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First American Financial Corp
Form 10-Q
July 23, 2015

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, 2015

OR

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)

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

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

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

Large accelerated filer Accelerated filer 1

Non-accelerated filer 1 (Do not check if a smaller reporting company) Smaller reporting company 1

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

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 17, 2015, there were 108,643,523 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

PART I: FINANCIAL INFORMATION

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

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-Q, INCLUDING BUT NOT LIMITED TO THOSE RELATING TO:

• THE EFFECT OF PENDING ACCOUNTING PRONOUNCEMENTS ON THE COMPANY'S FINANCIAL STATEMENTS;
• EXPECTED PENSION PLAN AND SUPPLEMENTAL BENEFIT PLAN CONTRIBUTIONS AND RETURNS;
• THE EFFECT OF LAWSUITS, REGULATORY EXAMINATIONS AND INVESTIGATIONS AND OTHER LEGAL PROCEEDINGS ON THE COMPANY'S FINANCIAL CONDITION, RESULTS OF OPERATIONS OR CASH FLOWS;
• FUTURE PAYMENT OF DIVIDENDS;
• THE SUFFICIENCY OF THE COMPANY'S RESOURCES TO SATISFY OPERATIONAL CASH REQUIREMENTS;
• THE EFFECTS OF THE CONSUMER FINANCIAL PROTECTION BUREAU'S INTEGRATED DISCLOSURE RULES;
• THE LIKELIHOOD OF CHANGES IN EXPECTED ULTIMATE LOSSES AND CORRESPONDING LOSS RATES AND CLAIM RESERVES;
• THE LIKELIHOOD AND EFFECTS OF CYBER ATTACKS AND SIMILAR INCIDENTS;
• FUTURE ACQUISITIONS; AND
• CANADIAN EXCISE TAXES FOR SERVICES PROVIDED TO LENDERS,
ARE 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 MAY CONTAIN THE WORDS "BELIEVE," "ANTICIPATE," "EXPECT," "PLAN," "PREDICT," "ESTIMATE," "PROJECT," "WILL BE," "WILL CONTAIN," "WILL LIKELY RESULT," OR OTHER SIMILAR WORDS AND PHRASES.

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:

• 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 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;
• THE CONSUMER FINANCIAL PROTECTION BUREAU'S EXERCISE OF ITS BROAD RULEMAKING AND SUPERVISORY POWERS;
• COMPLIANCE WITH THE CONSUMER FINANCIAL PROTECTION BUREAU'S INTEGRATED DISCLOSURE RULES;
• REGULATION OF TITLE INSURANCE RATES;
• REFORM OF GOVERNMENT-SPONSORED MORTGAGE ENTERPRISES;
• 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;
EXPENSES OF AND FUNDING OBLIGATIONS TO THE PENSION PLAN;
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 MITIGATION EFFORTS;

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SYSTEMS DAMAGE, FAILURES, INTERRUPTIONS AND INTRUSIONS, WIRE TRANSFER ERRORS OR UNAUTHORIZED DATA DISCLOSURES;
INABILITY TO REALIZE THE BENEFITS OF THE COMPANY'S OFFSHORE STRATEGY;
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 PART II, ITEM 1A OF THIS QUARTERLY REPORT ON FORM 10-Q. 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, 2015	December 31, 2014
Assets		
Cash and cash equivalents	\$ 1,269,660	\$ 1,190,080
Accounts and accrued income receivable, net	275,336	276,610
Income taxes receivable	1,802	5,547
Investments:		
Deposits with banks	17,972	21,445
Debt securities, includes pledged securities of \$124,701 and \$120,742	4,145,414	3,450,252
Equity securities	304,081	402,412
Other investments	160,795	159,783
	4,628,262	4,033,892
Property and equipment, net	394,060	395,287
Title plants and other indexes	547,059	530,589
Deferred income taxes	19,712	19,712
Goodwill	970,510	959,945
Other intangible assets, net	53,538	55,812
Other assets	193,613	198,626
	\$ 8,353,552	\$ 7,666,100
Liabilities and Equity		
Deposits	\$ 2,965,293	\$ 2,332,714
Accounts payable and accrued liabilities	860,856	854,105
Deferred revenue	201,591	202,764
Reserve for known and incurred but not reported claims	956,786	1,011,780
Income taxes payable	33,869	6,228
Deferred income taxes	91,372	95,128
Notes and contracts payable	584,538	587,337
	5,694,305	5,090,056
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, \$0.00001 par value; Authorized—500 shares;		
Outstanding—none	—	—
	1	1

