respectively, and increased URR amortization of \$27 million for the year ended December 31, 2015.

Components of the capitalized sales inducement balance included in the DAC asset are as follows:

|  | Years Ended December 31, |              |              |
|--|--------------------------|--------------|--------------|
|  | 2017                     | 2016         | 2015         |
|  | <i>(In Millions)</i>     |              |              |
| Balance, January 1                         | \$545                    | \$583        | \$667        |
| Deferred costs capitalized during the year | 11                       | 14           | 17           |
| Amortization of deferred costs             | (43)                     | (52)         | (101)        |
| Balance, December 31                       | <u>\$513</u>             | <u>\$545</u> | <u>\$583</u> |

## 6. INVESTMENTS

The net carrying amount, gross unrealized gains and losses, and estimated fair value of fixed maturity and equity securities available for sale are shown below. The net carrying amount of fixed maturity securities available for sale represents amortized cost adjusted for OTTI recognized in earnings and terminated fair value hedges. The net carrying amount of equity securities available for sale represents cost adjusted for OTTI. See Note 12 for information on the Company's estimated fair value measurements and disclosure.

|  | Net<br>Carrying<br>Amount | Gross Unrealized |              | Estimated<br>Fair Value |
|--|---------------------------|------------------|--------------|-------------------------|
|  |                           | Gains            | Losses       |                         |
| <i>(In Millions)</i>                             |                           |                  |              |                         |
| <u>December 31, 2017:</u>                        |                           |                  |              |                         |
| U.S. Government                                  | \$72                      | \$7              |              | \$79                    |
| Obligations of states and political subdivisions | 810                       | 172              |              | 982                     |
| Foreign governments                              | 489                       | 44               | \$1          | 532                     |
| Corporate securities                             | 39,099                    | 2,675            | 168          | 41,606                  |
| RMBS   | 1,846                     | 92               | 13           | 1,925                   |
| CMBS   | 1,025                     | 25               | 9            | 1,041                   |
| Other asset-backed securities                    | 1,244                     | 56               | 5            | 1,295                   |
| Total fixed maturity securities                  | <u>\$44,585</u>           | <u>\$3,071</u>   | <u>\$196</u> | <u>\$47,460</u>         |
| Perpetual preferred securities                   | \$13                      | \$1              |              | \$14                    |
| Other equity securities                          | 65                        | 3                |              | 68                      |
| Total equity securities                          | <u>\$78</u>               | <u>\$4</u>       | <u>—</u>     | <u>\$82</u>             |

|  | Net<br>Carrying<br>Amount | Gross Unrealized |              | Estimated<br>Fair Value |
|--|---------------------------|------------------|--------------|-------------------------|
|  |                           | Gains            | Losses       |                         |
| <i>(In Millions)</i>                             |                           |                  |              |                         |
| <u>December 31, 2016:</u>                        |                           |                  |              |                         |
| U.S. Government                                  | \$49                      | \$7              |              | \$56                    |
| Obligations of states and political subdivisions | 810                       | 132              | \$2          | 940                     |
| Foreign governments                              | 551                       | 41               | 7            | 585                     |
| Corporate securities                             | 35,739                    | 1,916            | 442          | 37,213                  |
| RMBS   | 2,197                     | 95               | 36           | 2,256                   |
| CMBS   | 924                       | 24               | 11           | 937                     |
| Other asset-backed securities                    | 1,221                     | 54               | 15           | 1,260                   |
| Total fixed maturity securities                  | <u>\$41,491</u>           | <u>\$2,269</u>   | <u>\$513</u> | <u>\$43,247</u>         |
| Perpetual preferred securities                   | \$62                      | \$9              | \$2          | \$69                    |
| Other equity securities                          | 28                        | 4                | 1            | 31                      |
| Total equity securities                          | <u>\$90</u>               | <u>\$13</u>      | <u>\$3</u>   | <u>\$100</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<br>Carrying<br>Amount | Gross Unrealized     |        | Estimated<br>Fair Value |
|---|---------------------------|----------------------|--------|-------------------------|
|   |                           | Gains                | Losses |                         |
|   |                           | <i>(in Millions)</i> |        |                         |
| Due in one year or less                     | \$917                     | \$22                 | \$2    | \$937                   |
| Due after one year through five years       | 7,936                     | 421                  | 13     | 8,344                   |
| Due after five years through ten years      | 18,097                    | 613                  | 81     | 18,629                  |
| Due after ten years                         | 13,520                    | 1,842                | 73     | 15,289                  |
|   | 40,470                    | 2,898                | 169    | 43,199                  |
| Mortgage-backed and asset-backed securities | 4,115                     | 173                  | 27     | 4,261                   |
| Total fixed maturity securities             | \$44,585                  | \$3,071              | \$196  | \$47,460                |

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

|                                 | Total                |                         |                               |
|---------------------------------|----------------------|-------------------------|-------------------------------|
|                                 | Number               | Estimated<br>Fair Value | Gross<br>Unrealized<br>Losses |
|                                 | <i>(In Millions)</i> |                         |                               |
| <u>December 31, 2017:</u>       |                      |                         |                               |
| Foreign governments             | 3                    | \$29                    | \$1                           |
| Corporate securities            | 568                  | 6,139                   | 168                           |
| RMBS                            | 66                   | 534                     | 13                            |
| CMBS                            | 21                   | 313                     | 9                             |
| Other asset-backed securities   | 63                   | 428                     | 5                             |
| Total fixed maturity securities | <u>721</u>           | <u>7,443</u>            | <u>196</u>                    |
| Other investments               | 3                    | 12                      | 3                             |
| Total other investments         | <u>3</u>             | <u>12</u>               | <u>3</u>                      |
| Total                           | <u>724</u>           | <u>\$7,455</u>          | <u>\$199</u>                  |

|                                 | Less than 12 Months  |                         |                               | 12 Months or Greater |                         |                               |
|---------------------------------|----------------------|-------------------------|-------------------------------|----------------------|-------------------------|-------------------------------|
|                                 | Number               | Estimated<br>Fair Value | Gross<br>Unrealized<br>Losses | Number               | Estimated<br>Fair Value | Gross<br>Unrealized<br>Losses |
|                                 | <i>(In Millions)</i> |                         |                               | <i>(In Millions)</i> |                         |                               |
| <u>December 31, 2017:</u>       |                      |                         |                               |                      |                         |                               |
| Foreign governments             |                      |                         |                               | 3                    | \$29                    | \$1                           |
| Corporate securities            | 292                  | \$2,573                 | \$34                          | 276                  | 3,566                   | 134                           |
| RMBS                            | 13                   | 145                     | 1                             | 53                   | 389                     | 12                            |
| CMBS                            | 13                   | 167                     | 2                             | 8                    | 146                     | 7                             |
| Other asset-backed securities   | 33                   | 209                     | 1                             | 30                   | 219                     | 4                             |
| Total fixed maturity securities | <u>351</u>           | <u>3,094</u>            | <u>38</u>                     | <u>370</u>           | <u>4,349</u>            | <u>158</u>                    |
| Other investments               | 1                    | 5                       | 1                             | 2                    | 7                       | 2                             |
| Total other investments         | <u>1</u>             | <u>5</u>                | <u>1</u>                      | <u>2</u>             | <u>7</u>                | <u>2</u>                      |
| Total                           | <u>352</u>           | <u>\$3,099</u>          | <u>\$39</u>                   | <u>372</u>           | <u>\$4,356</u>          | <u>\$160</u>                  |

|  | Total        |                         |                      |
|--|--------------|-------------------------|----------------------|
|  | Number       | Gross                   |                      |
|  |              | Estimated<br>Fair Value | Unrealized<br>Losses |
| <i>(In Millions)</i>                             |              |                         |                      |
| <u>December 31, 2016:</u>                        |              |                         |                      |
| Obligations of states and political subdivisions | 2            | \$103                   | \$2                  |
| Foreign governments                              | 7            | 69                      | 7                    |
| Corporate securities                             | 794          | 10,001                  | 442                  |
| RMBS   | 113          | 967                     | 36                   |
| CMBS   | 18           | 322                     | 11                   |
| Other asset-backed securities                    | 66           | 584                     | 15                   |
| Total fixed maturity securities                  | <u>1,000</u> | <u>12,046</u>           | <u>513</u>           |
| Perpetual preferred securities                   | 3            | 13                      | 2                    |
| Other equity securities                          | 3            | 9                       | 1                    |
| Other investments                                | 7            | 18                      | 4                    |
| Total other investments                          | <u>13</u>    | <u>40</u>               | <u>7</u>             |
| Total  | <u>1,013</u> | <u>\$12,086</u>         | <u>\$520</u>         |

|  | Less than 12 Months |                         |                      | 12 Months or Greater |                         |                      |
|--|---------------------|-------------------------|----------------------|----------------------|-------------------------|----------------------|
|  | Number              | Gross                   |                      | Number               | Gross                   |                      |
|  |                     | Estimated<br>Fair Value | Unrealized<br>Losses |                      | Estimated<br>Fair Value | Unrealized<br>Losses |
| <i>(In Millions)</i>                             |                     |                         |                      |                      |                         |                      |
| <u>December 31, 2016:</u>                        |                     |                         |                      |                      |                         |                      |
| Obligations of states and political subdivisions | 2                   | \$103                   | \$2                  |                      |                         |                      |
| Foreign governments                              | 4                   | 43                      | 3                    | 3                    | \$26                    | \$4                  |
| Corporate securities                             | 648                 | 8,559                   | 326                  | 146                  | 1,442                   | 116                  |
| RMBS   | 32                  | 441                     | 6                    | 81                   | 526                     | 30                   |
| CMBS   | 13                  | 293                     | 9                    | 5                    | 29                      | 2                    |
| Other asset-backed securities                    | 49                  | 455                     | 7                    | 17                   | 129                     | 8                    |
| Total fixed maturity securities                  | <u>748</u>          | <u>9,894</u>            | <u>353</u>           | <u>252</u>           | <u>2,152</u>            | <u>160</u>           |
| Perpetual preferred securities                   |                     |                         |                      | 3                    | 13                      | 2                    |
| Other equity securities                          | 3                   | 9                       | 1                    |                      |                         |                      |
| Other investments                                | 4                   | 9                       | 1                    | 3                    | 9                       | 3                    |
| Total other investments                          | <u>7</u>            | <u>18</u>               | <u>2</u>             | <u>6</u>             | <u>22</u>               | <u>5</u>             |
| Total  | <u>755</u>          | <u>\$9,912</u>          | <u>\$355</u>         | <u>258</u>           | <u>\$2,174</u>          | <u>\$165</u>         |

The gross unrealized losses on available for sale securities and other investments in the tables above decreased from \$520 million as of December 31, 2016 to \$199 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 and other investments with gross unrealized losses and has determined that the unrealized losses are temporary. The Company does not intend to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their net carrying amounts.

The Company has a securities lending program whereby the Company lends fixed maturity securities to financial institutions in short-term arrangements. The Company requires cash collateral equal to 102% of the estimated fair value of the loaned securities. All securities lending agreements are callable by the Company at any time. The contractual maturity on all securities lending arrangements is overnight and continuous. The following table presents the Company's security loans outstanding and the corresponding collateral held:

|   | December 31,         |       |
|---|----------------------|-------|
|   | 2017                 | 2016  |
|   | <i>(In Millions)</i> |       |
| Security loans outstanding, estimated fair value <sup>(1)</sup> | \$797                | \$178 |
| Reinvestment portfolio, estimated fair value <sup>(2)</sup>     | 824                  | 184   |
| Cash collateral liability <sup>(3)</sup>                        | 824                  | 184   |

<sup>(1)</sup> Included within fixed maturity securities available for sale, at estimated fair value and comprised of corporate securities.

<sup>(2)</sup> The reinvestment portfolio acquired with the cash collateral consists primarily of investments in reverse repurchase agreements collateralized by U.S. Treasuries and corporate bonds and is included in cash and cash equivalents.

<sup>(3)</sup> Included in other liabilities.

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

|                                 | Years Ended December 31, |                |                |
|---------------------------------|--------------------------|----------------|----------------|
|                                 | 2017                     | 2016           | 2015           |
|                                 | <i>(In Millions)</i>     |                |                |
| Fixed maturity securities       | \$1,912                  | \$1,812        | \$1,688        |
| Equity securities               | 5                        | 3              | 4              |
| Mortgage loans                  | 613                      | 550            | 582            |
| Real estate                     | 148                      | 120            | 103            |
| Policy loans                    | 212                      | 205            | 201            |
| Partnerships and joint ventures | 115                      | 39             | 106            |
| Other                           | 58                       | 40             | 37             |
| Gross investment income         | <u>3,063</u>             | <u>2,769</u>   | <u>2,721</u>   |
| Investment expense              | 223                      | 182            | 164            |
| Net investment income           | <u>\$2,840</u>           | <u>\$2,587</u> | <u>\$2,557</u> |

The components of net realized investment gain are as follows:

|  | Years Ended December 31, |       |       |
|--|--------------------------|-------|-------|
|  | 2017                     | 2016  | 2015  |
|  | <i>(In Millions)</i>     |       |       |
| Fixed maturity securities:                             |                          |       |       |
| Gross gains on sales                                   | \$87                     | \$37  | \$26  |
| Gross losses on sales                                  | (9)                      | (13)  | (8)   |
| Total fixed maturity securities                        | 78                       | 24    | 18    |
| Equity securities:                                     |                          |       |       |
| Gross gains on sales                                   | 17                       | 1     | 5     |
| Total equity securities                                | 17                       | 1     | 5     |
| FVO and trading securities                             | 44                       | (3)   | (33)  |
| Real estate  |                          | 78    | 2     |
| Variable annuity GLB embedded derivatives              | 166                      | 155   | 60    |
| Variable annuity GLB policy fees                       | 156                      | 161   | 209   |
| Variable annuity derivatives - total return swaps      | (218)                    | (107) | (21)  |
| Variable annuity derivatives - futures                 | (168)                    | (260) | (46)  |
| Variable annuity derivatives - equity put options      | (29)                     |       |       |
| Fixed indexed annuity embedded derivatives             | (128)                    | (47)  | (5)   |
| Fixed indexed annuity derivatives - total return swaps | 3                        |       |       |
| Fixed indexed annuity derivatives - futures            | 84                       | 45    | (2)   |
| Fixed indexed annuity derivatives - call options       | 2                        |       |       |
| Synthetic GIC policy fees                              | 45                       | 44    | 44    |
| Foreign currency and interest rate swaps               | (17)                     | (7)   | 25    |
| Life indexed account embedded derivatives              | (335)                    | (100) | 51    |
| Life indexed account derivatives - call options        | 341                      | 98    | (58)  |
| Other  | 7                        | 28    | (15)  |
| Net realized investment gain                           | \$48                     | \$110 | \$234 |

