First American Financial Corp
Form 10-Q
July 27, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2017

OR

1 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission file number 001-34580

FIRST AMERICAN FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Incorporated in Delaware	26-1911571
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1 First American Way, Santa Ana, California	92707-5913
(Address of principal executive offices)	(Zip Code)

(714) 250-3000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No 1

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No 1

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 1

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 1 No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes 1 No 1

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

On July 21, 2017, there were 110,721,195 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

Items 2 through 5 of Part II have been omitted because they are not applicable with respect to the current reporting period.

2

THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS CAN BE IDENTIFIED BY THE FACT THAT THEY DO NOT RELATE STRICTLY TO HISTORICAL OR CURRENT FACTS AND MAY CONTAIN THE WORDS “BELIEVE,” “ANTICIPATE,” “EXPECT,” “INTEND,” “PLAN,” “PREDICT,” “ESTIMATE,” “PROJECT,” “WILL BE,” “WILL CONTINUE,” “WILL LIKELY RESU OTHER SIMILAR WORDS AND PHRASES OR FUTURE OR CONDITIONAL VERBS SUCH AS “WILL,” “MAY,” “MIGHT,” “SHOULD,” “WOULD,” OR “COULD.” THESE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION, STATEMENTS REGARDING FUTURE OPERATIONS, PERFORMANCE, FINANCIAL CONDITION, PROSPECTS, PLANS AND STRATEGIES. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON CURRENT EXPECTATIONS AND ASSUMPTIONS THAT MAY PROVE TO BE INCORRECT.

RISKS AND UNCERTAINTIES EXIST THAT MAY CAUSE RESULTS TO DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE THE ANTICIPATED RESULTS TO DIFFER FROM THOSE DESCRIBED IN THE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION:

- INTEREST RATE FLUCTUATIONS;
- CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;
- VOLATILITY IN THE CAPITAL MARKETS;
- UNFAVORABLE ECONOMIC CONDITIONS;
- IMPAIRMENTS IN THE COMPANY’S GOODWILL OR OTHER INTANGIBLE ASSETS;
- FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;
- CHANGES IN APPLICABLE LAWS AND GOVERNMENT REGULATIONS;
- HEIGHTENED SCRUTINY BY LEGISLATORS AND REGULATORS OF THE COMPANY’S TITLE INSURANCE AND SERVICES SEGMENT AND CERTAIN OTHER OF THE COMPANY’S BUSINESSES;
- USE OF SOCIAL MEDIA BY THE COMPANY AND OTHER PARTIES;
- REGULATION OF TITLE INSURANCE RATES;
- LIMITATIONS ON ACCESS TO PUBLIC RECORDS AND OTHER DATA;
- CHANGES IN RELATIONSHIPS WITH LARGE MORTGAGE LENDERS AND GOVERNMENT-SPONSORED ENTERPRISES;
- CHANGES IN MEASURES OF THE STRENGTH OF THE COMPANY’S TITLE INSURANCE UNDERWRITERS, INCLUDING RATINGS AND STATUTORY CAPITAL AND SURPLUS;
- LOSSES IN THE COMPANY’S INVESTMENT PORTFOLIO;
- MATERIAL VARIANCE BETWEEN ACTUAL AND EXPECTED CLAIMS EXPERIENCE;
- DEFALCATIONS, INCREASED CLAIMS OR OTHER COSTS AND EXPENSES ATTRIBUTABLE TO THE COMPANY’S USE OF TITLE AGENTS;
- ANY INADEQUACY IN THE COMPANY’S RISK MANAGEMENT FRAMEWORK;
- SYSTEMS DAMAGE, FAILURES, INTERRUPTIONS AND INTRUSIONS, OR UNAUTHORIZED DATA DISCLOSURES;
- ERRORS AND FRAUD INVOLVING THE TRANSFER OF FUNDS;
- THE COMPANY’S USE OF A GLOBAL WORKFORCE;
- INABILITY OF THE COMPANY’S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS;
- INABILITY TO REALIZE THE BENEFITS OF, AND CHALLENGES ARISING FROM, THE COMPANY’S ACQUISITION STRATEGY; AND

- OTHER FACTORS DESCRIBED IN THIS QUARTERLY REPORT ON FORM 10-Q, INCLUDING UNDER THE CAPTION “RISK FACTORS” IN ITEM 1A OF PART II.

THE FORWARD-LOOKING STATEMENTS SPEAK ONLY AS OF THE DATE THEY ARE MADE. THE COMPANY DOES NOT UNDERTAKE TO UPDATE FORWARD-LOOKING STATEMENTS TO REFLECT CIRCUMSTANCES OR EVENTS THAT OCCUR AFTER THE DATE THE FORWARD-LOOKING STATEMENTS ARE MADE.

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.
FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

	June 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	$1,166,764	$1,006,138
Accounts and accrued income receivable, net	323,385	299,799
Income taxes receivable	7,902	67,970
Investments:		
Deposits with banks	21,762	21,222
Debt securities, includes pledged securities of $112,971 and $110,647	4,849,595	4,553,363
Equity securities	426,788	404,085
Other investments	160,455	162,029
	5,458,600	5,140,699
Property and equipment, net	433,038	434,050
Title plants and other indexes	572,780	564,309
Deferred income taxes	20,037	20,037
Goodwill	1,031,943	1,017,417
Other intangible assets, net	77,808	78,898
Other assets	222,029	202,460
	$9,314,286	$8,831,777
Liabilities and Equity		
Deposits	$3,097,796	$2,779,478
Accounts payable and accrued liabilities	696,992	793,955
Deferred revenue	233,607	228,905
Reserve for known and incurred but not reported claims	1,017,232	1,025,863
Income taxes payable	93,888	10,376
Deferred income taxes	242,158	242,158
Notes and contracts payable	734,455	736,693
	6,116,128	5,817,428
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—
Common stock, $0.00001 par value; Authorized—300,000 shares; Outstanding—110,721 shares and 109,944 shares	1	1

Additional paid-in capital	2,215,849	2,191,756
Retained earnings	1,150,582	1,046,822
Accumulated other comprehensive loss	(173,009)	(230,400)
Total stockholders’ equity	3,193,423	3,008,179
Noncontrolling interests	4,735	6,170
Total equity	3,198,158	3,014,349
	$9,314,286	$8,831,777

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues				
Direct premiums and escrow fees	$641,080	$623,975	$1,168,089	$1,125,889
Agent premiums	554,028	515,792	1,128,610	1,028,037
Information and other	201,851	182,771	384,360	337,848
Net investment income	39,609	30,925	72,649	58,295
Net realized investment gains	17,861	8,070	17,764	13,176
	1,454,429	1,361,533	2,771,472	2,563,245
Expenses				
Personnel costs	444,418	417,725	859,548	800,437
Premiums retained by agents	435,771	403,669	889,697	808,708
Other operating expenses	222,814	216,361	430,223	403,036
Provision for policy losses and other claims	110,958	122,360	213,346	229,458
Depreciation and amortization	30,145	23,994	60,292	46,414
Premium taxes	17,179	16,027	32,627	30,404
Interest	8,990	7,790	17,705	15,589
	1,270,275	1,207,926	2,503,438	2,334,046
Income before income taxes	184,154	153,607	268,034	229,199
Income taxes	62,259	51,156	88,070	74,076
Net income	121,895	102,451	179,964	155,123
Less: Net (loss) income attributable to noncontrolling interests	(362)	302	(575)	473
Net income attributable to the Company	$122,257	$102,149	$180,539	$154,650
Net income per share attributable to the Company's stockholders (Note 8):				
Basic	$1.10	$0.92	$1.62	$1.40
Diluted	$1.09	$0.92	$1.61	$1.40
Cash dividends declared per share	$0.34	$0.26	$0.68	$0.52
Weighted-average common shares outstanding (Note 8):				
Basic	111,549	110,480	111,374	110,327
Diluted	112,199	110,978	112,026	110,842

See notes to condensed consolidated financial statements.

