

Edgar Filing: First American Financial Corp - Form 10-Q

First American Financial Corp  
Form 10-Q  
July 24, 2014

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, 2014

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)

Edgar Filing: First American Financial Corp - Form 10-Q

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

Edgar Filing: First American Financial Corp - Form 10-Q

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, 2014, there were 107,103,099 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

PART I: FINANCIAL INFORMATION

|         |   |    |
|---------|---|----|
| Item 1. | <u>Financial Statements (unaudited)</u>   |    |
|         | <u>A. Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013</u>                                     | 5  |
|         | <u>B. Condensed Consolidated Statements of Income for the three and six months ended June 30, 2014 and 2013</u>               | 6  |
|         | <u>C. Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2013</u> | 7  |
|         | <u>D. Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013</u>                     | 8  |
|         | <u>E. Condensed Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2014</u>                     | 9  |
|         | <u>F. Notes to Condensed Consolidated Financial Statements</u>  | 10 |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                  | 35 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 45 |
| Item 4. | <u>Controls and Procedures</u>  | 45 |

PART II: OTHER INFORMATION

|          |                          |    |
|----------|--------------------------|----|
| Item 1.  | <u>Legal Proceedings</u> | 46 |
| Item 1A. | <u>Risk Factors</u>      | 48 |
| Item 6.  | <u>Exhibits</u>          | 54 |

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;

• THE HOLDING OF AND EXPECTED CASH FLOWS FROM DEBT SECURITIES AND ASSUMPTIONS RELATING THERETO;

• 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 ACTIONS TO BE TAKEN IN CONNECTION WITH THE COMPANY'S REVIEW OF ITS AGENCY RELATIONSHIPS;

• FUTURE PAYMENT OF DIVIDENDS;

• THE SUFFICIENCY OF THE COMPANY'S RESOURCES TO SATISFY OPERATIONAL CASH REQUIREMENTS;

• THE LIKELIHOOD OF CHANGES IN EXPECTED ULTIMATE LOSSES AND CORRESPONDING LOSS RATES AND CLAIM RESERVES;

• ANTICIPATED RECOVERIES IN CONNECTION WITH A LARGE COMMERCIAL CLAIM;

• FUTURE ACQUISITIONS AND THE VALUATION OF ACQUIRED BUSINESSES; AND

• THE IMPACT OF THE REDOMESTICATION OF THE COMPANY'S PRINCIPAL TITLE INSURANCE SUBSIDIARY FROM CALIFORNIA TO NEBRASKA,

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;

• 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;

3

---

ANY INADEQUACY IN THE COMPANY'S RISK MITIGATION EFFORTS;  
SYSTEMS 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;  
CHALLENGES AND ADVERSE EFFECTS ARISING FROM ACQUISITIONS; 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.

4

---



## 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,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| <b>Assets</b>   |                  |                      |
| Cash and cash equivalents   | \$ 1,041,259     | \$ 834,837           |
| Accounts and accrued income receivable, net                             | 291,607          | 236,895              |
| Income taxes receivable   | —                | 37,632               |
| <b>Investments:</b>   |                  |                      |
| Deposits with banks   | 24,108           | 23,492               |
| Debt securities, includes pledged securities of \$124,181 and \$123,956 | 2,947,204        | 2,819,817            |
| Equity securities   | 313,289          | 358,043              |
| Other long-term investments   | 179,637          | 183,976              |
|   | 3,464,238        | 3,385,328            |
| Loans receivable, net   | 58,841           | 73,755               |
| Property and equipment, net   | 368,600          | 361,348              |
| Title plants and other indexes  | 526,799          | 523,879              |
| Deferred income taxes   | 27,478           | 27,478               |
| Goodwill  | 993,871          | 846,026              |
| Other intangible assets, net  | 50,578           | 46,347               |
| Other assets  | 192,892          | 185,658              |
|   | \$ 7,016,163     | \$ 6,559,183         |
| <b>Liabilities and Equity</b>   |                  |                      |
| Deposits  | \$ 1,962,711     | \$ 1,692,932         |
| Accounts payable and accrued liabilities                                | 739,831          | 795,812              |
| Deferred revenue  | 187,608          | 192,184              |
| Reserve for known and incurred but not reported claims                  | 1,013,150        | 1,018,365            |
| Income taxes payable  | 14,274           | —                    |
| Deferred income taxes   | 97,170           | 93,362               |
| Notes and contracts payable   | 454,681          | 310,285              |
|   | 4,469,425        | 4,102,940            |
| <b>Commitments and contingencies (Note 16)</b>                          |                  |                      |
| <b>Stockholders' equity:</b>  |                  |                      |
| Preferred stock, \$0.00001 par value; Authorized—500 shares;            |                  |                      |
| Outstanding—none  | —                | —                    |

Edgar Filing: First American Financial Corp - Form 10-Q

|  |             |              |
|--|-------------|--------------|
| Common stock, \$0.00001 par value; Authorized—300,000 shares;<br>Outstanding—107,100 shares and 105,900 shares | 1           | 1            |
| Additional paid-in capital   | 2,096,246   | 2,077,828    |
| Retained earnings  | 553,734     | 520,764      |
| Accumulated other comprehensive loss   | (105,957 )  | (145,544 )   |
| Total stockholders' equity   | 2,544,024   | 2,453,049    |
| Noncontrolling interests   | 2,714       | 3,194        |
| Total equity   | 2,546,738   | 2,456,243    |
|  | \$7,016,163 | \$ 6,559,183 |

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)

|  | For the Three Months Ended |            | For the Six Months Ended |              |
|--|----------------------------|------------|--------------------------|--------------|
|  | June 30,                   | 2013       | June 30,                 | 2013         |
|  | 2014                       |            | 2014                     | 2013         |
| <b>Revenues</b>  |                            |            |                          |              |
| Direct premiums and escrow fees  | \$ 531,123                 | \$ 593,205 | \$ 964,995               | \$ 1,071,056 |
| Agent premiums   | 423,209                    | 496,730    | 844,133                  | 981,195      |
| Information and other  | 165,703                    | 171,522    | 303,345                  | 323,655      |
| Investment income  | 23,659                     | 22,485     | 41,426                   | 45,543       |
| Net realized investment gains  | 6,790                      | 4,522      | 9,902                    | 13,778       |
| Net other-than-temporary impairment (“OTTI”) losses recognized in earnings:      |                            |            |                          |              |
| Total OTTI losses on debt securities   | (137 )                     | —          | (167 )                   | —            |
| Portion of OTTI losses on debt securities recognized in other comprehensive loss | (378 )                     | —          | (866 )                   | —            |
|  | (515 )                     | —          | (1,033 )                 | —            |
|  | 1,149,969                  | 1,288,464  | 2,162,768                | 2,435,227    |
| <b>Expenses</b>  |                            |            |                          |              |
| Personnel costs  | 354,133                    | 364,767    | 680,651                  | 709,267      |
| Premiums retained by agents  | 338,271                    | 396,024    | 674,936                  | 783,567      |
| Other operating expenses   | 214,121                    | 232,765    | 402,488                  | 438,111      |
| Provision for policy losses and other claims                                     | 128,466                    | 198,766    | 218,349                  | 314,792      |
| Depreciation and amortization  | 19,780                     | 18,192     | 39,752                   | 36,587       |
| Premium taxes  | 14,254                     | 14,795     | 26,544                   | 26,912       |
| Interest   | 4,486                      | 3,931      | 8,337                    | 7,175        |
|  | 1,073,511                  | 1,229,240  | 2,051,057                | 2,316,411    |
| Income before income taxes   | 76,458                     | 59,224     | 111,711                  | 118,816      |
| Income taxes   | 25,770                     | 24,276     | 39,171                   | 47,636       |
| Net income   | 50,688                     | 34,948     | 72,540                   | 71,180       |
| Less: Net income attributable to noncontrolling interests                        | 94                         | 276        | 222                      | 330          |
| Net income attributable to the Company   | \$ 50,594                  | \$ 34,672  | \$ 72,318                | \$ 70,850    |
| Net income per share attributable to the Company’s stockholders (Note 10):       |                            |            |                          |              |
| Basic  | \$ 0.47                    | \$ 0.32    | \$ 0.68                  | \$ 0.66      |
| Diluted  | \$ 0.47                    | \$ 0.31    | \$ 0.67                  | \$ 0.64      |
| Cash dividends declared per share  | \$ —                       | \$ 0.12    | \$ 0.36                  | \$ 0.24      |
| Weighted-average common shares outstanding (Note 10):                            |                            |            |                          |              |
| Basic  | 106,878                    | 108,210    | 106,522                  | 107,881      |

|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Diluted | 108,647 | 110,311 | 108,423 | 110,072 |
|---------|---------|---------|---------|---------|

See notes to condensed consolidated financial statements.

6

---

## FIRST AMERICAN FINANCIAL CORPORATION

## AND SUBSIDIARY COMPANIES

## Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

|   | For the Three Months Ended |              | For the Six Months Ended |           |
|---|----------------------------|--------------|--------------------------|-----------|
|   | June 30,                   |              | June 30,                 |           |
|   | 2014                       | 2013         | 2014                     | 2013      |
| Net income  | \$ 50,688                  | \$ 34,948    | \$ 72,540                | \$ 71,180 |
| Other comprehensive income (loss), net of tax:  |                            |              |                          |           |
| Unrealized gain (loss) on securities  | 13,902                     | (40,492 )    | 25,804                   | (40,745 ) |
| Unrealized gain (loss) on securities for which credit losses have been recognized in earnings | 137                        | (612 )       | 435                      | 20        |
| Foreign currency translation adjustment   | 11,612                     | (9,794 )     | 5,572                    | (16,616 ) |
| Pension benefit adjustment  | 3,892                      | 4,143        | 7,783                    | 8,287     |
| Total other comprehensive income (loss), net of tax   | 29,543                     | (46,755 )    | 39,594                   | (49,054 ) |
| Comprehensive income (loss)   | 80,231                     | (11,807 )    | 112,134                  | 22,126    |
| Less: Comprehensive income attributable to noncontrolling interests                           | 98                         | 268          | 229                      | 323       |
| Comprehensive income (loss) attributable to the Company                                       | \$ 80,133                  | \$ (12,075 ) | \$ 111,905               | \$ 21,803 |

See notes to condensed consolidated financial statements.

## FIRST AMERICAN FINANCIAL CORPORATION

## AND SUBSIDIARY COMPANIES

## Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

|  | For the Six<br>Months Ended<br>June 30, |           |
|--|---|-----------|
|  | 2014                                    | 2013      |
| <b>Cash flows from operating activities:</b>   |   |           |
| Net income   | \$72,540                                | \$71,180  |
| <b>Adjustments to reconcile net income to cash provided by operating activities:</b>                 |   |           |
| Provision for policy losses and other claims   | 218,349                                 | 314,792   |
| Depreciation and amortization  | 39,752                                  | 36,587    |
| Amortization of premiums and accretion of discounts on securities, net                               | 11,967                                  | 11,872    |
| Excess tax benefits from share-based compensation  | (5,827 )                                | (5,681 )  |
| Share-based compensation   | 12,519                                  | 14,344    |
| Net realized investment gains  | (9,902 )                                | (13,778 ) |
| Net OTTI losses recognized in earnings   | 1,033                                   | —         |
| Equity in earnings of affiliates, net  | 1,748                                   | (7,136 )  |
| Dividends from equity method investments   | 3,471                                   | 5,137     |
| <b>Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:</b> |   |           |
| Claims paid, including assets acquired, net of recoveries  | (240,144 )                              | (224,739) |
| Net change in income tax accounts  | 33,493                                  | 28,967    |
| Increase in accounts and accrued income receivable   | (11,439 )                               | (8,682 )  |
| Decrease in accounts payable and accrued liabilities   | (74,174 )                               | (56,146 ) |
| (Decrease) increase in deferred revenue  | (5,017 )                                | 2,327     |
| Other, net   | (3,476 )                                | (10,610 ) |
| Cash provided by operating activities  | 44,893                                  | 158,434   |
| <b>Cash flows from investing activities:</b>   |   |           |
| Net cash effect of acquisitions/dispositions   | (166,354 )                              | (150 )    |
| Net increase in deposits with banks  | (256 )                                  | (2,419 )  |
| Net decrease in loans receivable   | 14,914                                  | 22,642    |
| Purchases of debt and equity securities  | (592,381 )                              | (701,372) |
| Proceeds from sales of debt and equity securities  | 386,744                                 | 286,705   |
| Proceeds from maturities of debt securities  | 173,644                                 | 271,004   |
| Net change in other long-term investments  | 1,364                                   | 1,974     |
| Capital expenditures   | (40,063 )                               | (38,879 ) |
| Proceeds from sale of property and equipment   | 13                                      | 5,071     |
| Cash used for investing activities   | (222,375 )                              | (155,424) |
| <b>Cash flows from financing activities:</b>   |   |           |
| Net change in deposits   | 269,779                                 | 171,454   |
| Proceeds from issuance of debt   | 300,735                                 | 249,095   |
| Repayment of debt  | (156,476 )                              | (163,761) |

Edgar Filing: First American Financial Corp - Form 10-Q

|  |             |           |
|--|-------------|-----------|
| Net payments in connection with share-based compensation plans | (911 )      | (4,488 )  |
| Net activity related to noncontrolling interests               | (633 )      | (504 )    |
| Excess tax benefits from share-based compensation              | 5,827       | 5,681     |
| Purchase of Company shares                                     | —           | (17,485 ) |
| Cash dividends   | (38,441 )   | (25,934 ) |
| Cash provided by financing activities                          | 379,880     | 214,058   |
| Effect of exchange rate changes on cash                        | 4,024       | (5,823 )  |
| Net increase in cash and cash equivalents                      | 206,422     | 211,245   |
| Cash and cash equivalents—Beginning of period                  | 834,837     | 670,529   |
| Cash and cash equivalents—End of period                        | \$1,041,259 | \$881,774 |
| Supplemental information:                                      |             |           |
| Cash paid during the period for:                               |             |           |
| Interest   | \$8,346     | \$2,657   |
| Premium taxes  | \$36,825    | \$33,913  |
| Income taxes, less refunds of \$1,016 and \$461                | \$5,827     | \$18,208  |

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, 2013                                    | 105,900   | \$ 1         | \$2,077,828                | \$520,764         | \$(145,544 )                         | \$2,453,049                | \$ 3,194                 | \$2,456,243 |
| Net income for six months ended June 30, 2014                   | —   | —            | —                          | 72,318            | —                                    | 72,318                     | 222                      | 72,540      |
| Dividends on common shares                                      | —   | —            | —                          | (38,441 )         | —                                    | (38,441 )                  | —                        | (38,441 )   |
| Shares issued in connection with share-based compensation plans | 1,200   | —            | 5,823                      | (907 )            | —                                    | 4,916                      | —                        | 4,916       |
| Share-based compensation expense                                | —   | —            | 12,519                     | —                 | —                                    | 12,519                     | —                        | 12,519      |
| Net activity related to noncontrolling interests                | —   | —            | 76                         | —                 | —                                    | 76                         | (709 )                   | (633 )      |
| Other comprehensive income (Note 15)                            | —   | —            | —                          | —                 | 39,587                               | 39,587                     | 7                        | 39,594      |
| Balance at June 30, 2014  | 107,100   | \$ 1         | \$2,096,246                | \$553,734         | \$(105,957 )                         | \$2,544,024                | \$ 2,714                 | \$2,546,738 |

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, 2013. 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.

Reclassifications, Revisions and Out-of-Period Adjustments

Certain 2013 amounts have been reclassified to conform to the 2014 presentation.

The condensed consolidated statement of cash flows for the six months ended June 30, 2013 was revised for an error which resulted in an adjustment between cash and cash equivalents and deposits with banks. The adjustment resulted in a reduction to net increase in deposits with banks of \$23.4 million, an increase in cash and cash equivalents—beginning of period of \$43.3 million and an increase in cash and cash equivalents—end of period of \$19.9 million.

The condensed consolidated balance sheet as of December 31, 2013 was revised for an error which resulted in an adjustment between income taxes receivable and deferred income taxes. The adjustment resulted in an increase to income taxes receivable of \$11.1 million, an increase in deferred income tax assets of \$27.5 million and an increase in deferred income tax liabilities of \$38.6 million.

During the three months ended June 30, 2014, the Company identified and recorded adjustments to correct for certain errors in foreign currency translation and transactions in prior periods. These adjustments resulted in an increase to other operating expenses of \$4.3 million.

The Company does not consider these adjustments to be material, individually or in the aggregate, to either the current year or any previously issued consolidated financial statements.

#### Recently Adopted Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (“FASB”) issued updated guidance intended to eliminate the diversity in practice regarding financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2013, with early adoption permitted. The adoption of the guidance had no impact on the Company’s condensed consolidated financial statements.

#### Pending Accounting Pronouncements

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

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

measurement of revenue and the timing of when it is recognized. 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. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption prohibited. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

In April 2014, the 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 31, 2014, with early adoption permitted. The Company expects the adoption of this guidance to have no 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 \$6.5 billion and \$4.7 billion at June 30, 2014 and December 31, 2013, respectively, of which \$1.8 billion and \$1.6 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 included in the accompanying condensed consolidated balance sheets in cash and cash equivalents and debt and equity securities, with offsetting liabilities included in deposits. The remaining escrow deposits were held at third-party financial institutions.

