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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

OR

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

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FIRST AMERICAN FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Incorporated in Delaware
(State or other jurisdiction of
incorporation or organization)

26-1911571
(I.R.S. Employer
Identification No.)

1 First American Way, Santa Ana, California
(Address of principal executive offices)

92707-5913
(Zip Code)

(714) 250-3000

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

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

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

PART I: FINANCIAL INFORMATION

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

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

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

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

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

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

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

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

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

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

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

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

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statement of Stockholders' Equity

(in thousands)

(unaudited)

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

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

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

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

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 – Basis of Condensed Consolidated Financial Statements

Basis of Presentation

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

Recently Adopted Accounting Pronouncements

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

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

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

Pending Accounting Pronouncements

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

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

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

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

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

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

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

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

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

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

In June 2016, the FASB issued updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a

broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

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

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

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

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

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

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

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

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

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

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

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

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

Note 3 – Debt and Equity Securities

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

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

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

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

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

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

(in thousands)	Less than 12 months		12 months or longer		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
June 30, 2017						
Debt securities:						
U.S. Treasury bonds	\$103,246	\$(1,455)	\$186	\$(29)	\$103,432	\$(1,484)
Municipal bonds	417,676	(12,676)	21,707	(809)	439,383	(13,485)
Foreign government bonds	94,332	(1,149)	350	(42)	94,682	(1,191)
Governmental agency bonds	154,574	(2,337)	5,353	(479)	159,927	(2,816)
Governmental agency mortgage-backed securities	977,367	(11,731)	649,022	(7,646)	1,626,389	(19,377)
U.S. corporate debt securities	160,663	(2,179)	15,406	(552)	176,069	(2,731)
Foreign corporate debt securities	42,068	(271)	1,440	(58)	43,508	(329)
Total debt securities	1,949,926	(31,798)	693,464	(9,615)	2,643,390	(41,413)
Equity securities	70,904	(1,451)				