First American Financial Corp
Form 10-Q
October 24, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

OR

o 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)

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

(714) 250-3000

(Registrant s telephone number, including area code)

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

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

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 x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

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

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 18, 2013, there were 105,701,742 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

Items 3 through 5 of Part II have been omitted because they are not applicable with respect to the current reporting period.

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

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

- EXPECTED PENSION PLAN AND SUPPLEMENTAL BENEFIT PLAN CONTRIBUTIONS AND RETURNS;

- THE EFFECT OF LAWSUITS, REGULATORY EXAMINATIONS AND INVESTIGATIONS AND OTHER LEGAL PROCEEDINGS ON THE COMPANY S FINANCIAL CONDITION, RESULTS OF OPERATIONS OR CASH FLOWS;

- THE EFFECTS OF FUTURE ACTIONS OR INACTION OF THE UNITED STATES GOVERNMENT OR RELATED AGENCIES, INCLUDING THOSE RELATED TO THE UNITED STATES DEBT CEILING, A SHUTDOWN OF THE FEDERAL GOVERNMENT, OR MONETARY POLICY;

- EXPENSE MANAGEMENT;

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

- THE REALIZATION OF TAX BENEFITS ASSOCIATED WITH CERTAIN LOSSES AND UNRECOGNIZED TAX BENEFIT ESTIMATES;

- FUTURE PAYMENT OF DIVIDENDS;

- THE SUFFICIENCY OF THE COMPANY S RESOURCES TO SATISFY OPERATIONAL CASH REQUIREMENTS; AND

- THE LIKELIHOOD OF CHANGES IN EXPECTED ULTIMATE LOSSES AND CORRESPONDING LOSS RATES AND CLAIM RESERVES,

ARE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS MAY CONTAIN THE WORDS BELIEVE, ANTICIPATE, EXPECT, PLAN, PREDICT, ESTIMATE, PROJECT, WILL BE, WILL WILL LIKELY RESULT, OR OTHER SIMILAR WORDS AND PHRASES.

RISKS AND UNCERTAINTIES EXIST THAT MAY CAUSE RESULTS TO DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE THE ANTICIPATED RESULTS TO DIFFER FROM THOSE DESCRIBED IN THE FORWARD-LOOKING

STATEMENTS INCLUDE:

· INTEREST RATE FLUCTUATIONS;

· CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;

· VOLATILITY IN THE CAPITAL MARKETS;

· UNFAVORABLE ECONOMIC CONDITIONS;

· IMPAIRMENTS IN THE COMPANY S GOODWILL OR OTHER INTANGIBLE ASSETS;

· FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;

· CHANGES IN APPLICABLE GOVERNMENT REGULATIONS;

· HEIGHTENED SCRUTINY BY LEGISLATORS AND REGULATORS OF THE COMPANY S TITLE INSURANCE AND SERVICES SEGMENT AND CERTAIN OTHER OF THE COMPANY S BUSINESSES;

· REGULATION OF TITLE INSURANCE RATES;

· REFORM OF GOVERNMENT-SPONSORED MORTGAGE ENTERPRISES;

· LIMITATIONS ON ACCESS TO PUBLIC RECORDS AND OTHER DATA;

· CHANGES IN RELATIONSHIPS WITH LARGE MORTGAGE LENDERS;

· CHANGES IN MEASURES OF THE STRENGTH OF THE COMPANY S TITLE INSURANCE UNDERWRITERS, INCLUDING RATINGS AND STATUTORY CAPITAL AND SURPLUS;

· LOSSES IN THE COMPANY S INVESTMENT PORTFOLIO;

· EXPENSES OF AND FUNDING OBLIGATIONS TO THE PENSION PLAN;

· MATERIAL VARIANCE BETWEEN ACTUAL AND EXPECTED CLAIMS EXPERIENCE;

· DEFALCATIONS, INCREASED CLAIMS OR OTHER COSTS AND EXPENSES ATTRIBUTABLE TO THE COMPANY S USE OF TITLE AGENTS;

· ANY INADEQUACY IN THE COMPANY S RISK MITIGATION EFFORTS;

· SYSTEMS INTERRUPTIONS AND INTRUSIONS, WIRE TRANSFER ERRORS OR UNAUTHORIZED DATA DISCLOSURES;

· INABILITY TO REALIZE THE BENEFITS OF THE COMPANY S OFFSHORE STRATEGY;

· INABILITY OF THE COMPANY S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS; AND

- OTHER FACTORS DESCRIBED IN PART II, ITEM 1A OF THIS QUARTERLY REPORT ON FORM 10-Q.