The tables below summarize the OTTI by investment type:

|   | Recognized in<br>Earnings | Included in<br>OCI | Total |
|---|---------------------------|--------------------|-------|
|   | <i>(In Millions)</i>      |                    |       |
| <u>Year Ended December 31, 2017:</u>        |                           |                    |       |
| Corporate securities                        | \$8                       |                    | \$8   |
| RMBS  | 1                         |                    | 1     |
| OTTI - fixed maturity securities            | 9                         | —                  | 9     |
| Other investments                           | 2                         |                    | 2     |
| Total OTTI                                  | \$11                      | —                  | \$11  |
| <u>Year Ended December 31, 2016:</u>        |                           |                    |       |
| Corporate securities                        | \$22                      | \$3                | \$25  |
| RMBS  | 12                        | 8                  | 20    |
| OTTI - fixed maturity securities            | 34                        | 11                 | 45    |
| Real estate                                 | 2                         |                    | 2     |
| Other investments                           | 6                         |                    | 6     |
| Total OTTI                                  | \$42                      | \$11               | \$53  |
| <u>Year Ended December 31, 2015:</u>        |                           |                    |       |
| Corporate securities                        | \$70                      |                    | \$70  |
| RMBS  | 2                         | \$6                | 8     |
| Perpetual preferred securities              | 9                         |                    | 9     |
| OTTI - fixed maturity and equity securities | 81                        | 6                  | 87    |
| Mortgage loans                              | 11                        |                    | 11    |
| Other investments                           | 4                         |                    | 4     |
| Total OTTI                                  | \$96                      | \$6                | \$102 |

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 Millions)</i>     |       |
| Cumulative credit loss, January 1   | \$174                    | \$187 |
| Additions for credit impairments recognized on:                                   |                          |       |
| Securities previously other than temporarily impaired                             |                          | 10    |
| Securities not previously other than temporarily impaired                         | 1                        | 2     |
| Total additions   | 1                        | 12    |
| Reductions for credit impairments previously recognized on:                       |                          |       |
| Securities due to an increase in expected cash flows and time value of cash flows | (1)                      | (4)   |
| Securities sold   |                          | (21)  |
| Total subtractions  | (1)                      | (25)  |
| Cumulative credit loss, December 31   | \$174                    | \$174 |



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 Millions)</i>    |             |       |
| <u>December 31, 2017:</u>                        |                         |             |       |
| Foreign governments                              |                         | \$1         | \$1   |
| Corporate securities                             |                         | 168         | 168   |
| RMBS   | \$7                     | 6           | 13    |
| CMBS   |                         | 9           | 9     |
| Other asset-backed securities                    |                         | 5           | 5     |
| Total fixed maturity securities                  | \$7                     | \$189       | \$196 |
| <u>December 31, 2016:</u>                        |                         |             |       |
| Obligations of states and political subdivisions |                         | \$2         | \$2   |
| Foreign governments                              |                         | 7           | 7     |
| Corporate securities                             | \$4                     | 438         | 442   |
| RMBS   | 20                      | 16          | 36    |
| CMBS   |                         | 11          | 11    |
| Other asset-backed securities                    |                         | 15          | 15    |
| Total fixed maturity securities                  | \$24                    | \$489       | \$513 |
| Perpetual preferred securities                   |                         | \$2         | \$2   |
| Other equity securities                          |                         | 1           | 1     |
| Total equity securities                          | —                       | \$3         | \$3   |

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 Millions)</i>     |       |           |
| <u>Available for sale securities:</u> |                          |       |           |
| Fixed maturity                        | \$1,119                  | \$502 | (\$1,648) |
| Equity                                | (6)                      | 7     |           |
| Total available for sale securities   | \$1,113                  | \$509 | (\$1,648) |

Trading securities, included in other investments, totaled \$624 million and \$252 million as of December 31, 2017 and 2016, respectively. The cumulative net unrealized gain on trading securities held as of December 31, 2017 and 2016 were \$9 million and zero, respectively. Net unrealized gain (loss) recognized in net realized investment gain on trading securities still held at the reporting date were \$7 million, \$1 million and (\$4) million as of December 31, 2017, 2016 and 2015, respectively.

FVO securities consist of U.S. Government securities and broadly syndicated bank loans. FVO securities totaled \$1,182 million and \$529 million as of December 31, 2017 and 2016, respectively. The change in unrealized gain (loss) on FVO securities is recognized in net realized investment gain and was \$33 million, (\$7) million and (\$27) million for the years ended December 31, 2017, 2016 and 2015, respectively. Interest income earned from FVO securities is recorded in net investment income and was \$26 million, \$17 million and \$17 million for the years ended December 31, 2017, 2016 and 2015, respectively.

As of December 31, 2017 and 2016, fixed maturity securities of \$12 million were on deposit with state insurance departments to satisfy regulatory requirements.

Mortgage loans totaled \$13,558 million and \$12,175 million as of December 31, 2017 and 2016, respectively. Mortgage loans are collateralized primarily by commercial properties mainly located throughout the U.S. As of December 31, 2017, \$2,460 million, \$2,033 million, \$1,716 million, \$1,432 million, and \$1,160 million were located in Texas, California, New York, Washington, and District of Columbia, respectively. Included in the December 31, 2017 amounts for Texas and New York are \$1,050 million and \$750 million, respectively, consolidated from the CMBS VIEs (Note 4). As of December 31, 2017, \$383 million and \$176 million were located in Canada and the UK, respectively. The Company did not have any mortgage loans with accrued interest more than 180 days past due as of December 31, 2017 or 2016. As of December 31, 2017, there was no single mortgage loan investment that exceeded 10% of stockholder's equity.

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

The loan review process will result in each loan being placed into a No 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.

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.

As of December 31, 2017 and 2016, there were 14 loans with a book value of \$305 million and \$307 million, respectively, that were considered impaired. Since the estimated fair value of the underlying collateral on these loans was greater than their carrying amount of the loans, no impairment loss was recorded. As of December 31, 2015, there were 16 loans with a book value of \$153 million that were considered impaired and an impairment loss of \$12 million (gross of reinsurance of \$1 million) was recognized for the year ended December 31, 2015 as the fair value of the underlying collateral of two of these loans was lower than their carrying amount. No impairment loss was recorded on the other 14 loans since the estimated fair value of the collateral was higher than their carrying amount.

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

| Property Type    | December 31, 2017 |         |                                   |         |                                    |         |                                       |         |          |         |
|------------------|-------------------|---------|-----------------------------------|---------|------------------------------------|---------|---------------------------------------|---------|----------|---------|
|                  | No Credit Concern |         | Level 1<br>Minimal Credit Concern |         | Level 2<br>Moderate Credit Concern |         | Level 3<br>Significant Credit Concern |         | Total    |         |
|                  | Weighted          |         | Weighted                          |         | Weighted                           |         | Weighted                              |         | Weighted |         |
|                  | Carrying          | Average | Carrying                          | Average | Carrying                           | Average | Carrying                              | Average | Carrying | Average |
|                  | Amount            | DCR     | Amount                            | DCR     | Amount                             | DCR     | Amount                                | DCR     | Amount   | DCR     |
| Agricultural     | \$115             | 2.11    |                                   |         |                                    |         |                                       |         | \$115    | 2.11    |
| Apartment        | 1,003             | 1.75    | \$45                              | 1.05    |                                    |         |                                       |         | 1,048    | 1.72    |
| Golf course      | 22                | 2.19    | 16                                | 0.82    | \$41                               | 1.00    | \$50                                  | 0.81    | 129      | 1.11    |
| Industrial       | 34                | 1.55    |                                   |         | 18                                 | 2.09    |                                       |         | 52       | 1.74    |
| Lodging          | 1,376             | 2.41    |                                   |         |                                    |         | 175                                   | 0.88    | 1,551    | 2.24    |
| Mobile home park | 189               | 2.94    |                                   |         |                                    |         |                                       |         | 189      | 2.94    |
| Office           | 3,307             | 2.05    | 446                               | 1.36    |                                    |         | 21                                    | 0.49    | 3,774    | 1.96    |
| Office - VIE     | 750               | 3.28    |                                   |         |                                    |         |                                       |         | 750      | 3.28    |
| Residential      | 63                | 1.43    |                                   |         |                                    |         |                                       |         | 63       | 1.43    |
| Retail           | 2,848             | 2.18    |                                   |         |                                    |         |                                       |         | 2,848    | 2.18    |
| Retail - VIE     | 1,050             | 2.39    |                                   |         |                                    |         |                                       |         | 1,050    | 2.39    |
| Construction     | 1,989             |         |                                   |         |                                    |         |                                       |         | 1,989    |         |
| Total            |                   |         |                                   |         |                                    |         |                                       |         |          |         |
| mortgage loans   | \$12,746          | 2.23    | \$507                             | 1.31    | \$59                               | 1.33    | \$246                                 | 0.83    | \$13,558 | 2.16    |

| Property Type    | December 31, 2016 |         |                                   |         |                                    |         |                                       |         |          |         |
|------------------|-------------------|---------|-----------------------------------|---------|------------------------------------|---------|---------------------------------------|---------|----------|---------|
|                  | No Credit Concern |         | Level 1<br>Minimal Credit Concern |         | Level 2<br>Moderate Credit Concern |         | Level 3<br>Significant Credit Concern |         | Total    |         |
|                  | Weighted          |         | Weighted                          |         | Weighted                           |         | Weighted                              |         | Weighted |         |
|                  | Carrying          | Average | Carrying                          | Average | Carrying                           | Average | Carrying                              | Average | Carrying | Average |
|                  | Amount            | DCR     | Amount                            | DCR     | Amount                             | DCR     | Amount                                | DCR     | Amount   | DCR     |
| Agricultural     | \$2               | 3.07    |                                   |         |                                    |         |                                       |         | \$2      | 3.07    |
| Apartment        | 701               | 1.85    | \$138                             | 1.09    |                                    |         |                                       |         | 839      | 1.73    |
| Golf course      | 23                | 2.33    | 15                                | 0.88    | \$42                               | 1.05    | \$52                                  | 0.79    | 132      | 1.16    |
| Industrial       |                   |         |                                   |         | 18                                 | 2.21    |                                       |         | 18       | 2.21    |
| Lodging          | 1,321             | 2.51    |                                   |         |                                    |         | 175                                   | 0.86    | 1,496    | 2.32    |
| Mobile home park | 192               | 2.77    |                                   |         |                                    |         |                                       |         | 192      | 2.77    |
| Office           | 3,357             | 2.02    | 446                               | 1.62    |                                    |         | 21                                    | 0.38    | 3,824    | 1.97    |
| Office - VIE     | 750               | 3.47    |                                   |         |                                    |         |                                       |         | 750      | 3.47    |
| Residential      | 38                | 1.45    |                                   |         |                                    |         |                                       |         | 38       | 1.45    |
| Retail           | 2,336             | 2.20    |                                   |         |                                    |         |                                       |         | 2,336    | 2.20    |
| Retail - VIE     | 1,050             | 3.24    |                                   |         |                                    |         |                                       |         | 1,050    | 3.24    |
| Construction     | 1,498             |         |                                   |         |                                    |         |                                       |         | 1,498    |         |
| Total            |                   |         |                                   |         |                                    |         |                                       |         |          |         |
| mortgage loans   | \$11,268          | 2.37    | \$599                             | 1.48    | \$60                               | 1.40    | \$248                                 | 0.80    | \$12,175 | 2.28    |

Real estate investments totaled \$1,287 million and \$641 million as of December 31, 2017 and 2016, respectively. The Company had no real estate investment impairments during the years ended December 31, 2017 and 2015. As of December 31, 2016, the Company had one real estate investment property with a book value prior to impairment measurement of \$4 million that was considered impaired and an impairment loss of \$2 million was recognized as the fair value of this property was lower than its carrying amount.

## 7. AIRCRAFT, NET

Aircraft, net, consists of the following:

|                          | December 31,         |                |
|--------------------------|----------------------|----------------|
|                          | 2017                 | 2016           |
|                          | <i>(In Millions)</i> |                |
| Aircraft                 | \$9,498              | \$9,552        |
| Accumulated depreciation | 1,664                | 1,697          |
| Aircraft, net            | <u>\$7,834</u>       | <u>\$7,855</u> |

The following table presents, by year, the future minimum operating lease rentals ACG is due under noncancelable operating leases as of December 31, 2017 *(In Millions)*:

| Years Ended December 31: |                |
|--------------------------|----------------|
| 2018                     | \$863          |
| 2019                     | 822            |
| 2020                     | 729            |
| 2021                     | 641            |
| 2022                     | 541            |
| Thereafter               | 1,266          |
| Total                    | <u>\$4,862</u> |

Future minimum operating lease rentals to foreign customers represented 85% of the total.

Included in the table above are aircraft subleased to airlines with lease maturity dates ranging from 2021 to 2024 with total future rentals of \$134 million. The revenue related to these aircraft, included in aircraft leasing revenue, was \$27 million for each of the years ended December 31, 2017, 2016 and 2015. During 2011 to 2013, these aircraft were sold to third parties and subsequently leased back under operating leases with maturity dates ranging from 2023 to 2025 with total minimum future lease commitments on these operating leases of \$140 million.

As of December 31, 2017 and 2016, aircraft with a carrying amount of \$1,627 million and \$1,839 million, respectively, were assigned as collateral to secure debt (Note 11). See Note 4 for amounts related to VIEs.

Aircraft and other assets held for sale totaled \$410 million and \$325 million as of December 31, 2017 and 2016, respectively, and are included in aircraft, net.

Included in aircraft, net as of December 31, 2017 and 2016 are \$164 million and \$124 million, respectively, of net aircraft maintenance right assets that represent the difference between the maintenance return conditions specified in the lease and the actual physical maintenance condition of acquired aircraft at the purchase date.

During the years ended December 31, 2017, 2016 and 2015, aircraft impairments of \$156 million, \$152 million and \$39 million, respectively, were recognized and included in operating and other expenses. See Note 12.