Trust assets held or managed by First American Trust, FSB totaled \$3.0 billion at June 30, 2014 and December 31, 2013. 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. As a result of holding these customers' assets in escrow, the Company has ongoing programs for realizing economic benefits, including investment programs, borrowing agreements, 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 \$1.8 billion and \$1.4 billion at June 30, 2014 and December 31, 2013, respectively. The like-kind exchange deposits were 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 return on the proceeds.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 3 – Debt and Equity Securities

The amortized cost and estimated fair value of investments in debt securities, all of which are classified as available-for-sale, are as follows:

| (in thousands)  | Amortized<br>cost | Gross unrealized |            | Estimated<br>fair value | Other-than-<br>temporary<br>impairments<br>in AOCI |
|---|-------------------|------------------|------------|-------------------------|--|
|   |                   | Gains            | Losses     |                         |  |
| June 30, 2014   |                   |                  |            |                         |  |
| U.S. Treasury<br>bonds                                  | \$82,510          | \$874            | \$(221 )   | \$83,163                | \$ —   |
| Municipal bonds   | 516,201           | 9,362            | (2,028 )   | 523,535                 | —  |
| Foreign bonds   | 190,195           | 1,621            | (135 )     | 191,681                 | —  |
| Governmental<br>agency bonds                            | 225,555           | 1,046            | (2,709 )   | 223,892                 | —  |
| Governmental<br>agency<br>mortgage-backed<br>securities | 1,460,102         | 5,956            | (12,001 )  | 1,454,057               | —  |
| Non-agency<br>mortgage-backed<br>securities (1)         | 17,941            | 1,346            | (1,293 )   | 17,994                  | 19,877   |
| Corporate debt<br>securities                            | 444,205           | 9,434            | (757 )     | 452,882                 | —  |
|   | \$2,936,709       | \$29,639         | \$(19,144) | \$2,947,204             | \$ 19,877  |
| December 31,<br>2013                                    |                   |                  |            |                         |  |
| U.S. Treasury<br>bonds                                  | \$66,400          | \$669            | \$(685 )   | \$66,384                | \$ —   |
| Municipal bonds   | 491,143           | 5,113            | (10,291 )  | 485,965                 | —  |
| Foreign bonds   | 221,298           | 1,836            | (626 )     | 222,508                 | —  |
| Governmental<br>agency bonds                            | 267,713           | 233              | (5,401 )   | 262,545                 | —  |
| Governmental<br>agency<br>mortgage-backed<br>securities | 1,426,489         | 2,074            | (25,254 )  | 1,403,309               | —  |
| Non-agency<br>mortgage-backed                           | 19,658            | 1,167            | (1,803 )   | 19,022                  | 20,743   |

securities (1)

Corporate debt

|            |             |          |            |             |           |
|------------|-------------|----------|------------|-------------|-----------|
| securities | 355,893     | 7,279    | (3,088 )   | 360,084     | —         |
|            | \$2,848,594 | \$18,371 | \$(47,148) | \$2,819,817 | \$ 20,743 |

(1) At June 30, 2014, the \$17.9 million amortized cost is net of \$1.0 million in other-than-temporary impairments determined to be credit related which have been recognized in earnings for the six months ended June 30, 2014. At June 30, 2014 and December 31, 2013, the \$1.3 million and \$1.8 million, respectively, of gross unrealized losses related to securities determined to be other-than-temporarily impaired. The \$19.9 million and \$20.7 million other-than-temporary impairments recorded in accumulated other comprehensive income (loss) (“AOCI”) at June 30, 2014 and December 31, 2013, respectively, which relate to non-agency mortgage-backed securities, represent the amount of other-than-temporary impairment losses recognized in AOCI which were not included in earnings as the losses were not considered to be credit related.

The cost and estimated fair value of investments in equity securities, all of which are classified as available-for-sale, are as follows:

| (in thousands)       | Cost      | Gross unrealized<br>Gains | Losses    | Estimated<br>fair value |
|----------------------|-----------|---------------------------|-----------|-------------------------|
| June 30, 2014        |           |                           |           |                         |
| Preferred<br>stocks  | \$9,653   | \$1,936                   | \$(232 )  | \$11,357                |
| Common<br>stocks     | 276,020   | 26,341                    | (429 )    | 301,932                 |
|                      | \$285,673 | \$28,277                  | \$(661 )  | \$313,289               |
| December 31,<br>2013 |           |                           |           |                         |
| Preferred<br>stocks  | \$9,915   | \$1,567                   | \$(397 )  | \$11,085                |
| Common<br>stocks     | 324,184   | 25,137                    | (2,363)   | 346,958                 |
|                      | \$334,099 | \$26,704                  | \$(2,760) | \$358,043               |

12

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The Company had the following net unrealized gains (losses) as of June 30, 2014 and December 31, 2013:

|  | As of<br>June 30,<br>2014 | As of<br>December 31,<br>2013 |
|--|---------------------------|-------------------------------|
| (in thousands)   |                           |                               |
| Debt securities<br>for which an<br>OTTI has been<br>recognized | \$87                      | \$ (625 )                     |
| Debt<br>securities—all<br>other                                | 10,408                    | (28,152 )                     |
| Equity<br>securities   | 27,616                    | 23,944                        |
|  | \$38,111                  | \$ (4,833 )                   |

Sales of debt and equity securities resulted in realized gains of \$8.0 million and \$5.6 million and realized losses of \$0.6 million and \$1.4 million for the three months ended June 30, 2014 and 2013, respectively, and realized gains of \$14.6 million and \$12.2 million and realized losses of \$4.3 million and \$2.0 million for the six months ended June 30, 2014 and 2013, respectively.

The Company had the following gross unrealized losses as of June 30, 2014 and December 31, 2013:

| (in thousands)  | Less than 12 months     |                      | 12 months or longer     |                      | Total                   |                      |
|---|-------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|   | Estimated<br>fair value | Unrealized<br>losses | Estimated<br>fair value | Unrealized<br>losses | Estimated<br>fair value | Unrealized<br>losses |
| June 30, 2014   |                         |                      |                         |                      |                         |                      |
| Debt securities:  |                         |                      |                         |                      |                         |                      |
| U.S. Treasury<br>bonds                                  | \$4,073                 | \$ (11 )             | \$17,246                | \$ (210 )            | \$21,319                | \$ (221 )            |
| Municipal bonds   | 48,817                  | (167 )               | 105,820                 | (1,861 )             | 154,637                 | (2,028 )             |
| Foreign bonds   | 11,473                  | (63 )                | 6,630                   | (72 )                | 18,103                  | (135 )               |
| Governmental<br>agency bonds                            | 8,259                   | (25 )                | 133,676                 | (2,684 )             | 141,935                 | (2,709 )             |
| Governmental<br>agency<br>mortgage-backed<br>securities | 424,099                 | (1,769 )             | 402,830                 | (10,232 )            | 826,929                 | (12,001 )            |
| Non-agency<br>mortgage-backed<br>securities             | 1,871                   | (213 )               | 6,566                   | (1,080 )             | 8,437                   | (1,293 )             |



Edgar Filing: First American Financial Corp - Form 10-Q

|  |             |              |           |              |             |              |
|--|-------------|--------------|-----------|--------------|-------------|--------------|
| Corporate debt securities                      | 86,760      | (482 )       | 26,921    | (275 )       | 113,681     | (757 )       |
| Total debt securities                          | 585,352     | (2,730 )     | 699,689   | (16,414 )    | 1,285,041   | (19,144 )    |
| Equity securities                              | 8,749       | (414 )       | 4,805     | (247 )       | 13,554      | (661 )       |
| Total  | \$594,101   | \$ (3,144 )  | \$704,494 | \$ (16,661 ) | \$1,298,595 | \$ (19,805 ) |
| December 31, 2013                              |             |              |           |              |             |              |
| Debt securities:                               |             |              |           |              |             |              |
| U.S. Treasury bonds                            |             |              |           |              |             |              |
|  | \$37,492    | \$ (685 )    | \$—       | \$—          | \$37,492    | \$ (685 )    |
| Municipal bonds                                | 230,180     | (8,938 )     | 27,687    | (1,353 )     | 257,867     | (10,291 )    |
| Foreign bonds                                  | 56,579      | (626 )       | —         | —            | 56,579      | (626 )       |
| Governmental agency bonds                      |             |              |           |              |             |              |
|  | 203,011     | (5,375 )     | 131       | (26 )        | 203,142     | (5,401 )     |
| Governmental agency mortgage-backed securities |             |              |           |              |             |              |
|  | 838,411     | (20,970 )    | 124,425   | (4,284 )     | 962,836     | (25,254 )    |
| Non-agency mortgage-backed securities          |             |              |           |              |             |              |
|  | —           | —            | 12,086    | (1,803 )     | 12,086      | (1,803 )     |
| Corporate debt securities                      |             |              |           |              |             |              |
|  | 129,394     | (2,422 )     | 12,500    | (666 )       | 141,894     | (3,088 )     |
| Total debt securities                          | 1,495,067   | (39,016 )    | 176,829   | (8,132 )     | 1,671,896   | (47,148 )    |
| Equity securities                              | 85,112      | (2,718 )     | 1,046     | (42 )        | 86,158      | (2,760 )     |
| Total  | \$1,580,179 | \$ (41,734 ) | \$177,875 | \$ (8,174 )  | \$1,758,054 | \$ (49,908 ) |

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Substantially all securities in the Company's non-agency mortgage-backed portfolio are senior tranches and all were investment grade at the time of purchase, however, all have subsequently been downgraded to below investment grade. The table below summarizes the composition of the Company's non-agency mortgage-backed securities as of June 30, 2014, by collateral type and year of issuance.

| (in thousands, except number of securities) | Number<br>of<br>Securities | Amortized<br>Cost | Estimated<br>Fair<br>Value |
|---|----------------------------|-------------------|----------------------------|
| Non-agency mortgage-backed securities:      |                            |                   |                            |
| Prime single family residential:            |                            |                   |                            |
| 2007  | 1                          | \$ 3,235          | \$ 2,759                   |
| 2006  | 3                          | 8,346             | 7,794                      |
| 2005  | 1                          | 851               | 817                        |
| Alt-A single family residential:            |                            |                   |                            |
| 2007  | 1                          | 5,509             | 6,624                      |
|   | 6                          | \$ 17,941         | \$ 17,994                  |

The amortized cost and estimated fair value of debt securities at June 30, 2014, by contractual maturities, are as follows:

| (in thousands)            | Due in one<br>year or less | Due after<br>one<br>through<br>five<br>years | Due after<br>five<br>through<br>ten<br>years | Due after<br>ten years | Total     |
|---------------------------|----------------------------|--|--|------------------------|-----------|
| U.S. Treasury bonds       |                            |  |  |                        |           |
| Amortized cost            | \$ 10,754                  | \$43,020                                     | \$26,304                                     | \$2,432                | \$82,510  |
| Estimated fair value      | \$ 10,850                  | \$43,199                                     | \$26,491                                     | \$2,623                | \$83,163  |
| Municipal bonds           |                            |  |  |                        |           |
| Amortized cost            | \$ 10,130                  | \$218,468                                    | \$171,734                                    | \$115,869              | \$516,201 |
| Estimated fair value      | \$ 10,222                  | \$221,151                                    | \$175,474                                    | \$116,688              | \$523,535 |
| Foreign bonds             |                            |  |  |                        |           |
| Amortized cost            | \$ 45,372                  | \$127,876                                    | \$15,984                                     | \$963                  | \$190,195 |
| Estimated fair value      | \$ 45,639                  | \$129,076                                    | \$15,988                                     | \$978                  | \$191,681 |
| Governmental agency bonds |                            |  |  |                        |           |
| Amortized cost            | \$ 6,450                   | \$131,967                                    | \$78,254                                     | \$8,884                | \$225,555 |

Edgar Filing: First American Financial Corp - Form 10-Q

|  |           |            |            |            |              |
|--|-----------|------------|------------|------------|--------------|
| Estimated fair value                                       | \$ 6,470  | \$ 131,174 | \$ 76,848  | \$ 9,400   | \$ 223,892   |
| Corporate debt securities                                  |           |            |            |            |              |
| Amortized cost   | \$ 22,851 | \$ 242,589 | \$ 150,941 | \$ 27,824  | \$ 444,205   |
| Estimated fair value                                       | \$ 23,123 | \$ 248,490 | \$ 152,788 | \$ 28,481  | \$ 452,882   |
| Total debt securities excluding mortgage-backed securities |           |            |            |            |              |
| Amortized cost   | \$ 95,557 | \$ 763,920 | \$ 443,217 | \$ 155,972 | \$ 1,458,666 |
| Estimated fair value                                       | \$ 96,304 | \$ 773,090 | \$ 447,589 | \$ 158,170 | \$ 1,475,153 |
| Total mortgage-backed securities                           |           |            |            |            |              |
| Amortized cost   |           |            |            |            | \$ 1,478,043 |
| Estimated fair value                                       |           |            |            |            | \$ 1,472,051 |
| Total debt securities                                      |           |            |            |            |              |
| Amortized cost   |           |            |            |            | \$ 2,936,709 |
| Estimated fair value                                       |           |            |            |            | \$ 2,947,204 |

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)

Other-than-temporary impairment — debt securities

If the Company intends to sell a debt security in an unrealized loss position or determines that it is more likely than not that the Company will be required to sell a debt security before it recovers its amortized cost basis, the debt security is other-than-temporarily impaired and it is written down to fair value with all losses recognized in earnings. As of June 30, 2014, the Company did not intend to sell any debt securities in an unrealized loss position and it is not more likely than not that the Company will be required to sell debt securities before recovery of their amortized cost basis.

If the Company does not expect to recover the amortized cost basis of a debt security with declines in fair value (even if the Company does not intend to sell the debt security and it is not more likely than not that the Company will be required to sell the debt security), the losses the Company considers to be the credit portion of the other-than-temporary impairment loss (“credit loss”) is recognized in earnings and the non-credit portion is recognized in other comprehensive income. The credit loss is the difference between the present value of the cash flows expected to be collected and the amortized cost basis of the debt security. The cash flows expected to be collected are discounted at the rate implicit in the security immediately prior to the recognition of the other-than-temporary impairment.

Expected future cash flows for debt securities are based on qualitative and quantitative factors specific to each security, including the probability of default and the estimated timing and amount of recovery. The detailed inputs used to project expected future cash flows may be different depending on the nature of the individual debt security.

The Company determines if a non-agency mortgage-backed security in a loss position is other-than-temporarily impaired by comparing the present value of the cash flows expected to be collected from the security to its amortized cost basis. If the present value of the cash flows expected to be collected exceed the amortized cost of the security, the Company concludes that the security is not other-than-temporarily impaired. The Company performs this analysis on all non-agency mortgage-backed securities in its portfolio that are in an unrealized loss position. For the securities that were determined not to be other-than-temporarily impaired at June 30, 2014, the present value of the cash flows expected to be collected exceeded the amortized cost of each security.

Cash flows expected to be collected for each non-agency mortgage-backed security are estimated by analyzing loan-level detail to estimate future cash flows from the underlying assets, which are then applied to the security based on the underlying contractual provisions of the securitization trust that issued the security (e.g. subordination levels, remaining payment terms, etc.). The Company uses third-party software to determine how the underlying collateral cash flows will be distributed to each security issued from the securitization trust. The primary assumptions used in estimating future collateral cash flows are prepayment speeds, default rates and loss severity. In developing these assumptions, the Company considers the financial condition of the borrower, loan to value ratio, loan type and geographical location of the underlying property. The Company utilizes publicly available information related to specific assets, generally available market data such as forward interest rate curves and securities, loans and property data and market analytics tools provided through a third party.

The table below summarizes the primary assumptions used at June 30, 2014 in estimating the cash flows expected to be collected for these securities.

|                   | Weighted average | Range        |
|-------------------|------------------|--------------|
| Prepayment speeds | 9.0              | % 8.3 %10.5% |
| Default rates     | 1.4              | % 0.3 %2.4 % |
| Loss severity     | 39.2             | % 14.4%52.3% |

As a result of the Company's security-level review, it recognized other-than-temporary impairments considered to be credit related on its non-agency mortgage-backed securities of \$0.5 million and \$1.0 million for the three and six months ended June 30, 2014, respectively, and did not recognize any other-than-temporary impairments considered to be credit related for the three and six months ended June 30, 2013. It is possible that the Company could recognize additional other-than-temporary impairment losses on securities it owns at June 30, 2014 if future events or information cause it to determine that a decline in value is other-than-temporary.

15

---

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The following table presents the change in the credit portion of the other-than-temporary impairments recognized in earnings on debt securities for which a portion of the other-than-temporary impairments related to other factors was recognized in other comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013.

| (in thousands)   | For the Three<br>Months Ended June 30, |           | For the Six<br>Months Ended June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2014                                   | 2013      | 2014                                 | 2013      |
| Cumulative credit<br>loss on debt securities<br>held at beginning of<br>period                             | \$ 16,996                              | \$ 16,478 | \$ 16,478                            | \$ 16,478 |
| Addition to credit<br>loss for which an<br>other-than-temporary<br>impairment was<br>previously recognized | 515                                    | —         | 1,033                                | —         |
| Cumulative credit<br>loss on debt securities<br>held at end of period                                      | \$ 17,511                              | \$ 16,478 | \$ 17,511                            | \$ 16,478 |

Other-than-temporary impairment — equity securities

When a decline in the fair value of an equity security, including common and preferred stock, is considered to be other-than-temporary, such equity security is written down to its fair value. When assessing if a decline in value is other-than-temporary, the factors considered include the length of time and extent to which fair value has been below cost, the probability that the Company will be unable to collect all amounts due under the contractual terms of the security, the seniority of the securities, issuer-specific news and other developments, the financial condition and prospects of the issuer (including credit ratings), macro-economic changes (including the outlook for industry sectors, which includes government policy initiatives) and the Company's ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery.

When an equity security has been in an unrealized loss position for greater than twelve months, the Company's review of the security includes the above noted factors as well as other evidence that might exist supporting the view that the security will recover its value in the foreseeable future, typically within the next twelve months. If objective, substantial evidence does not indicate a likely recovery during that timeframe, the Company's policy is that such losses are considered other-than-temporary and therefore an impairment loss is recorded. For the three and six months ended June 30, 2014 and 2013, the Company did not record other-than-temporary impairment losses related to its equity securities.

#### Fair value measurement

The Company classifies the fair value of its debt and equity securities 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 reporting entity (observable inputs) and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The hierarchy level assigned to each security in the Company's available-for-sale portfolio is based on management's assessment of the transparency and reliability of the inputs used in the valuation of such instrument 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 securities.

Level 2—Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets 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, a financial security's hierarchy level is based upon the lowest level of input that is significant to the fair value measurement. The valuation techniques and inputs used to estimate the fair value of the Company's debt and equity securities are summarized as follows:

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

### Debt Securities

The fair value of debt securities was 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. The fair value of non-agency mortgage-backed securities was obtained from the independent pricing services referenced above and subject to the Company's validation procedures discussed above. However, since these securities were not actively traded and there were fewer observable inputs available requiring the pricing services to use more judgment in determining the fair value of the securities, the Company classified its non-agency mortgage-backed securities as Level 3.

The significant unobservable inputs used in the fair value measurement of the Company's non-agency mortgage-backed securities include prepayment rates, default rates and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for default rates is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

### Equity Securities

The fair value 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.



FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The following table presents the Company's available-for-sale investments measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, classified using the three-level hierarchy for fair value measurements:

|  | Estimated   |           |             |          |
|--|-------------|-----------|-------------|----------|
| (in thousands)                                 | fair value  | Level 1   | Level 2     | Level 3  |
| June 30, 2014                                  |             |           |             |          |
| Debt securities:                               |             |           |             |          |
| U.S. Treasury bonds                            | \$83,163    | \$—       | \$83,163    | \$—      |
| Municipal bonds                                | 523,535     | —         | 523,535     | —        |
| Foreign bonds                                  | 191,681     | —         | 191,681     | —        |
| Governmental agency bonds                      | 223,892     | —         | 223,892     | —        |
| Governmental agency mortgage-backed securities | 1,454,057   | —         | 1,454,057   | —        |
| Non-agency mortgage-backed securities          | 17,994      | —         | —           | 17,994   |
| Corporate debt securities                      | 452,882     | —         | 452,882     | —        |
|  | 2,947,204   | —         | 2,929,210   | 17,994   |
| Equity securities:                             |             |           |             |          |
| Preferred stocks                               | 11,357      | 11,357    | —           | —        |
| Common stocks                                  | 301,932     | 301,932   | —           | —        |
|  | 313,289     | 313,289   | —           | —        |
|  | \$3,260,493 | \$313,289 | \$2,929,210 | \$17,994 |

|                     | Estimated  |         |          |         |
|---------------------|------------|---------|----------|---------|
| (in thousands)      | fair value | Level 1 | Level 2  | Level 3 |
| December 31, 2013   |            |         |          |         |
| Debt securities:    |            |         |          |         |
| U.S. Treasury bonds | \$66,384   | \$—     | \$66,384 | \$—     |
| Municipal bonds     | 485,965    | —       | 485,965  | —       |
| Foreign bonds       | 222,508    | —       | 222,508  | —       |
|                     | 262,545    | —       | 262,545  | —       |

|  |             |           |             |          |
|--|-------------|-----------|-------------|----------|
| Governmental agency bonds                      |             |           |             |          |
| Governmental agency mortgage-backed securities | 1,403,309   | —         | 1,403,309   | —        |
| Non-agency mortgage-backed securities          | 19,022      | —         | —           | 19,022   |
| Corporate debt securities                      | 360,084     | —         | 360,084     | —        |
|  | 2,819,817   | —         | 2,800,795   | 19,022   |
| Equity securities:                             |             |           |             |          |
| Preferred stocks                               | 11,085      | 11,085    | —           | —        |
| Common stocks                                  | 346,958     | 346,958   | —           | —        |
|  | 358,043     | 358,043   | —           | —        |
|  | \$3,177,860 | \$358,043 | \$2,800,795 | \$19,022 |

The Company did not have any transfers in and out of Level 1, Level 2 and Level 3 measurements during the three and six months ended June 30, 2014 and 2013. The Company's policy is to recognize transfers between levels in the fair value hierarchy at the end of the reporting period.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The following table presents a summary of the changes in fair value of Level 3 available-for-sale investments for the three and six months ended June 30, 2014 and 2013:

| (in thousands)  | For the Three<br>Months Ended June 30, |           | For the Six<br>Months Ended June 30, |           |
|---|--|-----------|--------------------------------------|-----------|
|   | 2014                                   | 2013      | 2014                                 | 2013      |
| Fair value at beginning of period   | \$ 18,646                              | \$ 22,620 | \$ 19,022                            | \$ 21,846 |
| Total gains/(losses) (realized and unrealized):   |  |           |                                      |           |
| Included in earnings:   |  |           |                                      |           |
| Net other-than-temporary impairment losses recognized in earnings   | (515 )                                 | —         | (1,033 )                             | —         |
| Included in other comprehensive income  | 223                                    | (990 )    | 689                                  | 121       |
| Settlements   | (360 )                                 | (1,019 )  | (684 )                               | (1,356 )  |
| Fair value at end of period   | \$ 17,994                              | \$ 20,611 | \$ 17,994                            | \$ 20,611 |
| Unrealized gains (losses) included in earnings for the period relating to Level 3 available-for-sale investments that were still held at the end of the period: |  |           |                                      |           |
| Net other-than-temporary impairment losses recognized in earnings   | \$ (515 )                              | \$ —      | \$ (1,033 )                          | \$ —      |

The Company did not purchase or sell any non-agency mortgage-backed securities during the three and six months ended June 30, 2014 and 2013.

## Note 4 – Financing Receivables

Financing receivables are summarized as follows:

|                                  | June 30,<br>2014 | December 31,<br>2013 |
|----------------------------------|------------------|----------------------|
|                                  | (in thousands)   |                      |
| Loans receivable, net:           |                  |                      |
| Real estate—mortgage             |                  |                      |
| Multi-family residential         | \$7,259          | \$ 7,455             |
| Commercial                       | 55,350           | 69,865               |
| Other                            | 403              | 712                  |
|                                  | 63,012           | 78,032               |
| Allowance for loan losses        | (3,627 )         | (3,626 )             |
| Participations sold              | (518 )           | (633 )               |
| Deferred loan fees, net          | (26 )            | (18 )                |
| Loans receivable, net            | 58,841           | 73,755               |
| Other long-term investments:     |                  |                      |
| Notes receivable—secured         | 9,611            | 10,533               |
| Notes receivable—unsecured       | 2,892            | 2,593                |
|                                  | 12,503           | 13,126               |
| Loss reserve                     | (2,395 )         | (2,584 )             |
| Notes receivable, net            | 10,108           | 10,542               |
| Total financing receivables, net | \$68,949         | \$ 84,297            |

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Aging analysis of loans and notes receivable at June 30, 2014 is as follows:

|                          | Total<br>(in thousands) | Current  | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or<br>more<br>past due | Non-accrual<br>status |
|--------------------------|-------------------------|----------|------------------------|------------------------|--------------------------------|-----------------------|
| <b>Loans Receivable:</b> |                         |          |                        |                        |                                |                       |
| Multi-family residential | \$7,259                 | \$7,259  | \$ —                   | \$ —                   | \$ —                           | \$ —                  |
| Commercial               | 55,350                  | 53,370   | —                      | —                      | —                              | 1,980                 |
| Other                    | 403                     | 403      | —                      | —                      | —                              | —                     |
|                          | \$63,012                | \$61,032 | \$ —                   | \$ —                   | \$ —                           | \$ 1,980              |
| <b>Notes Receivable:</b> |                         |          |                        |                        |                                |                       |
| Secured                  | \$9,611                 | \$5,142  | \$ 3,590               | \$ 45                  | \$ —                           | \$ 834                |
| Unsecured                | 2,892                   | 1,235    | 8                      | —                      | —                              | 1,649                 |
|                          | \$12,503                | \$6,377  | \$ 3,598               | \$ 45                  | \$ —                           | \$ 2,483              |

Aging analysis of loans and notes receivable at December 31, 2013 is as follows:

|                          | Total<br>(in thousands) | Current  | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or<br>more<br>past due | Non-accrual<br>status |
|--------------------------|-------------------------|----------|------------------------|------------------------|--------------------------------|-----------------------|
| <b>Loans Receivable:</b> |                         |          |                        |                        |                                |                       |
| Multi-family residential | \$7,455                 | \$7,455  | \$ —                   | \$ —                   | \$ —                           | \$ —                  |
| Commercial               | 69,865                  | 67,807   | —                      | —                      | —                              | 2,058                 |
| Other                    | 712                     | 712      | —                      | —                      | —                              | —                     |
|                          | \$78,032                | \$75,974 | \$ —                   | \$ —                   | \$ —                           | \$ 2,058              |
| <b>Notes Receivable:</b> |                         |          |                        |                        |                                |                       |
| Secured                  | \$10,533                | \$5,784  | \$ 3,668               | \$ —                   | \$ 231                         | \$ 850                |
| Unsecured                | 2,593                   | 771      | —                      | —                      | —                              | 1,822                 |
|                          | \$13,126                | \$6,555  | \$ 3,668               | \$ —                   | \$ 231                         | \$ 2,672              |

Note 5 – Goodwill

A summary of the changes in the carrying amount of goodwill, by operating segment, for the six months ended June 30, 2014 is as follows:

(in thousands)

Total

|                                       | Title<br>Insurance<br>and Services | Specialty<br>Insurance |            |
|---------------------------------------|------------------------------------|------------------------|------------|
| Balance as of<br>December 31,<br>2013 | \$ 799,261                         | \$ 46,765              | \$ 846,026 |
| Acquisitions                          | 147,203                            | —                      | 147,203    |
| Foreign<br>currency<br>exchange       | 642                                | —                      | 642        |
| Balance as of<br>June 30, 2014        | \$ 947,106                         | \$ 46,765              | \$ 993,871 |

For further discussion about the Company's acquisitions see Note 17 – Business Combinations.

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. There is no accumulated impairment for goodwill as the Company has never recognized any impairment for its reporting units.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

In accordance with accounting guidance and consistent with prior years, the Company's policy is to perform an annual assessment of goodwill for impairment for each reporting unit in the fourth quarter. An impairment analysis has not been performed during the six months ended June 30, 2014 as no triggering events requiring such an analysis occurred.

Note 6 – Other Intangible Assets

Other intangible assets consist of the following:

|                                     | June 30,  | December 31, |
|-------------------------------------|-----------|--------------|
| (in thousands)                      | 2014      | 2013         |
| Finite-lived intangible assets:     |           |              |
| Customer relationships              | \$86,674  | \$ 77,382    |
| Noncompete agreements               | 27,197    | 26,928       |
| Trademarks                          | 10,024    | 10,026       |
| Patents                             | 2,840     | 2,840        |
|                                     | 126,735   | 117,176      |
| Accumulated amortization            | (93,950 ) | (88,624 )    |
|                                     | 32,785    | 28,552       |
| Indefinite-lived intangible assets: |           |              |
| Licenses                            | 17,793    | 17,795       |
|                                     | \$50,578  | \$ 46,347    |

Amortization expense for finite-lived intangible assets was \$2.2 million and \$5.2 million for the three and six months ended June 30, 2014, respectively, and \$3.1 million and \$6.2 million for the three and six months ended June 30, 2013, respectively.

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

| Year | (in thousands) |
|------|----------------|
|      | \$ 3,621       |

| Remainder<br>of 2014 |          |
|----------------------|----------|
| 2015                 | \$ 5,282 |
| 2016                 | \$ 4,583 |
| 2017                 | \$ 2,856 |
| 2018                 | \$ 2,705 |
| 2019                 | \$ 2,267 |

#### Note 7 – Reserve for Known and Incurred But Not Reported Claims

A summary of the Company’s loss reserves, including known title claims, incurred but not reported claims (“IBNR”) and non-title claims, is as follows:

| (in thousands, except percentages) | June 30, 2014 |         | December 31, 2013 |         |
|------------------------------------|---------------|---------|-------------------|---------|
| Known title claims                 | \$ 128,317    | 12.7 %  | \$ 135,478        | 13.3 %  |
| IBNR                               | 838,903       | 82.8 %  | 840,104           | 82.5 %  |
| Total title claims                 | 967,220       | 95.5 %  | 975,582           | 95.8 %  |
| Non-title claims                   | 45,930        | 4.5 %   | 42,783            | 4.2 %   |
| Total loss reserves                | \$ 1,013,150  | 100.0 % | \$ 1,018,365      | 100.0 % |

The provision for title losses, expressed as a percentage of title premiums and escrow fees, was 8.9% and 7.5% for the three and six months ended June 30, 2014, respectively, and 14.8% and 12.0% for the three and six months ended June 30, 2013, respectively.



FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The current quarter rate of 8.9% reflects the ultimate loss rate of 6.0% for the current 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.

The second quarter of 2013 rate of 14.8% reflected an ultimate loss rate of 5.8% for policy year 2013 and an \$89.0 million net increase in the loss reserve estimates for prior policy years. The increase in loss reserve estimates for prior policy years reflected claims development above expected levels during the second quarter of 2013, primarily from domestic lenders policies and, to a lesser extent, the Company's guaranteed valuation product offered in Canada. The reserve strengthening associated with domestic lenders policies was \$58.7 million and was primarily attributable to policy years 2004 through 2008. During the second quarter of 2013, claims on domestic lenders policies significantly exceeded the Company's expectations and management expected this level of elevated claims experience to continue through 2013 and for a period thereafter. The reserve strengthening associated with the guaranteed valuation product offered in Canada was \$12.9 million and was primarily attributable to claims frequency exceeding the Company's expectations during the second quarter of 2013. Given management's revised outlook, a reserve strengthening was recorded to reflect increases to ultimate losses for prior policy years.

#### Note 8 – Notes and Contracts Payable

In May 2014, the Company amended and restated its credit agreement with JPMorgan Chase Bank, N.A. in its capacity as administrative agent and the lenders party thereto. The credit agreement is comprised of a \$700.0 million revolving credit facility. Unless terminated earlier, the revolving loan commitments under the credit agreement will terminate on May 14, 2019. The obligations of the Company under the credit agreement are neither secured nor guaranteed. The agreement replaced the Company's \$600.0 million senior unsecured credit agreement that had been in place since November 14, 2012. Proceeds under the credit agreement may be used for general corporate purposes.

The credit agreement includes an expansion option that permits the Company, subject to satisfaction of certain conditions, to increase the revolving commitments and/or add term loan tranches ("Incremental Term Loans") in an aggregate amount not to exceed \$150.0 million. Incremental Term Loans, if made, may not mature prior to the revolving commitment termination date, provided that amortization may occur prior to such date.

At the Company's election, borrowings of revolving loans under the credit agreement bear interest at (a) the Alternate Base Rate plus the applicable spread or (b) the Adjusted LIBOR rate plus the applicable spread (in each case as defined in the agreement). The Company may select interest periods of one, two, three or six months or (if agreed to by all lenders) such other number of months for Eurodollar borrowings of loans. The applicable spread varies depending upon the debt rating assigned by Moody's Investor Service, Inc. and/or Standard & Poor's Rating Services. The minimum applicable spread for Alternate Base Rate borrowings is 0.625% and the maximum is 1.00%. The minimum applicable spread for Adjusted LIBOR rate borrowings is 1.625% and the maximum is 2.00%. The rate of interest on Incremental Term Loans will be established at or about the time such loans are made and may differ from the rate of interest on revolving loans.

The credit agreement includes representations and warranties, reporting covenants, affirmative covenants, negative covenants, financial covenants and events of default customary for financings of this type. Upon the occurrence of an

event of default the lenders may accelerate the loans. Upon the occurrence of certain insolvency and bankruptcy events of default the loans will automatically accelerate. As of June 30, 2014, the Company was in compliance with the financial covenants under the credit agreement.

In March 2014, the Company borrowed \$150.0 million under its credit facility to partially fund acquisitions during the first quarter of 2014. See Note 17 – Business Combinations to the condensed consolidated financial statements for further discussion of the Company’s acquisitions. At June 30, 2014, outstanding borrowings under the facility totaled \$150.0 million at an interest rate of 1.90%.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 9 – Income Taxes

The Company's effective income tax rate (income tax expense as a percentage of income before income taxes) was 33.7% and 35.1% for the three and six months ended June 30, 2014, respectively, and 41.0% and 40.1% for the three and six months ended June 30, 2013, 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 reported on the Company's tax returns.

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, 2014 and December 31, 2013, the Company had a net payable to CoreLogic of \$54.1 million and \$56.5 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 the result of an examination settlement reached with a taxing authority for tax matters prior to the spin-off.

The Company evaluates the realizability of its deferred tax assets by assessing the valuation allowance and adjusting the amount of such 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. Failure to achieve the forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company's effective tax rate on future earnings.

As of June 30, 2014 and December 31, 2013, the liability for income taxes associated with uncertain tax positions was \$24.0 million and \$47.8 million, respectively. The decrease during the current year was primarily attributable to an examination settlement reached with a taxing authority for issues related to the timing of deductibility, which, accordingly, did not impact the Company's condensed consolidated statement of income. As of June 30, 2014 and December 31, 2013, the liabilities could be reduced by \$3.4 million and \$32.6 million, respectively, of offsetting tax benefits associated with the correlative effects of potential adjustments including timing adjustments and state income taxes. The net amounts of \$20.6 million and \$15.2 million as of June 30, 2014 and December 31, 2013, 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 tax expense. As of June 30, 2014 and December 31, 2013, the Company had accrued \$8.5 million and \$4.7 million, respectively, of interest and penalties (net of tax benefits of \$3.5 million and \$1.9 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 uncertain tax positions may significantly increase or decrease within the next 12 months. These changes may be the result of items such as 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. 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.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 10 – Earnings Per Share

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

| (in thousands, except per share amounts)   | For the Three Months Ended |           | For the Six Months Ended |           |
|--|----------------------------|-----------|--------------------------|-----------|
|  | June 30,<br>2014           | 2013      | June 30,<br>2014         | 2013      |
| <b>Numerator</b>   |                            |           |                          |           |
| Net income attributable to the Company   | \$ 50,594                  | \$ 34,672 | \$ 72,318                | \$ 70,850 |
| Less: dividends and undistributed earnings allocated to unvested restricted stock units (“RSUs”) | 123                        | 47        | 176                      | 100       |
| Net income allocated to common stockholders  | \$ 50,471                  | \$ 34,625 | \$ 72,142                | \$ 70,750 |
| <b>Denominator</b>   |                            |           |                          |           |
| Basic weighted-average shares  | 106,878                    | 108,210   | 106,522                  | 107,881   |
| Effect of dilutive employee stock options and RSUs   | 1,769                      | 2,101     | 1,901                    | 2,191     |
| Diluted weighted-average shares  | 108,647                    | 110,311   | 108,423                  | 110,072   |
| <b>Net income per share attributable to the Company’s stockholders</b>                           |                            |           |                          |           |
| Basic  | \$ 0.47                    | \$ 0.32   | \$ 0.68                  | \$ 0.66   |
| Diluted  | \$ 0.47                    | \$ 0.31   | \$ 0.67                  | \$ 0.64   |

For the three and six months ended June 30, 2014, 134 thousand and 133 thousand, respectively, of stock options and RSUs were excluded from the weighted-average diluted shares outstanding due to their antidilutive effect. For the three and six months ended June 30, 2013, no stock options or RSUs had an antidilutive effect on weighted-average diluted shares outstanding.