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

	September 30, 2013	December 31, 2012
Assets		
Cash and cash equivalents	$ 833,857	$ 627,208
Accounts and accrued income receivable, net	254,941	259,779
Income taxes receivable	32,559	14,093
Investments:		
Deposits with savings and loan associations and banks	60,964	71,196
Debt securities, includes pledged securities of $118,156 and $105,849	2,843,759	2,651,881
Equity securities	250,525	197,920
Other long-term investments	194,513	192,563
	3,349,761	3,113,560
Loans receivable, net	77,067	107,352
Property and equipment, net	361,547	343,450
Title plants and other indexes	523,456	521,741
Goodwill	843,477	845,857
Other intangible assets, net	47,959	57,095
Other assets	176,446	160,712
	$ 6,501,070	$ 6,050,847
Liabilities and Equity		
Deposits	$ 1,724,209	$ 1,411,193
Accounts payable and accrued liabilities	749,935	820,503
Due to CoreLogic, Inc. (CoreLogic), net	54,220	53,510
Deferred revenue	185,570	170,663
Reserve for known and incurred but not reported claims	1,054,037	976,462
Deferred income taxes	36,987	36,987
Notes and contracts payable	320,521	229,760
	4,125,479	3,699,078
Commitments and contingencies (Note 16)		
Stockholders equity:		
Preferred stock, $0.00001 par value, Authorized-500 shares; Outstanding-none		
Common stock, $0.00001 par value:		

Authorized-300,000 shares; Outstanding-105,689 shares and 107,239 shares as of September 30, 2013 and December 31, 2012, respectively	1	1
Additional paid-in capital	2,070,457	2,111,605
Retained earnings	482,141	387,015
Accumulated other comprehensive loss	(180,277)	(150,556)
Total stockholders equity	2,372,322	2,348,065
Noncontrolling interests	3,269	3,704
Total equity	2,375,591	2,351,769
	$ 6,501,070	$ 6,050,847

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
Revenues				
Direct premiums and escrow fees	$ 573,116	$ 535,846	$ 1,644,172	$ 1,446,920
Agent premiums	549,052	443,028	1,530,247	1,220,375
Information and other	159,775	159,103	483,430	482,690
Investment income	26,001	23,154	71,544	57,077
Net realized investment (losses) gains	(6,966)	47,271	6,812	61,500
Net other-than-temporary impairment (OTTI) losses recognized in earnings:				
Total OTTI losses on debt securities				(1,757)
Portion of OTTI losses on debt securities recognized in other comprehensive loss				(1,807)
				(3,564)
	1,300,978	1,208,402	3,736,205	3,264,998
Expenses				
Personnel costs	377,872	344,140	1,087,139	971,462
Premiums retained by agents	440,453	355,191	1,224,020	978,703
Other operating expenses	222,297	213,111	660,408	607,908
Provision for policy losses and other claims	114,952	106,209	429,744	288,276
Depreciation and amortization	18,554	18,429	55,141	54,944
Premium taxes	15,771	13,470	42,683	36,546
Interest	4,034	1,970	11,209	7,437
	1,193,933	1,052,520	3,510,344	2,945,276
Income before income taxes	107,045	155,882	225,861	319,722
Income taxes	42,950	51,982	90,586	111,196
Net income	64,095	103,900	135,275	208,526
Less: Net income attributable to noncontrolling interests	205	430	535	762
Net income attributable to the Company	$ 63,890	$ 103,470	$ 134,740	$ 207,764
Net income per share attributable to the Company s stockholders (Note 10):				
Basic	$ 0.60	$ 0.97	$ 1.25	$ 1.95
Diluted	$ 0.59	$ 0.95	$ 1.23	$ 1.92

Cash dividends declared per share	$ 0.12	$ 0.08	$ 0.36	$ 0.24
Weighted-average common shares outstanding (Note 10):				
Basic	106,437	106,445	107,400	106,099
Diluted	108,437	108,709	109,490	108,243

