First American Financial Corp
Form 10-Q
October 25, 2018

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 September 30, 2018

OR

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

For the transition period from ______ to ______

Commission file number 001-34580

FIRST AMERICAN FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(714) 250-3000

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 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	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 required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.   Yes 1   No 1

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

On October 19, 2018, there were 111,787,641 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

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

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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;
- 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;
- PROCESS AUTOMATION;
- TECHNOLOGICAL AND OTHER DEVELOPMENTS THAT CHANGE THE WAY REAL ESTATE TRANSACTIONS ARE CONDUCTED AND RELATED DOCUMENTS ARE PROCESSED;
- 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; 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)

	September 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	$2,205,319	$1,387,226
Accounts and accrued income receivable, net	362,614	311,084
Income taxes receivable	49,031	38,673
Investments:		
Deposits with banks	37,547	41,335
Debt securities, includes pledged securities of $107,288 and $108,427	5,529,860	4,752,684
Equity securities	447,749	466,516
Other investments	123,652	117,768
	6,138,808	5,378,303
Secured financings receivable	86,509	—
Property and equipment, net	457,545	439,569
Title plants and other indexes	575,431	568,452
Deferred income taxes	22,803	22,803
Goodwill	1,145,086	1,113,005
Other intangible assets, net	111,647	99,913
Other assets	225,334	214,194
	$11,380,127	$9,573,222
Liabilities and Equity		
Deposits	$4,548,635	$3,070,566
Accounts payable and accrued liabilities	826,729	793,157
Deferred revenue	255,324	240,822
Reserve for known and incurred but not reported claims	1,026,959	1,028,933
Income taxes payable	5,416	4,602
Deferred income taxes	219,307	219,307
Secured financings payable	86,501	—
Notes and contracts payable	735,258	732,810
	7,704,129	6,090,197
Commitments and contingencies (Note 14)		
Stockholders' equity:		

Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—
Common stock, $0.00001 par value; Authorized—300,000 shares; Outstanding—111,787 shares and 110,925 shares	1	1
Additional paid-in capital	2,266,830	2,236,351
Retained earnings	1,600,296	1,311,112
Accumulated other comprehensive loss	(192,912)	(67,509)
Total stockholders' equity	3,674,215	3,479,955
Noncontrolling interests	1,783	3,070
Total equity	3,675,998	3,483,025
	$11,380,127	$9,573,222

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 September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Revenues				
Direct premiums and escrow fees	$649,375	$651,104	$1,854,835	$1,819,193
Agent premiums	615,113	629,186	1,701,831	1,757,796
Information and other	198,680	201,819	596,090	586,179
Net investment income	67,874	44,460	167,000	117,109
Net realized investment gains (losses)	11,144	(7,001)	10,975	10,763
	1,542,186	1,519,568	4,330,731	4,291,040
Expenses				
Personnel costs	449,839	443,992	1,312,455	1,287,570
Premiums retained by agents	485,621	497,911	1,341,808	1,387,608
Other operating expenses	227,670	374,347	675,085	820,540
Provision for policy losses and other claims	122,196	120,349	336,395	333,695
Depreciation and amortization	31,729	36,000	92,534	96,292
Premium taxes	18,774	19,900	51,837	52,527
Interest	10,770	9,107	29,997	26,812
	1,346,599	1,501,606	3,840,111	4,005,044
Income before income taxes	195,587	17,962	490,620	285,996
Income tax expense (benefit)	44,126	(3,224)	107,896	84,846
Net income	151,461	21,186	382,724	201,150
Less: Net loss attributable to noncontrolling interests	(19)	(197)	(123)	(772)
Net income attributable to the Company	$151,480	$21,383	$382,847	$201,922
Net income per share attributable to the Company's stockholders (Note 9):				
Basic	$1.34	$0.19	$3.40	$1.81
Diluted	$1.34	$0.19	$3.38	$1.80
Cash dividends declared per share	$0.42	$0.38	$1.18	$1.06
Weighted-average common shares outstanding (Note 9):				
Basic	112,722	111,799	112,541	111,578
Diluted	113,365	112,575	113,213	112,254