Note 11 – Employee Benefit Plans

Net periodic cost related to the Company’s defined benefit pension and supplemental benefit plans during the three and six months ended June 30, 2014 and 2013 includes the following components:

| (in thousands) | For the Three Months Ended |      | For the Six Months Ended |      |
|----------------|----------------------------|------|--------------------------|------|
|                | June 30,<br>2014           | 2013 | June 30,<br>2014         | 2013 |

Edgar Filing: First American Financial Corp - Form 10-Q

|  |          |          |           |           |
|--|----------|----------|-----------|-----------|
| Expense:                                   |          |          |           |           |
| Service costs                              | \$ 329   | \$ 479   | \$ 658    | \$ 958    |
| Interest costs                             | 6,956    | 6,724    | 13,912    | 13,448    |
| Expected<br>return on plan<br>assets       | (4,694 ) | (4,674 ) | (9,388 )  | (9,348 )  |
| Amortization<br>of net actuarial<br>loss   | 7,407    | 8,002    | 14,814    | 16,004    |
| Amortization<br>of prior service<br>credit | (1,038 ) | (1,096 ) | (2,076 )  | (2,192 )  |
|  | \$ 8,960 | \$ 9,435 | \$ 17,920 | \$ 18,870 |

The Company contributed \$18.1 million to the defined benefit pension and supplemental benefit plans during the six months ended June 30, 2014, and expects to contribute an additional \$23.7 million during the remainder of 2014. These contributions include both 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.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 12 – Fair Value of Financial Instruments

Accounting guidance requires disclosure of fair value information about financial instruments, whether or not recognized at fair value on the balance sheet, for which it is practical to estimate that value. In the measurement of the fair value of certain financial instruments, other valuation techniques were utilized if quoted market prices were not available. These derived fair value estimates are significantly affected by the assumptions used. Additionally, the guidance excludes certain financial instruments including those related to insurance contracts, pension and other postretirement benefits, and equity method investments.

In estimating the fair value of the financial instruments presented, 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.

Accounts and accrued income receivable, net

The carrying amount for accounts and accrued income receivable, net is a reasonable estimate of fair value due to the short-term maturity of these assets.

Loans receivable, net

The fair value of loans receivable, net is estimated based on the discounted value of the future cash flows using current rates being offered for loans with similar terms to borrowers of similar credit quality.

Investments

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

The methodology for determining the fair value of debt and equity securities is discussed in Note 3 Debt and Equity Securities to the condensed consolidated financial statements.

The fair value of notes receivable, net is estimated based on the discounted value of the future cash flows using approximate current market rates being offered for notes with similar maturities and similar credit quality.

Deposits

The carrying value of escrow and other deposit accounts approximates fair value due to the short-term nature of this liability. The fair value of investment certificate accounts is estimated based on the discounted value of future cash flows using a discount rate approximating current market rates for similar liabilities.

Accounts payable and accrued liabilities

The carrying amount for accounts payable and accrued liabilities is a reasonable estimate of fair value due to the short-term maturity of these liabilities. The Company does not include the carrying amounts and fair values of pension costs and other retirement plans as the guidance excludes them from disclosure.

Notes and contracts payable

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

25

---



FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

The carrying amounts and fair values of the Company’s financial instruments as of June 30, 2014 and December 31, 2013 are presented in the following table:

|   | June 30, 2014 |             | December 31, 2013 |             |
|---|---------------|-------------|-------------------|-------------|
|   | Carrying      | Fair        | Carrying          | Fair        |
| (in thousands)                              | Amount        | Value       | Amount            | Value       |
| <b>Financial Assets:</b>                    |               |             |                   |             |
| Cash and cash equivalents                   | \$1,041,259   | \$1,041,259 | \$834,837         | \$834,837   |
| Accounts and accrued income receivable, net | \$291,607     | \$291,607   | \$236,895         | \$236,895   |
| Loans receivable, net                       | \$58,841      | \$60,223    | \$73,755          | \$73,397    |
| <b>Investments:</b>                         |               |             |                   |             |
| Deposits with banks                         | \$24,108      | \$24,204    | \$23,492          | \$23,601    |
| Debt securities                             | \$2,947,204   | \$2,947,204 | \$2,819,817       | \$2,819,817 |
| Equity securities                           | \$313,289     | \$313,289   | \$358,043         | \$358,043   |
| Notes receivable, net                       | \$10,108      | \$9,927     | \$10,542          | \$9,953     |
| <b>Financial Liabilities:</b>               |               |             |                   |             |
| Deposits                                    | \$1,962,711   | \$1,962,839 | \$1,692,932       | \$1,693,138 |
| Accounts payable and accrued liabilities    | \$361,730     | \$361,730   | \$406,819         | \$406,819   |
| Notes and contracts payable                 | \$454,681     | \$458,571   | \$310,285         | \$301,007   |

The following table presents the fair value of the Company’s financial instruments as of June 30, 2014 and December 31, 2013, classified using the three-level hierarchy for fair value measurements:

| (in thousands) | Fair Value | Level 1 | Level 2 | Level 3 |
|----------------|------------|---------|---------|---------|
| June 30, 2014  |            |         |         |         |

Edgar Filing: First American Financial Corp - Form 10-Q

|   |             |             |             |          |
|---|-------------|-------------|-------------|----------|
| Financial                                   |             |             |             |          |
| Assets:                                     |             |             |             |          |
| Cash and cash equivalents                   | \$1,041,259 | \$1,041,259 | \$—         | \$—      |
| Accounts and accrued income receivable, net | \$291,607   | \$291,607   | \$—         | \$—      |
| Loans receivable, net                       | \$60,223    | \$—         | \$—         | \$60,223 |
| Investments:                                |             |             |             |          |
| Deposits with banks                         | \$24,204    | \$3,046     | \$21,158    | \$—      |
| Debt securities                             | \$2,947,204 | \$—         | \$2,929,210 | \$17,994 |
| Equity securities                           | \$313,289   | \$313,289   | \$—         | \$—      |
| Notes receivable, net                       | \$9,927     | \$—         | \$—         | \$9,927  |
| Financial Liabilities:                      |             |             |             |          |
| Deposits                                    | \$1,962,839 | \$1,943,463 | \$19,376    | \$—      |
| Accounts payable and accrued liabilities    | \$361,730   | \$361,730   | \$—         | \$—      |
| Notes and contracts payable                 | \$458,571   | \$—         | \$448,090   | \$10,481 |

(in thousands) Fair Value Level 1 Level 2 Level 3  
December 31, 2013

|   |             |           |             |          |
|---|-------------|-----------|-------------|----------|
| Financial                                   |             |           |             |          |
| Assets:                                     |             |           |             |          |
| Cash and cash equivalents                   | \$834,837   | \$834,837 | \$—         | \$—      |
| Accounts and accrued income receivable, net | \$236,895   | \$236,895 | \$—         | \$—      |
| Loans receivable, net                       | \$73,397    | \$—       | \$—         | \$73,397 |
| Investments:                                |             |           |             |          |
| Deposits with banks                         | \$23,601    | \$2,070   | \$21,531    | \$—      |
| Debt securities                             | \$2,819,817 | \$—       | \$2,800,795 | \$19,022 |
| Equity securities                           | \$358,043   | \$358,043 | \$—         | \$—      |
| Notes receivable, net                       | \$9,953     | \$—       | \$—         | \$9,953  |

|  |              |              |            |          |
|--|--------------|--------------|------------|----------|
| Financial Liabilities:                   |              |              |            |          |
| Deposits                                 | \$ 1,693,138 | \$ 1,666,336 | \$ 26,802  | \$—      |
| Accounts payable and accrued liabilities | \$ 406,819   | \$ 406,819   | \$—        | \$—      |
| Notes and contracts payable              | \$ 301,007   | \$—          | \$ 294,221 | \$ 6,786 |

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 13 – Share-Based Compensation Plans

The following table presents the compensation expense associated with the Company's share-based compensation plans for the three and six months ended June 30, 2014 and 2013:

| (in thousands)               | For the Three Months Ended<br>June 30, |          | For the Six Months Ended<br>June 30, |           |
|------------------------------|--|----------|--------------------------------------|-----------|
|                              | 2014                                   | 2013     | 2014                                 | 2013      |
| Restricted stock units       | \$ 3,091                               | \$ 4,197 | \$ 11,365                            | \$ 13,698 |
| Stock options                | 68                                     | —        | 135                                  | —         |
| Employee stock purchase plan | (38 )                                  | 260      | 1,019                                | 646       |
|                              | \$ 3,121                               | \$ 4,457 | \$ 12,519                            | \$ 14,344 |

The following table summarizes RSU activity for the six months ended June 30, 2014:

| (in thousands, except weighted average grant-date fair value) | Shares  | Weighted-average grant-date fair value |
|---|---------|--|
| RSUs unvested at December 31, 2013                            | 2,720   | \$ 17.60                               |
| Granted during 2014   | 645     | \$ 26.63                               |
| Vested during 2014  | (1,021) | \$ 15.65                               |
| Forfeited during 2014   | (15 )   | \$ 16.46                               |
| RSUs unvested at June 30, 2014                                | 2,329   | \$ 20.97                               |

The following table summarizes stock option activity for the six months ended June 30, 2014:

| (in thousands, except weighted-average exercise price and contractual term) | Number outstanding | Weighted-average exercise price | Weighted-average remaining contractual term | Aggregate intrinsic value |
|---|--------------------|---------------------------------|---|---------------------------|
| Balance at December 31, 2013  | 1,270              | \$ 18.03                        |   |                           |
| Exercised during 2014   | (391 )             | \$ 14.15                        |   |                           |
| Balance at June 30, 2014  | 879                | \$ 19.76                        | 2.4 years                                   | \$ 7,057                  |

Edgar Filing: First American Financial Corp - Form 10-Q

|  |     |          |           |          |
|--|-----|----------|-----------|----------|
| Vested and expected to vest at June 30, 2014 | 879 | \$ 19.76 | 2.4 years | \$ 7,057 |
| Exercisable at June 30, 2014                 | 746 | \$ 18.36 | 1.1 years | \$ 7,039 |

Note 14 – Stockholders’ Equity

In March 2014, the Company’s board of directors approved an increase in the size of the Company’s stock repurchase plan from \$150.0 million to \$250.0 million, of which \$182.9 million remained as of June 30, 2014. Purchases may be made from time to time by the Company in the open market at prevailing market prices or in privately negotiated transactions. The Company did not repurchase any shares of its common stock during the three and six months ended June 30, 2014 and as of June 30, 2014, had repurchased and retired 3.2 million shares of its common stock under the current authorization for a total purchase price of \$67.1 million.

27

---

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 15 – Accumulated Other Comprehensive Income (Loss)

Changes in the balances of each component of accumulated other comprehensive income (loss) for the six months ended June 30, 2014 are as follows:

| (in thousands)   | Net unrealized<br>gains (losses)<br>on securities | Foreign<br>currency<br>translation<br>adjustment | Pension<br>benefit<br>adjustment | Accumulated<br>other<br>comprehensive<br>income (loss) |
|--|---|--|----------------------------------|--|
| Balance at<br>December 31,<br>2013   | \$ (8,727 )                                       | \$ (3,726 )                                      | \$ (133,084 )                    | \$ (145,537 )  |
| Change in net<br>unrealized<br>gains (losses)<br>on securities   | 42,232  | —  | —                                | 42,232   |
| Change in net<br>unrealized<br>gains (losses)<br>on securities for<br>which credit<br>losses have<br>been<br>recognized in<br>earnings | 712   | —  | —                                | 712  |
| Change in<br>foreign<br>currency<br>translation<br>adjustment  | —   | 5,572  | —                                | 5,572  |
| Amortization of<br>net actuarial<br>loss   | —   | —  | 14,814                           | 14,814   |
| Amortization of<br>prior service<br>credit   | —   | —  | (2,076 )                         | (2,076 )   |
| Tax effect   | (16,705 )   | —  | (4,955 )                         | (21,660 )  |
| Balance at June<br>30, 2014  | \$ 17,512   | \$ 1,846   | \$ (125,301 )                    | \$ (105,943 )  |
|  | \$ 17,498   | \$ 1,846   | \$ (125,301 )                    | \$ (105,957 )  |

Edgar Filing: First American Financial Corp - Form 10-Q

|                                       |           |          |              |              |
|---------------------------------------|-----------|----------|--------------|--------------|
| Allocated to the Company              |           |          |              |              |
| Allocated to noncontrolling interests | 14        | —        | —            | 14           |
| Balance at June 30, 2014              | \$ 17,512 | \$ 1,846 | \$(125,301 ) | \$(105,943 ) |

The following table presents the other comprehensive income (loss) reclassification adjustments for the three months ended June 30, 2014 and 2013:

| (in thousands)                                      | Net unrealized gains (losses) on securities | Foreign currency translation adjustment | Pension benefit adjustment | Accumulated other comprehensive income (loss) |
|---|---|---|----------------------------|---|
| Three Months Ended June 30, 2014                    |   |   |                            |   |
| Pretax change before reclassifications              | \$ 29,818                                   | \$ 11,612                               | \$ —                       | \$ 41,430                                     |
| Reclassifications out of AOCI                       | (6,840 )                                    | —                                       | 6,369                      | (471 )  |
| Tax effect  | (8,939 )                                    | —                                       | (2,477 )                   | (11,416 )                                     |
| Total other comprehensive income (loss), net of tax | \$ 14,039                                   | \$ 11,612                               | \$ 3,892                   | \$ 29,543                                     |
| Three Months Ended June 30, 2013                    |   |   |                            |   |
| Pretax change before reclassifications              | \$ (63,816 )                                | \$ (9,794 )                             | \$ —                       | \$ (73,610 )                                  |
| Reclassifications out of AOCI                       | (4,691 )                                    | —                                       | 6,906                      | 2,215   |
| Tax effect  | 27,403                                      | —                                       | (2,763 )                   | 24,640  |
| Total other comprehensive income (loss), net of tax | \$ (41,104 )                                | \$ (9,794 )                             | \$ 4,143                   | \$ (46,755 )                                  |

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 six months ended June 30, 2014 and 2013:

| (in thousands)                                      | Net unrealized gains (losses) on securities | Foreign currency translation adjustment | Pension benefit adjustment | Accumulated other comprehensive income (loss) |
|---|---|---|----------------------------|---|
| <b>Six Months Ended June 30, 2014</b>               |   |   |                            |   |
| Pretax change before reclassifications              | \$ 51,953                                   | \$ 5,572                                | \$ —                       | \$ 57,525                                     |
| Reclassifications out of AOCI                       | (9,009 )                                    | —                                       | 12,738                     | 3,729   |
| Tax effect  | (16,705 )                                   | —                                       | (4,955 )                   | (21,660 )                                     |
| Total other comprehensive income (loss), net of tax | \$ 26,239                                   | \$ 5,572                                | \$ 7,783                   | \$ 39,594                                     |
| <b>Six Months Ended June 30, 2013</b>               |   |   |                            |   |
| Pretax change before reclassifications              | \$ (56,622 )                                | \$ (16,616 )                            | \$ —                       | \$ (73,238 )                                  |
| Reclassifications out of AOCI                       | (11,254 )                                   | —                                       | 13,812                     | 2,558   |
| Tax effect  | 27,151                                      | —                                       | (5,525 )                   | 21,626  |
| Total other comprehensive income (loss), net of tax | \$ (40,725 )                                | \$ (16,616 )                            | \$ 8,287                   | \$ (49,054 )                                  |

The following table presents the effect of the reclassifications out of accumulated other comprehensive income (loss) on the respective line items in the condensed consolidated statements of income:

Amounts reclassified from  
accumulated other comprehensive



Edgar Filing: First American Financial Corp - Form 10-Q

|  | income (loss)<br>Three Months<br>Ended |           | Six Months Ended |            |   |
|--|--|-----------|------------------|------------|---|
| (in thousands)   | June 30,<br>2014                       | 2013      | June 30,<br>2014 | 2013       | Affected line items in the condensed<br>consolidated statements of income |
| Net unrealized gains (losses) on securities:                                 |  |           |                  |            |   |
| Net realized gains on sales of securities                                    | \$7,355                                | \$4,691   | \$10,042         | \$11,254   | Net realized investment gains   |
| Net OTTI losses recognized in earnings                                       | (515 )                                 | —         | (1,033 )         | —          | Net OTTI losses recognized in earnings                                    |
| Pretax total   | \$6,840                                | \$4,691   | \$9,009          | \$11,254   |   |
| Tax effect   | \$(2,661)                              | \$(1,876) | \$(3,505 )       | \$(4,502 ) |   |
| Pension benefit adjustment:  |  |           |                  |            |   |
| Amortization of defined benefit pension and supplemental benefit plan items: |  |           |                  |            |   |
| Net actuarial loss   | (7,407)                                | (8,002)   | (14,814)         | (16,004)   | (1)   |
| Prior service credit   | 1,038                                  | 1,096     | 2,076            | 2,192      | (1)   |
| Pretax total   | \$(6,369)                              | \$(6,906) | \$(12,738)       | \$(13,812) |   |
| Tax effect   | \$2,477                                | \$2,763   | \$4,955          | \$5,525    |   |

(1) These accumulated other comprehensive income components are included in the computation of net periodic cost. See Note 11 – Employee Benefit Plans for additional details.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 16 – 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.

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 *Haskins v. First American Title Insurance Company*, filed on September 29, 2010 and pending in the United States District Court of New Jersey,

Edgar Filing: First American Financial Corp - Form 10-Q

Levine v. First American Title Insurance Company, filed on February 26, 2009 and pending in the United States District Court of Pennsylvania,

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,

Raffone v. First American Title Insurance Company, filed on February 14, 2004 and pending in the Circuit Court, Nassau County, Florida, and

Slapikas v. First American Title Insurance Company, filed on December 19, 2005 and pending in the United States District Court for the Western District of Pennsylvania.

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

All of these lawsuits are putative class actions. A court has only granted class certification in Lewis and Raffone. The class originally certified in Slapikas was subsequently decertified. 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 or, where the Company has been able to make an estimate, the Company believes the amount is immaterial to the condensed consolidated financial statements as a whole.

• purchased minority interests in title insurance agents as an inducement to refer title insurance underwriting business to the Company or gave items of value to title insurance agents and others for referrals of business in violation of the Real Estate Settlement Procedures Act, including

• Edwards v. First American Financial Corporation, filed on June 12, 2007 and pending in the United States District Court for the Central District of California.

In Edwards a narrow class has been certified. For the reasons stated above, the Company has been unable to estimate the possible loss or the range of loss.

• engaged in the unauthorized practice of law, including

- Gale v. First American Title Insurance Company, et al., filed on October 16, 2006 and pending in the United States District Court of Connecticut.

The class originally certified in Gale was subsequently decertified. For the reasons described above, the Company has not yet been able to assess the probability of loss or estimate the possible loss or the range of loss.