6

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$121,895	$102,451	$179,964	$155,123
Other comprehensive income (loss), net of tax:				
Unrealized gains on securities	12,634	17,681	38,085	49,508
Foreign currency translation adjustment	8,709	(5,579)	12,143	6,525
Pension benefit adjustment	3,637	3,621	7,170	7,217
Total other comprehensive income (loss), net of tax	24,980	15,723	57,398	63,250
Comprehensive income	146,875	118,174	237,362	218,373
Less: Comprehensive (loss) income attributable to noncontrolling interests	(362)	272	(568)	489
Comprehensive income attributable to the Company	$147,237	$117,902	$237,930	$217,884

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statement of Stockholders' Equity

(in thousands)

(unaudited)

	First American Financial Corporation Stockholders							
	Shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total stockholders' equity	Noncontrolling interests	Total
Balance at December 31, 2016	109,944	$ 1	$ 2,191,756	$ 1,046,822	$ (230,400)	$ 3,008,179	$ 6,170	$ 3,014,349
Net income for six months ended June 30, 2017	—	—	—	180,539	—	180,539	(575)	179,964
Dividends on common shares	—	—	—	(75,099)	—	(75,099)	—	(75,099)
Shares issued in connection with share-based compensation plans	777	—	(487)	(1,680)	—	(2,167)	—	(2,167)
Share-based compensation	—	—	24,580	—	—	24,580	—	24,580
Net activity related to noncontrolling interests	—	—	—	—	—	—	(867)	(867)
Other comprehensive income (Note 12)	—	—	—	—	57,391	57,391	7	57,398
Balance at June 30, 2017	110,721	$ 1	$ 2,215,849	$ 1,150,582	$ (173,009)	$ 3,193,423	$ 4,735	$ 3,198,158

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net income	$179,964	$155,123
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	213,346	229,458
Depreciation and amortization	60,292	46,414
Amortization of premiums and accretion of discounts on debt securities, net	16,666	13,082
Excess tax benefits from share-based compensation	—	(3,137)
Net realized investment gains	(17,764)	(13,176)
Share-based compensation	24,580	21,968
Equity in earnings of affiliates, net	(3,447)	(3,018)
Dividends from equity method investments	5,562	3,749
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(225,849)	(225,568)
Net change in income tax accounts	104,656	7,486
Increase in accounts and accrued income receivable	(18,411)	(24,946)
Decrease in accounts payable and accrued liabilities	(92,662)	(60,826)
Decrease in deferred revenue	2,468	3,895
Other, net	(14,797)	(4,118)
Cash provided by operating activities	234,604	146,386
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(3,933)	(18,432)
Net decrease in deposits with banks	110	968
Purchases of debt and equity securities	(1,029,861)	(899,629)
Proceeds from sales of debt and equity securities	499,526	259,915
Proceeds from maturities of debt securities	276,843	436,125
Net change in other investments	2,105	2,346
Capital expenditures	(69,553)	(60,939)
Proceeds from sales of property and equipment	9,013	8,787
Cash used for investing activities	(315,750)	(270,859)
Cash flows from financing activities:		
Net change in deposits	318,318	401,350
Repayment of debt	(2,660)	(2,329)
Net activity related to noncontrolling interests	(879)	(768)
Excess tax benefits from share-based compensation	—	3,137
Net payments in connection with share-based compensation plans	(2,167)	(3,052)

Purchase of Company shares	—	(454)
Cash dividends	(75,099)	(56,897)
Cash provided by financing activities	237,513	340,987
Effect of exchange rate changes on cash	4,259	(2,021)
Net increase in cash and cash equivalents	160,626	214,493
Cash and cash equivalents—Beginning of period	1,006,138	1,027,321
Cash and cash equivalents—End of period	$1,166,764	$1,241,814
Supplemental information:		
Cash paid (received) during the period for:		
Interest	$16,811	$14,537
Premium taxes	$41,652	$40,340
Income taxes	$35,208	$67,261
Income tax refunds	$(51,904)	$(699)

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 – Basis of Condensed Consolidated Financial Statements

Basis of Presentation

The condensed consolidated financial information included in this report has been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X. The principles for condensed interim financial information do not require the inclusion of all the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016. The condensed consolidated financial statements included herein are unaudited; however, in the opinion of management, they contain all normal recurring adjustments necessary for a fair statement of the consolidated results for the interim periods. All material intercompany transactions and balances have been eliminated upon consolidation.

Recently Adopted Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board ("FASB") issued updated guidance to amend the consolidation guidance on how a reporting entity that is the single decision maker of a variable interest entity should treat indirect interests in the entity held through related parties that are under common control with the reporting entity when determining whether it is the primary beneficiary of that variable interest entity. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

In March 2016, the FASB issued updated guidance intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification on the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016. While the adoption of this guidance did have an impact on the Company's effective income tax rate for 2017, it did not have a material impact on the Company's condensed consolidated financial statements. See Note 7 Income Taxes for further discussion of the Company's effective income tax rates. Beginning in 2017, excess tax benefits from share-based compensation are presented in the condensed consolidated statements of cash flows in cash flows from operating activities within net change in income tax accounts.

In March 2016, the FASB issued updated guidance intended to simplify the accounting treatment for investments that become qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

Pending Accounting Pronouncements

In May 2017, the FASB issued updated guidance intended to reduce diversity in practice by clarifying which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In March 2017, the FASB issued updated guidance to amend the amortization period for certain purchased callable debt securities held at a premium to shorten the amortization period for the premium to the earliest call date. The updated guidance is intended to more closely align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities, and is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In March 2017, the FASB issued updated guidance intended to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost through the disaggregation of the service cost component from the other components of net benefit cost. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In January 2017, the FASB issued updated guidance intended to simplify how an entity tests goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Under the updated guidance, an entity will perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, with the loss recognized limited to the total amount of goodwill allocated to that reporting unit. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In January 2017, the FASB issued updated guidance to clarify the definition of a business with the objective of providing guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In November 2016, the FASB issued updated guidance intended to reduce the diversity in practice on presenting restricted cash or restricted cash equivalents in the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In October 2016, the FASB issued updated guidance intended to simplify and improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The updated guidance, which eliminates the intra-entity transfers exception, requires entities to recognize the income tax consequences of intra-entity transfers of assets, other than inventory, when the transfers occur. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In August 2016, the FASB issued updated guidance intended to eliminate the diversity in practice regarding the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated statements of cash flows.