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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$151,461	$21,186	$382,724	$201,150
Other comprehensive income (loss), net of tax:				
Unrealized (losses) gains on securities	(14,662)	13,929	(73,933)	52,014
Foreign currency translation adjustment	3,001	11,415	(11,296)	23,558
Pension benefit adjustment	118	85,891	357	93,061
Total other comprehensive income (loss), net of tax	(11,543)	111,235	(84,872)	168,633
Comprehensive income	139,918	132,421	297,852	369,783
Less: Comprehensive loss attributable to noncontrolling interests	(19)	(192)	(142)	(760)
Comprehensive income attributable to the Company	$139,937	$132,613	$297,994	$370,543

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements 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, 2017	110,925	$1	$2,236,351	$1,311,112	$(67,509)	$3,479,955	$3,070	$3,483,025
Cumulative-effect adjustment (Note 1)	—	—	—	40,550	(40,550)	—	—	—
Net income (loss) for three months ended March 31, 2018	—	—	—	76,227	—	76,227	(55)	76,172
Dividends on common shares	—	—	—	(42,330)	—	(42,330)	—	(42,330)
Shares issued in connection with share-based compensation	620	—	(11,759)	(847)	—	(12,606)	—	(12,606)
Share-based compensation	—	—	19,509	—	—	19,509	—	19,509
Net activity related to noncontrolling interests	—	—	189	—	—	189	(1,090)	(901)
Other comprehensive loss	—	—	—	—	(50,409)	(50,409)	(19)	(50,428)
Balance at March 31, 2018	111,545	1	2,244,290	1,384,712	(158,468)	3,470,535	1,906	3,472,441
Net income (loss) for three months ended June 30, 2018	—	—	—	155,140	—	155,140	(49)	155,091
Dividends on common shares	—	—	—	(42,387)	—	(42,387)	—	(42,387)
Shares issued in connection with share-based compensation	113	—	2,204	(827)	—	1,377	—	1,377
Share-based compensation	—	—	7,626	—	—	7,626	—	7,626
Net activity related to noncontrolling interests	—	—	133	—	—	133	(158)	(25)
Other comprehensive loss	—	—	—	—	(22,901)	(22,901)	—	(22,901)
Balance at June 30, 2018	111,658	1	2,254,253	1,496,638	(181,369)	3,569,523	1,699	3,571,222
Net income (loss) for three months ended September 30, 2018	—	—	—	151,480	—	151,480	(19)	151,461
Dividends on common shares	—	—	—	(46,912)	—	(46,912)	—	(46,912)
Shares issued in connection with share-based compensation	129	—	5,466	(910)	—	4,556	—	4,556
Share-based compensation	—	—	7,241	—	—	7,241	—	7,241
Net activity related to noncontrolling interests	—	—	(130)	—	—	(130)	103	(27)
Other comprehensive loss	—	—	—	—	(11,543)	(11,543)	—	(11,543)

Balance at September 30, 2018	111,787	$1	$2,266,830	$1,600,296	$(192,912)	$3,674,215	$1,783	$3,675,998

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Stockholders' Equity – (Continued)

