First American Financial Corp
Form 10-Q
July 26, 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 June 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<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |
| 1 First American Way, Santa Ana, California | 92707-5913 |
| (Address of principal executive offices) | (Zip Code) |

(714) 250-3000

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports 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 July 20, 2018, there were 111,658,912 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 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)

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Assets | | |
| Cash and cash equivalents | $1,226,510 | $1,387,226 |
| Accounts and accrued income receivable, net | 348,621 | 311,084 |
| Income taxes receivable | 35,776 | 38,673 |
| Investments: | | |
| Deposits with banks | 40,991 | 41,335 |
| Debt securities, includes pledged securities of $105,248 and $108,427 | 5,119,843 | 4,752,684 |
| Equity securities | 438,695 | 466,516 |
| Other investments | 116,582 | 117,768 |
| | 5,716,111 | 5,378,303 |
| Secured financings receivable | 96,148 | — |
| Property and equipment, net | 446,290 | 439,569 |
| Title plants and other indexes | 573,069 | 568,452 |
| Deferred income taxes | 22,803 | 22,803 |
| Goodwill | 1,166,976 | 1,113,005 |
| Other intangible assets, net | 104,258 | 99,913 |
| Other assets | 222,834 | 214,194 |
| | $9,959,396 | $9,573,222 |
| Liabilities and Equity | | |
| Deposits | $3,298,160 | $3,070,566 |
| Accounts payable and accrued liabilities | 770,660 | 793,157 |
| Deferred revenue | 239,528 | 240,822 |
| Reserve for known and incurred but not reported claims | 1,022,928 | 1,028,933 |
| Income taxes payable | 5,032 | 4,602 |
| Deferred income taxes | 219,307 | 219,307 |
| Secured financings payable | 96,166 | — |
| Notes and contracts payable | 736,393 | 732,810 |
| | 6,388,174 | 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—111,658 shares and 110,925 shares | 1 | 1 |
| Additional paid-in capital | 2,254,253 | 2,236,351 |
| Retained earnings | 1,496,638 | 1,311,112 |
| Accumulated other comprehensive loss | (181,369 ) | (67,509 ) |
| Total stockholders' equity | 3,569,523 | 3,479,955 |
| Noncontrolling interests | 1,699 | 3,070 |
| Total equity | 3,571,222 | 3,483,025 |
| | $9,959,396 | $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 June 30, 2018 | 2017 | Six Months Ended June 30, 2018 | 2017 |
|---|---|---|---|---|
| Revenues | | | | |
| Direct premiums and escrow fees | $661,582 | $641,080 | $1,205,460 | $1,168,089 |
| Agent premiums | 559,004 | 554,028 | 1,086,718 | 1,128,610 |
| Information and other | 208,752 | 201,851 | 397,410 | 384,360 |
| Net investment income | 56,334 | 39,609 | 99,126 | 72,649 |
| Net realized investment gains (losses) | 5,485 | 17,861 | (169) | 17,764 |
| | 1,491,157 | 1,454,429 | 2,788,545 | 2,771,472 |
| Expenses | | | | |
| Personnel costs | 448,974 | 436,441 | 862,616 | 843,578 |
| Premiums retained by agents | 439,550 | 435,771 | 856,187 | 889,697 |
| Other operating expenses | 228,935 | 230,791 | 447,415 | 446,193 |
| Provision for policy losses and other claims | 113,619 | 110,958 | 214,199 | 213,346 |
| Depreciation and amortization | 31,058 | 30,145 | 60,805 | 60,292 |
| Premium taxes | 17,049 | 17,179 | 33,063 | 32,627 |
| Interest | 10,004 | 8,990 | 19,227 | 17,705 |
| | 1,289,189 | 1,270,275 | 2,493,512 | 2,503,438 |
| Income before income taxes | 201,968 | 184,154 | 295,033 | 268,034 |
| Income taxes | 46,877 | 62,259 | 63,770 | 88,070 |
| Net income | 155,091 | 121,895 | 231,263 | 179,964 |
| Less: Net loss attributable to noncontrolling interests | (49) | (362) | (104) | (575) |
| Net income attributable to the Company | $155,140 | $122,257 | $231,367 | $180,539 |
| Net income per share attributable to the Company's stockholders (Note 9): | | | | |
| Basic | $1.38 | $1.10 | $2.06 | $1.62 |
| Diluted | $1.37 | $1.09 | $2.05 | $1.61 |
| Cash dividends declared per share | $0.38 | $0.34 | $0.76 | $0.68 |
| Weighted-average common shares outstanding (Note 9): | | | | |
| Basic | 112,556 | 111,549 | 112,406 | 111,374 |
| Diluted | 113,117 | 112,199 | 113,093 | 112,026 |

See notes to condensed consolidated financial statements.