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Common stock, \$0.00001 par value; Authorized—300,000 shares;
 Outstanding—108,642 shares and 107,541 shares

Additional paid-in capital	2,130,552	2,109,712
Retained earnings	737,980	662,310
Accumulated other comprehensive loss	(212,124)	(199,106)
Total stockholders' equity	2,656,409	2,572,917
Noncontrolling interests	2,838	3,127
Total equity	2,659,247	2,576,044
	\$8,353,552	\$ 7,666,100

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,	
	2015	2014	2015	2014
Revenues				
Direct premiums and escrow fees	\$628,425	\$531,123	\$1,146,929	\$964,995
Agent premiums	493,102	423,209	919,429	844,133
Information and other	170,530	165,703	317,178	303,345
Net investment income	27,864	23,659	48,422	41,426
Net realized investment gains	3,868	6,275	2,915	8,869
	1,323,789	1,149,969	2,434,873	2,162,768
Expenses				
Personnel costs	396,616	354,133	754,616	680,651
Premiums retained by agents	394,828	338,271	737,288	674,936
Other operating expenses	223,110	214,121	431,667	402,488
Provision for policy losses and other claims	122,870	128,466	224,424	218,349
Depreciation and amortization	21,463	19,780	42,317	39,752
Premium taxes	16,012	14,254	29,481	26,544
Interest	7,268	4,486	14,510	8,337
	1,182,167	1,073,511	2,234,303	2,051,057
Income before income taxes	141,622	76,458	200,570	111,711
Income taxes	48,043	25,770	69,195	39,171
Net income	93,579	50,688	131,375	72,540
Less: Net income attributable to noncontrolling interests	232	94	396	222
Net income attributable to the Company	\$93,347	\$50,594	\$130,979	\$72,318
Net income per share attributable to the Company's				
stockholders (Note 8):				
Basic	\$0.86	\$0.47	\$1.21	\$0.68
Diluted	\$0.85	\$0.47	\$1.19	\$0.67
Cash dividends declared per share	\$0.25	\$—	\$0.50	\$0.36
Weighted-average common shares outstanding (Note 8):				
Basic	108,459	106,878	108,102	106,522
Diluted	109,796	108,647	109,586	108,423

See notes to condensed consolidated financial statements.

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FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income	\$93,579	\$50,688	\$131,375	\$72,540
Other comprehensive income (loss), net of tax:				
Unrealized (losses) gains on securities	(28,506)	14,039	(8,432)	26,239
Foreign currency translation adjustment	4,866	11,612	(13,794)	5,572
Pension benefit adjustment	4,601	3,892	9,202	7,783
Other comprehensive (loss) income, net of tax	(19,039)	29,543	(13,024)	39,594
Comprehensive income	74,540	80,231	118,351	112,134
Less: Comprehensive income attributable to noncontrolling interests	227	98	390	229
Comprehensive income attributable to the Company	\$74,313	\$80,133	\$117,961	\$111,905