During the years ended December 31, 2017, 2016 and 2015, ACG had non cash transfers from aircraft orders and deposits (included in other assets) to aircraft, net of \$211 million, \$319 million and \$56 million, respectively.

During the years ended December 31, 2017, 2016 and 2015, gain (loss) on the sale of aircraft of \$19 million, \$11 million and (\$1) million, respectively, were recognized and included in other income.

During 2006, ACG and a bank sponsored a 50/50 joint venture. As ACG maintained control over the joint venture activities, ACG had a controlling financial interest and consolidated it as a subsidiary. During 2015, the non-recourse debt was paid off and ACG

assumed the bank's unfunded portion of the liabilities in exchange for the bank's 50% equity interest. As a result, the noncontrolling interest related to this joint venture was reduced to zero.

See Note 18 for future aircraft purchase commitments.

## 8. DERIVATIVES AND HEDGING ACTIVITIES

The Company primarily utilizes derivative instruments to manage its exposure to interest rate risk, foreign currency risk 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 either fair value or 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, liability, firm commitment, 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 and reinsurance contracts that are considered to have embedded derivatives. When it is determined that the embedded derivative possesses economic and risk characteristics that are not clearly and closely related to those of the host contract, and that a separate instrument with the same terms would qualify as a derivative instrument, it is separated from the host contract and accounted for as a stand-alone derivative.

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

GLBs on variable annuity contracts issued between January 1, 2007 and March 31, 2009 are partially reinsured by third party reinsurers. These reinsurance arrangements are used to offset a portion of the Company's exposure to the variable annuity GLBs for the lives of the host variable annuity contracts issued. The ceded portion of these variable annuity GLBs is considered an embedded derivative. The Company also reinsures certain variable annuity contracts with guaranteed minimum benefits to an affiliated reinsurer.

The Company employs hedging strategies (variable annuity derivatives) to mitigate equity risk associated with the variable annuity GLBs not covered by reinsurance. The Company utilizes total return swaps, exchange-traded equity futures and equity put options 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. The equity put options involve the exchange of an upfront payment for the return, at the end of the option agreement, of the equity index below a specified strike price. The Company also utilizes interest rate swaps to manage interest rate risk in variable annuity GLBs.

The Company offers fixed indexed annuity products where interest is credited to the policyholder's account balance based on domestic and/or international equity index changes, subject to various caps or participation rates. The indexed products contain embedded derivatives. The Company utilizes total return swaps, exchange-traded equity futures and call options based upon broad market indices to economically hedge the interest credited to the policyholder based upon the underlying equity index. Call options are contracts to buy the index at a predetermined time at a contracted price. These contracts involve the exchange of an

upfront premium payment for the return, at the end of the option agreement, of the differentials in the index at the time of exercise and the strike price subject to a cap and the settlements are recognized in net realized investment gain.

The Company issues synthetic GICs to Employee Retirement Income Security Act of 1974 (ERISA) qualified defined contribution employee benefit plans (ERISA Plan) that are considered derivatives. The ERISA Plan uses the contracts in its stable value fixed income option. The Company receives a fee, recognized in net realized investment gain, for providing book value accounting for the ERISA Plan stable value fixed income option. In the event that plan participant elections exceed the estimated fair value of the assets or if the contract is terminated and at the end of the termination period the book value under the contract exceeds the estimated fair value of the assets, then the Company is required to pay the ERISA Plan the difference between book value and estimated fair value. The Company mitigates the investment risk through pre-approval and monitoring of the investment guidelines, requiring high quality investments and adjustments to the plan crediting rates to compensate for unrealized losses in the portfolios. The estimated fair value of the derivative is zero as of December 31, 2017 and 2016.

Foreign currency interest rate swap agreements are used to convert fixed or floating rate foreign-denominated assets or liabilities to U.S. dollar fixed or floating rate assets or liabilities. 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 and liabilities that are denominated in foreign currencies. The main currencies that the Company economically hedges are the euro, British pound, Canadian dollar, and Japanese yen.

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 life insurance products 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 products with indexed accounts contain embedded derivatives. The Company utilizes call options to economically hedge the interest credited to the policyholder based upon the underlying index for its life insurance products with indexed account options. The majority of these 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 Millions)</i> |          |
| Variable annuity GLB embedded derivatives              | \$27,813             | \$29,804 |
| Variable annuity derivatives - total return swaps      | 1,154                | 1,479    |
| Variable annuity derivatives - futures                 | 656                  | 939      |
| Variable annuity derivatives - equity put options      | 242                  |          |
| Variable annuity derivatives - interest rate swaps     | 115                  | 115      |
| Fixed indexed annuity embedded derivatives             | 4,511                | 3,506    |
| Fixed indexed annuity derivatives - total return swaps | 16                   | 13       |
| Fixed indexed annuity derivatives - futures            | 418                  | 385      |
| Fixed indexed annuity derivatives - call options       | 373                  |          |
| Synthetic GICs   | 21,623               | 22,052   |
| Foreign currency and interest rate swaps               | 1,217                | 1,235    |
| Life indexed account embedded derivatives              | 5,266                | 3,975    |
| Life indexed account derivatives - call options        | 5,841                | 4,343    |
| Other  | 996                  | 923      |

Notional amount represents a standard of measurement of the volume of derivatives. Notional amount is not a quantification of market risk or credit risk and is not recorded in the consolidated statements of financial condition. Notional amounts generally represent those amounts used to calculate contractual cash flows to be exchanged and are not paid or received, except for certain contracts such as currency swaps. 13% of variable annuity notional amounts are reinsured by third-party reinsurers as of December 31, 2017 and 2016. 4% of variable annuity notional amounts are reinsured by an affiliated reinsurer as of December 31, 2017 and 2016.

The following table summarizes amounts recognized in net realized investment gain 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 and amortization of \$506 million, \$464 million and \$191 million for the years ended December 31, 2017, 2016 and 2015, respectively, which are recognized in net realized investment gain.

|   | Amount of Gain (Loss)    |              |              |
|---|--------------------------|--------------|--------------|
|   | Recognized in            |              |              |
|   | Income on Derivatives    |              |              |
|   | Years Ended December 31, |              |              |
|   | 2017                     | 2016         | 2015         |
|   | <i>(In Millions)</i>     |              |              |
| Variable annuity derivatives - total return swaps | (\$13)                   | (\$16)       | \$2          |
| Variable annuity derivatives - equity put options | (4)                      |              |              |
| Fixed indexed annuity derivatives - call options  | 3                        |              |              |
| Foreign currency and interest rate swaps          | (30)                     | 27           | 67           |
| Life indexed account derivatives - call options   | 527                      | 248          | 59           |
| Other   | 1                        | (2)          | (5)          |
| Embedded derivatives:                             |                          |              |              |
| Variable annuity GLB embedded derivatives         | 166                      | 155          | 60           |
| Fixed indexed annuity embedded derivatives        | (128)                    | (47)         | (5)          |
| Life indexed account embedded derivatives         | (335)                    | (100)        | 51           |
| Other   | (3)                      | 21           |              |
| Total   | <u>\$184</u>             | <u>\$286</u> | <u>\$229</u> |

#### DERIVATIVES DESIGNATED AS CASH FLOW HEDGES

The Company primarily utilizes foreign currency and interest rate swaps to manage its exposure to variability in cash flows due to changes in foreign currencies and in benchmark interest rates. These cash flows include those associated with existing assets and liabilities. The maximum length of time over which the Company is hedging its exposure to variability in future cash flows for forecasted transactions does not exceed 15 years.

The Company had outstanding foreign currency and interest rate swaps designated as cash flow hedges with notional amounts of \$394 million and \$352 million as of December 31, 2017 and 2016, respectively. The Company had gains (losses) recognized in OCI for changes in estimated fair value of foreign currency and interest rate swaps designated as cash flow hedges of (\$18) million, \$6 million and \$7 million for the years ended December 31, 2017, 2016 and 2015, respectively. For the years ended December 31, 2017, 2016 and 2015, all of the hedged forecasted transactions for designated cash flow hedges were determined to be probable of occurring.

The Company had losses for hedge ineffectiveness related to cash flow hedges of \$1 million, zero and zero for the years ended December 31, 2017, 2016 and 2015, respectively.

Amounts reclassified from AOCI to earnings resulting from the discontinuance of cash flow hedges due to forecasted cash flows that were no longer probable of occurring were zero for the years ended December 31, 2017, 2016 and 2015. Over the next twelve months, the Company anticipates that \$1 million of deferred gains on derivative instruments in AOCI will be reclassified to earnings consistent with when the hedged forecasted transaction affects earnings.

#### DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES

The Company had no fair value hedges as of December 31, 2017 and 2016.



CONSOLIDATED FINANCIAL STATEMENT IMPACT

Derivative instruments are recorded 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 12 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 Millions)</i> |                    | <i>(In Millions)</i>  |                      |
| Derivatives designated as hedging instruments:                                 |                      |                    |                       |                      |
| Foreign currency and interest rate swaps                                       |                      | \$2 <sup>(1)</sup> | \$19                  | <sup>(1)</sup>       |
|  | \$3                  | 6 <sup>(5)</sup>   | 3                     | \$7 <sup>(5)</sup>   |
| Total derivatives designated as hedging instruments                            | 3                    | 8                  | 22                    | 7                    |
| Derivatives not designated as hedging instruments:                             |                      |                    |                       |                      |
| Variable annuity derivatives - total return swaps                              | 1                    | 6 <sup>(1)</sup>   | 8                     | 9 <sup>(1)</sup>     |
|  |                      |                    | 5                     | 5 <sup>(5)</sup>     |
| Variable annuity derivatives - equity put options                              | 2                    | <sup>(5)</sup>     |                       |                      |
| Variable annuity derivatives - interest rate swaps                             |                      | 3 <sup>(1)</sup>   | 2                     | 2 <sup>(1)</sup>     |
|  | 3                    | <sup>(5)</sup>     |                       |                      |
| Fixed indexed annuity derivatives - call options                               | 6                    | <sup>(1)</sup>     |                       |                      |
|  | 5                    | <sup>(5)</sup>     |                       |                      |
| Foreign currency and interest rate swaps                                       | 48                   | 77 <sup>(1)</sup>  | 22                    | 20 <sup>(1)</sup>    |
|  | 30                   | 52 <sup>(5)</sup>  | 12                    | 16 <sup>(5)</sup>    |
| Life indexed account derivatives - call options                                | 141                  | 110 <sup>(1)</sup> | 1                     | <sup>(1)</sup>       |
|  | 246                  | 110 <sup>(5)</sup> | 1                     | <sup>(5)</sup>       |
| Other  |                      | 1 <sup>(1)</sup>   |                       |                      |
| Embedded derivatives:  |                      |                    |                       |                      |
| Variable annuity GLB embedded derivatives<br>(including reinsurance contracts) | 157                  | 178 <sup>(2)</sup> | 846                   | 1,033 <sup>(3)</sup> |
| Fixed indexed annuity embedded derivatives                                     |                      |                    | 465                   | 262 <sup>(4)</sup>   |
| Life indexed account embedded derivatives                                      |                      |                    | 526                   | 341 <sup>(4)</sup>   |
| Other  | 24                   | 19 <sup>(2)</sup>  | 27                    | 14 <sup>(4)</sup>    |
|  |                      |                    | 10                    | 4 <sup>(5)</sup>     |
| Total derivatives not designated as hedging instruments                        | 663                  | 556                | 1,925                 | 1,706                |
| Total derivatives  | \$666                | \$564              | \$1,947               | \$1,713              |

Location on the consolidated statements of financial condition:

(1) Other investments (2) Other assets (3) Future policy benefits (4) Policyholder account balances (5) Other liabilities

Cash collateral received from counterparties was \$223 million and \$145 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 \$60 million and \$68 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.

As of December 31, 2017 and 2016, the Company had also accepted collateral, consisting of various securities, with an estimated fair value of \$91 million and \$61 million, respectively, which are held in separate custodial accounts and are not recorded in the consolidated statements of financial condition. The Company is permitted by contract to sell or repledge this collateral and as of December 31, 2017 and 2016, none of the collateral had been sold or repledged. As of December 31, 2017 and 2016, the Company did not provide any collateral in the form of various securities.

## 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.

|                           | Gross Amounts of<br>Recognized<br>Assets/Liabilities <sup>(1)</sup> | Gross Amounts<br>Offset <sup>(2)</sup> | Net Amounts | Gross Amounts<br>Not Offset -<br>Asset Collateral | Net Amounts |
|---------------------------|---|--|-------------|---|-------------|
| <i>(In Millions)</i>      |   |  |             |   |             |
| <u>December 31, 2017:</u> |   |  |             |   |             |
| Derivative assets         | \$354   | (\$266)                                | \$88        | (\$87)  | \$1         |
| Derivative liabilities    | 74  | (68)                                   | 6           |   | 6           |
| <u>December 31, 2016:</u> |   |  |             |   |             |
| Derivative assets         | \$265   | (\$171)                                | \$94        | (\$58)  | \$36        |
| Derivative liabilities    | 62  | (41)                                   | 21          |   | 21          |

<sup>(1)</sup> As of December 31, 2017 and 2016, derivative assets include expense accruals of \$131 million and \$99 million, respectively, and derivative liabilities include expense accruals of \$1 million and \$6 million, respectively.

<sup>(2)</sup> As of December 31, 2017 and 2016, the Company received excess cash collateral of \$8 million and \$9 million, respectively, and provided excess cash collateral of \$4 million and \$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 requires 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 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 derivative 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 \$5 million. The maximum exposure to any single counterparty was \$4 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.

## 9. POLICYHOLDER LIABILITIES

### POLICYHOLDER ACCOUNT BALANCES

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

|  | December 31,         |                 |
|--|----------------------|-----------------|
|  | 2017                 | 2016            |
|  | <i>(In Millions)</i> |                 |
| UL   | \$28,651             | \$26,989        |
| Annuity and deposit liabilities            | 18,957               | 17,072          |
| Life indexed account embedded derivatives  | 526                  | 341             |
| Fixed indexed annuity embedded derivatives | 465                  | 262             |
| Funding agreements                         | 166                  | 243             |
| Total                                      | <u>\$48,765</u>      | <u>\$44,907</u> |

## FUTURE POLICY BENEFITS

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

|   | December 31,         |                 |
|---|----------------------|-----------------|
|   | 2017                 | 2016            |
|   | <i>(In Millions)</i> |                 |
| Annuity reserves                          | \$10,134             | \$8,703         |
| Policy benefits payable                   | 2,808                | 2,756           |
| URR                                       | 1,501                | 1,159           |
| Life insurance                            | 1,218                | 1,123           |
| Variable annuity GLB embedded derivatives | 846                  | 1,033           |
| Closed Block liabilities                  | 254                  | 252             |
| Other                                     | 134                  | 136             |
| Total                                     | <u>\$16,895</u>      | <u>\$15,162</u> |

### 10. SEPARATE ACCOUNTS AND GUARANTEED BENEFIT FEATURES

The Company issues variable annuity contracts through separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contract holder (traditional variable annuities). These contracts also include various types of GMDB and GLB features. For a discussion of certain GLBs accounted for as embedded derivatives, see Note 8.