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FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net income | $155,091 | $121,895 | $231,263 | $179,964 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized (losses) gains on securities | (12,475 ) | 12,634 | (59,271 ) | 38,085 |
| Foreign currency translation adjustment | (10,545 ) | 8,709 | (14,297 ) | 12,143 |
| Pension benefit adjustment | 119 | 3,637 | 239 | 7,170 |
| Total other comprehensive income (loss), net of tax | (22,901 ) | 24,980 | (73,329 ) | 57,398 |
| Comprehensive income | 132,190 | 146,875 | 157,934 | 237,362 |
| Less: Comprehensive loss attributable to noncontrolling interests | (49 ) | (362 ) | (123 ) | (568 ) |
| Comprehensive income attributable to the Company | $132,239 | $147,237 | $158,057 | $237,930 |

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, 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 six months ended June 30, 2018 | — | — | — | 231,367 | — | 231,367 | (104 ) | 231,263 |
| Dividends on common shares | — | — | — | (84,717 ) | — | (84,717 ) | — | (84,717 ) |
| Shares issued in connection with share-based compensation plans | 733 | — | (9,555 ) | (1,674 ) | — | (11,229 ) | — | (11,229 ) |
| Share-based compensation | — | — | 27,135 | — | — | 27,135 | — | 27,135 |
| Net activity related to noncontrolling interests | — | — | 322 | — | — | 322 | (1,248 ) | (926 ) |
| Other comprehensive loss (Note 13) | — | — | — | — | (73,310 ) | (73,310 ) | (19 ) | (73,329 ) |
| Balance at June 30, 2018 | 111,658 | $ 1 | $ 2,254,253 | $ 1,496,638 | $ (181,369 ) | $ 3,569,523 | $ 1,699 | $ 3,571,222 |

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, 2018 | 2017 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $231,263 | $179,964 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Provision for policy losses and other claims | 214,199 | 213,346 |
| Depreciation and amortization | 60,805 | 60,292 |
| Amortization of premiums and accretion of discounts on debt securities, net | 13,451 | 16,666 |
| Net realized investment losses (gains) | 169 | (17,764) |
| Share-based compensation | 27,135 | 24,580 |
| Equity in earnings of affiliates, net | (708) | (3,447) |
| Dividends from equity method investments | 1,774 | 5,562 |
| Changes in assets and liabilities excluding effects of acquisitions and noncash transactions: | | |
| Claims paid, including assets acquired, net of recoveries | (213,538) | (225,849) |
| Net change in income tax accounts | 20,560 | 104,656 |
| Increase in accounts and accrued income receivable | (36,700) | (18,411) |
| Decrease in accounts payable and accrued liabilities | (59,871) | (92,662) |
| (Decrease) increase in deferred revenue | (1,149) | 2,468 |
| Other, net | (3,290) | (14,797) |
| Cash provided by operating activities | 254,100 | 234,604 |
| Cash flows from investing activities: | | |
| Net cash effect of acquisitions/dispositions | (73,757) | (3,933) |
| Net (increase) decrease in deposits with banks | (757) | 110 |
| Purchases of debt and equity securities | (1,166,788) | (1,029,861) |
| Proceeds from sales of debt and equity securities | 470,670 | 499,526 |
| Proceeds from maturities of debt securities | 282,754 | 276,843 |
| Net change in other investments | 563 | 2,105 |
| Advances under secured financing agreements | (580,162) | — |
| Collections of secured financings receivable | 553,632 | — |
| Capital expenditures | (55,720) | (69,553) |
| Proceeds from sales of property and equipment | 1,624 | 9,013 |
| Cash used for investing activities | (567,941) | (315,750) |
| Cash flows from financing activities: | | |
| Net change in deposits | 227,594 | 318,318 |