In June 2016, the FASB issued updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

In February 2016, the FASB issued updated guidance that requires the rights and obligations associated with leasing arrangements be reflected on the balance sheet in order to increase transparency and comparability among organizations. Under the updated guidance, lessees will be required to recognize a right-of-use asset and a liability to make lease payments and disclose key information about leasing arrangements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. While the Company is currently evaluating the impact the new guidance will have on its condensed consolidated financial statements, the Company expects the adoption of the new guidance will result in a material increase in the assets and liabilities on its condensed consolidated balance sheets and will likely have an insignificant impact on its condensed consolidated statements of income and statements of cash flows.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In January 2016, the FASB issued updated guidance intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. In addition to making other targeted improvements to current guidance, the updated guidance also requires all equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in the fair value recognized through net income. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted in certain circumstances. While the Company expects the adoption of this guidance to impact its condensed consolidated statements of income, the materiality of the impact will depend upon the size of, and level of volatility experienced within, the Company’s equity portfolio.

In May 2014, the FASB issued updated guidance for recognizing revenue from contracts with customers to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within and across industries, and across capital markets. The new revenue standard contains principles that an entity will apply to determine the measurement of revenue and the timing of recognition. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. Revenue from insurance contracts is not within the scope of this guidance. In August 2015, the FASB issued updated guidance which defers the effective date of this guidance by one year. In 2016, the FASB issued additional updates to the new guidance primarily to clarify, among other things, the implementation guidance related to principal versus agent considerations, identifying performance obligations, accounting for licenses of intellectual property, and to provide narrow-scope improvements and additional practical expedients. In February 2017, the FASB issued an additional update to the new guidance to clarify the scope of derecognition guidance for nonfinancial assets and to provide guidance for partial sales of nonfinancial assets. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption prohibited. The Company expects to adopt the new guidance under the modified retrospective approach and, based on a preliminary assessment, does not expect the new guidance to have a material impact on its condensed consolidated financial statements.

Note 2 – Escrow Deposits, Like-kind Exchange Deposits and Trust Assets

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $7.5 billion and $6.8 billion at June 30, 2017 and December 31, 2016, respectively, of which $3.0 billion and $2.6 billion, respectively, were held at the Company’s federal savings bank subsidiary, First American Trust, FSB. The escrow deposits held at First American Trust, FSB are temporarily invested in cash and cash equivalents and debt securities, with offsetting liabilities included in deposits in the accompanying condensed consolidated balance sheets. The remaining escrow deposits were held at third-party financial institutions.

Trust assets held or managed by First American Trust, FSB totaled $3.4 billion and $3.2 billion at June 30, 2017 and December 31, 2016, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. However, the Company could be held contingently liable for the disposition of these assets.

In conducting its operations, the Company often holds customers' assets in escrow, pending completion of real estate transactions and, as a result, the Company has ongoing programs for realizing economic benefits with various financial institutions. The results from these programs are included in the condensed consolidated financial statements as income or a reduction in expense, as appropriate, based on the nature of the arrangement and benefit received.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

The Company facilitates tax-deferred property exchanges for customers pursuant to Section 1031 of the Internal Revenue Code and tax-deferred reverse exchanges pursuant to Revenue Procedure 2000-37. As a facilitator and intermediary, the Company holds the proceeds from sales transactions and takes temporary title to property identified by the customer to be acquired with such proceeds. Upon the completion of each such exchange, the identified property is transferred to the customer or, if the exchange does not take place, an amount equal to the sales proceeds or, in the case of a reverse exchange, title to the property held by the Company is transferred to the customer. Like-kind exchange funds held by the Company totaled $2.5 billion and $2.0 billion at June 30, 2017 and December 31, 2016, respectively. The like-kind exchange deposits are held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. All such amounts are placed in deposit accounts insured, up to applicable limits, by the Federal Deposit Insurance Corporation. The Company could be held contingently liable to the customer for the transfers of property, disbursements of proceeds and the returns on such proceeds.

Note 3 – Debt and Equity Securities

Investments in debt securities, classified as available-for-sale, are as follows:

	Amortized	Gross unrealized		Estimated
(in thousands)	cost	Gains	Losses	fair value
June 30, 2017				
U.S. Treasury bonds	$167,770	$1,589	$(1,484)	$167,875
Municipal bonds	1,084,377	12,939	(13,485)	1,083,831
Foreign government bonds	145,453	554	(1,191)	144,816
Governmental agency bonds	218,798	1,136	(2,816)	217,118
Governmental agency mortgage-backed securities	2,283,883	4,306	(19,377)	2,268,812
U.S. corporate debt securities	711,796	12,374	(2,731)	721,439
Foreign corporate debt securities	241,125	4,908	(329)	245,704
	$4,853,202	$37,806	$(41,413)	$4,849,595
December 31, 2016				
U.S. Treasury bonds	$155,441	$416	$(4,466)	$151,391
Municipal bonds	1,004,659	6,340	(26,666)	984,333
Foreign government bonds	141,887	600	(2,439)	140,048
Governmental agency bonds	197,343	691	(4,166)	193,868
Governmental agency mortgage-backed securities	2,187,482	2,983	(26,792)	2,163,673
U.S. corporate debt securities	675,683	8,282	(5,441)	678,524
Foreign corporate debt securities	240,526	2,490	(1,490)	241,526
	$4,603,021	$21,802	$(71,460)	$4,553,363

Investments in equity securities, classified as available-for-sale, are as follows:

(in thousands)	Cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
June 30, 2017				
Preferred stocks	$18,747	$126	$(1,334)	$17,539
Common stocks	376,960	34,224	(1,935)	409,249
	$395,707	$34,350	$(3,269)	$426,788
December 31, 2016				
Preferred stocks	$18,926	$—	$(3,344)	$15,582
Common stocks	367,169	26,034	(4,700)	388,503
	$386,095	$26,034	$(8,044)	$404,085

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Sales of debt and equity securities resulted in realized gains of $16.7 million and $12.2 million, and realized losses of $1.9 million and $4.6 million for the three months ended June 30, 2017 and 2016, respectively, and realized gains of $20.1 million and $13.2 million, and realized losses of $5.2 million and $7.0 million for the six months ended June 30, 2017 and 2016, respectively.