The GMDBs provide a specified minimum return upon death. Many of these death benefits are spousal, whereby a death benefit will be paid upon death of the first spouse. The survivor has the option to terminate the contract or continue it and have the death benefit paid into the contract and a second death benefit paid upon the survivor's death. The GMDB features include those where the Company contractually guarantees to the contract holder either (a) return of no less than total deposits made to the contract less any partial withdrawals (return of net deposits), (b) the highest contract value on any contract anniversary date through age 80 minus any payments or 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 and fixed 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 Millions)</u> |          |
| Return of net deposits:                  |                         |          |
| Separate account value                   | \$52,825                | \$49,764 |
| Net amount at risk <sup>(1)</sup>        | 457                     | 582      |
| Average attained age of contract holders | 67 years                | 66 years |
| Anniversary contract value:              |                         |          |
| Separate account value                   | \$14,061                | \$13,567 |
| Net amount at risk <sup>(1)</sup>        | 432                     | 541      |
| Average attained age of contract holders | 69 years                | 68 years |
| Minimum return:                          |                         |          |
| Separate account value                   | \$863                   | \$850    |
| Net amount at risk <sup>(1)</sup>        | 363                     | 430      |
| Average attained age of contract holders | 73 years                | 72 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,                |          | December 31,                |          |
|--|-------------------------|----------|-----------------------------|----------|-----------------------------|----------|
|  | 2017                    | 2016     | 2017                        | 2016     | 2017                        | 2016     |
|  | <u>GMIB</u>             |          | <u>GMWBL <sup>(2)</sup></u> |          | <u>GMWBL <sup>(3)</sup></u> |          |
|  | <i>(\$ In Millions)</i> |          | <i>(\$ In Millions)</i>     |          | <i>(\$ In Millions)</i>     |          |
| Separate account value                   | \$1,665                 | \$1,668  | \$6,924                     | \$5,908  |                             |          |
| Net amount at risk <sup>(1)</sup>        | 148                     | 232      | 153                         | 316      | \$80                        | \$69     |
| Average attained age of contract holders | 64 years                | 63 years | 67 years                    | 66 years | 67 years                    | 67 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.

<sup>(2)</sup> GMWBL related to variable contract annuities.

<sup>(3)</sup> GMWBL related to fixed contract annuities.

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,         |      | December 31,         |      |
|----------------------------|----------------------|------|----------------------|------|----------------------|------|----------------------|------|
|                            | 2017                 | 2016 | 2017                 | 2016 | 2017                 | 2016 | 2017                 | 2016 |
|                            | GMDB                 |      | GMIB                 |      | GMWBL <sup>(1)</sup> |      | GMWBL <sup>(2)</sup> |      |
|                            | <i>(In Millions)</i> |      | <i>(In Millions)</i> |      | <i>(In Millions)</i> |      | <i>(In Millions)</i> |      |
| Balance, beginning of year | \$9                  | \$9  | \$37                 | \$40 | \$55                 | \$44 | \$15                 | \$8  |
| Changes in reserves        | 9                    | 14   | 9                    | 6    | 20                   | 11   | 4                    | 7    |
| Benefits paid              | (7)                  | (14) | (7)                  | (9)  |                      |      |                      |      |
| Balance, end of year       | \$11                 | \$9  | \$39                 | \$37 | \$75                 | \$55 | \$19                 | \$15 |

<sup>(1)</sup> GMWBL related to variable contract annuities.

<sup>(2)</sup> GMWBL related to fixed contract annuities.

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

| Asset type:                  | December 31,         |          |
|------------------------------|----------------------|----------|
|                              | 2017                 | 2016     |
|                              | <i>(In Millions)</i> |          |
| Equity                       | \$34,324             | \$31,408 |
| Bonds                        | 15,536               | 15,278   |
| Money market                 | 261                  | 298      |
| Other                        | 2,948                | 3,012    |
| Total separate account value | \$53,069             | \$49,996 |

In addition, the Company issues certain life insurance contracts whereby the Company contractually guarantees to the contract holder a death benefit even when there is insufficient value to cover monthly mortality and expense charges, whereas otherwise the contract would typically lapse.

FDNLGR liabilities are determined by estimating the expected value of FDNLGR costs incurred when the policyholder account balance is projected to be zero and recognizing those costs over the accumulation period based on total expected assessments. The assumptions used in estimating the FDNLGR liability are consistent with those used for amortizing DAC. The FDNLGR costs used in calculating the FDNLGR liability are based on the average FDNLGR costs incurred over a range of scenarios.

The following table summarizes the FDNLGR liability, which are recorded in future policy benefits, and changes in these liabilities, which are reflected in policy benefits paid or provided:

|                              | Direct               | Ceded | Net   |
|------------------------------|----------------------|-------|-------|
|                              | <i>(In Millions)</i> |       |       |
| Balance, January 1, 2016     | \$557                | \$155 | \$402 |
| Incurred guaranteed benefits | 170                  | 38    | 132   |
| Paid guaranteed benefits     | (2)                  | 2     | (4)   |
| Balance, December 31, 2016   | 725                  | 195   | 530   |
| Incurred guaranteed benefits | 143                  | 87    | 56    |
| Paid guaranteed benefits     | (5)                  | (4)   | (1)   |
| Balance, December 31, 2017   | \$863                | \$278 | \$585 |

Information regarding life insurance contracts included in the FDNLGR liability is as follows:

|                                       | December 31,            |          |
|---------------------------------------|-------------------------|----------|
|                                       | 2017                    | 2016     |
|                                       | <i>(\$ In Millions)</i> |          |
| Net amount at risk <sup>(1)</sup>     | \$16,183                | \$16,461 |
| Average attained age of policyholders | 61 years                | 60 years |

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

## 11. DEBT AND FVO DEBT

Debt and FVO debt consists of the following:

|   | December 31,         |                |
|---|----------------------|----------------|
|   | 2017                 | 2016           |
|   | <i>(In Millions)</i> |                |
| Short-term debt and revolving credit facilities:                        |                      |                |
| Credit facility recourse only to ACG                                    | \$235                | \$1,020        |
| Other VIE debt (Note 4)   | 119                  | 21             |
| Total short-term debt and revolving credit facilities                   | <u>354</u>           | <u>1,041</u>   |
| Long-term debt:   |                      |                |
| Surplus notes   | 1,729                | 1,715          |
| Fair value hedge adjustments - terminated interest rate swap agreements | 154                  | 243            |
| Note payable to Pacific LifeCorp  |                      | 15             |
| Non-recourse long-term debt:  |                      |                |
| Debt recourse only to ACG   | 5,031                | 3,357          |
| VIE debt recourse only to ACG (Note 4)                                  | 693                  | 886            |
| Other non-recourse debt   | 827                  | 428            |
| CMBS VIE debt (Note 4)  | 1,521                | 1,521          |
| Other VIE debt  | 18                   | 18             |
| Total long-term debt  | <u>9,973</u>         | <u>8,183</u>   |
| Debt issuance cost  | (76)                 | (68)           |
| Total debt  | <u>\$10,251</u>      | <u>\$9,156</u> |
| FVO debt - VIE (Note 4)   | <u>\$462</u>         | <u>—</u>       |

### SHORT-TERM DEBT AND REVOLVING CREDIT FACILITIES

Pacific Life maintains a \$700 million commercial paper program. There was no commercial paper debt outstanding as of December 31, 2017 and 2016. In addition, Pacific Life has a bank revolving credit facility of \$400 million maturing in May 2021 that will serve as a back-up line of credit to the commercial paper program. Interest is at variable rates. This facility had no debt outstanding as of December 31, 2017 and 2016.

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.

Pacific Life is a member of the Federal Home Loan Bank (FHLB) of Topeka. Pacific Life is eligible to receive advances from the FHLB of Topeka based on a percentage of Pacific Life's statutory general account assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of Topeka requirements, debt covenant restrictions and insurance law and regulations. The Company had estimated available eligible collateral of \$1.6 billion as of December 31, 2017. Interest is at variable or fixed rates. The Company had no debt outstanding with the FHLB of Topeka as of December 31, 2017 and 2016.

PL&A is a member of the FHLB of San Francisco. PL&A is eligible to receive advances from the FHLB of San Francisco based on a percentage of PL&A's statutory net admitted assets provided it has sufficient available eligible collateral and is in compliance with the FHLB of San Francisco requirements and insurance law and regulations. PL&A had estimated available eligible collateral of \$71 million as of December 31, 2017. Interest is at variable or fixed rates. PL&A had no debt outstanding with the FHLB of San Francisco as of December 31, 2017 and 2016.



ACG has revolving credit facilities with banks totaling \$1,720 million borrowing capacity as of December 31, 2017. Interest on these loans is at variable rates, payable monthly and was 2.6% and 1.9% as of December 31, 2017 and 2016, respectively. The facilities expire at various dates ranging from 2019 to 2022. There was \$235 million and \$1,020 million outstanding in connection with these revolving credit facilities as of December 31, 2017 and 2016, respectively. These credit facilities are recourse only to ACG.

#### LONG-TERM DEBT

In October 2017, with the approval of the NE DOI, Pacific Life issued \$750 million of 4.3% surplus notes maturing on October 24, 2067. The notes accrue interest at a fixed rate of 4.3% through October 23, 2047, and thereafter until maturity at a floating rate equal to three-month London Interbank Offered Rate (LIBOR) for deposits in U.S. dollars plus 2.796%. Interest is payable semiannually on April 24 and October 24 until and including October 24, 2047, and thereafter quarterly on January 24, April 24, July 24 and October 24 of each year, commencing on January 24, 2048. Pacific Life may redeem all or a portion of the surplus notes at its option at any time on or after October 24, 2047 at the redemption price described under the terms of the surplus notes, subject to the prior approval of the NE DOI for such optional redemption. The surplus notes are unsecured and subordinated to all present and future senior indebtedness and policy claims of Pacific Life. All future payments of interest and principal on these surplus notes can be made only with the prior approval of the NE DOI. The carrying amount as of December 31, 2017 was \$749 million.

Pacific Life had \$385 million and \$621 million of surplus notes outstanding as of December 31, 2017 and 2016, respectively, at a fixed interest rate of 9.25%, maturing on June 15, 2039. Interest is payable semiannually on June 15 and December 15. Pacific Life may redeem all or a portion of these surplus notes at its option, subject to the prior approval of the NE DOI for such optional redemption. The surplus notes are unsecured and subordinated to all present and future senior indebtedness and policy claims of Pacific Life. All future payments of interest and principal on these surplus notes can be made only with the prior approval of the NE DOI. In January 2013, Pacific Life, with the approval of the NE DOI, pursuant to a tender offer, repurchased and retired \$323 million of the originally issued \$1 billion of 9.25% surplus notes. In February 2016, Pacific Life, with the approval of the NE DOI, repurchased and retired an additional \$56 million of 9.25% surplus notes. The partial retirement of these surplus notes was accounted for as an extinguishment of debt and a loss of \$5 million was recognized in interest expense during the year ended December 31, 2016. In October 2017, Pacific Life, with the approval of the NE DOI, pursuant to a tender offer, repurchased and retired an additional \$236 million of 9.25% surplus notes. The partial retirement of these surplus notes was accounted for as an extinguishment of debt and a loss of \$89 million was recognized in interest expense during the year ended December 31, 2017. Pacific Life previously terminated interest rate swaps converting these surplus notes to variable rate notes and fair value hedge adjustments were recorded to the net carrying amount and are being amortized as a reduction to interest expense over the remaining life of the surplus notes using the effective interest method. The resulting effective interest rate of these surplus notes is 6.4%. Total unamortized fair value hedge adjustments were \$126 million and \$208 million as of December 31, 2017 and 2016, respectively.

Pacific Life had \$134 million and \$150 million of surplus notes outstanding as of December 31, 2017 and 2016, respectively, at a fixed interest rate of 7.9%, maturing on December 30, 2023. Interest is payable semiannually on June 30 and December 30. These surplus notes may not be redeemed at the option of Pacific Life or any holder of the surplus notes. The surplus notes are unsecured and subordinated to all present and future senior indebtedness and policy claims of Pacific Life. All future payments of interest and principal on these surplus notes can be made only with the prior approval of the NE DOI. In October 2017, Pacific Life, with the approval of the NE DOI, pursuant to a tender offer, repurchased and retired \$16 million of the originally issued \$150 million of 7.9% surplus notes. The partial retirement of these surplus notes was accounted for as an extinguishment of debt and an immaterial loss was recognized in interest expense during the year ended December 31, 2017. Pacific Life previously terminated interest rate swaps converting the 7.9% surplus notes to variable rate notes and fair value hedge adjustments were recorded to the net carrying amount and are being amortized as a reduction to interest expense over the remaining life of the surplus notes using the effective interest method. The resulting effective interest rate of these surplus notes is 4.0%. Total unamortized fair value hedge adjustments were \$28 million and \$35 million as of December 31, 2017 and 2016, respectively.

The NE DOI approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for \$450 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on February 5 and August 5 at a fixed annual rate of 6.0%. All future payments of interest and principal on the internal surplus note can be made only with the prior approval of the NE DOI. The internal surplus note matures on February 5, 2020. In October 2017, Pacific Life, with the approval of the NE DOI, repurchased and retired \$217 million of the originally issued \$450 million of its 6.0% surplus note. In November 2017, Pacific Life, with the approval of the NE DOI, repurchased and retired an additional \$177 million of its 6.0% internal surplus note. The partial retirements of its surplus note were accounted for as an extinguishment of debt. The carrying amount as of December 31, 2017 and 2016 was \$56 million and \$450 million, respectively.