| | | |
|---|---|---|
| Borrowings under secured financing agreements | 579,871 | — |
| Repayments of secured financings payable | (553,513) | — |
| Repayments of notes and contracts payable | (2,681) | (2,660) |
| Net activity related to noncontrolling interests | (920) | (879) |
| Net payments in connection with share-based compensation plans | (11,229) | (2,167) |
| Cash dividends | (84,717) | (75,099) |
| Cash provided by financing activities | 154,405 | 237,513 |
| Effect of exchange rate changes on cash | (1,280) | 4,259 |
| Net (decrease) increase in cash and cash equivalents | (160,716) | 160,626 |
| Cash and cash equivalents—Beginning of period | 1,387,226 | 1,006,138 |
| Cash and cash equivalents—End of period | $1,226,510 | $1,166,764 |
| Supplemental information: | | |
| Cash paid (received) during the period for: | | |
| Interest | $18,591 | $16,811 |
| Premium taxes | $42,840 | $41,652 |
| Income taxes, less refunds of $18 and $51,904 | $42,456 | $(16,696) |

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 \$8.0 million and \$16.0 million were reclassified from personnel costs to other operating expenses on the condensed consolidated statements of income for the three and six months ended June 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 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 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)

## 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 theses 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.

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 June 30, 2018. Revenues recognized during the three and six months ended June 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 $8.7 billion and $7.5 billion at June 30, 2018 and December 31, 2017, respectively, of which $3.2 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 $3.7 billion at June 30, 2018 and December 31, 2017. 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.

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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 $2.5 billion and $2.6 billion at June 30, 2018 and December 31, 2017, 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 4 – Debt and Equity Securities

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

| | Amortized | Gross unrealized | | Estimated |
|---|---|---|---|---|
| (in thousands) | cost | Gains | Losses | fair value |
| June 30, 2018 | | | | |
| U.S. Treasury bonds | $172,266 | $512 | $(3,058) | $169,720 |
| Municipal bonds | 1,106,608 | 5,841 | (18,014) | 1,094,435 |
| Foreign government bonds | 148,289 | 305 | (2,674) | 145,920 |
| Governmental agency bonds | 262,355 | 463 | (5,798) | 257,020 |
| Governmental agency mortgage-backed securities | 2,475,714 | 2,985 | (39,449) | 2,439,250 |
| U.S. corporate debt securities | 761,229 | 2,332 | (14,637) | 748,924 |
| Foreign corporate debt securities | 268,118 | 862 | (4,406) | 264,574 |
| | $5,194,579 | $13,300 | $(88,036) | $5,119,843 |
| 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 $0.7 million and $1.3 million, realized losses of $2.6 million and $3.8 million, and proceeds of $186.6 million and $342.3 million for the three and six months ended June 30, 2018, respectively, and realized gains of $1.3 million and $2.9 million, realized losses of $0.3 million and $3.5 million, and proceeds of $139.6 million and $294.0 million for the three and six months ended June 30, 2017, respectively.

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

| (in thousands) | Less than 12 months Estimated fair value | Less than 12 months Unrealized losses | 12 months or longer Estimated fair value | 12 months or longer Unrealized losses | Total Estimated fair value | Total Unrealized losses |
|---|---|---|---|---|---|---|
| June 30, 2018 | | | | | | |
| U.S. Treasury bonds | $111,297 | $(1,927) | $34,287 | $(1,131) | $145,584 | $(3,058) |
| Municipal bonds | 473,525 | (5,656) | 227,275 | (12,358) | 700,800 | (18,014) |
| Foreign government bonds | 72,240 | (1,265) | 35,537 | (1,409) | 107,777 | (2,674) |
| Governmental agency bonds | 118,367 | (2,185) | 116,299 | (3,613) | 234,666 | (5,798) |
| Governmental agency mortgage-backed securities | 1,079,083 | (19,034) | 757,050 | (20,415) | 1,836,133 | (39,449) |
| U.S. corporate debt securities | 511,761 | (11,007) | 60,723 | (3,630) | 572,484 | (14,637) |
| Foreign corporate debt securities | 179,776 | (3,833) | 21,263 | (573) | 201,039 | (4,406) |
| | $2,546,049 | $(44,907) | $1,252,434 | $(43,129) | $3,798,483 | $(88,036) |
| 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 June 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 June 30, 2018.