Gross unrealized losses on investments in debt and equity securities are as follows:

	Less than 12 months		12 months or longer		Total	
(in thousands)	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
June 30, 2017						
Debt securities:						
U.S. Treasury bonds	$103,246	$(1,455)	$186	$(29)	$103,432	$(1,484)
Municipal bonds	417,676	(12,676)	21,707	(809)	439,383	(13,485)
Foreign government bonds	94,332	(1,149)	350	(42)	94,682	(1,191)
Governmental agency bonds	154,574	(2,337)	5,353	(479)	159,927	(2,816)
Governmental agency mortgage-backed securities	977,367	(11,731)	649,022	(7,646)	1,626,389	(19,377)
U.S. corporate debt securities	160,663	(2,179)	15,406	(552)	176,069	(2,731)
Foreign corporate debt securities	42,068	(271)	1,440	(58)	43,508	(329)
Total debt securities	1,949,926	(31,798)	693,464	(9,615)	2,643,390	(41,413)
Equity securities	70,904	(1,451)	23,259	(1,818)	94,163	(3,269)
Total	$2,020,830	$(33,249)	$716,723	$(11,433)	$2,737,553	$(44,682)
December 31, 2016						
Debt securities:						
U.S. Treasury bonds	$111,748	$(4,466)	$—	$—	$111,748	$(4,466)
Municipal bonds	635,531	(26,317)	16,485	(349)	652,016	(26,666)
Foreign government bonds	63,044	(2,371)	324	(68)	63,368	(2,439)
Governmental agency bonds	148,112	(4,166)	—	—	148,112	(4,166)
Governmental agency mortgage-backed securities	1,295,790	(19,097)	432,349	(7,695)	1,728,139	(26,792)
U.S. corporate debt securities	193,533	(4,560)	24,499	(881)	218,032	(5,441)
Foreign corporate debt securities	78,658	(1,150)	8,154	(340)	86,812	(1,490)
Total debt securities	2,526,416	(62,127)	481,811	(9,333)	3,008,227	(71,460)
Equity securities	70,261	(1,173)	59,019	(6,871)	129,280	(8,044)
Total	$2,596,677	$(63,300)	$540,830	$(16,204)	$3,137,507	$(79,504)

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Investments in debt securities at June 30, 2017, by contractual maturities, are as follows:

(in thousands)	Due in one year or less	Due after one through five years	Due after five through ten years	Due after ten years	Total
U.S. Treasury bonds					
Amortized cost	$ 52,472	$41,859	$29,565	$43,874	$167,770
Estimated fair value	$ 52,418	$41,715	$29,570	$44,172	$167,875
Municipal bonds					
Amortized cost	$ 58,674	$323,768	$251,017	$450,918	$1,084,377
Estimated fair value	$ 58,781	$326,946	$254,934	$443,170	$1,083,831
Foreign government bonds					
Amortized cost	$ 7,505	$112,018	$9,665	$16,265	$145,453
Estimated fair value	$ 7,536	$111,903	$9,727	$15,650	$144,816
Governmental agency bonds					
Amortized cost	$ 14,774	$107,546	$56,645	$39,833	$218,798
Estimated fair value	$ 14,756	$106,804	$56,114	$39,444	$217,118
U.S. corporate debt securities					
Amortized cost	$ 33,138	$295,993	$313,191	$69,474	$711,796
Estimated fair value	$ 33,271	$299,004	$317,260	$71,904	$721,439
Foreign corporate debt securities					
Amortized cost	$ 15,365	$114,751	$97,438	$13,571	$241,125
Estimated fair value	$ 15,389	$115,942	$99,750	$14,623	$245,704
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 181,928	$995,935	$757,521	$633,935	$2,569,319
Estimated fair value	$ 182,151	$1,002,314	$767,355	$628,963	$2,580,783
Total mortgage-backed securities					
Amortized cost					$2,283,883
Estimated fair value					$2,268,812
Total debt securities					
Amortized cost					$4,853,202
Estimated fair value					$4,849,595

Mortgage-backed securities, which include contractual terms to maturity, are not categorized by contractual maturity because borrowers may have the right to call or prepay obligations with, or without, call or prepayment penalties.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

The composition of the investment portfolio at June 30, 2017, by credit rating, is as follows:

(in thousands, except percentages)	A- or higher Estimated fair value	Percentage	BBB+ to BBB- Estimated fair value	Percentage	Non-Investment Grade Estimated fair value	Percentage	Total Estimated fair value	Percentage
June 30, 2017								
Debt securities:								
U.S. Treasury bonds	$167,875	100.0	$—	—	$—	—	$167,875	100.0
Municipal bonds	1,018,239	94.0	52,490	4.8	13,102	1.2	1,083,831	100.0
Foreign government bonds	117,374	81.1	21,793	15.0	5,649	3.9	144,816	100.0
Governmental agency bonds	217,118	100.0	—	—	—	—	217,118	100.0
Governmental agency mortgage-backed securities	2,268,812	100.0	—	—	—	—	2,268,812	100.0
U.S. corporate debt securities	251,870	35.0	246,312	34.1	223,257	30.9	721,439	100.0
Foreign corporate debt securities	119,872	48.7	93,015	37.9	32,817	13.4	245,704	100.0
Total debt securities	4,161,160	85.8	413,610	8.5	274,825	5.7	4,849,595	100.0
Preferred stocks	—	—	11,544	65.8	5,995	34.2	17,539	100.0
Total	$4,161,160	85.5	$425,154	8.7	$280,820	5.8	$4,867,134	100.0

As of June 30, 2017, the estimated fair value of total debt securities included $146.0 million of bank loans, of which $133.9 million was non-investment grade; $118.5 million of high yield corporate debt securities, all of which was non-investment grade; and $72.4 million of emerging market debt securities, of which $9.3 million was non-investment grade.

The composition of the investment portfolio in an unrealized loss position at June 30, 2017, by credit rating, is as follows:

(in thousands, except	A- or higher Estimated	Percentage	BBB+ to BBB- Estimated	Percentage	Non-Investment Grade Estimated	Percentage	Total Estimated	Percentage

percentages)	fair value		fair value		fair value		fair value	
June 30, 2017								
Debt securities:								
U.S. Treasury bonds	$103,432	100.0	$—	—	$—	—	$103,432	100.0
Municipal bonds	410,099	93.4	24,728	5.6	4,556	1.0	439,383	100.0
Foreign government bonds	70,980	74.9	18,323	19.4	5,379	5.7	94,682	100.0
Governmental agency bonds	159,927	100.0	—	—	—	—	159,927	100.0
Governmental agency mortgage-backed securities	1,626,389	100.0	—	—	—	—	1,626,389	100.0
U.S. corporate debt securities	61,000	34.6	71,104	40.4	43,965	25.0	176,069	100.0
Foreign corporate debt securities	22,605	52.0	16,097	37.0	4,806	11.0	43,508	100.0
Total debt securities	2,454,432	92.9	130,252	4.9	58,706	2.2	2,643,390	100.0
Preferred stocks	—	—	8,070	60.9	5,189	39.1	13,259	100.0
Total	$2,454,432	92.4	$138,322	5.2	$63,895	2.4	$2,656,649	100.0

As of June 30, 2017, the estimated fair value of total debt securities in an unrealized loss position included $31.6 million of bank loans, of which $30.5 million was non-investment grade; $15.9 million of high yield corporate debt securities, all of which was non-investment grade; and $28.4 million of emerging market debt securities, of which $7.8 million was non-investment grade.