The NE DOI approved the issuance of an internal surplus note by Pacific Life to Pacific LifeCorp for \$500 million with net cash proceeds of \$494 million. Pacific Life is required to pay Pacific LifeCorp interest on the internal surplus note semiannually on January 25 and July 25 at a fixed annual rate of 5.125%. All future payments of interest and principal on the internal surplus note can be made only with the prior approval of the NE DOI. The internal surplus note matures on January 25, 2043. In October 2017, Pacific Life, with the approval of the NE DOI, repurchased and retired \$90 million of the originally issued \$500 million of its 5.125% internal surplus note. The partial retirement of its surplus note was accounted for as an extinguishment of debt. The carrying amount outstanding as of December 31, 2017 and 2016 was \$405 million and \$494 million, respectively.

Pacific Life Reinsurance Company II Limited (PLRC), an exempt life reinsurance company domiciled in Barbados and wholly owned by Pacific Life, had a promissory note with Pacific LifeCorp to borrow up to \$50 million. In August 2017, the note was repaid and canceled. As of December 31, 2016, \$15 million was outstanding on the note.

ACG enters into various secured loans that are guaranteed by the Ex-Im bank or by the ECA. Interest on these loans is payable quarterly and ranged from 1.5% to 3.9% as of December 31, 2017 and 1.2% to 3.9% as of December 31, 2016. As of December 31, 2017, \$843 million was outstanding on these loans with maturities ranging from 2018 to 2024. As of December 31, 2016, \$1,071 million was outstanding on these loans. These loans are recourse only to ACG. See Note 4 for amounts included related to VIEs of \$693 million and \$886 million as of December 31, 2017 and 2016, respectively.

ACG enters into various senior unsecured notes and loans with third-parties. Interest on these notes and loans is payable quarterly or semi-annually and ranged from 0.7% to 7.2% as of December 31, 2017 and 2016. As of December 31, 2017, \$4,881 million was outstanding on these notes and loans with maturities ranging from 2018 to 2027. As of December 31, 2016, \$3,172 million was outstanding on these notes and loans. These notes and loans are recourse only to ACG.

Certain subsidiaries of Pacific Asset Holding LLC, a wholly owned subsidiary of Pacific Life, enter into various real estate property related loans with various third-parties. Interest on these loans accrues at fixed and variable rates and is payable monthly. Fixed rates ranged from 3.6% to 5.4% as of December 31, 2017 and 2016. The variable rates ranged from 3.0% to 4.1% as of December 31, 2017 and ranged from 2.1% to 3.4% as of December 31, 2016. As of December 31, 2017 and 2016, there was \$794 million and \$394 million, respectively, outstanding on these loans with maturities ranging from 2018 to 2027. Included in this amount is \$18 million of other VIE debt as of December 31, 2017 and 2016. All of these loans are secured by real estate properties and are non-recourse to the Company.

As of December 31, 2017 and 2016, the Company had a secured borrowing of \$51 million and \$52 million, respectively, due to an unrelated third-party. Payments of principal and interest are due monthly with an effective rate of 4.7% that matures on September 1, 2026. The lender's collateral for the amount borrowed is a participation interest in two of the Company's commercial mortgage loans that are secured by real estate property and is non-recourse to the Company.

As of December 31, 2017 and 2016, the Company had CMBS VIE debt of \$1,521 million outstanding (Note 4). Interest rates are fixed and range from 3.5% to 3.6% with maturities from 2025 to 2044. This debt is secured by commercial real estate property, is non-recourse to the Company, and the Company is not responsible for any principal or interest shortfalls from the underlying collateral.

Certain of the Company's debt instruments and credit facilities contain various administrative, reporting, legal and financial covenants. The Company believes it was in compliance with all such covenants as of December 31, 2017.

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

|                           | Surplus<br>Notes | Non-recourse Debt               |                               | Total   |
|---------------------------|------------------|---------------------------------|-------------------------------|---------|
|                           |                  | Debt<br>Recourse<br>Only to ACG | Other<br>Non-recourse<br>Debt |         |
| Years Ending December 31: |                  | <i>(In Millions)</i>            |                               |         |
| 2018                      |                  | \$1,278                         | \$65                          | \$1,343 |
| 2019                      |                  | 373                             | 19                            | 392     |
| 2020                      | \$56             | 956                             | 230                           | 1,242   |
| 2021                      |                  | 879                             | 87                            | 966     |
| 2022                      |                  | 1,083                           | 31                            | 1,114   |
| Thereafter                | 1,679            | 1,173                           | 395                           | 3,247   |
| Total                     | \$1,735          | \$5,742                         | \$827                         | \$8,304 |

The table above excludes short-term debt, revolving credit facilities, VIE debt, fair value hedge adjustments and original issue discount fees of \$24 million. ACG VIE debt is included in the table above as it is recourse to ACG.

#### FVO DEBT

As of December 31, 2017, the Company had FVO debt from a CLO classified as a VIE (Note 4) of \$462 million with floating interest rates that range from LIBOR plus 1.29% to 6.68%, maturing in 2029. This debt is secured by broadly syndicated bank loans, is non-recourse to the Company and the Company is not responsible for any principal or interest shortfalls from the underlying collateral.

## 12. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

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

- Level 1 Unadjusted quoted prices for identical instruments in active markets. Level 1 financial instruments 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<br>Derivatives<br>Estimated<br>Fair Value | Netting<br>Adjustments <sup>(1)</sup> | Total     |
|--|----------------------|----------|---------|---|---------------------------------------|-----------|
|  | <i>(In Millions)</i> |          |         |   |                                       |           |
| <u>December 31, 2017:</u>  |                      |          |         |   |                                       |           |
| Assets:  |                      |          |         |   |                                       |           |
| U.S. Government  |                      | \$79     |         |   |                                       | \$79      |
| Obligations of states and political subdivisions                   |                      | 958      | \$24    |   |                                       | 982       |
| Foreign governments  |                      | 504      | 28      |   |                                       | 532       |
| Corporate securities   |                      | 40,130   | 1,476   |   |                                       | 41,606    |
| RMBS   |                      | 1,910    | 15      |   |                                       | 1,925     |
| CMBS   |                      | 941      | 100     |   |                                       | 1,041     |
| Other asset-backed securities                                      |                      | 921      | 374     |   |                                       | 1,295     |
| Total fixed maturity securities                                    | —                    | 45,443   | 2,017   | —   | —                                     | 47,460    |
| Perpetual preferred securities                                     |                      | 14       |         |   |                                       | 14        |
| Other equity securities  | \$68                 |          |         |   |                                       | 68        |
| Total equity securities  | 68                   | 14       | —       | —   | —                                     | 82        |
| FVO securities   |                      | 1,182    |         |   |                                       | 1,182     |
| Other investments:   |                      |          |         |   |                                       |           |
| Trading securities   | 375                  | 249      |         |   |                                       | 624       |
| Other investments <sup>(2)</sup>                                   | 36                   | 120      | 5       |   |                                       | 161       |
| Other investments measured at NAV <sup>(3)</sup>                   |                      |          |         |   |                                       | 275       |
| Total other investments carried at fair value                      | 411                  | 369      | 5       | —   | —                                     | 1,060     |
| Derivatives:   |                      |          |         |   |                                       |           |
| Foreign currency and interest rate swaps                           |                      | 84       |         | \$84  | (\$79)                                | 5         |
| Equity derivatives   |                      |          | 401     | 401   | (262)                                 | 139       |
| Embedded derivatives   |                      |          | 181     | 181   |                                       | 181       |
| Total derivatives  | —                    | 84       | 582     | 666   | (341)                                 | 325       |
| Separate account assets:   |                      |          |         |   |                                       |           |
| Separate account assets  | 61,067               | 110      |         |   |                                       | 61,177    |
| Separate account assets measured at NAV <sup>(3)</sup>             |                      |          |         |   |                                       | 279       |
| Total separate account assets carried at fair value <sup>(4)</sup> | 61,067               | 110      | —       | —   | —                                     | 61,456    |
| Total  | \$61,546             | \$47,202 | \$2,604 | \$666   | (\$341)                               | \$111,565 |
| Liabilities:   |                      |          |         |   |                                       |           |
| FVO debt   |                      | \$462    |         |   |                                       | \$462     |
| Derivatives:   |                      |          |         |   |                                       |           |
| Foreign currency and interest rate swaps                           |                      | 58       |         | \$58  | (\$79)                                | (21)      |
| Equity derivatives   |                      |          | \$15    | 15  | (262)                                 | (247)     |
| Embedded derivatives   |                      |          | 1,874   | 1,874   |                                       | 1,874     |
| Total derivatives  | —                    | 58       | 1,889   | 1,947   | (341)                                 | 1,606     |
| Total  | —                    | \$520    | \$1,889 | \$1,947   | (\$341)                               | \$2,068   |

|  | Level 1       | Level 2  | Level 3 | Gross<br>Derivatives<br>Estimated<br>Fair Value | Netting<br>Adjustments <sup>(1)</sup> | Total     |
|--|---------------|----------|---------|---|---------------------------------------|-----------|
|  | (In Millions) |          |         |   |                                       |           |
| <u>December 31, 2016:</u>  |               |          |         |   |                                       |           |
| Assets:  |               |          |         |   |                                       |           |
| U.S. Government  |               | \$56     |         |   |                                       | \$56      |
| Obligations of states and political subdivisions                   |               | 914      | \$26    |   |                                       | 940       |
| Foreign governments  |               | 536      | 49      |   |                                       | 585       |
| Corporate securities   |               | 35,626   | 1,587   |   |                                       | 37,213    |
| RMBS   |               | 2,221    | 35      |   |                                       | 2,256     |
| CMBS   |               | 831      | 106     |   |                                       | 937       |
| Other asset-backed securities                                      |               | 776      | 484     |   |                                       | 1,260     |
| Total fixed maturity securities                                    | —             | 40,960   | 2,287   | —   | —                                     | 43,247    |
| Perpetual preferred securities                                     |               | 69       |         |   |                                       | 69        |
| Other equity securities  | \$31          |          |         |   |                                       | 31        |
| Total equity securities  | 31            | 69       | —       | —   | —                                     | 100       |
| FVO securities   |               | 529      |         |   |                                       | 529       |
| Other investments:   |               |          |         |   |                                       |           |
| Trading securities   | 9             | 243      |         |   |                                       | 252       |
| Other investments <sup>(2)</sup>                                   | 77            | 153      | 5       |   |                                       | 235       |
| Other investments measured at NAV <sup>(3)</sup>                   |               |          |         |   |                                       | 136       |
| Total other investments carried at fair value                      | 86            | 396      | 5       | —   | —                                     | 623       |
| Derivatives:   |               |          |         |   |                                       |           |
| Foreign currency and interest rate swaps                           |               | 140      |         | \$140   | (\$80)                                | 60        |
| Equity derivatives   |               |          | 226     | 226   | (119)                                 | 107       |
| Embedded derivatives   |               |          | 197     | 197   |                                       | 197       |
| Other  |               | 1        |         | 1   |                                       | 1         |
| Total derivatives  | —             | 141      | 423     | 564   | (199)                                 | 365       |
| Separate account assets:   |               |          |         |   |                                       |           |
| Separate account assets  | 57,070        | 111      |         |   |                                       | 57,181    |
| Separate account assets measured at NAV <sup>(3)</sup>             |               |          |         |   |                                       | 245       |
| Total separate account assets carried at fair value <sup>(4)</sup> | 57,070        | 111      | —       | —   | —                                     | 57,426    |
| Total  | \$57,187      | \$42,206 | \$2,715 | \$564   | (\$199)                               | \$102,290 |
| Liabilities:   |               |          |         |   |                                       |           |
| Derivatives:   |               |          |         |   |                                       |           |
| Foreign currency and interest rate swaps                           |               | \$45     |         | \$45  | (\$80)                                | (\$35)    |
| Equity derivatives   |               |          | \$14    | 14  | (119)                                 | (105)     |
| Embedded derivatives   |               |          | 1,654   | 1,654   |                                       | 1,654     |
| Total  | —             | \$45     | \$1,668 | \$1,713   | (\$199)                               | \$1,514   |

<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> Excludes investments accounted for under the equity and cost methods of accounting.

<sup>(3)</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 consolidated statements of financial condition.

- (4) 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 Millions)</i>  |                 |                          |                        |
| Hedge funds                  | \$103                | Monthly - 23%<br>Quarterly - 61%<br>Semi-Annually - 2%<br>Annually - 14% | None            | 30 – 90 days             |                        |
| Private equity funds         | 172                  | None   | N/A             | N/A                      | \$468                  |
| Separate account hedge funds | 279                  | Monthly - 29%<br>Quarterly - 60%<br>Semi-Annually - 8%<br>Annually - 3%  | None to 7 years | 5 – 125 days             |                        |
| Total measured at NAV        | \$554                |  |                 |                          | \$468                  |

#### ESTIMATED FAIR VALUE MEASUREMENT

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

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

#### FIXED MATURITY, EQUITY, FVO AND TRADING SECURITIES

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

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

For prices received from independent pricing services, the Company applies a formal process to challenge any prices received that are not considered representative of estimated fair value. If prices received from independent pricing services are not considered reflective of market activity or representative of estimated fair value, independent non-binding broker quotations are obtained, or an

internally-developed valuation is prepared. Upon evaluation, the Company determines which source represents the best estimate of fair value. Overrides of third-party prices to internally-developed valuations of estimated fair value did not produce material differences in the estimated fair values for the majority of the portfolio. In the absence of such market observable activity, management's best estimate is used.

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

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

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

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

## OTHER INVESTMENTS

Other investments include non-marketable equity securities that do not have readily determinable estimated fair value. Certain significant inputs used in determining the estimated fair value of these equities are based on management assumptions or contractual terms with another party that cannot be readily observable in the market. These non-marketable equity securities are classified as Level 3 assets. Also included in other investments are the securities of the 40 Act Funds, which are valued using the same methodology as described above for fixed maturity, equity, FVO and trading securities.

## 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 primarily 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 and reinsurance 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, market fees and broker quotations. A derivative instrument containing Level 2 inputs will be classified as a Level 3 financial instrument in its entirety if it has at least one significant Level 3 input.

#### VARIABLE ANNUITY GLB EMBEDDED DERIVATIVES

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

Estimated fair value is calculated as an aggregation of estimated fair value and additional risk margins including behavior risk margin, mortality risk margin and credit standing adjustment. The resulting aggregation is reconciled or calibrated, if necessary, to market information that is, or may be, available to the Company, but may not be observable by other market participants. Each of the components described below are unobservable in the market place and requires subjectivity by the Company in determining their value.