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Investments in debt securities at June 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 | $ 31,771 | $ 48,201 | $ 40,899 | $ 51,395 | $ 172,266 |
| Estimated fair value | $ 31,647 | $ 47,291 | $ 40,044 | $ 50,738 | $ 169,720 |
| Municipal bonds | | | | | |
| Amortized cost | $ 73,033 | $ 295,362 | $ 300,483 | $ 437,730 | $ 1,106,608 |
| Estimated fair value | $ 73,044 | $ 295,138 | $ 297,958 | $ 428,295 | $ 1,094,435 |
| Foreign government bonds | | | | | |
| Amortized cost | $ 19,550 | $ 101,513 | $ 11,382 | $ 15,844 | $ 148,289 |
| Estimated fair value | $ 19,520 | $ 100,893 | $ 11,081 | $ 14,426 | $ 145,920 |
| Governmental agency bonds | | | | | |
| Amortized cost | $ 31,852 | $ 100,514 | $ 76,537 | $ 53,452 | $ 262,355 |
| Estimated fair value | $ 31,763 | $ 98,014 | $ 75,784 | $ 51,459 | $ 257,020 |
| U.S. corporate debt securities | | | | | |
| Amortized cost | $ 21,982 | $ 356,138 | $ 311,501 | $ 71,608 | $ 761,229 |
| Estimated fair value | $ 21,951 | $ 351,759 | $ 305,639 | $ 69,575 | $ 748,924 |
| Foreign corporate debt securities | | | | | |
| Amortized cost | $ 20,650 | $ 152,492 | $ 82,081 | $ 12,895 | $ 268,118 |
| Estimated fair value | $ 20,639 | $ 151,135 | $ 80,145 | $ 12,655 | $ 264,574 |
| Total debt securities excluding mortgage-backed securities | | | | | |
| Amortized cost | $ 198,838 | $ 1,054,220 | $ 822,883 | $ 642,924 | $ 2,718,865 |
| Estimated fair value | $ 198,564 | $ 1,044,230 | $ 810,651 | $ 627,148 | $ 2,680,593 |
| Total mortgage-backed securities | | | | | |
| Amortized cost | | | | | $ 2,475,714 |
| Estimated fair value | | | | | $ 2,439,250 |
| Total debt securities | | | | | |
| Amortized cost | | | | | $ 5,194,579 |
| Estimated fair value | | | | | $ 5,119,843 |

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 |
|---|---|---|
| June 30, 2018 | | |
| Preferred stocks | $18,292 | $17,946 |
| Common stocks | 378,396 | 420,749 |
| | $396,688 | $438,695 |
| 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 of $7.7 million and $1.8 million were recognized for the three and six months ended June 30, 2018, respectively, as a result of changes in the fair values of equity securities. Included in net gains during the three and six months ended June 30, 2018, were net unrealized gains of $5.6 million and $1.8 million, respectively, related to equity securities still held at June 30, 2018. For the three and six months ended June 30, 2017, sales of equity securities resulted in realized gains of $15.4 million and $17.2 million and realized losses of $1.6 million and $1.7 million, respectively.

The composition of the investment portfolio at June 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 | $169,720 | 100.0 | $— | — | $— | — | $169,720 | 100.0 |
| Municipal bonds | 1,011,354 | 92.4 | 59,805 | 5.5 | 23,276 | 2.1 | 1,094,435 | 100.0 |
| Foreign government bonds | 117,244 | 80.3 | 23,596 | 16.2 | 5,080 | 3.5 | 145,920 | 100.0 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Governmental agency bonds | 257,020 | 100.0 | — | — | — | — | 257,020 | 100.0 |
| Governmental agency mortgage-backed securities | 2,439,250 | 100.0 | — | — | — | — | 2,439,250 | 100.0 |
| U.S. corporate debt securities | 301,840 | 40.3 | 245,345 | 32.8 | 201,739 | 26.9 | 748,924 | 100.0 |
| Foreign corporate debt securities | 122,937 | 46.5 | 110,837 | 41.9 | 30,800 | 11.6 | 264,574 | 100.0 |
| Total debt securities | 4,419,365 | 86.3 | 439,583 | 8.6 | 260,895 | 5.1 | 5,119,843 | 100.0 |
| Preferred stocks | 58 | 0.3 | 13,106 | 73.0 | 4,782 | 26.7 | 17,946 | 100.0 |
| Total | $4,419,423 | 86.0 | $452,689 | 8.8 | $265,677 | 5.2 | $5,137,789 | 100.0 |