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,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 131,375	\$ 72,540
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	224,424	218,349
Depreciation and amortization	42,317	39,752
Amortization of premiums and accretion of discounts on debt securities, net	14,045	11,967
Excess tax benefits from share-based compensation	(8,417)	(5,827)
Net realized investment gains	(2,915)	(8,869)
Share-based compensation	15,563	12,519
Equity in earnings of affiliates, net	(4,880)	1,748
Dividends from equity method investments	5,940	3,471
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(251,542)	(240,144)
Net change in income tax accounts	37,875	33,493
Increase in accounts and accrued income receivable	(20,961)	(11,439)
Decrease in accounts payable and accrued liabilities	(26,188)	(74,174)
Decrease in deferred revenue	(955)	(5,017)
Other, net	11,262	(3,476)
Cash provided by operating activities	166,943	44,893
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(25,929)	(166,354)
Net decrease (increase) in deposits with banks	2,959	(256)
Purchases of debt and equity securities	(1,207,037)	(592,381)
Proceeds from sales of debt and equity securities	344,170	386,744
Proceeds from maturities of debt securities	263,015	173,644
Net change in other investments	4,509	1,364
Net paydowns on loans receivable	—	14,914
Capital expenditures	(61,837)	(40,063)
Proceeds from sales of property and equipment	16,608	13
Cash used for investing activities	(663,542)	(222,375)
Cash flows from financing activities:		
Net change in deposits	632,579	269,779
Net proceeds from issuance of debt	—	300,735

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Repayment of debt	(2,623)	(156,476)
Net activity related to noncontrolling interests	(679)	(633)
Excess tax benefits from share-based compensation	8,417	5,827
Net payments in connection with share-based compensation plans	(4,328)	(911)
Cash dividends	(54,121)	(38,441)
Cash provided by financing activities	579,245	379,880
Effect of exchange rate changes on cash	(3,066)	4,024
Net increase in cash and cash equivalents	79,580	206,422
Cash and cash equivalents—Beginning of period	1,190,080	834,837
Cash and cash equivalents—End of period	\$1,269,660	\$1,041,259
Supplemental information:		
Cash paid during the period for:		
Interest	\$14,664	\$8,346
Premium taxes	\$34,043	\$36,825
Income taxes, less refunds of \$713 and \$1,016	\$30,973	\$5,827
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, 2014	107,541	\$ 1	\$ 2,109,712	\$ 662,310	\$(199,106)	\$ 2,572,917	\$ 3,127	\$ 2,576,044
Net income for six months ended June 30, 2015	—	—	—	130,979	—	130,979	396	131,375
Dividends on common shares	—	—	—	(54,121)	—	(54,121)	—	(54,121)
Shares issued in connection with share-based compensation plans	1,101	—	5,277	(1,188)	—	4,089	—	4,089
Share-based compensation expense	—	—	15,563	—	—	15,563	—	15,563
Net activity related to noncontrolling interests	—	—	—	—	—	—	(679)	(679)
Other comprehensive income (Note 12)	—	—	—	—	(13,018)	(13,018)	(6)	(13,024)
Balance at June 30, 2015	108,642	\$ 1	\$ 2,130,552	\$ 737,980	\$(212,124)	\$ 2,656,409	\$ 2,838	\$ 2,659,247

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, 2014. 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 April 2014, the Financial Accounting Standards Board (“FASB”) issued updated guidance which changes the criteria for determining which disposals are required to be presented as discontinued operations and modifies related disclosure requirements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2014, with early adoption permitted. The adoption of this guidance had no impact on the Company’s condensed consolidated financial statements.

Pending Accounting Pronouncements

In May 2015, the FASB issued updated disclosure guidance related to short-duration contracts issued by insurance entities. The updated guidance is intended to increase the transparency of significant estimates made in measuring liabilities for unpaid claims and claim adjustment expenses and to provide additional insight into an insurance entity’s ability to underwrite and anticipate costs associated with claims. The updated guidance is effective for annual reporting periods beginning after December 15, 2015 and for interim periods within annual periods beginning after December 15, 2016, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to impact its condensed consolidated financial statements.

In May 2015, the FASB issued updated guidance intended to eliminate the diversity in practice surrounding how investments measured at net asset value under the practical expedient with future redemption dates have been categorized in the fair value hierarchy. Under the updated guidance, investments for which fair value is measured at net asset value per share using the practical expedient should no longer be categorized in the fair value hierarchy. The updated guidance requires retrospective adoption for all periods presented and is effective for interim and annual

reporting periods beginning after December 15, 2015, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to impact its condensed consolidated financial statements.