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$ 64,095	$ 103,900	$ 135,275	$ 208,526
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on securities	5,839	11,051	(34,906)	37,120
Unrealized gain on securities for which credit-related portion was recognized in earnings	400	1,914	420	5,494
Foreign currency translation adjustment	8,968	8,469	(7,648)	7,803
Pension benefit adjustment	4,121	1,258	12,408	3,773
Total other comprehensive income (loss), net of tax	19,328	22,692	(29,726)	54,190
Comprehensive income	83,423	126,592	105,549	262,716
Less: Comprehensive income attributable to noncontrolling interests	207	434	530	768
Comprehensive income attributable to the Company	$ 83,216	$ 126,158	$ 105,019	$ 261,948

See notes to condensed consolidated financial statements.

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FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	For the Nine Months Ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 135,275	$ 208,526
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	429,744	288,276
Depreciation and amortization	55,141	54,944
Excess tax benefits from share-based compensation	(5,796)	(1,029)
Share-based compensation	18,601	11,922
Net realized investment gains	(6,812)	(61,500)
Net OTTI losses recognized in earnings		3,564
Equity in earnings of affiliates, net	(11,240)	(1,948)
Dividends from equity method investments	7,072	6,413
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(348,058)	(338,911)
Net change in income tax accounts	2,931	81,008
Decrease (increase) in accounts and accrued income receivable	3,977	(33,482)
(Decrease) increase in accounts payable and accrued liabilities	(54,443)	15,369
Net change in due to CoreLogic, net	(539)	(77)
Increase in deferred revenue	15,127	13,961
Other, net	4,853	4,459
Cash provided by operating activities	245,833	251,495
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(650)	(26,142)
Net decrease (increase) in deposits with banks	10,411	(30,880)
Net decrease in loans receivable	30,285	26,885
Purchases of debt and equity securities	(1,227,720)	(1,320,652)
Proceeds from sales of debt and equity securities	507,757	835,535
Proceeds from maturities of debt securities	401,941	359,518
Net change in other long-term investments	1,971	5,819
Capital expenditures	(61,017)	(56,642)
Proceeds from sale of property and equipment	5,399	7,423
Cash used for investing activities	(331,623)	(199,136)
Cash flows from financing activities:		
Net change in deposits	313,016	322,469
Proceeds from issuance of debt	249,095	340,065
Repayment of debt	(167,036)	(367,940)

Net (payments) proceeds in connection with share-based compensation plans		(1,080)		3,253
Net activity related to noncontrolling interests		(1,800)		(2,563)
Excess tax benefits from share-based compensation		5,796		1,029
Purchase of Company shares		(64,606)		
Cash dividends		(38,629)		(23,315)
Cash provided by financing activities		294,756		272,998
Effect of exchange rate changes on cash		(2,317)		1,716
Net increase in cash and cash equivalents		206,649		327,073
Cash and cash equivalents Beginning of period		627,208		418,299
Cash and cash equivalents End of period	$	833,857	$	745,372
Supplemental information:				
Cash paid during the period for:				
Interest	$	9,428	$	7,227
Premium taxes	$	45,475	$	37,615
Income taxes, net	$	87,242	$	30,439
Noncash investing and financing activities:				
Property and equipment acquired through capital lease obligations	$	8,920	$	
Liabilities assumed in connection with acquisitions	$		$	2,768

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
nce at ember 31,	107,239	$ 1	$ 2,111,605	$ 387,015	$ (150,556)	$ 2,348,065	$ 3,704	$ 2,351,769
ncome for months d ember 30,				134,740		134,740	535	135,27
dends on mon shares				(38,629)		(38,629)		(38,62
hase of pany es	(2,951)		(64,606)			(64,606)		(64,60
es issued nnection e-based pensation s	1,401		5,701	(985)		4,716		4,71
e-based pensation			18,601			18,601		18,60
ctivity ed to ontrolling ests			(844)			(844)	(965)	(1,80
r prehensive me (Note					(29,721)	(29,721)	(5)	(29,72
	105,689	$ 1	$ 2,070,457	$ 482,141	$ (180,277)	$ 2,372,322	$ 3,269	$ 2,375,59

nce at ember 30,

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

Spin off

First American Financial Corporation (the Company) became a publicly traded company following its spin-off from its prior parent, The First American Corporation (TFAC), on June 1, 2010 (the Separation). On that date, TFAC distributed all of the Company s outstanding shares to the record date shareholders of TFAC on a one-for-one basis (the Distribution). After the Distribution, the Company owned TFAC s financial services businesses and TFAC, which reincorporated and assumed the name CoreLogic, Inc. (CoreLogic), continued to own its information solutions businesses.