As of June 30, 2018, the estimated fair value of total debt securities included $155.4 million of bank loans, of which $141.9 million was non-investment grade; $84.5 million of high yield corporate debt securities, all of which was non-investment grade; and $84.4 million of emerging market debt securities, of which $11.2 million was non-investment grade.

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The composition of the debt securities portfolio in an unrealized loss position at June 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 | $145,584 | 100.0 | $— | — | $— | — | $145,584 | 100.0 |
| Municipal bonds | 654,260 | 93.4 | 36,534 | 5.2 | 10,006 | 1.4 | 700,800 | 100.0 |
| Foreign government bonds | 79,130 | 73.4 | 23,567 | 21.9 | 5,080 | 4.7 | 107,777 | 100.0 |
| Governmental agency bonds | 234,666 | 100.0 | — | — | — | — | 234,666 | 100.0 |
| Governmental agency mortgage-backed securities | 1,836,133 | 100.0 | — | — | — | — | 1,836,133 | 100.0 |
| U.S. corporate debt securities | 255,973 | 44.7 | 200,971 | 35.1 | 115,540 | 20.2 | 572,484 | 100.0 |
| Foreign corporate debt securities | 82,024 | 40.8 | 94,505 | 47.0 | 24,510 | 12.2 | 201,039 | 100.0 |
| Total | $3,287,770 | 86.6 | $355,577 | 9.4 | $155,136 | 4.0 | $3,798,483 | 100.0 |

As of June 30, 2018, the estimated fair value of total debt securities in an unrealized loss position included $74.4 million of bank loans, of which $70.2 million was non-investment grade; $64.7 million of high yield corporate debt securities, all of which was non-investment grade; and $72.7 million of emerging market debt securities, of which $10.2 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 six months ended June 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 | 56,751 | — | 56,751 |
| Foreign currency translation | (2,780) | — | (2,780) |
| Balance at June 30, 2018 | $1,120,211 | $46,765 | $1,166,976 |

The Company's four reporting units for purposes of assessing goodwill for impairment are title insurance, home warranty, property and casualty insurance and trust and other services. During the six months ended June 30, 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) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Finite-lived intangible assets: | | |
| Customer relationships | $108,931 | $106,086 |
| Noncompete agreements | 11,227 | 11,509 |
| Trademarks | 8,227 | 9,229 |
| Internal-use software licenses | 26,182 | 28,956 |
| Patents | 2,840 | 2,840 |
| | 157,407 | 158,620 |
| Accumulated amortization | (70,033 ) | (75,591 ) |
| | 87,374 | 83,029 |
| Indefinite-lived intangible assets: | | |
| Licenses | 16,884 | 16,884 |
| | $104,258 | $99,913 |

Amortization expense for finite-lived intangible assets was $7.1 million and $14.1 million for the three and six months ended June 30, 2018, respectively, and $6.5 million and $12.7 million for the three and six months ended June 30, 2017, respectively.

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

| Year | (in thousands) |
|---|---|
| Remainder of 2018 | $ 12,842 |
| 2019 | $ 18,264 |
| 2020 | $ 11,889 |
| 2021 | $ 9,023 |
| 2022 | $ 8,573 |
| 2023 | $ 8,519 |

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

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

| (in thousands) | Six months ended June 30, 2018 | 2017 |
|---|---|---|
| Balance at beginning of period | $1,028,933 | $1,025,863 |
| Provision related to: | | |
| Current year | 199,165 | 209,082 |
| Prior years | 15,034 | 4,264 |
| | 214,199 | 213,346 |
| Payments, net of recoveries, related to: | | |
| Current year | 90,752 | 91,915 |
| Prior years | 122,786 | 133,934 |
| | 213,538 | 225,849 |
| Other | (6,666) | 3,872 |
| Balance at end of period | $1,022,928 | $1,017,232 |