• overcharged or improperly charged fees for products and services provided in connection with the closing of real estate transactions, denied home warranty claims, recorded telephone calls, and gave items of value to developers, builders and others as inducements to refer business in violation of certain other laws, such as consumer protection laws and laws generally prohibiting unfair business practices, and certain obligations, including

• Bushman v. First American Title Insurance Company, et al., filed on November 21, 2013 and pending in the Circuit Court of the State of Michigan, County of Washtenaw,

• Carrera v. First American Home Buyers Protection Corporation, filed on September 23, 2009 and pending in the United States District Court for the Southern District of California,

• Chassen v. First American Financial Corporation, et al., filed on January 22, 2009 and pending in the United States District Court of New Jersey,

• Diaz v. First American Home Buyers Protection Corporation, filed on March 10, 2009 and pending in the United States District Court for the Southern District of California,

• Gunning v. First American Title Insurance Company, filed on July 14, 2008 and pending in the United States District Court for the Eastern District of Kentucky,

• Kaufman v. First American Financial Corporation, et al., filed on December 21, 2007 and pending in the Superior Court of the State of California, County of Los Angeles,

• Kirk v. First American Financial Corporation, et al., filed on June 15, 2006 and pending in the Superior Court of the State of California, County of Los Angeles,

• Muehling v. First American Title Company, filed on December 11, 2012 and pending in the Superior Court of the State of California, County of Alameda,

- Sjobring v. First American Financial Corporation, et al., filed on February 25, 2005 and pending in the Superior Court of the State of California, County of Los Angeles,

• Snyder v. First American Financial Corporation, et al., filed on June 21, 2014 and pending in the United States District Court for the District of Colorado, and

Wilmot v. First American Financial Corporation, et al., filed on April 20, 2007 and pending in the Superior Court of the State of California, County of Los Angeles.

31

---

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

All of these lawsuits, except Kaufman and Kirk, are putative class actions for which a class has not been certified. In Kaufman a class was certified but that certification was subsequently vacated. A trial of the Kirk matter has concluded and plaintiff has filed a notice of appeal. For the reasons described above, 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 immaterial to the condensed consolidated financial statements as a whole.

While some of the lawsuits described above may be material to the Company's operating results in any particular period if an unfavorable outcome results, the Company does not believe that any of these lawsuits will have a material adverse effect on the Company's overall financial condition or liquidity.

The Company also is a party to non-ordinary course lawsuits other than those described above. With respect to these lawsuits, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the condensed consolidated financial statements as a whole.

The Company's title insurance, property and casualty insurance, home warranty, banking, thrift, trust and investment advisory businesses are regulated by various federal, state and local governmental agencies. Many of the Company's other businesses operate within statutory guidelines. Consequently, the Company may from time to time be subject to examination or investigation by such governmental agencies. Currently, governmental agencies are examining or investigating certain of the Company's operations. These exams or investigations include inquiries into, among other matters, pricing and rate setting practices in the title insurance industry, competition in the title insurance industry, real estate settlement service customer acquisition and retention practices and agency relationships. With respect to matters where the Company has determined that a loss is both probable and reasonably estimable, the Company has recorded a liability representing its best estimate of the financial exposure based on known facts. While the ultimate disposition of each such exam or investigation is not yet determinable, the Company does not believe that individually or in the aggregate they will have a material adverse effect on the Company's financial condition, results of operations or cash flows. These exams or investigations could, however, result in changes to the Company's business practices which could ultimately have a material adverse impact on the Company's financial condition, results of operations or cash flows.

The Company and its subsidiaries also are involved in numerous ongoing routine legal and regulatory proceedings related to their operations. With respect to each of these proceedings, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the condensed consolidated financial statements as a whole.

#### Note 17 – Business Combinations

In March 2014, the Company completed the acquisition of a company that provides loan quality analytics, decision support tools and loan review services for the mortgage industry for a purchase price of \$155.0 million. The Company has recorded preliminary fair value estimates for the assets acquired and liabilities assumed which are subject to change pending completion of the Company's purchase price allocation. The Company completed three additional acquisitions during the six months ended June 30, 2014, for an aggregate purchase price of \$10.9 million.

The Company allocates the purchase price of each acquisition to the assets acquired and liabilities assumed using a variety of valuation techniques including discounted cash flow analysis. These acquisitions have been included in the Company's title insurance and services segment. In March 2014, the Company drew \$150.0 million on its credit facility to partially fund the acquisitions.

32

---

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

Note 18 – Segment Information

The Company consists of the following reportable segments and a corporate function:

- The Company's title insurance and services segment issues title insurance policies on residential and commercial property in the United States and offers similar or related products and services internationally. This segment also provides closing and/or escrow services; accommodates tax-deferred exchanges of real estate; provides products, services and solutions involving the use of real property related data designed to mitigate risk or otherwise facilitate real estate transactions; maintains, manages and provides access to title plant records and images; and provides banking, trust and investment advisory services. The Company, through its principal title insurance subsidiary and such subsidiary's affiliates, transacts its title insurance business through a network of direct operations and agents. Through this network, the Company issues policies in the 49 states that permit the issuance of title insurance policies and the District of Columbia. The Company also offers title insurance and other insurance and guarantee products, as well as related settlement services in foreign countries, including Canada, the United Kingdom, Australia and various other established and emerging markets.
- The Company's specialty insurance segment issues property and casualty insurance policies and sells home warranty products. The property and casualty insurance business provides insurance coverage to residential homeowners and renters for liability losses and typical hazards such as fire, theft, vandalism and other types of property damage. This business is licensed to issue policies in all 50 states and the District of Columbia and actively issues policies in 46 states. In certain markets it also offers preferred risk auto insurance to better compete with other carriers offering bundled home and auto insurance. The home warranty business provides residential service contracts that cover residential systems, such as heating and air conditioning systems, and appliances against failures that occur as the result of normal usage during the coverage period. This business currently operates in 39 states and the District of Columbia.

The corporate function consists primarily of certain financing facilities as well as the corporate services that support the Company's business operations. Eliminations consist of inter-segment revenues and related expenses included in the results of the operating segments.

Selected financial information, by reporting segment, is as follows:

For the three months ended June 30, 2014:

| (in thousands)                  | Revenues    | Income (loss)<br>before<br>income taxes | Depreciation<br>and<br>amortization | Capital<br>expenditures |
|---------------------------------|-------------|---|-------------------------------------|-------------------------|
| Title Insurance<br>and Services | \$1,055,395 | \$ 84,837                               | \$ 17,623                           | \$ 18,028               |
| Specialty<br>Insurance          | 91,184      | 11,035                                  | 1,338                               | 878                     |
| Corporate                       | 3,779       | (19,414 )                               | 819                                 | —                       |



Edgar Filing: First American Financial Corp - Form 10-Q

|              |             |           |           |           |
|--------------|-------------|-----------|-----------|-----------|
| Eliminations | (389 )      | —         | —         | —         |
|              | \$1,149,969 | \$ 76,458 | \$ 19,780 | \$ 18,906 |

For the three months ended June 30, 2013:

| (in thousands)                  | Revenues    | Income (loss)<br>before<br>income taxes | Depreciation<br>and<br>amortization | Capital<br>expenditures |
|---------------------------------|-------------|---|-------------------------------------|-------------------------|
| Title Insurance<br>and Services | \$1,205,047 | \$ 73,040                               | \$ 16,260                           | \$ 19,664               |
| Specialty<br>Insurance          | 84,023      | 7,291                                   | 1,209                               | 558                     |
| Corporate                       | 138         | (21,107 )                               | 723                                 | —                       |
| Eliminations                    | (744 )      | —                                       | —                                   | —                       |
|                                 | \$1,288,464 | \$ 59,224                               | \$ 18,192                           | \$ 20,222               |

FIRST AMERICAN FINANCIAL CORPORATION  
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements – (Continued)  
(unaudited)

For the six months ended June 30, 2014:

| (in thousands)                  | Revenues    | Income (loss)<br>before<br>income taxes | Depreciation<br>and<br>amortization | Capital<br>expenditures |
|---------------------------------|-------------|---|-------------------------------------|-------------------------|
| Title Insurance<br>and Services | \$1,980,724 | \$ 127,473                              | \$ 35,537                           | \$ 38,007               |
| Specialty<br>Insurance          | 178,325     | 24,933                                  | 2,577                               | 2,056                   |
| Corporate                       | 4,498       | (40,695 )                               | 1,638                               | —                       |
| Eliminations                    | (779 )      | —                                       | —                                   | —                       |
|                                 | \$2,162,768 | \$ 111,711                              | \$ 39,752                           | \$ 40,063               |

For the six months ended June 30, 2013:

| (in thousands)                  | Revenues    | Income (loss)<br>before<br>income taxes | Depreciation<br>and<br>amortization | Capital<br>expenditures |
|---------------------------------|-------------|---|-------------------------------------|-------------------------|
| Title Insurance<br>and Services | \$2,267,626 | \$ 137,308                              | \$ 32,744                           | \$ 37,287               |
| Specialty<br>Insurance          | 165,534     | 23,195                                  | 2,387                               | 1,592                   |
| Corporate                       | 3,568       | (41,687 )                               | 1,456                               | —                       |
| Eliminations                    | (1,501 )    | —                                       | —                                   | —                       |
|                                 | \$2,435,227 | \$ 118,816                              | \$ 36,587                           | \$ 38,879               |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

CERTAIN STATEMENTS IN THIS QUARTERLY REPORT ON FORM 10-Q, INCLUDING BUT NOT LIMITED TO THOSE SET FORTH ON PAGE 3 OF THIS QUARTERLY REPORT 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 CONTINUE," "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 THE FACTORS SET FORTH ON PAGES 3-4 OF THIS QUARTERLY REPORT. 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.

This Management's Discussion and Analysis contains certain financial measures that are not presented in accordance with generally accepted accounting principles ("GAAP"), including adjusted information and other revenues, adjusted personnel costs and adjusted other operating expenses, in each case excluding the effects of recent acquisitions. The Company is presenting these non-GAAP financial measures because they provide the Company's management and readers of this Quarterly Report on Form 10-Q with additional insight into the operational performance of the Company relative to earlier periods. The Company does not intend for these non-GAAP financial measures to be a substitute for any GAAP financial information. In this Quarterly Report on Form 10-Q, these non-GAAP financial measures have been presented with, and reconciled to, the most directly comparable GAAP financial measures. Readers of this Quarterly Report on Form 10-Q should use these non-GAAP financial measures only in conjunction with the comparable GAAP financial measures.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical accounting policies are those policies used in the preparation of First American Financial Corporation's (the "Company's") financial statements that require management to make estimates and judgments that affect the reported amounts of certain assets, liabilities, revenues, expenses and related disclosure of contingencies. A summary of these policies can be found in the Management's Discussion and Analysis section of the Company's Annual Report on Form 10-K for the year ended December 31, 2013. There have been no material changes to the Company's critical accounting policies since the filing of its Annual Report on Form 10-K for the year ended December 31, 2013.

#### Recently Adopted Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued updated guidance intended to eliminate the diversity in practice regarding financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2013, with early adoption permitted. The adoption of the guidance had no impact on the Company's condensed consolidated financial statements.

#### Pending Accounting Pronouncements

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 when it is recognized. 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

35

---

exchange for those goods or services. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption prohibited. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

In April 2014, the 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 31, 2014, with early adoption permitted. The Company expects the adoption of this guidance to have no impact on its condensed consolidated financial statements.

## Results of Operations

### Summary of Second Quarter

A substantial portion of the revenues for the Company's title insurance and services segment results from the sale and refinancing of residential and commercial real estate. In the Company's specialty insurance segment, revenues associated with the initial year of coverage in both the home warranty and property and casualty operations are impacted by volatility in residential purchase transactions. Traditionally, the greatest volume of real estate activity, particularly residential purchase activity, has occurred in the spring and summer months. However, changes in interest rates, as well as other economic factors, can cause fluctuations in the traditional pattern of real estate activity.

The Company's total revenue declined 10.7% in the second quarter of 2014 when compared with the second quarter of 2013. The Company's total revenue was negatively impacted by a significant decrease in refinance transactions.

According to the Mortgage Bankers Association's July 15, 2014 Mortgage Finance Forecast (the "MBA Forecast"), residential mortgage originations in the United States (based on the total dollar value of the transactions) decreased 50.3% in the second quarter of 2014 when compared with the second quarter of 2013. According to the MBA Forecast, the dollar amount of purchase originations decreased 13.7% and refinance originations decreased 69.2%. This residential mortgage origination activity resulted in a 3.5% decrease in domestic residential purchase orders closed per day and a 57.5% decrease in domestic refinance orders closed per day by the Company's direct title operations in the second quarter of 2014 when compared to the second quarter of 2013.

The level of domestic title orders opened per day by the Company's direct title operations during the second quarter of 2014 decreased by 24.5% when compared with the second quarter of 2013. The order mix continued to shift toward residential purchase and commercial transactions, which typically generate higher premiums than refinance transactions. Residential purchase open orders per day were essentially flat and commercial open orders per day decreased 3.6%, while refinance open orders per day decreased 47.6%.

Title Insurance and Services

| Thousands, except percentages)                                | Three Months Ended June 30, |           |             |          | Six Months Ended June 30, |           |             |         |
|---|-----------------------------|-----------|-------------|----------|---------------------------|-----------|-------------|---------|
|   | 2014                        | 2013      | \$ Change   | % Change | 2014                      | 2013      | \$ Change   | % C     |
| Revenues  |                             |           |             |          |                           |           |             |         |
| Direct premiums and escrow fees                               | \$443,365                   | \$511,918 | \$(68,553 ) | (13.4)%  | \$792,728                 | \$911,902 | \$(119,174) | (13.1)% |
| Agent premiums  | 423,209                     | 496,730   | (73,521 )   | (14.8)   | 844,133                   | 981,195   | (137,062)   | (14.0)  |
| Commission and other  | 165,222                     | 171,104   | (5,882 )    | (3.4 )   | 302,400                   | 322,852   | (20,452 )   | (6.3)   |
| Investment income   | 19,332                      | 21,599    | (2,267 )    | (10.5)   | 35,035                    | 40,585    | (5,550 )    | (13.7)  |
| Realized investment gains                                     | 4,782                       | 3,696     | 1,086       | 29.4     | 7,461                     | 11,092    | (3,631 )    | (32.7)  |
| Other-than-temporary impairment losses recognized in earnings | (515 )                      | —         | (515 )      | —        | (1,033 )                  | —         | (1,033 )    | —       |
|   | 1,055,395                   | 1,205,047 | (149,652)   | (12.4)   | 1,980,724                 | 2,267,626 | (286,902)   | (12.7)  |
| Expenses  |                             |           |             |          |                           |           |             |         |
| Salaries and personnel costs                                  | 327,218                     | 340,046   | (12,828 )   | (3.8 )   | 627,498                   | 656,889   | (29,391 )   | (4.5)   |
| Commissions retained by agents                                | 338,271                     | 396,024   | (57,753 )   | (14.6)   | 674,936                   | 783,567   | (108,631)   | (13.9)  |
| Other operating expenses                                      | 197,050                     | 216,230   | (19,180 )   | (8.9 )   | 367,132                   | 404,843   | (37,711 )   | (9.3)   |
| Provision for policy losses and claims                        | 77,089                      | 149,534   | (72,445 )   | (48.4)   | 123,305                   | 226,894   | (103,589)   | (45.7)  |
| Depreciation and amortization                                 | 17,623                      | 16,260    | 1,363       | 8.4      | 35,537                    | 32,744    | 2,793       | 8.5     |
| Income tax expense  | 12,666                      | 13,268    | (602 )      | (4.5 )   | 23,602                    | 24,172    | (570 )      | (2.4)   |
| Other   | 641                         | 645       | (4 )        | (0.6 )   | 1,241                     | 1,209     | 32          | 2.6     |
|   | 970,558                     | 1,132,007 | (161,449)   | (14.3)   | 1,853,251                 | 2,130,318 | (277,067)   | (13.0)  |
| Income before income taxes                                    | \$84,837                    | \$73,040  | \$11,797    | 16.2 %   | \$127,473                 | \$137,308 | \$(9,835 )  | (7.2)%  |
| Income tax expense  | 8.0 %                       | 6.1 %     | 1.9 %       | 31.1 %   | 6.4 %                     | 6.1 %     | 0.3 %       | 4.9 %   |

Direct premiums and escrow fees were \$443.4 million and \$792.7 million for the three and six months ended June 30, 2014, respectively, decreases of \$68.6 million, or 13.4%, and \$119.2 million, or 13.1%, when compared with the respective periods of the prior year. These decreases were primarily due to a decrease in the number of domestic title orders closed by the Company's direct operations, partially offset by an increase in domestic average revenues per order closed. The average revenues per order closed were \$1,830 and \$1,781 for the three and six months ended June 30, 2014, respectively, increases of 27.1% and 32.5% when compared with \$1,440 and \$1,345 for the respective periods of the prior year. The increases in average revenues per order closed were primarily attributable to an increase in the mix of direct revenues generated from higher premium residential purchase and commercial transactions. The Company's direct title operations closed 214,200 and 394,300 title orders during the three and six months ended June 30, 2014, respectively, decreases of 33.3% and 35.6% when compared with 321,300 and 612,700 title orders closed during the respective periods of the prior year, which was generally consistent with residential mortgage origination activity in the United States as reported in the MBA Forecast.

Agent premiums were \$423.2 million and \$844.1 million for the three and six months ended June 30, 2014, respectively, decreases of \$73.5 million, or 14.8%, and \$137.1 million, or 14.0%, when compared with the respective periods of the prior year. Agent premiums are recorded when notice of issuance is received from the agent, which is generally when cash payment is received by the Company. As a result, there is generally a delay between the agent's issuance of a title policy and the Company's recognition of agent premiums. Therefore, second quarter agent premiums typically reflect first quarter mortgage origination activity. The decrease in agent premiums quarter over quarter was consistent with the 12.7% decrease in the Company's direct premiums and escrow fees in the first quarter of 2014 as compared with the first quarter of 2013. The Company continuously analyzes the terms and profitability of its title

agency relationships and, where it deems it necessary, amends agent agreements to the extent possible.

Information and other revenues primarily consist of revenues generated from fees associated with title search and related reports, title and other real property records and images, other non-insured settlement services, and risk mitigation products and services. These revenues generally trend with direct premiums and escrow fees but are typically less volatile since a portion of the revenues are subscription based and do not fluctuate with transaction volumes.

Information and other revenues were \$165.2 million and \$302.4 million for the three and six months ended June 30, 2014, respectively, decreases of \$5.9 million, or 3.4%, and \$20.5 million, or 6.3%, when compared with the respective periods of

37

---

the prior year. Excluding the \$17.8 million and \$22.0 million impact of new acquisitions for the three and six months ended June 30, 2014, respectively, information and other revenues for the three and six months ended June 30, 2014 decreased \$23.7 million, or 13.8%, and \$42.5 million, or 13.2%, respectively, when compared to the respective periods of the prior year. The decreases in information and other revenues, adjusted for the impact of new acquisitions, were primarily attributable to lower demand for the Company's default and title plant information products as a result of the decrease in domestic loss mitigation, foreclosure and mortgage origination activities in the three and six months ended June 30, 2014 when compared with the same periods of the prior year.