(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 (loss) for three months ended March 31, 2017	—	—	—	58,282	—	58,282	(213)	58,069
Dividends on common shares	—	—	—	(37,495)	—	(37,495)	—	(37,495)
Shares issued in connection with share-based compensation	584	—	(5,078)	(869)	—	(5,947)	—	(5,947)
Share-based compensation	—	—	17,032	—	—	17,032	—	17,032
Net activity related to noncontrolling interests	—	—	—	—	—	—	(841)	(841)
Other comprehensive income	—	—	—	—	32,411	32,411	7	32,418
Balance at March 31, 2017	110,528	1	2,203,710	1,066,740	(197,989)	3,072,462	5,123	3,077,585
Net income (loss) for three months ended June 30, 2017	—	—	—	122,257	—	122,257	(362)	121,895
Dividends on common shares	—	—	—	(37,604)	—	(37,604)	—	(37,604)
Shares issued in connection with share-based compensation	193	—	4,591	(811)	—	3,780	—	3,780
Share-based compensation	—	—	7,548	—	—	7,548	—	7,548
Net activity related to noncontrolling interests	—	—	—	—	—	—	(26)	(26)
Other comprehensive income	—	—	—	—	24,980	24,980	—	24,980
Balance at June 30, 2017	110,721	1	2,215,849	1,150,582	(173,009)	3,193,423	4,735	3,198,158
Net income (loss) for three months ended September 30, 2017	—	—	—	21,383	—	21,383	(197)	21,186
Dividends on common shares	—	—	—	(42,075)	—	(42,075)	—	(42,075)
Shares issued in connection with share-based compensation	96	—	4,271	(909)	—	3,362	—	3,362
Share-based compensation	—	—	6,616	—	—	6,616	—	6,616
Net activity related to noncontrolling interests	—	—	(45)	—	—	(45)	(40)	(85)
Other comprehensive income	—	—	—	—	111,230	111,230	5	111,235
Balance at September 30, 2017	110,817	$1	$2,226,691	$1,128,981	$(61,779)	$3,293,894	$4,503	$3,298,397

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$382,724	$201,150
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	336,395	333,695
Depreciation and amortization	92,534	96,292
Amortization of premiums and accretion of discounts on debt securities, net	20,521	25,013
Net realized investment gains	(10,975)	(10,763)
Share-based compensation	34,376	31,196
Equity in earnings of affiliates, net	(2,255)	(4,550)
Dividends from equity method investments	3,419	9,593
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(333,970)	(351,397)
Net change in income tax accounts	12,301	34,462
Increase in accounts and accrued income receivable	(51,150)	(11,907)
(Decrease) increase in accounts payable and accrued liabilities	(11,806)	95,383
Increase in deferred revenue	14,678	20,313
Other, net	(1,931)	(12,953)
Cash provided by operating activities	484,861	455,527
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(73,757)	(82,993)
Net decrease in deposits with banks	2,462	1,171
Purchases of debt and equity securities	(1,924,260)	(1,276,401)
Proceeds from sales of debt and equity securities	660,548	599,365
Proceeds from maturities of debt securities	429,287	457,334
Net change in other investments	(6,612)	2,555
Advances under secured financing agreements	(1,537,657)	—
Collections of secured financings receivable	1,520,911	—
Capital expenditures	(87,319)	(103,064)
Proceeds from sales of property and equipment	1,670	9,882
Cash used for investing activities	(1,014,727)	(392,151)
Cash flows from financing activities:		
Net change in deposits	1,478,069	185,948

Borrowings under secured financing agreements	1,537,593	—
Repayments of secured financings payable	(1,520,855)	—
Repayments of notes and contracts payable	(4,111)	(4,128)
Net activity related to noncontrolling interests	(945)	(964)
Net (payments) proceeds in connection with share-based compensation plans	(6,673)	1,195
Payments of cash dividends	(131,629)	(117,174)
Cash provided by financing activities	1,351,449	64,877
Effect of exchange rate changes on cash	(3,490)	7,524
Net increase in cash and cash equivalents	818,093	135,777
Cash and cash equivalents—Beginning of period	1,387,226	1,006,138
Cash and cash equivalents—End of period	$2,205,319	$1,141,915
Supplemental information:		
Cash paid during the period for:		
Interest	$28,030	$24,619
Premium taxes	$56,396	$55,233
Income taxes, less refunds of $1,047 and $52,828	$95,041	$50,264

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, 2017. 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 May 2017, the Financial Accounting Standards Board ("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 adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

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 adopted this change in accounting principle at the beginning of 2018 and applied the change retrospectively to the prior year. As a result, other components of net benefit cost totaling $155.4 million and $171.4 million were reclassified from personnel costs to other operating expenses on the condensed consolidated statements of income for the three and nine months ended September 30, 2017, respectively. See Note 10 Employee Benefit Plans for further information on the Company's net periodic pension costs.