- Behavior risk margin: This component adds a margin that market participants would require for the risk that the Company's assumptions about policyholder behavior used in the estimated fair value model could differ from actual experience. This component includes assumptions about withdrawal utilization and lapse rates.
- Mortality risk margin: This component adds a margin in mortality assumptions, both for decrements for policyholders with GLBs, and for expected payout lifetimes in guaranteed minimum withdrawal benefits.
- Credit standing adjustment: This component makes an adjustment that market participants would make to reflect the chance that GLB obligations or the GLB reinsurance recoverables will not be fulfilled (nonperformance risk).

#### SEPARATE ACCOUNT ASSETS

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

Level 1 assets 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 2 and 3 assets include fixed maturity securities. The pricing methodology and valuation controls are the same as those previously described in fixed maturity securities available for sale.



## LEVEL 3 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,<br>2017   | Total Gains or Losses   |                    | Transfers<br>Into<br>Level 3 <sup>(1)</sup> | Transfers<br>Out of<br>Level 3 <sup>(1)</sup> | Purchases    | Sales          | Settlements    | December 31,<br>2017 |
|---|----------------------|-------------------------|--------------------|---|---|--------------|----------------|----------------|----------------------|
|   |                      | Included in<br>Earnings | Included in<br>OCI |   |   |              |                |                |                      |
|   | <i>(In Millions)</i> |                         |                    |   |   |              |                |                |                      |
| Obligations of states and<br>political subdivisions | \$26                 |                         | (\$3)              | \$2   |   |              |                | (\$1)          | \$24                 |
| Foreign governments                                 | 49                   |                         | (1)                | 1   | (\$18)  |              |                | (3)            | 28                   |
| Corporate securities                                | 1,587                | \$67                    | 57                 | 54  | (512)   | \$534        | (\$178)        | (133)          | 1,476                |
| RMBS  | 35                   |                         | 2                  | 5   | (55)  | 35           |                | (7)            | 15                   |
| CMBS  | 106                  |                         | (2)                |   | (16)  | 13           |                | (1)            | 100                  |
| Other asset-backed securities                       | 484                  | 1                       | 2                  | 29  | (129)   | 66           |                | (79)           | 374                  |
| Total fixed maturity securities                     | <u>2,287</u>         | <u>68</u>               | <u>55</u>          | <u>91</u>                                   | <u>(730)</u>                                  | <u>648</u>   | <u>(178)</u>   | <u>(224)</u>   | <u>2,017</u>         |
| Other investments                                   | 5                    |                         |                    |   |   |              |                |                | 5                    |
| Derivatives, net: <sup>(2)</sup>                    |                      |                         |                    |   |   |              |                |                |                      |
| Equity derivatives                                  | 212                  | 488                     |                    |   |   | 44           |                | (358)          | 386                  |
| Embedded derivatives                                | (1,457)              | (301)                   | 1                  |   |   | (311)        |                | 375            | (1,693)              |
| Total derivatives                                   | <u>(1,245)</u>       | <u>187</u>              | <u>1</u>           | <u>—</u>                                    | <u>—</u>                                      | <u>(267)</u> | <u>—</u>       | <u>17</u>      | <u>(1,307)</u>       |
| Total   | <u>\$1,047</u>       | <u>\$255</u>            | <u>\$56</u>        | <u>\$91</u>                                 | <u>(\$730)</u>                                | <u>\$381</u> | <u>(\$178)</u> | <u>(\$207)</u> | <u>\$715</u>         |

|  | January 1,<br>2016 | Total Gains or Losses   |                    | Transfers<br>Into<br>Level 3 <sup>(1)</sup> | Transfers<br>Out of<br>Level 3 <sup>(1)</sup> | Purchases | Sales   | Settlements | December 31,<br>2016 |
|--|--------------------|-------------------------|--------------------|---|---|-----------|---------|-------------|----------------------|
|  |                    | Included in<br>Earnings | Included in<br>OCI |   |   |           |         |             |                      |
| <i>(In Millions)</i>                             |                    |                         |                    |   |   |           |         |             |                      |
| Obligations of states and political subdivisions | \$29               |                         | (\$3)              |   |   |           |         |             | \$26                 |
| Foreign governments                              | 8                  |                         | (1)                | \$45  |   |           |         | (\$3)       | 49                   |
| Corporate securities                             | 1,620              | (\$10)                  | 79                 | 168   | (\$317)                                       | \$284     | (\$89)  | (148)       | 1,587                |
| RMBS   | 151                | (2)                     | 3                  | 20  | (122)   | 7         |         | (22)        | 35                   |
| CMBS   | 54                 |                         | (2)                | 1   | (36)  | 90        |         | (1)         | 106                  |
| Collateralized debt obligations                  | 65                 | 18                      | (10)               |   | (12)  | 13        | (73)    | (1)         | —                    |
| Other asset-backed securities                    | 319                | 1                       | (3)                | 63  | (87)  | 247       |         | (56)        | 484                  |
| Total fixed maturity securities                  | 2,246              | 7                       | 63                 | 297   | (574)   | 641       | (162)   | (231)       | 2,287                |
| Other investments                                | 5                  |                         |                    |   |   |           |         |             | 5                    |
| Derivatives, net: <sup>(2)</sup>                 |                    |                         |                    |   |   |           |         |             |                      |
| Equity derivatives                               | 91                 | 232                     |                    |   |   |           |         | (111)       | 212                  |
| Embedded derivatives                             | (1,379)            | 29                      | (3)                |   |   | (230)     |         | 126         | (1,457)              |
| Total derivatives                                | (1,288)            | 261                     | (3)                | —   | —   | (230)     | —       | 15          | (1,245)              |
| Total  | \$963              | \$268                   | \$60               | \$297                                       | (\$574)                                       | \$411     | (\$162) | (\$216)     | \$1,047              |

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

<sup>(2)</sup> Excludes derivative net settlements of (\$414) million and (\$241) million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain. Excludes synthetic GIC policy fees of \$45 million and \$44 million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain. Excludes embedded derivative policy fees of \$156 million and \$161 million for the years ended December 31, 2017 and 2016, respectively, that are recorded in net realized investment gain.

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<br>Investment<br>Income | Net<br>Realized<br>Investment<br>Gain (Loss) | OTTI  | Total |
|--------------------------------------|-----------------------------|--|-------|-------|
| <u>Year Ended December 31, 2017:</u> |                             |  |       |       |
|                                      | <i>(In Millions)</i>        |  |       |       |
| Corporate securities                 | \$17                        | \$55   | (\$5) | \$67  |
| Other asset-backed securities        |                             | 1  |       | 1     |
| Total fixed maturity securities      | 17                          | 56   | (5)   | 68    |
| Equity derivatives                   |                             | 488  |       | 488   |
| Embedded derivatives                 |                             | (301)  |       | (301) |
| Total derivatives                    | —                           | 187  | —     | 187   |
| Total                                | \$17                        | \$243  | (\$5) | \$255 |

|                                      | Net<br>Investment<br>Income | Net<br>Realized<br>Investment<br>Gain (Loss) | OTTI   | Total  |
|--------------------------------------|-----------------------------|--|--------|--------|
| <u>Year Ended December 31, 2016:</u> |                             |  |        |        |
|                                      | <i>(In Millions)</i>        |  |        |        |
| Corporate securities                 | \$14                        | \$1  | (\$25) | (\$10) |
| RMBS                                 |                             |  | (2)    | (2)    |
| Collateralized debt obligations      | 4                           | 14   |        | 18     |
| Other asset-backed securities        | 1                           |  |        | 1      |
| Total fixed maturity securities      | 19                          | 15   | (27)   | 7      |
| Equity derivatives                   |                             | 232  |        | 232    |
| Embedded derivatives                 |                             | 29   |        | 29     |
| Total derivatives                    | —                           | 261  | —      | 261    |
| Total                                | \$19                        | \$276  | (\$27) | \$268  |

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 Millions)</i>     |       |
| Derivatives, net: <sup>(1)</sup> |                          |       |
| Equity derivatives               | \$331                    | \$143 |
| Embedded derivatives             | (180)                    | 33    |
| Total derivatives                | \$151                    | \$176 |

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

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 Millions).

|  | Estimated Fair Value<br>Asset (Liability) | Predominant<br>Valuation Method | Significant<br>Unobservable Inputs | Range<br>(Weighted Average) |
|--|---|---------------------------------|------------------------------------|-----------------------------|
| Obligations of states and political subdivisions | \$24                                      | Discounted cash flow            | Spread <sup>(1)</sup>              | 419-432 (428)               |
| Foreign governments                              | 28  | Discounted cash flow            | Spread <sup>(1)</sup>              | 35-56 (36)                  |
| Corporate securities                             | 1,476                                     | Discounted cash flow            | Spread <sup>(1)</sup>              | 22-1005 (225)               |
|  |   | Collateral value                | Collateral value <sup>(3)</sup>    | 23-84 (79)                  |
|  |   | Market pricing                  | Quoted prices <sup>(2)</sup>       | 10-103 (98)                 |
| RMBS   | 15  | Market pricing                  | Quoted prices <sup>(2)</sup>       | 58                          |
|  |   | Collateral value                | Collateral value <sup>(3)</sup>    | 105                         |
| CMBS   | 100                                       | Market pricing                  | Quoted prices <sup>(2)</sup>       | 92-95 (94)                  |
|  |   | Discounted cash flow            | Spread <sup>(1)</sup>              | 150-300 (163)               |
|  |   |                                 | Prepayment rate                    | 0% - 7% (1%)                |
|  |   |                                 | Default rate                       | 0%                          |
|  |   |                                 | Severity                           | 0%                          |
| Other asset-backed securities                    | 374                                       | Discounted cash flow            | Spread <sup>(1)</sup>              | 35-275 (107)                |
|  |   | Market pricing                  | Quoted prices <sup>(2)</sup>       | 77-114 (102)                |
|  |   | Cap at call price               | Call price                         | 100                         |
| Other investments                                | 5   | Redemption value                | Redemption value <sup>(4)</sup>    | 100                         |
| Equity derivatives                               | 386                                       | Option pricing model            | Equity volatility                  | 12% - 62% (18%)             |
| Embedded derivatives <sup>(5)</sup>              | (1,693)                                   | Option pricing techniques       | Equity volatility                  | 12% - 62%                   |
|  |   |                                 | Mortality:                         |                             |
|  |   |                                 | Ages 0-40                          | 0.01% - 0.18%               |
|  |   |                                 | Ages 41-60                         | 0.06% - 0.55%               |
|  |   |                                 | Ages 61-120                        | 0.39% - 100%                |
|  |   |                                 | Mortality improvement              | 0% - 1.50%                  |
|  |   |                                 | Withdrawal utilization             | 0% - 90%                    |
|  |   |                                 | Lapse rates                        | 0% - 100%                   |
|  |   |                                 | Credit standing adjustment         | 0.12% - 1.32%               |
| <b>Total</b>                                     | <b>\$715</b>                              |                                 |                                    |                             |

<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> Valuation based on the Company's share of estimated fair values of the underlying assets held in the trusts.

<sup>(4)</sup> Represents FHLB common stock that is valued at the contractual amount that will be received upon redemption.

<sup>(5)</sup> This liability consists of embedded derivatives from variable annuity GLBs, fixed indexed annuity products 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.

## NONRECURRING FAIR VALUE MEASUREMENTS

Certain assets are measured at estimated fair value on a nonrecurring basis and are not included in the tables presented above. The following table presents assets fair valued on a nonrecurring basis during the fiscal year and still held as of December 31, 2017 and 2016 (*In Millions*):

|                                   | December 31,           |                        |         |         |
|-----------------------------------|------------------------|------------------------|---------|---------|
|                                   | 2017                   |                        | 2016    |         |
|                                   | Level 2 <sup>(1)</sup> | Level 3 <sup>(2)</sup> | Level 2 | Level 3 |
| Aircraft and other related assets | \$193                  | \$16                   | \$246   | \$88    |

<sup>(1)</sup> Included in aircraft and other related assets is \$70 million measured during the year ended December 31, 2017.

<sup>(2)</sup> Included in aircraft and other related assets is \$8 million measured during the year ended December 31, 2017.

## AIRCRAFT AND OTHER RELATED ASSETS

The Company measures the fair value of aircraft and other related assets on a nonrecurring basis as part of the recoverability assessment. The recoverability assessment is performed quarterly and whenever events or changes in circumstances indicate that the carrying amount of aircraft may not be recoverable. When aircraft are held for sale, the fair value measurement is based on the estimated sales price, less selling costs (Level 2 input). For aircraft that are held for use, the fair value measurements are based on the present value of the future cash flows (i.e., an income approach) that uses Level 3 inputs, which include contractual lease payments, projected future lease payments, projected sales prices, and the disposition value.

The Company did not have any other significant nonfinancial assets or liabilities measured at fair value on a nonrecurring basis resulting from impairments as of December 31, 2017 and 2016. The Company has not made any significant 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 Millions)</i> |                      |                   |                      |
| Assets:   |                      |                      |                   |                      |
| Mortgage loans                                  | \$13,558             | \$14,005             | \$12,175          | \$12,413             |
| Policy loans                                    | 7,681                | 7,681                | 7,437             | 7,437                |
| Other investments                               | 217                  | 236                  | 192               | 231                  |
| Cash and cash equivalents                       | 2,639                | 2,639                | 1,360             | 1,360                |
| Restricted cash                                 | 211                  | 211                  | 188               | 188                  |
| Liabilities:                                    |                      |                      |                   |                      |
| Funding agreements                              | 166                  | 167                  | 243               | 239                  |
| Annuity and deposit liabilities                 | 18,957               | 18,957               | 17,072            | 17,072               |
| Short-term debt and revolving credit facilities | 354                  | 354                  | 1,041             | 1,041                |
| Long-term debt                                  | 9,973                | 10,357               | 8,183             | 8,592                |

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.