In April 2015, the FASB issued updated guidance intended to clarify the accounting treatment for cloud computing arrangements that include software licenses. Under the updated guidance, if a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, 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 April 2015, the FASB issued updated guidance intended to simplify, and provide consistency to, the presentation of debt issuance costs. The new standard requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, 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
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Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In February 2015, the FASB issued updated guidance which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company expects the adoption of this guidance to have no impact on its condensed consolidated financial statements.

In June 2014, the FASB issued updated guidance intended to eliminate the diversity in practice regarding share-based payment awards that include terms which provide for a performance target that affects vesting being achieved after the requisite service period. The new standard requires that a performance target which affects vesting and could be achieved after the requisite service period be treated as a performance condition that affects vesting and should not be reflected in estimating the grant-date fair value. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company expects the adoption of this guidance to have no impact on its condensed consolidated financial statements.

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. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption prohibited. The Company is currently assessing the impact of the new guidance 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 \$7.9 billion and \$6.3 billion at June 30, 2015 and December 31, 2014, respectively, of which \$2.8 billion and \$2.2 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 and equity 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 \$3.1 billion and \$3.0 billion at June 30, 2015 and December 31, 2014, 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, including investment programs and vendor services arrangements with various financial institutions. The effects of 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.

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 \$2.4 billion at June 30, 2015 and December 31, 2014, 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

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

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, all of which are classified as available-for-sale, are as follows:

(in thousands)	Amortized cost	Gross unrealized Gains	Losses	Estimated fair value
June 30, 2015				
U.S. Treasury bonds	\$102,861	\$569	\$(1,610)	\$101,820
Municipal bonds	669,164	8,886	(3,009)	675,041
Foreign bonds	189,499	3,002	(53)	192,448
Governmental agency bonds	419,150	1,004	(2,425)	417,729
Governmental agency mortgage-backed securities	2,016,851	6,986	(10,652)	2,013,185
Corporate debt securities	747,256	6,307	(8,372)	745,191
	\$4,144,781	\$26,754	\$(26,121)	\$4,145,414
December 31, 2014				
U.S. Treasury bonds	\$64,195	\$968	\$(181)	\$64,982
Municipal bonds	577,703	10,981	(1,007)	587,677
Foreign bonds	194,749	2,009	(8)	196,750
Governmental agency bonds	198,330	1,562	(2,018)	197,874
Governmental agency mortgage-backed securities	1,812,766	8,491	(9,095)	1,812,162
Non-agency mortgage-backed securities	15,949	1,306	(717)	16,538

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Corporate debt securities	568,774	8,759	(3,264)	574,269
	\$3,432,466	\$34,076	\$(16,290)	\$3,450,252

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

(in thousands)	Cost	Gross unrealized Gains	Losses	Estimated fair value
June 30, 2015				
Preferred stocks	\$19,578	\$688	\$(1,225)	\$19,041
Common stocks	271,551	17,876	(4,387)	285,040
	\$291,129	\$18,564	\$(5,612)	\$304,081
December 31, 2014				
Preferred stocks	\$14,976	\$596	\$(47)	\$15,525
Common stocks	378,938	16,680	(8,731)	386,887
	\$393,914	\$17,276	\$(8,778)	\$402,412

Sales of debt and equity securities resulted in realized gains of \$1.5 million and \$8.0 million and realized losses of \$0.4 million and \$0.6 million for the three months ended June 30, 2015 and 2014, respectively, and realized gains of \$5.1 million and \$14.6 million and realized losses of \$6.6 million and \$4.3 million for the six months ended June 30, 2015 and 2014, respectively.

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Notes to Condensed Consolidated Financial Statements – (Continued)
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Gross unrealized losses on investments in debt and equity securities are as follows:

(in thousands)	Less than 12 months		12 months or longer		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
June 30, 2015						
Debt securities:						
U.S. Treasury bonds	\$56,754	\$ (1,580)	\$11,012	\$ (30)	\$67,766	\$ (1,610)
Municipal bonds	248,986	(2,807)	12,983	(202)	261,969	(3,009)
Foreign bonds	7,713	(53)	—	—	7,713	(53)
Governmental agency bonds	237,630	(2,005)	44,764	(420)	282,394	(2,425)
Governmental agency mortgage-backed securities	797,995	(5,197)	179,534	(5,455)	977,529	(10,652)
Corporate debt securities	312,517	(7,751)	17,861	(621)	330,378	(8,372)
Total debt securities	1,661,595	(19,393)	266,154	(6,728)	1,927,749	(26,121)
Equity securities	107,681	(3,833)	17,551	(1,779)	125,232	(5,612)
Total	\$1,769,276	\$ (23,226)	\$283,705	\$ (8,507)	\$2,052,981	\$ (31,733)
December 31, 2014						
Debt securities:						
U.S. Treasury bonds	\$8,122	\$ (27)	\$15,124	\$ (154)	\$23,246	\$ (181)
Municipal bonds	137,755	(689)	19,625	(318)	157,380	(1,007)
Foreign bonds	6,215	(8)	—	—	6,215	(8)
Governmental agency bonds	27,479	(88)	127,936	(1,930)	155,415	(2,018)
Governmental agency mortgage-backed securities	383,717	(1,612)	300,918	(7,483)	684,635	(9,095)
Non-agency mortgage-backed securities	—	—	5,611	(717)	5,611	(717)
Corporate debt securities	198,079	(3,151)	9,683	(113)	207,762	(3,264)
	761,367	(5,575)	478,897	(10,715)	1,240,264	(16,290)

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Total debt securities						
Equity securities	208,922	(8,587)	2,340	(191)	211,262	(8,778)
Total	\$970,289	\$(14,162)	\$481,237	\$(10,906)	\$1,451,526	\$(25,068)

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Investments in debt securities at June 30, 2015, 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	\$ 3,680	\$69,082	\$13,615	\$16,484	\$102,861
Estimated fair value	\$ 3,738	\$69,157	\$13,512	\$15,413	\$101,820
Municipal bonds					
Amortized cost	\$ 37,237	\$278,179	\$220,717	\$133,031	\$669,164
Estimated fair value	\$ 37,389	\$280,146	\$223,300	\$134,206	\$675,041
Foreign bonds					
Amortized cost	\$ 48,442	\$126,251	\$11,652	\$3,154	\$189,499
Estimated fair value	\$ 48,788	\$128,657	\$11,834	\$3,169	\$192,448
Governmental agency bonds					
Amortized cost	\$ 12,293	\$354,761	\$28,247	\$23,849	\$419,150
Estimated fair value	\$ 12,312	\$353,776	\$28,418	\$23,223	\$417,729
Corporate debt securities					
Amortized cost	\$ 19,668	\$289,397	\$370,973	\$67,218	\$747,256
Estimated fair value	\$ 19,900	\$292,130	\$368,710	\$64,451	\$745,191
Total debt securities excluding mortgage-backed securities					
Amortized cost	\$ 121,320	\$1,117,670	\$645,204	\$243,736	\$2,127,930
Estimated fair value	\$ 122,127	\$1,123,866	\$645,774	\$240,462	\$2,132,229
Total mortgage-backed securities					
Amortized cost					\$2,016,851
					\$2,013,185

Estimated fair value	
Total debt securities	
Amortized cost	\$4,144,781
Estimated fair value	\$4,145,414

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 such obligations with or without call or prepayment penalties.

Note 4 – Goodwill

A summary of the changes in the carrying amount of goodwill, by operating segment, for the six months ended June 30, 2015, is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance as of December 31, 2014	\$ 913,180	\$ 46,765	\$959,945
Acquisitions	14,183	—	14,183
Foreign currency translation	(3,618)	—	(3,618)
Balance as of June 30, 2015	\$ 923,745	\$ 46,765	\$970,510

The Company's four reporting units for purposes of assessing impairment are title insurance, home warranty, property and casualty insurance and trust and other services. During the six months ended June 30, 2015 there were no triggering events that would require an impairment analysis. There is no accumulated impairment for goodwill as the Company has never recognized impairment to any of its reporting units.