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 adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

In November 2016, the FASB issued updated guidance intended to reduce the diversity in practice on presenting restricted cash and 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 adoption of this guidance had no impact on the Company's 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 adoption of this guidance had no impact on the Company's 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 adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

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. The Company adopted this guidance at the beginning of 2018 and recognized cumulative net unrealized gains, net of taxes, of $40.6 million related to its investments in equity securities, previously classified as available-for-sale, through a cumulative-effect adjustment to retained earnings. Changes in the fair values of these investments are reflected in net realized investment gains/losses on the Company's condensed consolidated statements of income. See Note 4 Debt and Equity Securities for further discussion of the Company's investments in equity securities.

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. The Company elected to adopt the new guidance under the modified retrospective approach, which, except for the disclosure requirements, did not have a material impact on its condensed consolidated financial statements. See Note 2 Adoption of Revenue Guidance for further information about the Company's revenues within the scope of the new guidance.

Pending Accounting Pronouncements

In August 2018, the FASB issued updated guidance that is intended to reduce potential diversity in practice in accounting for the costs of implementing cloud computing arrangements (i.e., hosting arrangements) that are service contracts. The updated guidance aligns the requirements for capitalizing implementation costs for these arrangements with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. 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 this guidance on its condensed consolidated financial statements.

In August 2018, the FASB issued updated guidance as part of its disclosure framework project intended to improve the effectiveness of disclosures in the notes to the financial statements. The updated guidance eliminates, adds and modifies certain disclosure requirements related to fair value measurements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. Except for the disclosure requirements, 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 will 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 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 this 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 required to be adopted using a modified retrospective transition approach. In July 2018, the FASB issued additional updates to the new guidance which allows for the initial application of the guidance at the adoption date and for the recognition of a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. 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.

Note 2 – Adoption of Revenue Guidance

The Company's information and other revenues and escrow fees are within the scope of the new accounting guidance related to the recognition of revenue from contracts with customers, which the Company adopted effective January 1, 2018. Under the new guidance, revenue is recognized when control of the promised goods or services is transferred to the customer and in an amount that reflects the consideration the Company expects to be entitled to in exchange for these goods or services. See Note 1 Basis of Condensed Consolidated Financial Statements for further discussion of the new guidance.

For those products and services where the Company's performance obligation is satisfied at a point in time and for which there is no ongoing obligation, revenue is recognized upon delivery. For those products and services where the Company satisfies its performance obligation over time as the product or service is being transferred to the customer, revenue is generally recognized using the output method as the products or services are delivered.

The Company has elected to apply the optional exemptions allowed under the new guidance whereby the Company is not required to disclose either the transaction price allocated to performance obligations that are unsatisfied as of the end of the period or an explanation as to when the Company expects to recognize the related revenue. Such contracts generally include performance obligations that are contingent upon the closing of a real estate transaction or include variable consideration based on order volumes, and have remaining contract terms of generally less than three years. The Company is eligible to apply the optional exemptions to its remaining performance obligations due to 1) the performance obligation is part of a contract that has an original duration of one year or less, 2) the associated revenue being recognized is based on the Company's right to invoice for the value of the product or service delivered, 3) the associated variable consideration is being allocated entirely to wholly unsatisfied performance obligations or 4) immateriality.

The Company has also elected to apply the practical expedient allowed under the new guidance whereby it can disregard the impact to the transaction price of the effects of a significant financing component for arrangements where the Company expects the period between delivery of the product or service and customer payment to be one year or less. In addition, the Company has elected to apply the practical expedient whereby it can recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period for the asset that the Company otherwise would have recognized is one year or less.