The provision for title insurance losses, expressed as a percentage of title insurance premiums and escrow fees, was 4.0% for the three and six months ended June 30, 2018 and 2017. The current quarter rate of 4.0% reflects the ultimate loss rate for the current policy year and no change in the loss reserve estimates for prior policy years. The 4.0% rate for the second quarter of 2017 reflected the ultimate loss rate for the 2017 policy year and no change in the loss reserve estimates for prior policy years.

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

| (in thousands, except percentages) | June 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Known title claims | $87,809 | 8.6 % | $83,094 | 8.1 % |
| Incurred but not reported claims | 867,206 | 84.8 % | 875,724 | 85.1 % |
| Total title claims | 955,015 | 93.4 % | 958,818 | 93.2 % |
| Non-title claims | 67,913 | 6.6 % | 70,115 | 6.8 % |
| Total loss reserves | $1,022,928 | 100.0 % | $1,028,933 | 100.0 % |

Note 8 – Income Taxes

On December 22, 2017, comprehensive tax reform legislation known as the Tax Cuts and Jobs Act (the "Tax Reform Act") was signed into law. The Tax Reform Act amended the Internal Revenue Code to reduce U.S. tax rates and modify policies, credits and deductions for individuals and businesses.

Also, on December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118, which provided for a one-year measurement period that allows businesses time to evaluate the financial statement implications of the Tax Reform Act. The measurement period allows businesses to gather the information necessary to prepare and analyze the tax accounting effects of the Tax Reform Act on financial statements issued during the measurement period. The ultimate impact of the Tax Reform Act on the Company's financial statements may differ, perhaps materially, from the amounts originally estimated due to further refinement of the Company's calculations, changes in interpretations and assumptions the Company has made, guidance that may be issued by taxing authorities and regulatory bodies, and actions the Company may take as a result of the Tax Reform Act. The Company anticipates completing its tax accounting for the Tax Reform Act during the measurement period, and will record and disclose any adjustments made to its initial estimates during that time frame.

The Company's effective income tax rates (income tax expense as a percentage of income before income taxes) were 23.2% and 21.6% for the three and six months ended June 30, 2018, respectively, and 33.8% and 32.9% for the three and six months ended June 30, 2017, respectively. The Company's effective tax rates differ from the statutory federal rates of 21% and 35% for 2018 and 2017, respectively, primarily due to changes in state and foreign income taxes resulting from fluctuations in the Company's noninsurance and foreign subsidiaries' contributions to pretax income, changes in the ratio of permanent differences to income before income taxes and the recognition of excess tax benefits or tax deficiencies associated with share-based payment transactions through income tax expense.

In connection with the Company's June 2010 spin-off from its prior parent, the Company entered into a tax sharing agreement which governs the Company's and its prior parent's respective rights, responsibilities and obligations for certain tax related matters. At June 30, 2018 and December 31, 2017, the Company had a net payable to its prior parent of $15.3 million and $15.0 million, respectively, related to tax matters prior to the spin-off. This amount is included in the Company's condensed consolidated balance sheets in accounts payable and accrued liabilities. The increase during the current year was primarily the result of an additional accrual for tax matters prior to the spin-off.

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

As of June 30, 2018 and December 31, 2017, the liability for income taxes associated with uncertain tax positions was $13.1 million and $12.8 million, respectively. As of June 30, 2018 and December 31, 2017, the liability could be reduced by $3.7 million due to offsetting tax benefits associated with the correlative effects of potential adjustments, including timing adjustments and state income taxes. The net amounts of $9.4 million and $9.1 million as of June 30, 2018 and December 31, 2017, respectively, if recognized, would favorably affect the Company's effective tax rate.

The Company's continuing practice is to recognize interest and penalties, if any, related to uncertain tax positions in income tax expense. As of June 30, 2018 and December 31, 2017, the Company had accrued $5.6 million and $5.3 million, respectively, of interest and penalties (net of tax benefits of $1.5 million and $1.4 million, respectively) related to uncertain tax positions.