#### RESTRICTED CASH

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

#### FUNDING AGREEMENTS

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

#### ANNUITY AND DEPOSIT LIABILITIES

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

#### DEBT AND REVOLVING CREDIT FACILITIES

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

### 13. OTHER COMPREHENSIVE INCOME (LOSS)

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

|  | Unrealized<br>Gain (Loss) on<br>Securities Available<br>for Sale, Net <sup>(1)</sup> | Gain (Loss) on<br>Derivatives | Other,<br>Net | Total<br>AOCI |
|--|--|-------------------------------|---------------|---------------|
|  | <i>(In Millions)</i>   |                               |               |               |
| Balance, January 1, 2015                             | \$1,292  | \$82                          | (\$12)        | \$1,362       |
| Change in OCI before reclassifications               | (1,097) <sup>(2)</sup>   | 7                             | (8)           | (1,098)       |
| Income tax (expense) benefit                         | 384  | (4)                           | 3             | 383           |
| Amounts reclassified from AOCI                       | 63   |                               |               | 63            |
| Income tax expense (benefit)                         | (22)   |                               |               | (22)          |
| Balance, December 31, 2015                           | 620  | 85                            | (17)          | 688           |
| Change in OCI before reclassifications               | 336 <sup>(2)</sup>   | 6                             | (7)           | 335           |
| Income tax (expense) benefit                         | (120)  | (2)                           | 3             | (119)         |
| Amounts reclassified from AOCI                       | 9  | (1)                           |               | 8             |
| Income tax expense                                   | (3)  |                               |               | (3)           |
| Balance, December 31, 2016                           | 842  | 88                            | (21)          | 909           |
| Change in OCI before reclassifications               | 734 <sup>(2)</sup>   | (18)                          | 8             | 724           |
| Income tax (expense) benefit                         | (255)  | 6                             |               | (249)         |
| Amounts reclassified from AOCI                       | (86)   |                               |               | (86)          |
| Income tax expense                                   | 30   |                               |               | 30            |
| Reclassification of deferred tax effects<br>(Note 1) | 272  | 17                            | (4)           | 285           |
| Balance, December 31, 2017                           | \$1,537  | \$93                          | (\$17)        | \$1,613       |

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

<sup>(2)</sup> Includes allocation of holding gain (loss) from DAC, URR and future policy benefits of (\$465) million, (\$164) million and \$614 million 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 consolidated statements of operations. Amounts are shown gross of tax.

| Reclassification adjustments:                                      | Years Ended December 31, |                       |                       |
|--|--------------------------|-----------------------|-----------------------|
|  | 2017                     | 2016                  | 2015                  |
|  | <i>(In Millions)</i>     |                       |                       |
| Unrealized (gain) loss on securities available for sale, net:      |                          |                       |                       |
| Sale of securities available for sale                              | (\$95) <sup>(1)</sup>    | (\$25) <sup>(1)</sup> | (\$18) <sup>(1)</sup> |
| OTTI recognized on securities available for sale                   | 9 <sup>(2)</sup>         | 34 <sup>(2)</sup>     | 81 <sup>(2)</sup>     |
| Total unrealized (gain) loss on securities available for sale, net | (86)                     | 9                     | 63                    |
| (Gain) loss on derivatives:  |                          |                       |                       |
| Foreign currency and interest rate swaps                           |                          | (2) <sup>(1)</sup>    |                       |
|  | (3) <sup>(3)</sup>       | (2) <sup>(3)</sup>    | (2) <sup>(3)</sup>    |
|  | 2 <sup>(4)</sup>         | 2 <sup>(4)</sup>      | 2 <sup>(4)</sup>      |
|  | 1 <sup>(5)</sup>         | 1 <sup>(5)</sup>      |                       |
| Total gain on derivatives  | —                        | (1)                   | —                     |
| Total amounts reclassified from AOCI                               | (\$86)                   | \$8                   | \$63                  |

Location on the consolidated statements of operations:

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

<sup>(5)</sup> Operating and other expenses

## 14. REINSURANCE

The accounting for reinsurance requires extensive use of assumptions and estimates, particularly related to the future performance of the underlying business and the potential impact of counterparty credit risk. The Company periodically reviews, and modifies as appropriate, the estimates and assumptions used to establish assets and liabilities relating to assumed and ceded reinsurance. Reinsurance receivables, included in other assets, were \$1,190 million and \$1,195 million as of December 31, 2017 and 2016, respectively. Reinsurance payables, included in other liabilities, were \$253 million and \$227 million as of December 31, 2017 and 2016, respectively.

The components of insurance premiums are as follows:

|                                    | Years Ended December 31, |         |         |
|------------------------------------|--------------------------|---------|---------|
|                                    | 2017                     | 2016    | 2015    |
|                                    | <i>(In Millions)</i>     |         |         |
| Direct premiums                    | \$1,502                  | \$1,213 | \$1,018 |
| Reinsurance assumed <sup>(1)</sup> | 1,048                    | 1,034   | 1,307   |
| Reinsurance ceded                  | (409)                    | (392)   | (392)   |
| Insurance premiums                 | \$2,141                  | \$1,855 | \$1,933 |

<sup>(1)</sup> Included are \$56 million, \$58 million and \$319 million of assumed premiums from PLRL for the years ended December 31, 2017, 2016 and 2015, respectively.



## 15. INCOME TAXES

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

|                                      | Years Ended December 31, |              |              |
|--------------------------------------|--------------------------|--------------|--------------|
|                                      | 2017                     | 2016         | 2015         |
|                                      | <i>(In Millions)</i>     |              |              |
| Current                              | \$259                    | \$84         | \$36         |
| Deferred                             | (643)                    | 123          | 113          |
| Provision (benefit) for income taxes | <u>(\$384)</u>           | <u>\$207</u> | <u>\$149</u> |

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

|   | Years Ended December 31, |              |              |
|---|--------------------------|--------------|--------------|
|   | 2017                     | 2016         | 2015         |
|   | <i>(In Millions)</i>     |              |              |
| Provision for income taxes at the statutory rate                      | \$342                    | \$346        | \$263        |
| Separate account dividends received deduction                         | (81)                     | (107)        | (84)         |
| Tax credits   | (24)                     | (22)         | (20)         |
| Remeasurement of operating deferred taxes                             | (395)                    |              |              |
| Remeasurement of OCI deferred taxes                                   | (285)                    |              |              |
| Transition tax on deemed repatriation                                 | 23                       |              |              |
| Tax on financial reporting basis over tax basis of foreign subsidiary | 48                       |              |              |
| Other   | (12)                     | (10)         | (10)         |
| Provision (benefit) for income taxes                                  | <u>(\$384)</u>           | <u>\$207</u> | <u>\$149</u> |

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

|  | December 31,         |                  |
|--|----------------------|------------------|
|  | 2017                 | 2016             |
|  | <u>(In Millions)</u> |                  |
| Deferred tax assets:   |                      |                  |
| Policyholder reserves  | \$564                | \$954            |
| Tax credit carryforwards   | 408                  | 386              |
| Investment valuation   | 343                  | 495              |
| Deferred compensation  | 51                   | 79               |
| Tax net operating loss carryforwards                             | 3                    | 60               |
| Other  | 116                  | 101              |
| Total deferred tax assets  | <u>1,485</u>         | <u>2,075</u>     |
| Deferred tax liabilities:  |                      |                  |
| DAC  | (716)                | (1,133)          |
| Partnership investments  | (646)                | (92)             |
| Hedging  | (365)                | (494)            |
| Depreciation   | (2)                  | (944)            |
| Other  | (27)                 | (38)             |
| Total deferred tax liabilities                                   | <u>(1,756)</u>       | <u>(2,701)</u>   |
| Net deferred tax liability                                       | (271)                | (626)            |
| Unrealized gain on derivatives and securities available for sale | (410)                | (480)            |
| Other adjustments  | (8)                  | (4)              |
| Net deferred tax liability                                       | <u>(\$689)</u>       | <u>(\$1,110)</u> |

The Company has \$192 million of LIHTC that expire between 2020 and 2035 and \$216 million of alternative minimum tax (AMT) credits that are expected to be either fully utilized or refunded between 2018 and 2021.

The Company has \$11 million of life company Federal loss carryovers that expire between 2026 and 2031.

Management has assessed that it is more likely than not that the Company's deferred tax assets as of December 31, 2017 will be realized through projected future taxable income and the reversal of existing deferred tax liabilities listed above.

The following is a tabular reconciliation of the total amounts of unrecognized tax benefits *(In Millions)*:

|                                 |             |
|---------------------------------|-------------|
| Balance as of January 1, 2015   | \$—         |
| Increase - prior year positions | <u>58</u>   |
| Balance as of December 31, 2015 | 58          |
| Increase - prior year positions | 52          |
| Decrease - prior year positions | <u>(58)</u> |
| Balance as of December 31, 2016 | 52          |
| Decrease - prior year positions | <u>(52)</u> |
| Balance as of December 31, 2017 | <u>\$—</u>  |

The Company identified liabilities for uncertain tax positions in 2015 and 2016 for which there is uncertainty about the timing, but not the deductibility, of tax deductions relating to aircraft depreciation and aircraft maintenance reserves. The unrecognized tax benefits have been recorded as a reduction to the deferred tax asset for net operating loss carryforwards.

The Company filed an application for an automatic change in the method of accounting for aircraft depreciation with the Internal Revenue Service (IRS) in 2016 and adjusted its net operating loss carryover to 2017 for aircraft maintenance reserves, which reduced the liability for uncertain tax positions by \$58 million during 2016 and \$52 million during 2017. The Company does not expect material changes to its unrecognized tax benefits for the twelve month period following the reporting date.

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.

During the years ended December 31, 2017, 2016 and 2015, the Company paid an insignificant amount of interest and penalties to state tax authorities.

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; implemented a territorial tax system, and imposed a transition tax on deemed repatriated earnings of foreign subsidiaries; broadened the base of taxable income, particularly with respect to the calculation of tax reserves, DAC, and the Dividends Received Deduction (DRD); and repealed the corporate AMT.

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 \$680 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 Act provides for a one-time "deemed repatriation" of accumulated foreign earnings in the year ended December 31, 2017. The Company expects to pay U.S. Federal cash tax of \$23 million on the deemed repatriation over an 8-year period, and has recorded this estimated amount as part of its provision (benefit) for income tax for the year ended December 31, 2017.

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 \$285 million of deferred tax benefit from AOCI to retained earnings (see the consolidated statements of equity and Notes 1 and 13).
- The Act also repealed the corporate AMT for tax years beginning January 1, 2018, and provides that existing AMT credit carryovers are refundable beginning in 2018. The Company has \$216 million of AMT credit carryovers that are expected to be fully refunded between 2018 and 2021.

Prior to the enactment of the Act, the Company considered the earnings in its non-U.S. subsidiaries to be indefinitely reinvested; accordingly, it recorded no deferred income taxes with respect to the excess of the amount for financial reporting over the tax basis in its non-U.S. subsidiaries, including undistributed foreign earnings. The transition tax included in the Act reduced this excess, but

did not eliminate it. As the remaining excess of the amount for financial reporting over the tax basis reverses, it may result in additional non-U.S. withholding taxes, as well as U.S. Federal and state taxes. More specifically:

- As of December 31, 2017, the Company changed its prior assertion of indefinite reinvestment of earnings in Singapore, and recorded a deferred tax liability of \$48 million as a provisional amount, with respect to remaining financial reporting basis over the tax basis in its Singapore subsidiary. This amount may change after further analysis of the international provisions of the Act, completion of calculations of the earnings and profits of the Singapore subsidiary, and the implementation of tax planning responsive to the Act.

## 16. SEGMENT INFORMATION

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

The Life Insurance segment provides a broad range of life insurance products through multiple distribution channels operating in the affluent, broad and corporate markets. Principal products include universal life, indexed universal life, variable universal life, hybrid Long Term Care, and term life. Distribution channels include independent producers, financial advisory networks, independent brokerage general agencies, wirehouses, e-tailers and M Financial, an association of independently owned and operated insurance and financial producers.

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

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

The Reinsurance segment primarily includes the domestic retrocession business, which assumes mortality risks from other life reinsurers. Additionally, retrocession agreements related to non-traditional longevity reinsurance are assumed from PLRL. The international retrocession business serves clients primarily in Canada, Europe and Asia.

The Corporate and Other segment consists of assets, liabilities and activities, which support the Company's operating segments. Included in these support activities is the management of investments, the Company's financing activities (including the issuance of long-term and short-term debt), and other expenses and other assets not directly attributable to the operating segments. The Corporate and Other segment also includes operations that do not qualify as operating segments and the elimination of intersegment transactions.