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The Company records a contract asset, and recognizes revenue, upon delivery of certain products related to the closing of a real property transaction where the Company's right to payment is subject to the closing of the real estate transaction. The Company records a contract liability for payments received in advance of revenue recognition for certain products or services. Contract assets and liabilities were not material at September 30, 2018. Revenues recognized during the three and nine months ended September 30, 2018 that were included in contract liabilities at the beginning of the period were not material.

For information about the Company's revenues disaggregated by reportable segment see Note 16 Segment Information.

Note 3 – 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 $8.9 billion and $7.5 billion at September 30, 2018 and December 31, 2017, respectively, of which $4.4 billion and $2.9 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 $3.8 billion and $3.7 billion at September 30, 2018 and December 31, 2017, 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.

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 $2.6 billion at September 30, 2018 and December 31, 2017. 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.

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Note 4 – 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
September 30, 2018				
U.S. Treasury bonds	$204,854	$135	$(5,033)	$199,956
Municipal bonds	1,093,531	3,630	(22,973)	1,074,188
Foreign government bonds	156,289	231	(2,518)	154,002
Governmental agency bonds	334,690	284	(8,425)	326,549
Governmental agency mortgage-backed securities	2,786,111	2,422	(49,763)	2,738,770
U.S. corporate debt securities	773,189	2,763	(12,147)	763,805
Foreign corporate debt securities	275,290	1,020	(3,720)	272,590
	$5,623,954	$10,485	$(104,579)	$5,529,860
December 31, 2017				
U.S. Treasury bonds	$173,049	$2,199	$(1,250)	$173,998
Municipal bonds	1,031,146	12,185	(7,394)	1,035,937
Foreign government bonds	170,220	489	(1,221)	169,488
Governmental agency bonds	212,731	1,061	(2,322)	211,470
Governmental agency mortgage-backed securities	2,172,377	3,168	(16,588)	2,158,957
U.S. corporate debt securities	734,409	11,768	(2,962)	743,215
Foreign corporate debt securities	256,430	4,145	(956)	259,619
	$4,750,362	$35,015	$(32,693)	$4,752,684

Sales of debt securities resulted in realized gains of $0.6 million and $1.9 million, realized losses of $3.1 million and $6.9 million, and proceeds of $183.1 million and $525.4 million for the three and nine months ended September 30, 2018, respectively, and realized gains of $0.9 million and $3.9 million, realized losses of $0.4 million and $4.0 million, and proceeds of $63.7 million and $357.7 million for the three and nine months ended September 30, 2017, respectively.

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

	Less than 12 months		12 months or longer		Total	
(in thousands)	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
September 30, 2018						
U.S. Treasury bonds	$138,105	$(2,976)	$49,131	$(2,057)	$187,236	$(5,033)
Municipal bonds	508,857	(7,747)	296,302	(15,226)	805,159	(22,973)
Foreign government bonds	101,286	(1,250)	33,004	(1,268)	134,290	(2,518)
Governmental agency bonds	183,040	(3,260)	136,979	(5,165)	320,019	(8,425)
Governmental agency mortgage-backed securities	1,367,730	(21,748)	877,474	(28,015)	2,245,204	(49,763)
U.S. corporate debt securities	442,049	(7,825)	86,252	(4,322)	528,301	(12,147)
Foreign corporate debt securities	152,560	(2,546)	39,727	(1,174)	192,287	(3,720)
	$2,893,627	$(47,352)	$1,518,869	$(57,227)	$4,412,496	$(104,579)
December 31, 2017						
U.S. Treasury bonds	$78,605	$(511)	$37,498	$(739)	$116,103	$(1,250)
Municipal bonds	279,292	(1,714)	226,895	(5,680)	506,187	(7,394)
Foreign government bonds	98,942	(972)	6,678	(249)	105,620	(1,221)
Governmental agency bonds	55,707	(409)	93,737	(1,913)	149,444	(2,322)
Governmental agency mortgage-backed securities	671,871	(4,868)	774,959	(11,720)	1,446,830	(16,588)
U.S. corporate debt securities	171,817	(1,568)	60,724	(1,394)	232,541	(2,962)
Foreign corporate debt securities	81,525	(821)	5,697	(135)	87,222	(956)
	$1,437,759	$(10,863)	$1,206,188	$(21,830)	$2,643,947	$(32,693)