Investment income totaled \$19.3 million and \$35.0 million for the three and six months ended June 30, 2014, respectively, decreases of \$2.3 million, or 10.5%, and \$5.6 million, or 13.7%, when compared with the respective periods of the prior year. The decreases were primarily due to lower equity in earnings and increased impairment losses related to investments accounted for using the equity method, partially offset by higher interest income from the investment portfolio.

Net realized investment gains totaled \$4.8 million and \$7.5 million for the three and six months ended June 30, 2014, respectively, compared to \$3.7 million and \$11.1 million for the three and six months ended June 30, 2013, respectively, and were primarily from the sales of debt and equity securities. Net realized investment gains for the six months ended June 30, 2013 also included a gain from the sale of an office building.

The title insurance and services segment recognized \$0.5 million and \$1.0 million in other-than-temporary impairment losses for the three and six months ended June 30, 2014, respectively, related to the Company's non-agency mortgage-backed securities portfolio. No other-than-temporary impairment losses were recognized for the three and six months ended June 30, 2013.

The title insurance and services segment (primarily direct operations) is labor intensive; accordingly, a major expense component is personnel costs. This expense component is affected by two primary factors: the need to monitor personnel changes to match the level of corresponding or anticipated new orders and the need to provide quality service.

Personnel costs were \$327.2 million and \$627.5 million for the three and six months ended June 30, 2014, respectively, decreases of \$12.8 million, or 3.8%, and \$29.4 million, or 4.5%, when compared with the respective periods of the prior year. Excluding the \$12.7 million and \$16.1 million impact of new acquisitions for the three and six months ended June 30, 2014, respectively, personnel costs for the three and six months ended June 30, 2014 decreased \$25.6 million, or 7.5%, and \$45.5 million, or 6.9%, respectively, when compared with the respective periods of the prior year. The decreases in personnel costs, adjusted for the impact of new acquisitions, were primarily attributable to lower salary, overtime, incentive compensation and employee benefit costs. The lower salary costs were attributable to reduced headcount when compared to the respective periods of the prior year. The lower overtime and incentive compensation costs were due to the lower order volumes and revenues when compared to the respective periods of the prior year. The lower employee benefit costs were due to changes in the Company's medical and dental insurance plans and lower incurred medical claims.

Agents retained \$338.3 million and \$674.9 million of title premiums generated by agency operations for the three and six months ended June 30, 2014, respectively, which compares with \$396.0 million and \$783.6 million for the respective periods of the prior year. The percentage of title premiums retained by agents was 79.9% and 80.0% for the three and six months ended June 30, 2014, respectively, compared to 79.7% and 79.9% for the respective periods of the prior year.

Other operating expenses for the title insurance and services segment were \$197.1 million and \$367.1 million for the three and six months ended June 30, 2014, respectively, decreases of \$19.2 million, or 8.9%, and \$37.7 million, or



9.3%, when compared with the same periods of the prior year. Excluding the \$9.2 million and \$11.1 million impact of new acquisitions for the three and six months ended June 30, 2014, respectively, other operating expenses for the three and six months ended June 30, 2014 decreased \$28.4 million, or 13.1%, and \$48.8 million, or 12.1%, respectively, when compared with the respective periods of the prior year. The decreases in other operating expenses, adjusted for the impact of new acquisitions, were primarily attributable to lower production related expense and temporary labor costs driven by lower order volumes.

The provision for policy losses and other claims, expressed as a percentage of title premiums and escrow fees, was 8.9% and 7.5% for the three and six months ended June 30, 2014, respectively, compared to 14.8% and 12.0% in the respective periods of the prior year.

The current quarter rate of 8.9% reflected an ultimate loss rate of 6.0% for the current 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.

The second quarter of 2013 rate of 14.8% reflected an ultimate loss rate of 5.8% for policy year 2013 and an \$89.0 million net increase in the loss reserve estimates for prior policy years. The increase in loss reserve estimates for prior policy years reflected claims development above expected levels during the second quarter of 2013, primarily from domestic lenders policies and, to a lesser extent, the Company's guaranteed valuation product offered in Canada. The reserve strengthening associated with domestic lenders policies was \$58.7 million and was primarily attributable to policy years 2004 through 2008. During the second quarter of 2013, claims on domestic lenders policies significantly exceeded the Company's expectations and management expected this level of elevated claims experience to continue through 2013 and for a period thereafter. The reserve strengthening associated with the guaranteed valuation product offered in Canada was \$12.9 million and was primarily attributable to claims frequency exceeding the Company's expectations during the second quarter of 2013. Given management's revised outlook, a reserve strengthening was recorded to reflect increases to ultimate losses for prior policy years.

Premium taxes were \$12.7 million and \$23.6 million for the three and six months ended June 30, 2014 respectively, decreases of \$0.6 million, or 4.5%, and \$0.6 million, or 2.4%, respectively, compared to \$13.3 million and \$24.2 million for the respective periods of the prior year. Premium taxes as a percentage of title insurance premiums and escrow fees were 1.5% and 1.4% for the three and six months ended June 30, 2014, respectively, and 1.3% for the respective periods in 2013.

In general, the title insurance business is a lower profit margin business when compared to the Company's specialty insurance segment. The lower profit margins reflect the high cost of performing the essential services required before insuring title, whereas the corresponding revenues are subject to regulatory and competitive pricing restraints. Due to this relatively high proportion of fixed costs, title insurance profit margins generally improve as closed order volumes increase. Title insurance profit margins are affected by the composition (residential or commercial) and type (resale, refinancing or new construction) of real estate activity. Title insurance profit margins are also affected by the percentage of title insurance premiums generated by agency operations. Profit margins from direct operations are generally higher than from agency operations due primarily to the large portion of the premium that is retained by the agent. The pre-tax margins for the three and six months ended June 30, 2014 were 8.0% and 6.4%, respectively, compared with 6.1% in the respective periods of the prior year.

### Specialty Insurance

| (in thousands, except percentages)           | Three Months Ended June 30, |          |           |          | Six Months Ended June 30, |           |           |          |
|--|-----------------------------|----------|-----------|----------|---------------------------|-----------|-----------|----------|
|  | 2014                        | 2013     | \$ Change | % Change | 2014                      | 2013      | \$ Change | % Change |
| <b>Revenues</b>                              |                             |          |           |          |                           |           |           |          |
| Direct premiums                              | \$87,758                    | \$81,287 | \$6,471   | 8.0 %    | \$172,267                 | \$159,154 | \$13,113  | 8.2 %    |
| Information and other                        | 487                         | 424      | 63        | 14.9     | 957                       | 814       | 143       | 17.6     |
| Investment income                            | 1,842                       | 1,787    | 55        | 3.1      | 3,571                     | 3,466     | 105       | 3.0      |
| Net realized investment gains                | 1,097                       | 525      | 572       | 109.0    | 1,530                     | 2,100     | (570 )    | (27.1)   |
|  | 91,184                      | 84,023   | 7,161     | 8.5      | 178,325                   | 165,534   | 12,791    | 7.7      |
| <b>Expenses</b>                              |                             |          |           |          |                           |           |           |          |
| Personnel costs                              | 15,487                      | 14,905   | 582       | 3.9      | 31,001                    | 29,236    | 1,765     | 6.0      |
| Other operating expenses                     | 10,359                      | 9,859    | 500       | 5.1      | 21,828                    | 20,078    | 1,750     | 8.7      |
| Provision for policy losses and other claims | 51,377                      | 49,232   | 2,145     | 4.4      | 95,044                    | 87,898    | 7,146     | 8.1      |
| Depreciation and amortization                | 1,338                       | 1,209    | 129       | 10.7     | 2,577                     | 2,387     | 190       | 8.0      |
| Premium taxes                                | 1,588                       | 1,527    | 61        | 4.0      | 2,942                     | 2,740     | 202       | 7.4      |
|  | 80,149                      | 76,732   | 3,417     | 4.5      | 153,392                   | 142,339   | 11,053    | 7.8      |

Edgar Filing: First American Financial Corp - Form 10-Q

|                            |          |         |         |        |          |          |         |       |
|----------------------------|----------|---------|---------|--------|----------|----------|---------|-------|
| Income before income taxes | \$11,035 | \$7,291 | \$3,744 | 51.4 % | \$24,933 | \$23,195 | \$1,738 | 7.5 % |
| Margins                    | 12.1 %   | 8.7 %   | 3.4 %   | 39.1 % | 14.0 %   | 14.0 %   | — %     | — %   |

Direct premiums were \$87.8 million and \$172.3 million for the three and six months ended June 30, 2014, respectively, increases of \$6.5 million, or 8.0%, and \$13.1 million, or 8.2%, when compared with the respective periods of the prior year. The increases were primarily due to an increase in the number of home warranty residential service contracts issued and, to a lesser extent, an increase in property and casualty policies issued. The increases in home warranty residential service contracts were primarily associated with renewals.

39

Net realized investment gains totaled \$1.1 million and \$1.5 million for the three and six months ended June 30, 2014, respectively, and \$0.5 million and \$2.1 million for the three and six months ended June 30, 2013, respectively, and were from the sales of debt and equity securities.

Personnel costs and other operating expenses were \$25.8 million and \$52.8 million for the three and six months ended June 30, 2014, respectively, increases of \$1.1 million, or 4.4%, and \$3.5 million, or 7.1%, when compared with the respective periods of the prior year. The increases were primarily related to higher salary expense due to increased headcount associated with the increased volume in the home warranty and property and casualty businesses and increased amortization of deferred acquisition costs.

The provision for home warranty claims, expressed as a percentage of home warranty premiums, was 58.3% and 53.3% for the three and six months ended June 30, 2014, respectively, compared with 64.1% and 56.3% for the respective periods of the prior year. The decrease in the claims rate for the three months ended June 30, 2014 was primarily attributable to a lower frequency of claims due to milder weather conditions when compared to the same period of the prior year. The provision for property and casualty claims, expressed as a percentage of property and casualty insurance premiums, was 59.1% and 58.8% for the three and six months ended June 30, 2014, respectively, compared with 53.9% and 53.2% for the respective periods of the prior year. The increase in the claims rate for the three months ended June 30, 2014 was primarily attributable to higher claims frequency, partially offset by lower severity, when compared to the same period of the prior year. The claims rate for the three months ended June 30, 2014 was also impacted by losses associated with California wildfires.

Premium taxes were \$1.6 million and \$2.9 million for the three and six months ended June 30, 2014, respectively, compared with \$1.5 million and \$2.7 million for the respective periods of the prior year. Premium taxes as a percentage of specialty insurance segment premiums were 1.8% and 1.7% for the three and six months ended June 30, 2014, respectively, compared with 1.9% and 1.7% for the respective periods of the prior year.

A large part of the revenues for the specialty insurance businesses are generated by renewals and are not dependent on the level of real estate activity. With the exception of loss expense, the majority of the expenses for this segment are variable in nature and therefore generally fluctuate consistent with revenue fluctuations. Accordingly, profit margins for this segment (before loss expense) are relatively constant, although as a result of some fixed expenses, profit margins (before loss expense) should nominally improve as premium revenues increase. Pre-tax margins for the three and six months ended June 30, 2014 were 12.1% and 14.0%, respectively, compared with 8.7% and 14.0% in the respective periods of the prior year.

#### Corporate

| (in thousands, except percentages) | Three Months Ended June 30, |         |           |                  | Six Months Ended June 30, |         |           |          |
|------------------------------------|-----------------------------|---------|-----------|------------------|---------------------------|---------|-----------|----------|
|                                    | 2014                        | 2013    | \$ Change | % Change         | 2014                      | 2013    | \$ Change | % Change |
| <b>Revenues</b>                    |                             |         |           |                  |                           |         |           |          |
| Investment income (losses)         | \$2,868                     | \$(163) | \$3,031   | N/M <sup>1</sup> | \$3,587                   | \$2,982 | \$605     | 20.3%    |
| Net realized investment gains      | 911                         | 301     | 610       | 202.7            | 911                       | 586     | 325       | 55.5     |
|                                    | 3,779                       | 138     | 3,641     | N/M <sup>1</sup> | 4,498                     | 3,568   | 930       | 26.1     |
| <b>Expenses</b>                    |                             |         |           |                  |                           |         |           |          |
| Personnel costs                    | 11,428                      | 9,816   | 1,612     | 16.4             | 22,152                    | 23,142  | (990)     | (4.3)    |
| Other operating expenses           | 6,718                       | 6,707   | 11        | 0.2              | 13,541                    | 13,227  | 314       | 2.4      |
| Depreciation and amortization      | 819                         | 723     | 96        | 13.3             | 1,638                     | 1,456   | 182       | 12.5     |
| Interest                           | 4,228                       | 3,999   | 229       | 5.7              | 7,862                     | 7,430   | 432       | 5.8      |

Edgar Filing: First American Financial Corp - Form 10-Q

|                          |            |            |         |     |   |            |            |       |        |
|--------------------------|------------|------------|---------|-----|---|------------|------------|-------|--------|
|                          | 23,193     | 21,245     | 1,948   | 9.2 |   | 45,193     | 45,255     | (62 ) | (0.1 ) |
| Loss before income taxes | \$(19,414) | \$(21,107) | \$1,693 | 8.0 | % | \$(40,695) | \$(41,687) | \$992 | 2.4 %  |

(1)Not meaningful

Investment income totaled \$2.9 million and \$3.6 million for the three and six months ended June 30, 2014, respectively, compared with losses of \$0.2 million and income of \$3.0 million for the respective periods of the prior year. The increases in investment income were primarily attributable to higher earnings on investments associated with the Company's deferred compensation plan.

Corporate personnel costs and other operating expenses were \$18.1 million and \$35.7 million for the three and six months ended June 30, 2014, respectively, compared with \$16.5 million and \$36.4 million for the respective periods of the prior year. The increase for the three months ended June 30, 2014 was primarily attributable to increased costs associated with the

40

---

Company's deferred compensation plan. The decrease for the six months ended June 30, 2014 was primarily attributable to decreased costs associated with the Company's employee benefit plans.

#### Eliminations

Eliminations primarily represent interest income and related interest expense associated with intercompany notes between the Company's segments, which are eliminated in the condensed consolidated financial statements. The Company's inter-segment eliminations were not material for the three and six months ended June 30, 2014 and 2013.

#### INCOME TAXES

The Company's effective income tax rate (income tax expense as a percentage of income before income taxes) was 33.7% and 35.1% for the three and six months ended June 30, 2014, respectively, compared with 41.0% and 40.1% for the respective periods of the prior year. 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 reported on the Company's tax returns.

The Company evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such 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 deferred tax assets. Failure to achieve forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company's effective tax rate on future earnings.

#### NET INCOME AND NET INCOME ATTRIBUTABLE TO THE COMPANY

Net income for the three and six months ended June 30, 2014 was \$50.7 million and \$72.5 million, respectively, compared with \$34.9 million and \$71.2 million for the respective periods of the prior year. Net income attributable to the Company for the three and six months ended June 30, 2014 was \$50.6 million, or \$0.47 per diluted share, and \$72.3 million, or \$0.67 per diluted share, respectively, compared with \$34.7 million, or \$0.31 per diluted share, and \$70.9 million, or \$0.64 per diluted share, for the respective periods of the prior year.

#### LIQUIDITY AND CAPITAL RESOURCES

**Cash Requirements.** The Company generates cash primarily from the sale of its products and services and investment income. The Company's current cash requirements include operating expenses, taxes, payments of principal and interest on its debt, capital expenditures, potential business acquisitions and dividends on its common stock. Management forecasts the cash needs of the holding company and its primary subsidiaries and regularly reviews their short-term and long-term projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying such forecasts. Due to the Company's ability to generate cash flows from operations and its liquid-asset position, management believes that its resources are sufficient to satisfy its anticipated operational cash requirements and obligations for at least the next twelve months.

The substantial majority of the Company's business is dependent upon activity in the real estate and mortgage markets, which are cyclical and seasonal. Periods of increasing interest rates and reduced mortgage financing availability generally have an adverse effect on residential real estate activity and therefore typically decrease the Company's revenues. In contrast, periods of declining interest rates and increased mortgage financing availability generally have a positive effect on residential real estate activity which typically increases the Company's revenues. Residential

purchase activity is typically slower in the winter months with increased volumes in the spring and summer months. Residential refinance activity is typically more volatile than purchase activity and is highly impacted by changes in interest rates. Commercial real estate volumes are less sensitive to changes in interest rates, but fluctuate based on local supply and demand conditions for space and mortgage financing availability.

Cash provided by operating activities amounted to \$44.9 million and \$158.4 million for the six months ended June 30, 2014 and 2013, respectively, after claim payments, net of recoveries, of \$240.1 million and \$224.7 million, respectively. The principal nonoperating uses of cash and cash equivalents for the six months ended June 30, 2014 were purchases of debt and equity securities, business acquisitions, repayment of debt, capital expenditures and dividends to common stockholders. The principal nonoperating uses of cash and cash equivalents for the six months ended June 30, 2013 were purchases of debt and equity securities, repayment of debt, capital expenditures, dividends to common stockholders and the purchase of Company

shares. The most significant nonoperating sources of cash and cash equivalents for the six months ended June 30, 2014 were proceeds from the sales and maturities of debt and equity securities, proceeds from the issuance of debt and increases in the deposit balances at the Company's banking operations. The most significant nonoperating sources of cash and cash equivalents for the six months ended June 30, 2013 were proceeds from the sales and maturities of debt and equity securities, proceeds from the issuance of debt and increases in the deposit balances at the Company's banking operations. The net effect of all activities on total cash and cash equivalents were increases of \$206.4 million and \$211.2 million for the six months ended June 30, 2014 and 2013, respectively.

The Company continually assesses its capital allocation strategy, including decisions relating to dividends, stock repurchases, capital expenditures, acquisitions and investments. In March 2014, the Company's board of directors approved an increase in the Company's quarterly cash dividend to 24 cents per common share, representing a 100% increase from the prior level of 12 cents per common share. The dividend increase became effective beginning with the June 2014 dividend. Management expects that the Company will continue to pay quarterly cash dividends at or above the second quarter 2014 level. The timing, declaration and payment of future dividends, however, falls within the discretion of the Company's board of directors and will depend upon many factors, including the Company's financial condition and earnings, the capital requirements of the Company's businesses, industry practice, restrictions imposed by applicable law and any other factors the board of directors deems relevant from time to time.