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Note 5 – Other Intangible Assets

Other intangible assets consist of the following:

	June 30,	December 31,
(in thousands)	2015	2014
Finite-lived intangible assets:		
Customer relationships	\$95,788	\$ 94,850
Noncompete agreements	27,631	27,286
Trademarks	9,398	11,241
Patents	2,840	2,840
	135,657	136,217
Accumulated amortization	(98,996)	(97,282)
	36,661	38,935
Indefinite-lived intangible assets:		
Licenses	16,877	16,877
	\$53,538	\$ 55,812

Amortization expense for finite-lived intangible assets was \$2.4 million and \$4.8 million for the three and six months ended June 30, 2015, respectively, and \$2.2 million and \$5.2 million for the three and six months ended June 30, 2014, respectively.

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

Year	(in thousands)
Remainder of 2015	\$ 4,582
2016	\$ 8,511
2017	\$ 7,250

2018	\$ 4,797
2019	\$ 4,004
2020	\$ 2,162

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

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

(in thousands, except percentages)	June 30, 2015		December 31, 2014	
Known title claims	\$93,230	9.7 %	\$165,330	16.3 %
Incurred but not reported claims	812,140	84.9 %	802,069	79.3 %
Total title claims	905,370	94.6 %	967,399	95.6 %
Non-title claims	51,416	5.4 %	44,381	4.4 %
Total loss reserves	\$956,786	100.0%	\$1,011,780	100.0%

The Company's reserve for known title claims was \$93.2 million at June 30, 2015, a decline of \$72.1 million, or 43.6%, from the balance at December 31, 2014. This decline is primarily attributable to settlement payments associated with certain large claims during the first quarter of 2015. The reserve for known title claims associated with these claims recorded at December 31, 2014 was \$56.0 million. The Company paid \$35.0 million, net of \$21.0 million recovered through reinsurance, during the first quarter of 2015 to settle these claims.

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The provision for title insurance losses, expressed as a percentage of title insurance premiums and escrow fees, was 6.5% for the three and six months ended June 30, 2015 and 8.9% and 7.5% for the three and six months ended June 30, 2014, respectively.

The current quarter rate of 6.5% reflects the ultimate loss rate of 6.0% for the current policy year and a \$5.1 million net increase in the loss reserve estimates for prior policy years.

The second quarter of 2014 rate of 8.9% reflected the ultimate loss rate of 6.0% for the 2014 policy year and a \$25.1 million net increase in the loss reserve estimates for prior policy years. The increase in loss reserve estimates for prior policy years was primarily related to a large commercial claim from policy year 2007, net of anticipated recoveries.

Note 7 – Income Taxes

The Company's effective income tax rate (income tax expense as a percentage of income before income taxes) was 33.9% and 34.5% for the three and six months ended June 30, 2015, respectively, and 33.7% and 35.1% for the three and six months ended June 30, 2014, respectively. The differences in the effective tax rates were primarily due to changes in the ratio of permanent differences to income before income taxes, changes in state and foreign income taxes resulting from fluctuations in the Company's noninsurance and foreign subsidiaries' contribution to pretax profits and changes in the liability related to tax positions on the Company's tax returns recorded in 2014.

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, 2015 and December 31, 2014, the Company had a net payable to CoreLogic of \$35.6 million and \$35.1 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 increase during the current year was primarily the result of an additional accrual for tax matters prior to the spin-off.

The Company evaluates the realizability of its deferred tax assets by assessing the valuation allowance and adjusts the allowance, if necessary. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The ability or failure to achieve the forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets. Based on 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, 2015 and December 31, 2014, the liability for income taxes associated with uncertain tax positions was \$24.2 million and \$24.1 million, respectively. The net increase in the liability during 2015 was primarily attributable to activity related to examinations conducted by various taxing authorities. As of June 30, 2015 and December 31, 2014, the liability could be reduced by \$3.4 million of offsetting tax benefits associated with the correlative effects of potential adjustments including timing adjustments and state income taxes. The net amounts of \$20.8 million and

\$20.7 million as of June 30, 2015 and December 31, 2014, 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, 2015 and December 31, 2014, the Company had accrued \$9.3 million and \$8.9 million, respectively, of interest and penalties (net of tax benefits of \$3.9 million and \$3.7 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 decrease within the next 12 months. These changes 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

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Kingdom. The Company is no longer subject to U.S. federal, state and non-U.S. income tax examinations by taxing authorities for years prior to 2005.