Based on the Company’s review of its debt securities in an unrealized loss position at September 30, 2018, it determined that the losses were primarily the result of changes in interest rates, which were considered to be temporary, rather than a deterioration in credit quality. The Company does not intend to sell and it is not more likely than not that the Company will be required to sell these securities prior to recovering their amortized cost. As such, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2018.

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Investments in debt securities at September 30, 2018, by contractual maturities, are as follows:

(in thousands)	Due in one year or less	Due after one through five years	Due after five through ten years	Due after ten years	Total
U.S. Treasury bonds					
Amortized cost	$ 27,440	$63,667	$51,675	$62,072	$204,854
Estimated fair value	$ 27,200	$62,757	$50,409	$59,590	$199,956
Municipal bonds					
Amortized cost	$ 84,445	$273,965	$305,452	$429,669	$1,093,531
Estimated fair value	$ 84,352	$272,119	$300,956	$416,761	$1,074,188
Foreign government bonds					
Amortized cost	$ 19,036	$109,717	$11,715	$15,821	$156,289
Estimated fair value	$ 19,002	$108,840	$11,505	$14,655	$154,002
Governmental agency bonds					
Amortized cost	$ 33,161	$119,472	$127,656	$54,401	$334,690
Estimated fair value	$ 33,115	$116,611	$125,714	$51,109	$326,549
U.S. corporate debt securities					
Amortized cost	$ 31,337	$368,851	$329,269	$43,732	$773,189
Estimated fair value	$ 31,258	$364,834	$324,843	$42,870	$763,805
Foreign corporate debt securities					
Amortized cost	$ 26,278	$157,324	$83,175	$8,513	$275,290
Estimated fair value	$ 26,241	$155,799	$82,037	$8,513	$272,590
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 221,697	$1,092,996	$908,942	$614,208	$2,837,843
Estimated fair value	$ 221,168	$1,080,960	$895,464	$593,498	$2,791,090
Total mortgage-backed securities					
Amortized cost					$2,786,111
Estimated fair value					$2,738,770
Total debt securities					
Amortized cost					$5,623,954
Estimated fair value					$5,529,860

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

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Investments in equity securities are as follows:

(in thousands)	Cost	Estimated fair value
September 30, 2018		
Preferred stocks	$18,616	$18,432
Common stocks	373,543	429,317
	$392,159	$447,749
December 31, 2017		
Preferred stocks	$19,233	$18,990
Common stocks	394,439	447,526
	$413,672	$466,516

The Company adopted new accounting guidance on January 1, 2018, which requires investments in equity securities with readily determinable fair values to be measured at fair value with changes in fair value recognized through net income. See Note 1 Basis of Condensed Consolidated Financial Statements for further discussion of the new guidance.

Net gains (realized and unrealized) of $14.2 million and $16.0 million were recognized for the three and nine months ended September 30, 2018, respectively, as a result of changes in the fair values of equity securities. Included in net gains during the three and nine months ended September 30, 2018, were net unrealized gains of $14.1 million and $15.9 million, respectively, related to equity securities still held at September 30, 2018. For the three and nine months ended September 30, 2017, sales of equity securities resulted in realized gains of $0.7 million and $17.9 million and realized losses of $0.3 million and $2.0 million, respectively.