In March 2014, the Company's board of directors approved an increase in the size of the Company's stock repurchase plan from \$150.0 million to \$250.0 million, of which \$182.9 million remained as of June 30, 2014. Purchases may be made from time to time by the Company in the open market at prevailing market prices or in privately negotiated transactions. The Company did not repurchase any shares of its common stock during the three and six months ended June 30, 2014 and as of June 30, 2014, had repurchased and retired 3.2 million shares of its common stock under the current authorization for a total purchase price of \$67.1 million.

The Company completed acquisitions for an aggregate purchase price of \$165.9 million during the first six months of 2014, and in March 2014 borrowed \$150.0 million under its credit facility, which is discussed below, to partially fund these acquisitions.

**Holding Company.** First American Financial Corporation is a holding company that conducts all of its operations through its subsidiaries. The holding company's current cash requirements include payments of principal and interest on its debt, taxes, payments in connection with employee benefit plans, dividends on its common stock and other expenses. The holding company is dependent upon dividends and other payments from its operating subsidiaries to meet its cash requirements. The Company's target is to maintain a cash balance at the holding company equal to at least twelve months of estimated cash requirements. At certain points in time, the actual cash balance at the holding company may vary from this target due to, among other potential factors, the timing and amount of cash payments made and dividend payments received. Pursuant to insurance and other regulations under which the Company's insurance subsidiaries operate, the amount of dividends, loans and advances available to the holding company is limited, principally for the protection of policyholders. As of June 30, 2014, under such regulations, the maximum amount of dividends, loans and advances available to the holding company from its insurance subsidiaries for the remainder of 2014, without prior approval from applicable regulators, was \$258.4 million. Such restrictions have not had, nor are they expected to have, an impact on the holding company's ability to meet its cash obligations.

The Company's principal title insurance subsidiary, First American Title Insurance Company ("FATICO"), which was domiciled in the state of California as of June 30, 2014, redomesticated to Nebraska effective July 1, 2014. The Company expects the redomestication to impact FATICO's total statutory capital and surplus, statutory net income and the maximum amount of dividends FATICO can pay to the holding company due to differences in prescribed accounting practices and other regulations between the two states. While the Company is still assessing the impact of the redomestication, it is not expected to be material to the liquidity or capital resources of the holding company.



As of June 30, 2014, the holding company's sources of liquidity included \$207.3 million of cash and cash equivalents and \$550.0 million available on the Company's \$700.0 million revolving credit facility. Management believes that liquidity at the holding company is sufficient to satisfy anticipated cash requirements and obligations for at least the next twelve months.

Financing. In May 2014, the Company amended and restated its credit agreement with JPMorgan Chase Bank, N.A. in its capacity as administrative agent and the lenders party thereto. The credit agreement is comprised of a \$700.0 million revolving credit facility. Unless terminated earlier, the revolving loan commitments under the credit agreement will terminate on May 14, 2019. The obligations of the Company under the credit agreement are neither secured nor guaranteed. The

agreement replaced the Company's \$600.0 million senior unsecured credit agreement that had been in place since November 14, 2012. Proceeds under the credit agreement may be used for general corporate purposes.

The credit agreement includes an expansion option that permits the Company, subject to satisfaction of certain conditions, to increase the revolving commitments and/or add term loan tranches ("Incremental Term Loans") in an aggregate amount not to exceed \$150.0 million. Incremental Term Loans, if made, may not mature prior to the revolving commitment termination date, provided that amortization may occur prior to such date.

At the Company's election, borrowings of revolving loans under the credit agreement bear interest at (a) the Alternate Base Rate plus the applicable spread or (b) the Adjusted LIBOR rate plus the applicable spread (in each case as defined in the agreement). The Company may select interest periods of one, two, three or six months or (if agreed to by all lenders) such other number of months for Eurodollar borrowings of loans. The applicable spread varies depending upon the debt rating assigned by Moody's Investor Service, Inc. ("Moody's") and/or Standard & Poor's Rating Services ("S&P"). The minimum applicable spread for Alternate Base Rate borrowings is 0.625% and the maximum is 1.00%. The minimum applicable spread for Adjusted LIBOR rate borrowings is 1.625% and the maximum is 2.00%. The rate of interest on Incremental Term Loans will be established at or about the time such loans are made and may differ from the rate of interest on revolving loans.

The credit agreement includes representations and warranties, reporting covenants, affirmative covenants, negative covenants, financial covenants and events of default customary for financings of this type. Upon the occurrence of an event of default the lenders may accelerate the loans. Upon the occurrence of certain insolvency and bankruptcy events of default the loans will automatically accelerate. As of June 30, 2014, the Company was in compliance with the financial covenants under the credit agreement.

In March 2014, the Company borrowed \$150.0 million under its credit facility to partially fund acquisitions during the first quarter of 2014, and at June 30, 2014, outstanding borrowings under the facility totaled \$150.0 million at an interest rate of 1.90%. See Note 17 – Business Combinations to the condensed consolidated financial statements for further discussion of the Company's acquisitions.

In addition to amounts available under its credit facility, certain subsidiaries of the Company are parties to master repurchase agreements which are used periodically as part of the Company's liquidity management activities and to support its risk management activities. In particular, securities loaned or sold under repurchase agreements may be used as short-term funding sources. During the six months ended June 30, 2014, the Company did not enter into any financing transactions under these agreements and as of June 30, 2014, no amounts were outstanding.

Notes and contracts payable as a percentage of total capitalization was 15.1% and 11.2% at June 30, 2014 and December 31, 2013, respectively. The increase primarily reflects the Company's borrowings under the credit facility during 2014.

Investment Portfolio. The Company maintains a high quality, liquid investment portfolio that is primarily held at its insurance and banking subsidiaries. As of June 30, 2014, 91% of the Company's investment portfolio consisted of fixed income securities, of which 66% are United States government-backed or rated AAA and 98% were rated or classified as investment grade. Percentages are based on the amortized cost basis of the securities. Credit ratings are based on S&P and Moody's published ratings. If a security was rated differently by both rating agencies, the lower of the two ratings was selected.



The table below outlines the composition of the investment portfolio in an unrealized loss position, by credit rating, (percentages are based on the amortized cost basis of the investments) as of June 30, 2014:

| June 30, 2014   | A Ratings<br>or<br>Higher | BBB+<br>to BBB-<br>Ratings | Non Investment<br>Grade/Not<br>Rated |   |       |   |
|---|---------------------------|----------------------------|--------------------------------------|---|-------|---|
| U.S. Treasury<br>bonds                                  | 100.0                     | %                          | 0.0                                  | % | 0.0   | % |
| Municipal bonds   | 99.7                      | %                          | 0.3                                  | % | 0.0   | % |
| Foreign bonds   | 99.2                      | %                          | 0.8                                  | % | 0.0   | % |
| Governmental<br>agency bonds                            | 100.0                     | %                          | 0.0                                  | % | 0.0   | % |
| Governmental<br>agency<br>mortgage-backed<br>securities | 100.0                     | %                          | 0.0                                  | % | 0.0   | % |
| Non-agency<br>mortgage-backed<br>securities             | 0.0                       | %                          | 0.0                                  | % | 100.0 | % |
| Corporate debt<br>securities                            | 47.0                      | %                          | 33.0                                 | % | 20.0  | % |
| Preferred stock   | 29.9                      | %                          | 70.1                                 | % | 0.0   | % |
|   | 94.2                      | %                          | 3.3                                  | % | 2.5   | % |

In addition to its debt and equity investment securities portfolio, the Company maintains certain money-market and other short-term investments.

Off-balance sheet arrangements. The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled \$6.5 billion and \$4.7 billion at June 30, 2014 and December 31, 2013, respectively, of which \$1.8 billion and \$1.6 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 included in the accompanying condensed consolidated balance sheets in cash and cash equivalents and debt and equity securities, with offsetting liabilities included in deposits. The remaining escrow deposits were held at third-party financial institutions.

Trust assets held or managed by First American Trust, FSB totaled \$3.0 billion at June 30, 2014 and December 31, 2013. 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. As a result of holding these customers' assets in escrow, the Company has ongoing programs for realizing economic benefits, including investment programs, borrowing agreements, 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 \$1.8 billion and \$1.4 billion at June 30, 2014 and December 31, 2013, respectively. The like-kind exchange deposits were 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 return on the proceeds.

At June 30, 2014 and December 31, 2013, the Company was contingently liable for guarantees of indebtedness owed by affiliates and third parties to banks and others totaling \$13.8 million and \$14.7 million, respectively. The guarantee arrangements relate to promissory notes and other contracts and contingently require the Company to make payments to the guaranteed party based on the failure of debtors to make scheduled payments according to the terms of the notes and contracts. The Company's maximum potential amount of future payments under these guarantees totaled \$13.8 million at June 30, 2014 and \$14.7 million at December 31, 2013, and is limited in duration to the terms of the underlying indebtedness. The Company has not incurred any costs as a result of these guarantees and has not recorded a liability on its condensed consolidated balance sheets related to these guarantees at June 30, 2014 and December 31, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company's primary exposure to market risk relates to interest rate risk associated with certain financial instruments. Although the Company monitors its risk associated with fluctuations in interest rates, it does not currently use derivative financial instruments on any significant scale to hedge these risks.

There have been no material changes in the Company's market risks since the filing of its Annual Report on Form 10-K for the year ended December 31, 2013.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The Company's chief executive officer and chief financial officer have concluded that, as of June 30, 2014, the end of the quarterly period covered by this Quarterly Report on Form 10-Q, the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended, were effective, based on the evaluation of these controls and procedures required by Rule 13a-15(b) thereunder.

Changes in Internal Control Over Financial Reporting

There was no change in the Company's internal control over financial reporting during the quarter ended June 30, 2014, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II: OTHER INFORMATION

### Item 1. Legal Proceedings.

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.

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
- *Haskins v. First American Title Insurance Company*, filed on September 29, 2010 and pending in the United States District Court of New Jersey,
- *Levine v. First American Title Insurance Company*, filed on February 26, 2009 and pending in the United States District Court of Pennsylvania,
-

Edgar Filing: First American Financial Corp - Form 10-Q

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,

Raffone v. First American Title Insurance Company, filed on February 14, 2004 and pending in the Circuit Court, Nassau County, Florida, and

Slapikas v. First American Title Insurance Company, filed on December 19, 2005 and pending in the United States District Court for the Western District of Pennsylvania.



All of these lawsuits are putative class actions. A court has only granted class certification in Lewis and Raffone. The class originally certified in Slapikas was subsequently decertified. 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 or, where the Company has been able to make an estimate, the Company believes the amount is immaterial to the condensed consolidated financial statements as a whole.

• purchased minority interests in title insurance agents as an inducement to refer title insurance underwriting business to the Company or gave items of value to title insurance agents and others for referrals of business in violation of the Real Estate Settlement Procedures Act, including

• **Edwards v. First American Financial Corporation**, filed on June 12, 2007 and pending in the United States District Court for the Central District of California.

In Edwards a narrow class has been certified. For the reasons stated above, the Company has been unable to estimate the possible loss or the range of loss.

• engaged in the unauthorized practice of law, including

• **Gale v. First American Title Insurance Company, et al.**, filed on October 16, 2006 and pending in the United States District Court of Connecticut.

The class originally certified in Gale was subsequently decertified. For the reasons described above, the Company has not yet been able to assess the probability of loss or estimate the possible loss or the range of loss.

• overcharged or improperly charged fees for products and services provided in connection with the closing of real estate transactions, denied home warranty claims, recorded telephone calls, and gave items of value to developers, builders and others as inducements to refer business in violation of certain other laws, such as consumer protection laws and laws generally prohibiting unfair business practices, and certain obligations, including

• **Bushman v. First American Title Insurance Company, et al.**, filed on November 21, 2013 and pending in the Circuit Court of the State of Michigan, County of Washtenaw,

• **Carrera v. First American Home Buyers Protection Corporation**, filed on September 23, 2009 and pending in the United States District Court for the Southern District of California,

• **Chassen v. First American Financial Corporation, et al.**, filed on January 22, 2009 and pending in the United States District Court of New Jersey,

• **Diaz v. First American Home Buyers Protection Corporation**, filed on March 10, 2009 and pending in the United States District Court for the Southern District of California,

• **Gunning v. First American Title Insurance Company**, filed on July 14, 2008 and pending in the United States District Court for the Eastern District of Kentucky,

• **Kaufman v. First American Financial Corporation, et al.**, filed on December 21, 2007 and pending in the Superior Court of the State of California, County of Los Angeles,

• **Kirk v. First American Financial Corporation, et al.**, filed on June 15, 2006 and pending in the Superior Court of the State of California, County of Los Angeles,

• **Muehling v. First American Title Company**, filed on December 11, 2012 and pending in the Superior Court of the State of California, County of Alameda,

• **Sjobring v. First American Financial Corporation, et al.**, filed on February 25, 2005 and pending in the Superior Court of the State of California, County of Los Angeles,

• **Snyder v. First American Financial Corporation, et al.**, filed on June 21, 2014 and pending in the United States District Court for the District of Colorado, and

• **Wilmot v. First American Financial Corporation, et al.**, filed on April 20, 2007 and pending in the Superior Court of the State of California, County of Los Angeles.

All of these lawsuits, except Kaufman and Kirk, are putative class actions for which a class has not been certified. In Kaufman a class was certified but that certification was subsequently vacated. A trial of the Kirk matter has concluded and plaintiff has filed a notice of appeal. For the reasons described above, 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

47

---

Company has been able to make an estimate, the Company believes the amount is immaterial to the condensed consolidated financial statements as a whole.

While some of the lawsuits described above may be material to the Company's operating results in any particular period if an unfavorable outcome results, the Company does not believe that any of these lawsuits will have a material adverse effect on the Company's overall financial condition or liquidity.

The Company also is a party to non-ordinary course lawsuits other than those described above. With respect to these lawsuits, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the condensed consolidated financial statements as a whole.

The Company's title insurance, property and casualty insurance, home warranty, banking, thrift, trust and investment advisory businesses are regulated by various federal, state and local governmental agencies. Many of the Company's other businesses operate within statutory guidelines. Consequently, the Company may from time to time be subject to examination or investigation by such governmental agencies. Currently, governmental agencies are examining or investigating certain of the Company's operations. These exams or investigations include inquiries into, among other matters, pricing and rate setting practices in the title insurance industry, competition in the title insurance industry, real estate settlement service customer acquisition and retention practices and agency relationships. With respect to matters where the Company has determined that a loss is both probable and reasonably estimable, the Company has recorded a liability representing its best estimate of the financial exposure based on known facts. While the ultimate disposition of each such exam or investigation is not yet determinable, the Company does not believe that individually or in the aggregate they will have a material adverse effect on the Company's financial condition, results of operations or cash flows. These exams or investigations could, however, result in changes to the Company's business practices which could ultimately have a material adverse impact on the Company's financial condition, results of operations or cash flows.

The Company and its subsidiaries also are involved in numerous ongoing routine legal and regulatory proceedings related to their operations. With respect to each of these proceedings, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the condensed consolidated financial statements as a whole.

#### Item 1A. Risk Factors.

You should carefully consider each of the following risk factors and the other information contained in this Quarterly Report on Form 10-Q. The Company faces risks other than those listed here, including those that are unknown to the Company and others of which the Company may be aware but, at present, considers immaterial. Because of the following factors, as well as other variables affecting the Company's operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

1. Conditions in the real estate market generally impact the demand for a substantial portion of the Company's products and services and the Company's claims experience

Demand for a substantial portion of the Company's products and services generally decreases as the number of real estate transactions in which its products and services are purchased decreases. The number of real estate transactions in which the Company's products and services are purchased decreases in the following situations:

- when mortgage interest rates are high or rising;

- when the availability of credit, including commercial and residential mortgage funding, is limited; and
- when real estate values are declining.

These circumstances, particularly declining real estate values and the increase in foreclosures that often results therefrom, also tend to adversely impact the Company's title claims experience.

## 2. Unfavorable economic conditions may have a material adverse effect on the Company

Uncertainty and negative trends in general economic conditions in the United States and abroad, including significant tightening of credit markets and a general decline in the value of real property, historically have created a difficult operating environment for the Company's businesses and other companies in its industries. In addition, the Company holds investments in entities, such as title agencies, settlement service providers and property and casualty insurance companies, and

48

---

instruments, such as mortgage-backed securities, which may be negatively impacted by these conditions. The Company also owns a federal savings bank into which it deposits some of its own funds and some funds held in trust for third parties. This bank invests those funds and any realized losses incurred will be reflected in the Company's consolidated results. The likelihood of such losses, which generally would not occur if the Company were to deposit these funds in an unaffiliated entity, increases when economic conditions are unfavorable. Depending upon the ultimate severity and duration of any economic downturn, the resulting effects on the Company could be materially adverse, including a significant reduction in revenues, earnings and cash flows, challenges to the Company's ability to satisfy covenants or otherwise meet its obligations under debt facilities, difficulties in obtaining access to capital, challenges to the Company's ability to pay dividends at currently anticipated levels, deterioration in the value of its investments and increased credit risk from customers and others with obligations to the Company.

3. Unfavorable economic or other conditions could cause the Company to write off a portion of its goodwill and other intangible assets

The Company performs an impairment test of the carrying value of goodwill and other indefinite-lived intangible assets annually in the fourth quarter, or sooner if circumstances indicate a possible impairment. Finite-lived intangible assets are subject to impairment tests on a periodic basis. Factors that may be considered in connection with this review include, without limitation, underperformance relative to historical or projected future operating results, reductions in the Company's stock price and market capitalization, increased cost of capital and negative macroeconomic, industry and company-specific trends. These and other factors could lead to a conclusion that goodwill or other intangible assets are no longer fully recoverable, in which case the Company would be required to write off the portion believed to be unrecoverable. Total goodwill and other intangible assets reflected on the Company's consolidated balance sheet as of June 30, 2014 are \$1.0 billion. Any substantial goodwill and other intangible asset impairments that may be required could have a material adverse effect on the Company's results of operations and financial condition.

4. Failures at financial institutions at which the Company deposits funds could adversely affect the Company

The Company deposits substantial funds in financial institutions. These funds include amounts owned by third parties, such as escrow deposits. Should one or more of the financial institutions at which deposits are maintained fail, there is no guarantee that the Company would recover the funds deposited, whether through Federal Deposit Insurance Corporation coverage or otherwise. In the event of any such failure, the Company also could be held liable for the funds owned by third parties.