The credit ratings in the above tables reflect published ratings obtained from Standard & Poor’s Rating Services, DBRS, Inc., Fitch Ratings, Inc. and Moody’s Investor Services, Inc. If a security was rated differently among the rating agencies, the lowest rating was selected. Governmental agency mortgage-backed securities are not rated by any of the ratings agencies; however, these securities have been included in the above table in the “A- or higher” category because the payments of principal and interest are guaranteed by the governmental agency that issued the security.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Note 4 – Goodwill

A summary of the changes in the carrying amount of goodwill, by operating segment, for the six months ended June 30, 2017, is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance as of December 31, 2016	$ 970,652	$ 46,765	$ 1,017,417
Acquisitions	12,633	—	12,633
Foreign currency translation	2,191	—	2,191
Other adjustments	(298)	—	(298)
Balance as of June 30, 2017	$ 985,178	$ 46,765	$ 1,031,943

The Company's four reporting units for purposes of assessing goodwill for impairment are title insurance, home warranty, property and casualty insurance and trust and other services. During the six months ended June 30, 2017 there were no triggering events that would require an impairment analysis.

Note 5 – Other Intangible Assets

Other intangible assets consist of the following:

(in thousands)	June 30, 2017	December 31, 2016
Finite-lived intangible assets:		
Customer relationships	$ 77,070	$ 78,542
Noncompete agreements	9,994	10,007
Trademarks	7,189	6,472
Internal-use software licenses	26,692	16,038
Patents	2,840	2,840
	123,785	113,899
Accumulated amortization	(62,861)	(51,885)
	60,924	62,014
Indefinite-lived intangible assets:		

Licenses	16,884	16,884
	$77,808	$ 78,898

Amortization expense for finite-lived intangible assets was $6.5 million and $12.7 million for the three and six months ended June 30, 2017, respectively, and $3.2 million and $5.6 million for the three and six months ended June 30, 2016, respectively.

Estimated amortization expense for finite-lived intangible assets for the next five years is as follows:

Year	(in thousands)
Remainder of 2017	$ 14,288
2018	$ 13,239
2019	$ 8,617
2020	$ 4,864
2021	$ 2,976
2022	$ 2,380

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Note 6 – Reserve for Known and Incurred But Not Reported Claims

Activity in the reserve for known and incurred but not reported claims is summarized as follows:

(in thousands)	Six months ended June 30, 2017	2016
Balance at beginning of period	$1,025,863	$983,880
Provision related to:		
Current year	209,082	216,425
Prior years	4,264	13,033
	213,346	229,458
Payments, net of recoveries, related to:		
Current year	91,915	84,495
Prior years	133,934	141,073
	225,849	225,568
Other	3,872	6,994
Balance at end of period	$1,017,232	$994,764

The provision for title insurance losses, expressed as a percentage of title insurance premiums and escrow fees, was 4.0% for the three and six months ended June 30, 2017 compared to 5.5% for the three and six months ended June 30, 2016. The current quarter rate of 4.0% reflects the ultimate loss rate for the current policy year and no change in the loss reserve estimates for prior policy years. The second quarter of 2016 rate of 5.5% reflected the ultimate loss rate of 5.0% for the 2016 policy year and a $5.2 million net increase in the loss reserve estimates for prior policy years.

A summary of the Company’s loss reserves is as follows:

(in thousands, except percentages)	June 30, 2017		December 31, 2016	
Known title claims	$75,678	7.4 %	$83,805	8.1 %
Incurred but not reported claims	883,508	86.9 %	888,126	86.6 %
Total title claims	959,186	94.3 %	971,931	94.7 %
Non-title claims	58,046	5.7 %	53,932	5.3 %
Total loss reserves	$1,017,232	100.0 %	$1,025,863	100.0 %

Note 7 – Income Taxes

The Company's effective income tax rates (income tax expense as a percentage of income before income taxes) were 33.8% and 32.9% for the three and six months ended June 30, 2017, respectively, and 33.3% and 32.3% for the three and six months ended June 30, 2016, respectively. The Company's effective tax rates differ from the statutory federal rate of 35% primarily due to changes in state and foreign income taxes resulting from fluctuations in the Company's noninsurance and foreign subsidiaries' contributions to pretax income and changes in the ratio of permanent differences to income before income taxes. The Company's effective tax rate for 2017 also reflects the adoption of new accounting guidance related to the accounting for share-based payment transactions, which requires, among other items, that all excess tax benefits and tax deficiencies associated with share-based payment transactions be recorded in income tax expense rather than in additional paid-in capital, as previously required. The impact to the Company of adopting this guidance was a reduction in income tax expense of $0.3 million and $2.7 million for the three and six months ended June 30, 2017, respectively. See Note 1 Basis of Condensed Consolidated Financial Statements for further discussion of the new guidance. The Company's effective tax rate for 2016 reflects the resolution of certain tax authority examinations and tax credits claimed in 2016 and in prior years.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In connection with the Company's June 2010 spin-off from its prior parent, which subsequently assumed the name CoreLogic, Inc. ("CoreLogic"), it entered into a tax sharing agreement which governs the Company's and CoreLogic's respective rights, responsibilities and obligations for certain tax related matters. At June 30, 2017 and December 31, 2016, the Company had a net payable to CoreLogic of $12.9 million and $16.3 million, respectively, related to tax matters prior to the spin-off. This amount is included in the Company's condensed consolidated balance sheets in accounts payable and accrued liabilities. The decrease during the current year was primarily due to payments made for tax matters prior to the spin-off.

The Company evaluates the realizability of its deferred tax assets by assessing the valuation allowance and makes adjustments to the allowance as necessary. The factors used to assess the likelihood of realization include the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the deferred tax assets. The Company's ability or failure to achieve forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets. Based on actual future operating results in certain jurisdictions, it is possible that the current valuation allowance positions of those jurisdictions could be adjusted in the next 12 months.

As of June 30, 2017 and December 31, 2016, the liability for income taxes associated with uncertain tax positions was $18.5 million and $18.1 million, respectively. The net increase in the liability during 2017 was primarily attributable to reserves for tax positions taken by the Company. As of June 30, 2017 and December 31, 2016, the liability could be reduced by $5.7 million due to offsetting tax benefits associated with the correlative effects of potential adjustments, including timing adjustments and state income taxes. The net amounts of $12.8 million and $12.4 million as of June 30, 2017 and December 31, 2016, respectively, if recognized, would favorably affect the Company's effective tax rate.

The Company's continuing practice is to recognize interest and penalties, if any, related to uncertain tax positions in income tax expense. As of June 30, 2017 and December 31, 2016, the Company had accrued $4.3 million and $4.1 million, respectively, of interest and penalties (net of tax benefits of $2.0 million and $1.8 million, respectively) related to uncertain tax positions.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of the Company's unrecognized tax positions may significantly increase or decrease within the next 12 months. Any such change may be the result of ongoing audits or the expiration of federal and state statutes of limitations for the assessment of taxes.