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

The Company, or one of its subsidiaries, files income tax returns in the U.S. federal jurisdiction, various state jurisdictions and various non-U.S. jurisdictions. The primary non-federal jurisdictions are California, Canada, India and the United Kingdom. As of June 30, 2018, the Company had concluded U.S. federal income tax examinations through 2015 and is generally no longer subject to state and non-U.S. income tax examinations for years prior to 2005.

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Note 9 – Earnings Per Share

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, | | June 30, | |
| (in thousands, except per share amounts) | 2018 | 2017 | 2018 | 2017 |
| Numerator | | | | |
| Net income attributable to the Company | $155,140 | $122,257 | $231,367 | $180,539 |
| Denominator | | | | |
| Basic weighted-average shares | 112,556 | 111,549 | 112,406 | 111,374 |
| Effect of dilutive employee stock options and restricted stock units (“RSUs”) | 561 | 650 | 687 | 652 |
| Diluted weighted-average shares | 113,117 | 112,199 | 113,093 | 112,026 |
| Net income per share attributable to the Company’s stockholders | | | | |
| Basic | $1.38 | $1.10 | $2.06 | $1.62 |
| Diluted | $1.37 | $1.09 | $2.05 | $1.61 |

For the three and six months ended June 30, 2018, no RSUs had an antidilutive effect on weighted-average diluted common shares outstanding, and for the three and six months ended June 30, 2017, 2 thousand RSUs and 1 thousand RSUs, respectively, were excluded from the weighted-average diluted common shares outstanding due to their antidilutive effect. No stock options had an antidilutive effect on weighted-average diluted common shares outstanding for either period in the current year or in the prior year.

Note 10 – Employee Benefit Plans

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, | | June 30, | |
| (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Expense: | | | | |
| Service costs | $130 | $183 | $260 | $367 |
| Interest costs | 2,018 | 4,458 | 4,036 | 9,099 |
| Expected return on plan assets | — | (2,370) | — | (4,740) |

| | | | | |
|---|---|---|---|---|
| Amortization of net actuarial loss | 1,205 | 6,902 | 2,410 | 13,834 |
| Amortization of prior service credit | (1,045) | (1,012) | (2,090) | (2,223) |
| | $2,308 | $8,161 | $4,616 | $16,337 |

The Company adopted new accounting guidance which requires the components of net periodic cost, other than the service cost component, to be included in other operating expenses in the Company's condensed consolidated statements of income. The change was applied retrospectively to the prior year, which resulted in a reclass of $8.0 million and $16.0 million from personnel costs to other operating expenses for the three and six months ended June 30, 2017, respectively. For further information about the new guidance see Note 1 Basis of Condensed Consolidated Financial Statements.

Prior year net periodic cost includes costs related to the Company's previously terminated defined benefit pension plans, for which the Company has no remaining obligation.

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Note 11 – Fair Value Measurements

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

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

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

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

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

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

Assets measured at fair value on a recurring basis

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

Debt securities

The fair values of debt securities were based on the market values obtained from independent pricing services that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and price quotes from well-established, independent broker-dealers. The independent pricing services monitor market indicators, industry and economic events, and for broker-quoted only securities, obtain quotes from market makers or broker-dealers that they recognize to be market participants. The pricing services utilize the market approach in determining the fair value of the debt securities held by the Company. The Company obtains an understanding of the valuation models and assumptions utilized by the services and has controls in place to determine that the values provided represent fair values. 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.

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

Equity securities

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

The following tables present the fair values of the Company's assets, measured on a recurring basis, as of June 30, 2018 and December 31, 2017:

| (in thousands) | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| June 30, 2018 | | | | |
| Debt securities: | | | | |
| U.S. Treasury bonds | $169,720 | $ — | $169,720 | $ — |
| Municipal bonds | 1,094,435 | — | 1,094,435 | — |
| Foreign government bonds | 145,920 | — | 145,920 | — |
| Governmental agency bonds | 257,020 | — | 257,020 | — |
| Governmental agency mortgage-backed securities | 2,439,250 | — | 2,439,250 | — |
| U.S. corporate debt securities | 748,924 | | | |