5. Changes in government regulation could prohibit or limit the Company's operations, make it more burdensome to conduct such operations or result in decreased demand for the Company's products and services

Many of the Company's businesses, including its title insurance, property and casualty insurance, home warranty, banking, trust and investment businesses, are regulated by various federal, state, local and foreign governmental agencies. These and other of the Company's businesses also operate within statutory guidelines. The industry in which the Company operates and the markets into which it sells its products are also regulated and subject to statutory guidelines. Changes in the applicable regulatory environment, statutory guidelines or interpretations of existing regulations or statutes, enhanced governmental oversight or efforts by governmental agencies to cause customers to refrain from using the Company's products or services could prohibit or limit its future operations or make it more burdensome to conduct such operations or result in decreased demand for the Company's products and services. The impact of these changes would be more significant if they involve jurisdictions in which the Company generates a greater portion of its title premiums, such as the states of Arizona, California, Florida, Michigan, New York, Ohio, Pennsylvania and Texas and the province of Ontario, Canada. These changes may compel the Company to reduce its prices, may restrict its ability to implement price increases or acquire assets or businesses, may limit the manner in

which the Company conducts its business or otherwise may have a negative impact on its ability to generate revenues, earnings and cash flows.

6. Scrutiny of the Company's businesses and the industries in which it operates by governmental entities and others could adversely affect its operations and financial condition

The real estate settlement services industry, an industry in which the Company generates a substantial portion of its revenue and earnings, is subject to heightened scrutiny by regulators, legislators, the media and plaintiffs' attorneys. Though often directed at the industry generally, these groups may also focus their attention directly on the Company's businesses. In either case, this scrutiny may result in changes which could adversely affect the Company's operations and, therefore, its financial condition and liquidity.

Governmental entities have routinely inquired into certain practices in the real estate settlement services industry to determine whether certain of the Company's businesses or its competitors have violated applicable laws, which include, among others, the insurance codes of the various jurisdictions and the Real Estate Settlement Procedures Act and similar state, federal and foreign laws. Departments of insurance in the various states, federal regulators and applicable regulators in international jurisdictions, either separately or together, also periodically conduct targeted inquiries into the practices of title insurance companies and other settlement services providers in their respective jurisdictions.

Further, from time to time plaintiffs' lawyers may target the Company and other members of the Company's industry with lawsuits claiming legal violations or other wrongful conduct. These lawsuits may involve large groups of plaintiffs and claims for substantial damages. Any of these types of inquiries or proceedings may result in a finding of a violation of the law or other wrongful conduct and may result in the payment of fines or damages or the imposition of restrictions on the Company's conduct which could impact its operations and financial condition. Moreover, these laws and standards of conduct often are ambiguous and, thus, it may be difficult to ensure compliance. This ambiguity may force the Company to mitigate its risk by settling claims or by ending practices that generate revenues, earnings and cash flows.

We increasingly utilize social media to communicate with customers, vendors and other individuals interested in our Company. Information delivered via social media can be easily accessed and rapidly disseminated, and the use of social media by us and other parties could result in reputational harm, decreased customer loyalty or other issues that could diminish the value of the Company's brand or result in significant liability.

#### 7. Regulation of title insurance rates could adversely affect the Company's results of operations

Title insurance rates are subject to extensive regulation, which varies from state to state. In many states the approval of the applicable state insurance regulator is required prior to implementing a rate change. This regulation could hinder the Company's ability to promptly adapt to changing market dynamics through price adjustments, which could adversely affect its results of operations, particularly in a rapidly declining market.

#### 8. Reform of government-sponsored enterprises could negatively impact the Company

Historically, a substantial proportion of home loans originated in the United States were sold to and, generally, resold in a securitized form by, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). As a condition to the purchase of a home loan Fannie Mae and Freddie Mac generally required the purchase of title insurance for their benefit and, as applicable, the benefit of the holders of home loans they may have securitized. The federal government currently is considering various alternatives to reform Fannie Mae and Freddie Mac. The role, if any, that these enterprises or other enterprises fulfilling a similar function will play in the mortgage process following the adoption of any reforms is not currently known. The timing of the adoption and, thereafter, the implementation of the reforms is similarly unknown. Due to the significance of the role of these enterprises, the mortgage process itself may substantially change as a result of these reforms and related discussions. It is possible that these entities, as reformed, or the successors to these entities may require changes to the way title insurance is priced or delivered, changes to standard policy terms or other changes which may make the title insurance business less profitable. These reforms may also alter the home loan market, such as by causing higher mortgage interest rates due to decreased governmental support of mortgage-backed securities. These consequences could be materially adverse to the Company and its financial condition.

#### 9. The Company may find it difficult to acquire necessary data

Certain data used and supplied by the Company are subject to regulation by various federal, state and local regulatory authorities. Compliance with existing federal, state and local laws and regulations with respect to such data has not had a material adverse effect on the Company's results of operations, financial condition or liquidity to date. Nonetheless, federal, state and local laws and regulations in the United States designed to protect the public from the misuse of personal information in the marketplace and adverse publicity or potential litigation concerning the commercial use of such information may affect the Company's operations and could result in substantial regulatory compliance expense, litigation expense and a loss of revenue. The suppliers of data to the Company face similar burdens. As a result of these and other factors, the Company may find it financially burdensome to acquire necessary data.

10. Changes in the Company's relationships with large mortgage lenders or government-sponsored enterprises could adversely affect the Company

A relatively small number of lenders originate a majority of the mortgages in the United States and Canada. Due to the consolidated nature of the industry, the Company derives a significant percentage of its revenues from a relatively small base

50

---



of lenders, and their borrowers, which enhances the negotiating power of these lenders with respect to the pricing and the terms on which they purchase the Company's products and other matters. Similarly, government-sponsored enterprises, because of their significant role in the mortgage process, have significant influence over the Company and other service providers. These circumstances could adversely affect the Company's revenues and profitability. Changes in the Company's relationship with any of these lenders or government-sponsored enterprises, the loss of all or a portion of the business the Company derives from these parties or any refusal of these parties to accept the Company's products and services could have a material adverse effect on the Company.

11. A downgrade by ratings agencies, reductions in statutory capital and surplus maintained by the Company's title insurance underwriters or a deterioration in other measures of financial strength may negatively affect the Company's results of operations and competitive position

Certain of the Company's customers use measurements of the financial strength of the Company's title insurance underwriters, including, among others, ratings provided by ratings agencies and levels of statutory capital and surplus maintained by those underwriters, in determining the amount of a policy they will accept and the amount of reinsurance required. Each of the major ratings agencies currently rates the Company's title insurance operations. The Company's principal title insurance underwriter's financial strength ratings are "A3" by Moody's Investor Services, Inc., "A" by Fitch Ratings Ltd., "BBB+" by Standard & Poor's Ratings Services and "A-" by A.M. Best Company, Inc. These ratings provide the agencies' perspectives on the financial strength, operating performance and cash generating ability of those operations. These agencies continually review these ratings and the ratings are subject to change. Statutory capital and surplus, or the amount by which statutory assets exceed statutory liabilities, is also a measure of financial strength. The Company's principal title insurance underwriter maintained \$996.0 million of total statutory capital and surplus as of December 31, 2013. Accordingly, if the ratings or statutory capital and surplus of these title insurance underwriters are reduced from their current levels, or if there is a deterioration in other measures of financial strength, the Company's results of operations, competitive position and liquidity could be adversely affected.

12. The Company's investment portfolio is subject to certain risks and could experience losses

The Company maintains a substantial investment portfolio, primarily consisting of fixed income securities (including mortgage-backed securities). The investment portfolio also includes money-market and other short-term investments, as well as preferred and common stock. Securities in the Company's investment portfolio are subject to certain economic and financial market risks, such as credit risk, interest rate (including call, prepayment and extension) risk and/or liquidity risk. The risk of loss associated with the portfolio is increased during periods of instability in credit markets and economic conditions. If the carrying value of the investments exceeds the fair value, and the decline in fair value is deemed to be other-than-temporary, the Company will be required to write down the value of the investments, which could have a material adverse effect on the Company's results of operations, statutory surplus and financial condition.

13. The Company's pension plan is currently underfunded and pension expenses and funding obligations could increase significantly as a result of weak performance of financial markets and its effect on plan assets

The Company is responsible for the obligations of its defined benefit pension plan, which it assumed from its former parent, The First American Corporation, on June 1, 2010 in connection with the spin-off transaction which was consummated on that date. The plan was closed to new entrants effective December 31, 2001 and amended to "freeze" all benefit accruals as of April 30, 2008. The Company's future funding obligations for this plan depend upon, among other factors, the future performance of assets held in trust for the plan and interest rates. The pension plan was underfunded as of June 30, 2014 by \$56.4 million and the Company may need to make significant contributions to the plan. In addition, pension expenses and funding requirements may also be greater than currently anticipated if the market values of the assets held by the pension plan decline or if the other assumptions regarding plan earnings,

expenses and interest rates require adjustment. The Company's obligations under this plan could have a material adverse effect on its results of operations, financial condition and liquidity.

14. Actual claims experience could materially vary from the expected claims experience reflected in the Company's reserve for incurred but not reported claims

The Company maintains a reserve for incurred but not reported ("IBNR") claims pertaining to its title, escrow and other insurance and guarantee products. The majority of this reserve pertains to title insurance policies, which are long-duration contracts with the majority of the claims reported within the first few years following the issuance of the policy. Generally, 75% to 85% of claim amounts become known in the first six years of the policy life, and the majority of IBNR reserves relate to the six most recent policy years. Changes in expected ultimate losses and corresponding loss rates for recent

51

---

policy years are considered likely and could result in a material adjustment to the IBNR reserves. Based on historical experience, management believes a 50 basis point change to the loss rates for the most recent policy years, positive or negative, is reasonably likely given the long duration nature of a title insurance policy. For example, if the expected ultimate losses for each of the last six policy years increased or decreased by 50 basis points, the resulting impact on the Company's IBNR reserve would be an increase or decrease, as the case may be, of \$105.2 million. A material change in expected ultimate losses and corresponding loss rates for older policy years is also possible, particularly for policy years with loss ratios exceeding historical norms. The estimates made by management in determining the appropriate level of IBNR reserves could ultimately prove to be materially different from actual claims experience.

15. The issuance of the Company's title insurance policies and related activities by title agents, which operate with substantial independence from the Company, could adversely affect the Company

The Company's title insurance subsidiaries issue a significant portion of their policies through title agents that operate with a substantial degree of independence from the Company. While these title agents are subject to certain contractual limitations that are designed to limit the Company's risk with respect to their activities, there is no guarantee that the agents will fulfill their contractual obligations to the Company. In addition, regulators are increasingly seeking to hold the Company responsible for the actions of these title agents and, under certain circumstances, the Company may be held liable directly to third parties for actions (including defalcations) or omissions of these agents. As a result, the Company's use of title agents could result in increased claims on the Company's policies issued through agents and an increase in other costs and expenses.

16. The Company's risk mitigation efforts may prove inadequate

The Company assumes risks in the ordinary course of its business, including through the issuance of title insurance policies and the provision of other products and services. The Company mitigates these risks through a number of different means, including the implementation of underwriting policies and procedures and other mechanisms for assessing risk. However, underwriting of title insurance policies and other risk-assumption decisions frequently involves a substantial degree of individual judgment. The Company's risk mitigation efforts or the reliability of any necessary judgment may prove inadequate, especially in situations where the Company or individuals involved in risk taking decisions are encouraged by customers or others, or because of competitive pressures, to assume risks or to expeditiously make risk determinations. This circumstance could have an adverse effect on the Company's results of operations, financial condition and liquidity.

17. Systems interruptions and intrusions, wire transfer errors and unauthorized data disclosures may impair the delivery of the Company's products and services, harm the Company's reputation, result in material claims for damages or otherwise adversely affect the Company

Systems interruptions and intrusions may impair the delivery of the Company's products and services, resulting in a loss of customers and a corresponding loss in revenue. The Company's businesses depend heavily upon computer systems located in data centers, which are maintained and managed by a third party. Certain events beyond the Company's control, including natural disasters, telecommunications failures and intrusions into the Company's systems by third parties could temporarily or permanently interrupt the delivery of products and services. These interruptions also may interfere with suppliers' ability to provide necessary data and employees' ability to attend work and perform their responsibilities. The Company also relies on its systems, employees and domestic and international banks to transfer funds. These transfers are susceptible to user input error, fraud, system interruptions or intrusions, incorrect processing and similar errors that could result in lost funds that may be significant. As part of its business, the Company maintains non-public personal information on consumers. There can be no assurance that unauthorized disclosure will not occur either through system intrusions or the actions of third parties or employees. Unauthorized disclosures could adversely affect the Company's reputation and expose it to material claims for damages.

18. The Company may not be able to realize the benefits of its offshore strategy

The Company utilizes lower cost labor in foreign countries, such as India and the Philippines, among others. These countries are subject to relatively high degrees of political and social instability and may lack the infrastructure to withstand natural disasters. Such disruptions could decrease efficiency and increase the Company's costs in these countries. Weakness of the United States dollar in relation to the currencies used in these foreign countries may also reduce the savings achievable through this strategy. Furthermore, the practice of utilizing labor based in foreign countries is subject to heightened scrutiny in the United States and, as a result, some of the Company's customers may require it to use labor based in the United States. Laws or regulations that require the Company to use labor based in the United States or effectively increase the cost of the Company's foreign labor also could be enacted. The Company may not be able to pass on these increased costs to its customers.

52

---

19. Acquisitions may have an adverse effect on our business

The Company has in the past acquired, and is expected to acquire in the future, other businesses. When businesses are acquired, the Company may not be able to integrate or manage these businesses in such a manner as to realize the anticipated synergies or otherwise produce returns that justify the investment. Acquired businesses may subject the Company to increased regulatory or compliance requirements. The Company may not be able to successfully retain employees of acquired businesses or integrate them, and could lose customers, suppliers or other partners as a result of the acquisitions. For these and other reasons, including changes in market conditions, the projections used to value the acquired businesses may prove inaccurate. In addition, the Company might incur unanticipated liabilities from acquisitions. These and other factors related to acquisitions could have a material adverse effect on the Company's results of operations, financial condition and liquidity. The Company's management also will continue to be required to dedicate substantial time and effort to the integration of its acquisitions. These efforts could divert management's focus and resources from other strategic opportunities and operational matters.

20. As a holding company, the Company depends on distributions from its subsidiaries, and if distributions from its subsidiaries are materially impaired, the Company's ability to declare and pay dividends may be adversely affected; in addition, insurance and other regulations limit the amount of dividends, loans and advances available from the Company's insurance subsidiaries

The Company is a holding company whose primary assets are investments in its operating subsidiaries. The Company's ability to pay dividends is dependent on the ability of its subsidiaries to pay dividends or repay funds. If the Company's operating subsidiaries are not able to pay dividends or repay funds, the Company may not be able to fulfill parent company obligations and/or declare and pay dividends to its stockholders. Moreover, pursuant to insurance and other regulations under which the Company's insurance subsidiaries operate, the amount of dividends, loans and advances available is limited. As of June 30, 2014, under such regulations, the maximum amount of dividends, loans and advances available for the remainder of 2014 from these insurance subsidiaries, without prior approval from applicable regulators, was \$258.4 million.

21. Certain provisions of the Company's bylaws and certificate of incorporation may reduce the likelihood of any unsolicited acquisition proposal or potential change of control that the Company's stockholders might consider favorable

The Company's bylaws and certificate of incorporation contain provisions that could be considered "anti-takeover" provisions because they make it harder for a third-party to acquire the Company without the consent of the Company's incumbent board of directors. Under these provisions:

- election of the Company's board of directors is staggered such that only one-third of the directors are elected by the stockholders each year and the directors serve three year terms prior to reelection;
- stockholders may not remove directors without cause, change the size of the board of directors or, except as may be provided for in the terms of preferred stock the Company issues in the future, fill vacancies on the board of directors;
- stockholders may act only at stockholder meetings and not by written consent;
- stockholders must comply with advance notice provisions for nominating directors or presenting other proposals at stockholder meetings; and
- the Company's board of directors may without stockholder approval issue preferred shares and determine their rights and terms, including voting rights, or adopt a stockholder rights plan.

While the Company believes that they are appropriate, these provisions, which may only be amended by the affirmative vote of the holders of approximately 67% of the Company's issued voting shares, could have the effect of discouraging an unsolicited acquisition proposal or delaying, deferring or preventing a change of control transaction

that might involve a premium price or otherwise be considered favorably by the Company's stockholders.

53

---

Item 6. Exhibits.

See Exhibit Index. (Each management contract or compensatory plan or arrangement in which any director or named executive officer of First American Financial Corporation, as defined by Item 402(a)(3) of Regulation S-K (17 C.F.R. §229.402(a)(3)), participates that is included among the exhibits listed on the Exhibit Index is identified on the Exhibit Index by an asterisk (\*).)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST AMERICAN FINANCIAL CORPORATION

(Registrant)

By /s/ Dennis J. Gilmore

Dennis J. Gilmore  
Chief Executive Officer

(Principal Executive Officer)

By /s/ Mark E. Seaton

Mark E. Seaton  
Chief Financial Officer

(Principal Financial Officer)

Date: July 24, 2014



## EXHIBIT INDEX

| Exhibit No. | Description   | Location  |
|-------------|---|-----------|
| 10.1        | Amended and Restated Credit Agreement dated as of May 14, 2014, among First American Financial Corporation, the Lenders party thereto and JPMorgan Chase Bank, N.A., as Administrative Agent. | Attached. |
| 10.2*       | Employment Agreement, dated May 22, 2014, between First American Financial Corporation and Dennis J. Gilmore.   | Attached. |
| 10.3*       | Employment Agreement, dated May 22, 2014, between First American Financial Corporation and Kenneth D. DeGiorgio.  | Attached. |
| 10.4*       | Employment Agreement, dated May 15, 2014, between First American Financial Corporation and Christopher M. Leavell.  | Attached. |
| 10.5*       | Employment Agreement, dated May 15, 2014, between First American Financial Corporation and Mark E. Seaton.  | Attached. |
| 31(a)       | Certification by Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.  | Attached. |
| 31(b)       | Certification by Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.  | Attached. |
| 32(a)       | Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.  | Attached. |
| 32(b)       | Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.  | Attached. |
| 101.INS     | XBRL Instance Document.   | Attached. |
| 101.SCH     | XBRL Taxonomy Extension Schema Document.  | Attached. |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document.  | Attached. |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document.   | Attached. |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document.  | Attached. |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document.   | Attached. |