The Company, or one of its subsidiaries, files income tax returns in the U.S. federal jurisdiction, various state jurisdictions, and various non-U.S. jurisdictions. The primary non-federal jurisdictions are California, Canada, India and the United Kingdom. During 2016, the Company concluded U.S. federal income tax examinations for calendar years 2005 through 2013. The Company is generally no longer subject to U.S. federal, state and non-U.S. income tax examinations for years prior to 2005.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Note 8 – Earnings Per Share

The computation of basic and diluted earnings per share is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share amounts)	2017	2016	2017	2016
Numerator				
Net income attributable to the Company	$122,257	$102,149	$180,539	$154,650
Denominator				
Basic weighted-average shares	111,549	110,480	111,374	110,327
Effect of dilutive employee stock options and restricted stock units (“RSUs”)	650	498	652	515
Diluted weighted-average shares	112,199	110,978	112,026	110,842
Net income per share attributable to the Company’s stockholders				
Basic	$1.10	$0.92	$1.62	$1.40
Diluted	$1.09	$0.92	$1.61	$1.40

For the three and six months ended June 30, 2017 and 2016, 2 thousand RSUs and 1 thousand RSUs, respectively, were excluded from weighted-average diluted common shares outstanding due to their antidilutive effect.

Note 9 – Employee Benefit Plans

Net periodic cost related to the Company’s defined benefit pension and supplemental benefit plans includes the following components:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2017	2016	2017	2016
Expense:				
Service costs	$183	$260	$367	$521
Interest costs	4,458	6,037	9,099	12,001
Expected return on plan assets	(2,370)	(3,073)	(4,740)	(6,167)
Amortization of net actuarial	6,902	7,073	13,834	14,110

loss				
Amortization of prior service credit	(1,012)	(1,211)	(2,223)	(2,422)
	$ 8,161	$ 9,086	$ 16,337	$ 18,043

Pension termination and settlement

In May 2016, the Company's board of directors terminated the Company's funded defined benefit pension plan known as the First American Financial Corporation Pension Plan, effective as of July 31, 2016. The pension plan was closed to new entrants effective December 31, 2001 and amended to "freeze" all benefit accruals as of April 30, 2008. Also, in May 2016, a subsidiary of the Company terminated its small regional funded defined benefit pension plan effective as of August 31, 2016. All financial impacts discussed below reflect the termination of both pension plans.

The pension plans offer participants annuity payments based on a number of factors and, for certain participants, an alternative lump sum distribution option. During 2016, the Company offered lump sum distributions to certain participants, which were settled by the pension plans in the fourth quarter. The Company made additional cash contributions in 2016 of $84.8 million above scheduled amounts and recognized $66.3 million in settlement costs during the fourth quarter of 2016 related to distributions of pension plan assets totaling $127.2 million to participants electing lump sum payments.

The Company made cash contributions of $34.0 million in March 2017 to fully fund its pension obligation. In July 2017, the Company completed the transfer of all remaining benefit obligations related to the pension plans to a highly rated insurance company. As a result, the Company will recognize approximately $153 million of pension expense in the condensed consolidated statements of income in the third quarter of 2017.

Note 10 – Fair Value Measurements

Certain of the Company's assets are carried at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Company categorizes its assets and liabilities carried at fair value using a three-level hierarchy for fair value measurements that distinguishes between market participant assumptions developed based on market data obtained from sources independent of the Company (observable inputs) and the Company's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The hierarchy for inputs used in determining fair value maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. The hierarchy level assigned to the assets and liabilities is based on management's assessment of the transparency and reliability of the inputs used to estimate the fair values at the measurement date. The three hierarchy levels are defined as follows:

Level 1—Valuations based on unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2—Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets or liabilities at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement, and involve management judgment.

If the inputs used to measure fair value fall into different levels of the fair value hierarchy, the hierarchy level assigned is based upon the lowest level of input that is significant to the fair value measurement.

Assets measured at fair value on a recurring basis

The valuation techniques and inputs used by the Company to estimate the fair value of assets measured on a recurring basis are summarized as follows:

Debt securities

The fair values of debt securities were based on the market values obtained from independent pricing services that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and price quotes from well-established independent broker-dealers. The independent pricing services monitor market indicators, industry and economic events, and for broker-quoted only securities, obtain quotes from market makers or broker-dealers that they recognize to be market participants. The pricing services utilize the market approach in determining the fair value of the debt securities held by the Company. The Company obtains an understanding of the valuation models and assumptions utilized by the services and has controls in place to determine that the values provided represent fair value. The Company’s validation procedures include comparing prices received from the pricing services to quotes received from other third party sources for certain securities with market prices that are readily verifiable. If the price comparison results in differences over a predefined threshold, the Company will assess the reasonableness of the changes relative to prior periods given the prevailing market conditions and assess changes in the issuers’ credit worthiness, performance of any underlying collateral and prices of the instrument relative to similar issuances. To date, the Company has not made any material adjustments to the fair value measurements provided by the pricing services.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Typical inputs and assumptions to pricing models used to value the Company's U.S. Treasury bonds, municipal bonds, foreign government bonds, governmental agency bonds, governmental agency mortgage-backed securities and U.S. and foreign corporate debt securities include, but are not limited to, benchmark yields, reported trades, broker-dealer quotes, credit spreads, credit ratings, bond insurance (if applicable), benchmark securities, bids, offers, reference data and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include the structure of issuance, characteristics of the issuer, collateral attributes and prepayment speeds. Certain corporate debt securities were not actively traded and there were fewer observable inputs available requiring the use of more judgment in determining their fair values, which resulted in their classification as Level 3.

Equity securities

The fair values of equity securities, including preferred and common stocks, were based on quoted market prices for identical assets that are readily and regularly available in an active market.

The following tables present the fair values of the Company's assets, measured on a recurring basis, as of June 30, 2017 and December 31, 2016:

(in thousands)	Total	Level 1	Level 2	Level 3
June 30, 2017				
Assets:				
Debt securities:				
U.S. Treasury bonds	$167,875	$—	$167,875	$—
Municipal bonds	1,083,831	—	1,083,831	—
Foreign government bonds	144,816	—	144,816	—
Governmental agency bonds	217,118	—	217,118	—
Governmental agency mortgage-backed securities	2,268,812	—	2,268,812	—
U.S. corporate debt securities	721,439	—	703,311	18,128
Foreign corporate debt securities	245,704	—	243,789	1,915
	4,849,595	—	4,829,552	20,043
Equity securities:				
Preferred stocks	17,539	17,539	—	—
Common stocks	409,249	409,249	—	—
	426,788	426,788	—	—
Total assets	$5,276,383	$426,788	$4,829,552	$20,043

(in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2016				
Assets:				
Debt securities:				
U.S. Treasury bonds	$151,391	$—	$151,391	$—
Municipal bonds	984,333	—	984,333	—

Foreign government bonds	140,048	—	140,048	—
Governmental agency bonds	193,868	—	193,868	—
Governmental agency mortgage-backed securities	2,163,673	—	2,163,673	—
U.S. corporate debt securities	678,524	—	631,859	46,665
Foreign corporate debt securities	241,526	—	235,258	6,268
	4,553,363	—	4,500,430	52,933
Equity securities:				
Preferred stocks	15,582	15,582	—	—
Common stocks	388,503	388,503	—	—
	404,085	404,085	—	—
Total assets	$4,957,448	$404,085	$4,500,430	$52,933

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

There were no transfers between Levels 1 and 2 during the three and six months ended June 30, 2017 and 2016. Transfers into or out of the Level 3 category occur when unobservable inputs become more or less significant to the fair value measurement. For the three and six months ended June 30, 2017 and 2016, transfers between Level 2 and Level 3 were based on market liquidity and related transparency of pricing and associated observable inputs for certain of the Company's corporate debt securities. The Company's policy is to recognize transfers between levels in the fair value hierarchy at the end of the reporting period.