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

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

The Company generates the majority of its revenues and net income from customers located in the U.S. As of December 31, 2017 and 2016, the Company had foreign investments with an estimated fair value of \$12.7 billion and \$11.4 billion, respectively. Aircraft leased to foreign customers were \$6.6 billion and \$6.9 billion as of December 31, 2017 and 2016, respectively. Revenues derived from any customer did not exceed 10% of consolidated 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:

|  | Life<br>Insurance    | Retirement<br>Solutions | Aircraft<br>Leasing | Reinsurance    | Corporate<br>and Other | Total            |
|--|----------------------|-------------------------|---------------------|----------------|------------------------|------------------|
| <b>REVENUES</b>  |                      |                         |                     |                |                        |                  |
|  | <i>(In Millions)</i> |                         |                     |                |                        |                  |
| Policy fees and insurance premiums                           | \$1,110              | \$2,246                 |                     | \$991          |                        | \$4,347          |
| Net investment income  | 1,201                | 1,385                   | \$5                 | 33             | \$216                  | 2,840            |
| Net realized investment gain (loss)                          | 14                   | (89)                    | (5)                 | 8              | 120                    | 48               |
| OTTI   | (3)                  | (6)                     |                     |                | (2)                    | (11)             |
| Investment advisory fees                                     | 27                   | 262                     |                     |                | 11                     | 300              |
| Aircraft leasing revenue                                     |                      |                         | 898                 |                |                        | 898              |
| Other income   | 39                   | 191                     | 52                  | 30             | 2                      | 314              |
| <b>Total revenues</b>  | <b>2,388</b>         | <b>3,989</b>            | <b>950</b>          | <b>1,062</b>   | <b>347</b>             | <b>8,736</b>     |
| <b>BENEFITS AND EXPENSES</b>                                 |                      |                         |                     |                |                        |                  |
| Policy benefits  | 668                  | 1,881                   |                     | 914            |                        | 3,463            |
| Interest credited  | 915                  | 460                     |                     |                | 8                      | 1,383            |
| Commission expenses  | 188                  | 557                     |                     | 24             |                        | 769              |
| Operating expenses   | 418                  | 467                     | 261                 | 33             | 122                    | 1,301            |
| Depreciation of aircraft                                     |                      |                         | 322                 |                |                        | 322              |
| Interest expense   | 12                   |                         | 221                 |                | 289                    | 522              |
| <b>Total benefits and expenses</b>                           | <b>2,201</b>         | <b>3,365</b>            | <b>804</b>          | <b>971</b>     | <b>419</b>             | <b>7,760</b>     |
| Income (loss) before provision (benefit) for<br>income taxes | 187                  | 624                     | 146                 | 91             | (72)                   | 976              |
| Provision (benefit) for income taxes                         | (59)                 | (68)                    | (225)               | 7              | (39)                   | (384)            |
| <b>Net income (loss)</b>                                     | <b>246</b>           | <b>692</b>              | <b>371</b>          | <b>84</b>      | <b>(33)</b>            | <b>1,360</b>     |
| Less: net income attributable to<br>noncontrolling interests |                      |                         | (1)                 |                | (5)                    | (6)              |
| <b>Net income (loss) attributable to the Company</b>         | <b>\$246</b>         | <b>\$692</b>            | <b>\$370</b>        | <b>\$84</b>    | <b>(\$38)</b>          | <b>\$1,354</b>   |
| <b>Total assets</b>  | <b>\$44,410</b>      | <b>\$90,616</b>         | <b>\$9,798</b>      | <b>\$1,761</b> | <b>\$8,313</b>         | <b>\$154,898</b> |
| DAC  | 1,630                | 3,016                   |                     | 47             |                        | 4,693            |
| Separate account assets                                      | 8,242                | 53,214                  |                     |                |                        | 61,456           |
| Policyholder and contract liabilities                        | 32,490               | 31,949                  |                     | 1,055          | 166                    | 65,660           |
| Separate account liabilities                                 | 8,242                | 53,214                  |                     |                |                        | 61,456           |

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

|  | Life<br>Insurance    | Retirement<br>Solutions | Aircraft<br>Leasing | Reinsurance  | Corporate<br>and Other | Total        |
|--|----------------------|-------------------------|---------------------|--------------|------------------------|--------------|
| <b>REVENUES</b>  |                      |                         |                     |              |                        |              |
|  | <i>(In Millions)</i> |                         |                     |              |                        |              |
| Policy fees and insurance premiums                           | \$1,196              | \$1,937                 |                     | \$975        |                        | \$4,108      |
| Net investment income  | 1,146                | 1,267                   | \$3                 | 36           | \$135                  | 2,587        |
| Net realized investment gain (loss)                          |                      | (58)                    | (4)                 | 22           | 150                    | 110          |
| OTTI   | (18)                 | (8)                     |                     |              | (16)                   | (42)         |
| Investment advisory fees                                     | 25                   | 262                     |                     |              | 7                      | 294          |
| Aircraft leasing revenue                                     |                      |                         | 1,018               |              |                        | 1,018        |
| Other income   | 32                   | 209                     | 48                  | 90           |                        | 379          |
| <b>Total revenues</b>  | <b>2,381</b>         | <b>3,609</b>            | <b>1,065</b>        | <b>1,123</b> | <b>276</b>             | <b>8,454</b> |
| <b>BENEFITS AND EXPENSES</b>                                 |                      |                         |                     |              |                        |              |
| Policy benefits  | 729                  | 1,596                   |                     | 857          |                        | 3,182        |
| Interest credited  | 878                  | 417                     |                     |              | 11                     | 1,306        |
| Commission expenses  | 294                  | 634                     |                     | 25           |                        | 953          |
| Operating expenses   | 388                  | 461                     | 274                 | 35           | 104                    | 1,262        |
| Depreciation of aircraft                                     |                      |                         | 331                 |              |                        | 331          |
| Interest expense   | 10                   |                         | 233                 | 1            | 186                    | 430          |
| <b>Total benefits and expenses</b>                           | <b>2,299</b>         | <b>3,108</b>            | <b>838</b>          | <b>918</b>   | <b>301</b>             | <b>7,464</b> |
| Income (loss) before provision (benefit)<br>for income taxes | 82                   | 501                     | 227                 | 205          | (25)                   | 990          |
| Provision (benefit) for income taxes                         | 9                    | 59                      | 89                  | 72           | (22)                   | 207          |
| <b>Net income (loss)</b>                                     | <b>73</b>            | <b>442</b>              | <b>138</b>          | <b>133</b>   | <b>(3)</b>             | <b>783</b>   |
| Less: net income attributable to<br>noncontrolling interests |                      |                         |                     |              | (26)                   | (26)         |
| <b>Net income (loss) attributable to the Company</b>         | <b>\$73</b>          | <b>\$442</b>            | <b>\$138</b>        | <b>\$133</b> | <b>(\$29)</b>          | <b>\$757</b> |
| Total assets   | \$40,733             | \$83,933                | \$9,070             | \$1,838      | \$5,470                | \$141,044    |
| DAC  | 1,393                | 3,063                   |                     | 53           |                        | 4,509        |
| Separate account assets                                      | 7,313                | 50,113                  |                     |              |                        | 57,426       |
| Policyholder and contract liabilities                        | 30,288               | 28,550                  |                     | 988          | 243                    | 60,069       |
| Separate account liabilities                                 | 7,313                | 50,113                  |                     |              |                        | 57,426       |

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

|  | Life<br>Insurance | Retirement<br>Solutions | Aircraft<br>Leasing | Reinsurance  | Corporate<br>and Other | Total        |
|--|-------------------|-------------------------|---------------------|--------------|------------------------|--------------|
| <i>(In Millions)</i>                                       |                   |                         |                     |              |                        |              |
| <b>REVENUES</b>  |                   |                         |                     |              |                        |              |
| Policy fees and insurance premiums                         | \$1,206           | \$1,734                 |                     | \$1,239      |                        | \$4,179      |
| Net investment income                                      | 1,133             | 1,201                   | \$1                 | 25           | \$197                  | 2,557        |
| Net realized investment gain                               | 17                | 186                     | 1                   |              | 30                     | 234          |
| OTTI   | (58)              | (27)                    |                     |              | (11)                   | (96)         |
| Investment advisory fees                                   | 27                | 296                     |                     |              | 30                     | 353          |
| Aircraft leasing revenue                                   |                   |                         | 833                 |              |                        | 833          |
| Other income   | 21                | 207                     | 23                  | 17           | (8)                    | 260          |
| <b>Total revenues</b>                                      | <b>2,346</b>      | <b>3,597</b>            | <b>858</b>          | <b>1,281</b> | <b>238</b>             | <b>8,320</b> |
| <b>BENEFITS AND EXPENSES</b>                               |                   |                         |                     |              |                        |              |
| Policy benefits  | 667               | 1,404                   |                     | 1,178        |                        | 3,249        |
| Interest credited  | 852               | 383                     |                     |              | 15                     | 1,250        |
| Commission expenses  | 345               | 831                     |                     | 24           |                        | 1,200        |
| Operating expenses   | 356               | 463                     | 141                 | 28           | 126                    | 1,114        |
| Depreciation of aircraft                                   |                   |                         | 342                 |              |                        | 342          |
| Interest expense   | 7                 |                         | 231                 |              | 176                    | 414          |
| <b>Total benefits and expenses</b>                         | <b>2,227</b>      | <b>3,081</b>            | <b>714</b>          | <b>1,230</b> | <b>317</b>             | <b>7,569</b> |
| Income (loss) before provision (benefit)                   |                   |                         |                     |              |                        |              |
| for income taxes   | 119               | 516                     | 144                 | 51           | (79)                   | 751          |
| Provision (benefit) for income taxes                       | 30                | 89                      | 37                  | 18           | (25)                   | 149          |
| <b>Net income (loss)</b>                                   | <b>89</b>         | <b>427</b>              | <b>107</b>          | <b>33</b>    | <b>(54)</b>            | <b>602</b>   |
| Less: net loss attributable to<br>noncontrolling interests |                   |                         |                     |              | 2                      | 2            |
| <b>Net income (loss) attributable to the Company</b>       | <b>\$89</b>       | <b>\$427</b>            | <b>\$107</b>        | <b>\$33</b>  | <b>(\$52)</b>          | <b>\$604</b> |

## 17. TRANSACTIONS WITH RELATED PARTIES

PLFA serves as the investment adviser for the Pacific Select Fund and the Pacific Funds Series Trust. Investment advisory and other fees are based primarily upon the NAV of the underlying portfolios. These fees, included in investment advisory fees and other income, amounted to \$342 million, \$339 million and \$378 million for the years ended December 31, 2017, 2016 and 2015, respectively. In addition, Pacific Life and PLFA provide certain support services to the Pacific Select Fund and the Pacific Funds Series Trust based on an allocation of actual costs. These fees amounted to \$16 million, \$17 million and \$14 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Additionally, the Pacific Select Fund and Pacific Funds Series Trust have service and other plans whereby the funds pay Pacific Select Distributors, LLC (PSD), a wholly owned broker-dealer subsidiary of Pacific Life, as distributor of the funds, a service fee in connection with services rendered to or procured for shareholders of the fund or their variable annuity and life insurance contract owners. These services may include, but are not limited to, payment of compensation to broker-dealers, including PSD itself, and other financial institutions and organizations, which assist in providing any of the services. For the years ended December 31, 2017, 2016 and 2015, PSD received \$116 million, \$115 million and \$130 million, respectively, in service and other fees from the Pacific Select Fund and Pacific Funds Series Trust, which are recorded in other income.

Pacific Life and PL&A'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 Pacific Life and PL&A. Consequently, substantially all of the Pacific Life and PL&A'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 \$3.6 billion and \$3.2 billion 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 \$2.8 billion and \$2.3 billion as of December 31, 2017 and 2016, respectively. Related to these contracts, Pacific Life and PL&A received \$475 million, \$361 million and \$298 million of insurance premiums and paid \$210 million, \$190 million and \$164 million of policy benefits for the years ended December 31, 2017, 2016 and 2015, respectively.

ACG has derivative swap contracts with Pacific LifeCorp as the counterparty. The notional amounts total \$562 million and \$716 million as of December 31, 2017 and 2016, respectively. The estimated fair values of the derivatives were net liabilities of \$5 million and \$16 million as of December 31, 2017 and 2016, respectively.

## 18. COMMITMENTS AND CONTINGENCIES

### COMMITMENTS

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

| <u>Years Ending December 31:</u> | <u>Mortgage Loans</u> | <u>Limited Partnerships</u> | <u>Fixed Maturity Securities and Other Investments</u> | <u>Total</u>   |
|----------------------------------|-----------------------|-----------------------------|--|----------------|
| 2018                             | \$505                 | \$300                       | \$565  | \$1,370        |
| 2019                             | 412                   | 169                         | 6  | 587            |
| 2020                             | 278                   | 132                         |  | 410            |
| 2021                             | 101                   | 123                         |  | 224            |
| 2022                             | 65                    | 105                         |  | 170            |
| Thereafter                       |                       | 133                         | 2  | 135            |
| Total                            | <u>\$1,361</u>        | <u>\$962</u>                | <u>\$573</u>   | <u>\$2,896</u> |

The Company leases office facilities under various operating leases, which in most, but not all cases, are noncancelable. Rent expense, which is included in operating and other expenses, in connection with these leases was \$9 million, \$8 million and \$8 million for the years ended December 31, 2017, 2016 and 2015, respectively. Aggregate minimum future office lease commitments are as follows *(In Millions)*:

|                                  |             |
|----------------------------------|-------------|
| <u>Years Ending December 31:</u> |             |
| 2018                             | \$10        |
| 2019 through 2022                | 28          |
| 2023 and thereafter              | 25          |
| Total                            | <u>\$63</u> |



As of December 31, 2017, ACG had commitments to purchase aircraft scheduled for delivery through 2022. All of these commitments arise from fixed price purchase agreements with Boeing, Airbus and other third parties, and include adjustments for inflation. As of December 31, 2017, the aggregate estimated total remaining payments (including adjustments for certain contractual escalation provisions) are due as follows (*In Millions*):

| <u>Years Ending December 31:</u> |                |
|----------------------------------|----------------|
| 2018                             | \$1,563        |
| 2019                             | 1,857          |
| 2020                             | 1,763          |
| 2021                             | 1,945          |
| 2022                             | 887            |
| Total                            | <u>\$8,015</u> |

As of December 31, 2017, deposits related to these agreements totaled \$1,073 million and are included in other assets.

Pacific Life entered into agreements with PLRL and Pacific Life Re (Australia) Pty Limited (PLRA), a wholly owned indirect subsidiary of Pacific LifeCorp, to guarantee the performance of reinsurance obligations of PLRL and PLRA. These guarantees are secondary to the guarantees provided by Pacific LifeCorp and would only be triggered in the event of nonperformance by both PLRL or PLRA and Pacific LifeCorp. Management believes that additional obligations, if any, related to the guarantee agreements are not likely to have a material adverse effect on the Company's consolidated financial statements.

Pacific Life has an agreement with PLRC to guarantee the performance of reinsurance obligations of PLRC. Management believes that additional obligations, if any, related to the guarantee agreement are not likely to have a material adverse effect on the Company's consolidated financial statements.

Pacific Life has a commitment to provide funds, on Pacific LifeCorp's behalf, of up to 100 million pound sterling to PLRL. This commitment is secondary to Pacific LifeCorp and is contingent on the nonperformance by Pacific LifeCorp. Management believes that additional obligations, if any, related to this commitment are not likely to have a material adverse effect on the Company's consolidated financial statements.

#### CONTINGENCIES - LITIGATION

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

#### 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 15), 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 consolidated financial statements.

#### CONTINGENCIES - OTHER

In the course of its business, the Company provides certain indemnifications related to dispositions, acquisitions, investments, lease agreements or other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to time limitations that vary in duration, including contractual limitations and those that arise by operation of law, such as applicable statutes of limitation. Because the amounts of

these types of indemnifications often are not explicitly stated, the overall maximum amount of the obligation under such indemnifications cannot be reasonably estimated. The Company has not historically made material payments for these types of indemnifications. The estimated maximum potential amount of future payments under these obligations is not determinable due to the lack of a stated maximum liability for certain matters. Management believes that judgments, if any, against the Company related to such 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 consolidated financial statements.

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

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

See Note 2 for discussion of contingencies related to reinsurance of statutory reserves to affiliates.

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

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

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