The composition of the investment portfolio at September 30, 2018, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
(in thousands, except percentages)	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage
Debt securities:								
U.S. Treasury bonds	$199,956	100.0	$—	—	$—	—	$199,956	100.0
Municipal bonds	997,639	92.9	52,149	4.9	24,400	2.2	1,074,188	100.0
Foreign government bonds	125,378	81.4	23,757	15.4	4,867	3.2	154,002	100.0

Governmental agency bonds	326,549	100.0	—	—	—	—	326,549	100.0
Governmental agency mortgage-backed securities	2,738,770	100.0	—	—	—	—	2,738,770	100.0
U.S. corporate debt securities	303,068	39.7	248,671	32.6	212,066	27.7	763,805	100.0
Foreign corporate debt securities	123,299	45.2	112,708	41.3	36,583	13.5	272,590	100.0
Total debt securities	4,814,659	87.1	437,285	7.9	277,916	5.0	5,529,860	100.0
Preferred stocks	58	0.3	16,017	86.9	2,357	12.8	18,432	100.0
Total	$4,814,717	86.8	$453,302	8.2	$280,273	5.0	$5,548,292	100.0

As of September 30, 2018, the estimated fair value of total debt securities included $157.1 million of bank loans, of which $146.3 million was non-investment grade; $95.6 million of high yield corporate debt securities, all of which was non-investment grade; and $86.3 million of emerging market debt securities, of which $11.6 million was non-investment grade.

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The composition of the debt securities portfolio in an unrealized loss position at September 30, 2018, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
(in thousands, except percentages)	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage
U.S. Treasury bonds	$187,236	100.0	$—	—	$—	—	$187,236	100.0
Municipal bonds	757,128	94.0	34,436	4.3	13,595	1.7	805,159	100.0
Foreign government bonds	106,665	79.5	22,758	16.9	4,867	3.6	134,290	100.0
Governmental agency bonds	320,019	100.0	—	—	—	—	320,019	100.0
Governmental agency mortgage-backed securities	2,245,204	100.0	—	—	—	—	2,245,204	100.0
U.S. corporate debt securities	260,752	49.3	193,826	36.7	73,723	14.0	528,301	100.0
Foreign corporate debt securities	82,630	43.0	89,010	46.3	20,647	10.7	192,287	100.0
Total	$3,959,634	89.7	$340,030	7.7	$112,832	2.6	$4,412,496	100.0

As of September 30, 2018, the estimated fair value of total debt securities in an unrealized loss position included $28.9 million of bank loans, of which $28.5 million was non-investment grade; $60.6 million of high yield corporate debt securities, all of which was non-investment grade; and $72.9 million of emerging market debt securities, of which $10.1 million was non-investment grade.

The credit ratings in the above tables reflect published ratings obtained from globally recognized securities rating agencies. If a security was rated differently among the rating agencies, the lowest rating was selected. Governmental agency mortgage-backed securities are not rated by any of the ratings agencies; however, these securities have been included in the above table in the “A- or higher” category because the payments of principal and interest are guaranteed by the governmental agency that issued the security.

Note 5 – Goodwill

A summary of the changes in the carrying amount of goodwill, by operating segment, for the nine months ended September 30, 2018, is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance at December 31, 2017	$1,066,240	$46,765	$1,113,005
Acquisitions	34,261	—	34,261
Foreign currency translation	(2,180)	—	(2,180)
Balance at September 30, 2018	$1,098,321	$46,765	$1,145,086

The Company's four reporting units for purposes of assessing goodwill for impairment are title insurance, home warranty, property and casualty insurance and trust and other services. During the nine months ended September 30, 2018, there were no triggering events that would more likely than not reduce the fair value of any reporting unit below its carrying amount.

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Note 6 – Other Intangible Assets

Other intangible assets consist of the following:

(in thousands)	September 30, 2018	December 31, 2017
Finite-lived intangible assets:		
Customer relationships	$ 116,030	$ 106,086
Noncompete agreements	12,965	11,509
Trademarks	10,016	9,229
Internal-use software licenses	25,779	28,956
Patents	2,840	2,840
	167,630	158,620
Accumulated amortization	(72,867)	(75,591)
	94,763	83,029
Indefinite-lived intangible assets:		
Licenses	16,884	