The following table presents a summary of the changes in the fair values of Level 3 assets, measured on a recurring basis, for the three months ended June 30, 2017 and 2016:

	June 30, 2017			June 30, 2016		
(in thousands)	U.S. corporate debt securities	Foreign corporate debt securities	Total	U.S. corporate debt securities	Foreign corporate debt securities	Total
Fair value at beginning of period	$13,434	$ 2,862	$16,296	$14,993	$ 1,332	$16,325
Transfers into Level 3	4,658	—	4,658	2,948	—	2,948
Transfers out of Level 3	(1,235)	(525)	(1,760)	(5,840)	(762)	(6,602)
Net realized and unrealized gains (losses):						
Included in earnings	15	3	18	(36)	—	(36)
Included in other comprehensive income (loss)	(92)	(5)	(97)	179	55	234
Purchases	4,521	—	4,521	4,640	100	4,740
Sales	(404)	(156)	(560)	(1,446)	—	(1,446)
Settlements	(2,769)	(264)	(3,033)	(945)	(2)	(947)
Fair value at end of period	$18,128	$ 1,915	$20,043	$14,493	$ 723	$15,216

The following table presents a summary of the changes in the fair values of Level 3 assets, measured on a recurring basis, for the six months ended June 30, 2017 and 2016:

	June 30, 2017			June 30, 2016		
(in thousands)	U.S. corporate debt securities	Foreign corporate debt securities	Total	U.S. corporate debt securities	Foreign corporate debt securities	Total
Fair value at beginning of period	$46,665	$ 6,268	$52,933	$43,567	$ 6,572	$50,139
Transfers into Level 3	300	—	300	857	—	857
Transfers out of Level 3	(26,543)	(2,569)	(29,112)	(33,372)	(3,773)	(37,145)
Net realized and unrealized gains (losses):						
Included in earnings	91	8	99	(111)	(35)	(146)
Included in other comprehensive income (loss)	(380)	(49)	(429)	667	(9)	658
Purchases	9,262	551	9,813	7,993	100	8,093

Sales	(2,383)	(769)	(3,152)	(3,473)	(1,049)	(4,522)
Settlements	(8,884)	(1,525)	(10,409)	(1,635)	(1,083)	(2,718)
Fair value at end of period	$18,128	$ 1,915	$20,043	$14,493	$ 723	$15,216

Financial instruments not measured at fair value

In estimating the fair values of its financial instruments not measured at fair value, the Company used the following methods and assumptions:

Cash and cash equivalents

The carrying amount for cash and cash equivalents is a reasonable estimate of fair value due to the short-term maturity of these investments.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Deposits with banks

The fair value of deposits with banks is estimated based on rates currently offered for deposits of similar remaining maturities, where applicable.

Notes receivable, net

The fair value of notes receivable, net is estimated based on current market rates being offered for notes with similar maturities and credit quality.

Deposits

The carrying value of escrow and other deposit accounts approximates fair value due to the short-term nature of these liabilities.

Notes and contracts payable

The fair value of notes and contracts payable is estimated based on current rates offered to the Company for debt of similar remaining maturities.

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments not measured at fair value as of June 30, 2017 and December 31, 2016:

(in thousands)	Carrying Amount	Estimated fair value Total	Level 1	Level 2	Level 3
June 30, 2017					
Assets:					
Cash and cash equivalents	$1,166,764	$1,166,764	$1,166,764	$—	$—
Deposits with banks	$21,762	$21,715	$255	$21,460	$—
Notes receivable, net	$7,890	$7,745	$—	$—	$7,745
Liabilities:					
Deposits	$3,097,796	$3,097,796	$3,097,796	$—	$—
Notes and contracts payable	$734,455	$754,104	$—	$749,923	$4,181

(in thousands)	Carrying Amount	Estimated fair value Total	Level 1	Level 2	Level 3
December 31, 2016					
Assets:					
Cash and cash equivalents	$1,006,138	$1,006,138	$1,006,138	$—	$—
Deposits with banks	$21,222	$21,176	$1,017	$20,159	$—
Notes receivable, net	$7,799	$7,542	$—	$—	$7,542

Liabilities:					
Deposits	$2,779,478	$2,779,478	$2,779,478	$—	$—
Notes and contracts payable	$736,693	$734,812	$—	$729,658	$5,154

24

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Note 11 – Share-Based Compensation

The following table presents compensation expense associated with the Company's share-based compensation plans:

(in thousands)	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Expense:				
RSUs	$ 6,754	$ 5,384	$ 22,769	$ 20,365
Stock options	67	68	134	135
Employee stock purchase plan	726	658	1,677	1,468
	$ 7,547	$ 6,110	$ 24,580	$ 21,968

The following table summarizes RSU activity for the six months ended June 30, 2017:

(in thousands, except weighted-average grant-date fair value)	Shares	Weighted-average grant-date fair value
RSUs unvested at December 31, 2016	1,510	$ 33.38
Granted during 2017	868	$ 39.29
Vested during 2017	(834)	$ 34.22
Forfeited during 2017	(5)	$ 32.78
RSUs unvested at June 30, 2017	1,539	$ 36.26

Note 12 – Accumulated Other Comprehensive Income (Loss) ("AOCI")

The following table presents a summary of the changes in each component of AOCI for the six months ended June 30, 2017:

(in thousands)	Unrealized	Foreign	Pension	Accumulated

	gains (losses) on securities	currency translation adjustment	benefit adjustment	other comprehensive income (loss)
Balance at December 31, 2016	$ (26,760)	$ (63,576)	$ (140,057)	$ (230,393)
Change in unrealized gains (losses) on securities	59,140	—	—	59,140
Change in foreign currency translation adjustment	—	12,143	—	12,143
Amortization of net actuarial loss	—	—	13,834	13,834
Amortization of prior service credit	—	—	(2,223)	(2,223)
Tax effect	(21,055)	—	(4,441)	(25,496)
Balance at June 30, 2017	$ 11,325	$ (51,433)	$ (132,887)	$ (172,995)
Allocated to the Company	$ 11,311	$ (51,433)	$ (132,887)	$ (173,009)
Allocated to noncontrolling interests	14	—	—	14
Balance at June 30, 2017	$ 11,325	$ (51,433)	$ (132,887)	$ (172,995)