Note 8 – Earnings Per Share

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

(in thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Numerator				
Net income attributable to the Company	\$93,347	\$50,594	\$130,979	\$72,318
Less: dividends and undistributed earnings allocated to unvested restricted stock units (“RSUs”)	88	123	150	176
Net income allocated to common stockholders	\$93,259	\$50,471	\$130,829	\$72,142
Denominator				
Basic weighted-average shares	108,459	106,878	108,102	106,522
Effect of dilutive employee stock options and RSUs	1,337	1,769	1,484	1,901
Diluted weighted-average shares	109,796	108,647	109,586	108,423
Net income per share attributable to the Company’s stockholders				
Basic	\$0.86	\$0.47	\$1.21	\$0.68
Diluted	\$0.85	\$0.47	\$1.19	\$0.67

RSUs excluded from weighted-average diluted common shares outstanding due to their antidilutive effect totaled 4 thousand and 2 thousand for the three and six months ended June 30, 2015, respectively. Stock options and RSUs excluded from weighted-average diluted common shares outstanding due to their antidilutive effect for the three and six months ended June 30, 2014 totaled 134 thousand and 133 thousand, respectively.

Note 9 – Employee Benefit Plans

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Net periodic cost related to the Company's defined benefit pension and supplemental benefit plans during the three and six months ended June 30, 2015 and 2014 includes the following components:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2015	2014	2015	2014
Expense:				
Service costs	\$ 390	\$ 329	\$ 780	\$ 658
Interest costs	7,009	6,956	14,018	13,912
Expected return on plan assets	(5,448)	(4,694)	(10,896)	(9,388)
Amortization of net actuarial loss	8,492	7,407	16,984	14,814
Amortization of prior service credit	(1,041)	(1,038)	(2,082)	(2,076)
	\$ 9,402	\$ 8,960	\$ 18,804	\$ 17,920

The Company contributed \$17.7 million to the defined benefit pension and supplemental benefit plans during the six months ended June 30, 2015 and expects to contribute an additional \$18.1 million during the remainder of 2015.

These contributions include those required by funding regulations as well as discretionary contributions necessary to provide benefit payments to participants of certain of the Company's non-qualified supplemental benefit plans.

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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.

Typical inputs and assumptions to pricing models used to value the Company's U.S. Treasury bonds, municipal bonds, foreign bonds, governmental agency bonds, governmental agency mortgage-backed securities and 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. Non-agency mortgage-backed securities and certain corporate debt securities were not actively traded and there were fewer observable inputs available requiring the pricing services to use more judgment in determining their fair values, which resulted in their classification as Level 3.

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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 table presents the fair values of the Company's assets measured on a recurring basis as of June 30, 2015 and December 31, 2014:

(in thousands)	Total	Level 1	Level 2	Level 3
June 30, 2015				
Assets:				
Debt securities:				
U.S. Treasury bonds	\$ 101,820	\$—	\$ 101,820	\$—
Municipal bonds	675,041	—	675,041	—
Foreign bonds	192,448	—	192,448	—
Governmental agency bonds	417,729	—	417,729	—
Governmental agency mortgage-backed securities	2,013,185	—	2,013,185	—
Corporate debt securities	745,191	—	733,833	11,358
	4,145,414	—	4,134,056	11,358
Equity securities:				
Preferred stocks	19,041	19,041	—	—
Common stocks	285,040	285,040	—	—
	304,081	304,081	—	—
Total assets	\$4,449,495	\$ 304,081	\$ 4,134,056	\$ 11,358

(in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2014				
Assets:				
Debt securities:				
U.S. Treasury bonds	\$ 64,982	\$ —	\$ 64,982	\$ —
Municipal bonds	587,677	—	587,677	—

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Foreign bonds	196,750	—	196,750	—
Governmental agency bonds	197,874	—	197,874	—
Governmental agency mortgage-backed securities	1,812,162	—	1,812,162	—
Non-agency mortgage-backed securities	16,538	—	—	—