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

The following table presents the other comprehensive income (loss) reclassification adjustments for the three months ended June 30, 2017 and 2016:

(in thousands)	Unrealized gains (losses) on securities	Foreign currency translation adjustment	Pension benefit adjustment	Total other comprehensive income (loss)
Three Months Ended June 30, 2017				
Pretax change before reclassifications	$ 34,237	$ 8,709	$ —	$ 42,946
Reclassifications out of AOCI	(14,729)	—	5,890	(8,839)
Tax effect	(6,874)	—	(2,253)	(9,127)
Total other comprehensive income (loss), net of tax	$ 12,634	$ 8,709	$ 3,637	$ 24,980
Three Months Ended June 30, 2016				
Pretax change before reclassifications	$ 34,987	$ (5,579)	$ —	$ 29,408
Reclassifications out of AOCI	(7,242)	—	5,862	(1,380)
Tax effect	(10,064)	—	(2,241)	(12,305)
Total other comprehensive income (loss), net of tax	$ 17,681	$ (5,579)	$ 3,621	$ 15,723

The following table presents the other comprehensive income (loss) reclassification adjustments for the six months ended June 30, 2017 and 2016:

(in thousands)	Unrealized gains (losses) on securities	Foreign currency translation adjustment	Pension benefit adjustment	Total other comprehensive income (loss)
Six Months Ended June 30, 2017				
Pretax change before reclassifications	$ 72,930	$ 12,143	$ —	$ 85,073
Reclassifications out of AOCI	(13,790)	—	11,611	(2,179)
Tax effect	(21,055)	—	(4,441)	(25,496)
Total other comprehensive income (loss), net of tax	$ 38,085	$ 12,143	$ 7,170	$ 57,398
Six Months Ended June 30, 2016				
Pretax change before reclassifications	$ 84,781	$ 6,525	$ —	$ 91,306
Reclassifications out of AOCI	(5,143)	—	11,688	6,545

Tax effect	(30,130)	—	(4,471)	(34,601)
Total other comprehensive income (loss), net of tax	$ 49,508	$ 6,525	$ 7,217	$ 63,250

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

The following table presents the effect of the reclassifications out of AOCI on the respective line items in the condensed consolidated statements of income:

	Amounts reclassified from AOCI				
	Three Months Ended		Six Months Ended		
	June 30,		June 30,		Affected line items in the condensed
(in thousands)	2017	2016	2017	2016	consolidated statements of income
Unrealized gains (losses) on securities:					
Net realized gains on sales of securities	$14,729	$7,242	$13,790	$5,628	Net realized investment gains
Net other-than-temporary impairment losses	—	—	—	(485)	Net realized investment gains
Pretax total	$14,729	$7,242	$13,790	$5,143	
Tax effect	$(5,244)	$(2,740)	$(5,274)	$(1,967)	
Pension benefit adjustment:					
Amortization of net actuarial loss	$(6,902)	$(7,073)	$(13,834)	$(14,110)	(1)
Amortization of prior service credit	1,012	1,211	2,223	2,422	(1)
Pretax total	$(5,890)	$(5,862)	$(11,611)	$(11,688)	
Tax effect	$2,253	$2,241	$4,441	$4,471	

(1) These components of AOCI are included in the computation of net periodic cost. See Note 9 Employee Benefit Plans for additional details.

Note 13 – Litigation and Regulatory Contingencies

The Company and its subsidiaries are parties to a number of non-ordinary course lawsuits. These lawsuits frequently are similar in nature to other lawsuits pending against the Company's competitors.

For those non-ordinary course lawsuits where the Company has determined that a loss is both probable and reasonably estimable, a liability representing the best estimate of the Company's financial exposure based on known facts has been recorded. Actual losses may materially differ from the amounts recorded.

For a substantial majority of these lawsuits, however, it is not possible to assess the probability of loss. Most of these lawsuits are putative class actions which require a plaintiff to satisfy a number of procedural requirements before proceeding to trial. These requirements include, among others, demonstration to a court that the law proscribes in some manner the Company's activities, the making of factual allegations sufficient to suggest that the Company's activities exceeded the limits of the law and a determination by the court—known as class certification—that the law permits a group of individuals to pursue the case together as a class. In certain instances the Company may also be able to compel the plaintiff to arbitrate its claim on an individual basis. If these procedural requirements are not met, either the lawsuit cannot proceed or, as is the case with class certification or compelled arbitration, the plaintiffs lose the financial incentive to proceed with the case (or the amount at issue effectively becomes de minimis). Frequently, a court's determination as to these procedural requirements is subject to appeal to a higher court. As a result of, among other factors, ambiguities and inconsistencies in the myriad laws applicable to the Company's business and the uniqueness of the factual issues presented in any given lawsuit, the Company often cannot determine the probability of loss until a court has finally determined that a plaintiff has satisfied applicable procedural requirements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

Furthermore, because most of these lawsuits are putative class actions, it is often impossible to estimate the possible loss or a range of loss amounts, even where the Company has determined that a loss is reasonably possible. Generally class actions involve a large number of people and the effort to determine which people satisfy the requirements to become plaintiffs—or class members—is often time consuming and burdensome. Moreover, these lawsuits raise complex factual issues which result in uncertainty as to their outcome and, ultimately, make it difficult for the Company to estimate the amount of damages which a plaintiff might successfully prove. In addition, many of the Company's businesses are regulated by various federal, state, local and foreign governmental agencies and are subject to numerous statutory guidelines. These regulations and statutory guidelines often are complex, inconsistent or ambiguous, which results in additional uncertainty as to the outcome of a given lawsuit—including the amount of damages a plaintiff might be afforded—or makes it difficult to analogize experience in one case or jurisdiction to another case or jurisdiction.

Most of the non-ordinary course lawsuits to which the Company and its subsidiaries are parties challenge practices in the Company's title insurance business, though a limited number of cases also pertain to the Company's other businesses. These lawsuits include, among others, cases alleging, among other assertions, that the Company, one of its subsidiaries and/or one of its agents:

- charged an improper rate for title insurance in a refinance transaction, including
- Lewis v. First American Title Insurance Company, filed on November 28, 2006 and pending in the United States District Court for the District of Idaho.

A court has granted class certification in Lewis. For the reasons stated above, the Company has been unable to assess the probability of loss or estimate the possible loss or the range of loss.

- misclassified certain employees, including
- Cruz v. First American Financial Corporation, et al., filed on November 25, 2015 and pending in the Superior Court of the State of California, County of Orange,
- Sager v. Interthinx, Inc., filed on January 23, 2015 and pending in the Superior Court of the State of California, County of Los Angeles, and
- Weber v. Interthinx, Inc., et al., filed on April 17, 2015 and pending in the United States District Court for the Eastern District of Missouri.

These lawsuits are putative class actions for which a class has not been certified. For the reasons described above, as well as the applicability of certain indemnification rights the Company may have, the Company has not yet been able to assess the probability of loss or estimate the possible loss or the range of loss or, where the Company has been able to make an estimate, the Company believes the amount is not material to the condensed consolidated financial statements as a whole.