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, 2012. 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. Certain 2012 amounts have been reclassified to conform to the 2013 presentation.

Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued updated guidance requiring entities to present, either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If the component is not required to be reclassified to net income in its entirety, entities should instead cross reference to the related footnote for additional information. The updated guidance was effective prospectively for interim and annual reporting periods beginning after December 15, 2012, with early adoption permitted. Except for the disclosure requirements, the adoption of the guidance had no impact on the Company s condensed consolidated financial statements.

In July 2012, the FASB issued updated guidance that is intended to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets, other than goodwill, by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The updated guidance permits entities to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with current guidance. The updated guidance was effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of the guidance had no impact on the Company s condensed consolidated financial statements.

In December 2011, the FASB issued updated guidance requiring entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The updated guidance was effective for interim and annual reporting periods beginning on or after January 1, 2013. The adoption of the guidance had no impact on the Company s condensed consolidated financial statements.

Pending Accounting Pronouncements

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

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

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $5.0 billion and $4.2 billion at September 30, 2013 and December 31, 2012, respectively, of which $1.6 billion and $1.2 billion, respectively, were held at the Company s federal savings bank subsidiary, First American Trust, FSB. The escrow deposits held at First American Trust, FSB are included in the accompanying condensed consolidated balance sheets in cash and cash equivalents and debt and equity securities, with offsetting liabilities included in deposits. The remaining escrow deposits were held at third-party financial institutions.

Trust assets totaled $2.9 billion and $2.8 billion at September 30, 2013 and December 31, 2012, respectively, and were held or managed by First American Trust, FSB. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. However, the Company could be held contingently liable for the disposition of these assets.

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

The Company facilitates tax-deferred property exchanges for customers pursuant to Section 1031 of the Internal Revenue Code and tax-deferred reverse exchanges pursuant to Revenue Procedure 2000-37. As a facilitator and intermediary, the Company holds the proceeds from sales transactions and takes temporary title to property identified by the customer to be acquired with such proceeds. Upon the completion of such exchange, the identified property is transferred to the customer or, if the exchange does not take place, an amount equal to the sales proceeds or, in the case of a reverse exchange, title to the property held by the Company is transferred to the customer. Like-kind exchange funds held by the Company totaled $1.1 billion and $1.4 billion at September 30, 2013 and December 31, 2012, respectively. The like-kind exchange deposits were held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. All such amounts are placed in deposit accounts insured, up to applicable limits, by the Federal Deposit Insurance Corporation. The Company could be held contingently liable to the customer for the transfers of property, disbursements of proceeds and the return on the proceeds.

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FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)

Note 3 Debt and Equity Securities

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

(in thousands)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value	Other-than-temporary impairments in AOCI
September 30, 2013					
U.S. Treasury bonds	$ 92,977	$ 1,012	$ (470)	$ 93,519	$
Municipal bonds	470,768	5,482	(10,263)	465,987	
Foreign bonds	219,175	1,495	(649)	220,021	
Governmental agency bonds	296,569	416	(4,604)	292,381	
Governmental agency mortgage-backed securities	1,394,859	3,325	(18,326)	1,379,858	
Non-agency mortgage-backed securities (1)	24,085		(3,782)	20,303	20,743
Corporate debt securities	367,099	7,786	(3,195)	371,690	
	$ 2,865,532	$ 19,516	$ (41,289)	$ 2,843,759	$ 20,743
December 31, 2012					
U.S. Treasury bonds	$ 80,651	$ 1,574	$ (50)	$ 82,175	$
Municipal bonds	361,912	14,516	(606)	375,822	
Foreign bonds	236,630	2,312	(197)	238,745	
Governmental agency bonds	324,323	1,445	(318)	325,450	
Governmental agency mortgage-backed securities	1,271,408	11,259	(1,135)	1,281,532	
	26,656		(4,810)	21,846	20,743

Non-agency mortgage-backed securities (1)					
Corporate debt securities	311,695	14,941	(325)	326,311	
	$ 2,613,275	$ 46,047	$ (7,441)	$ 2,651,881	$ 20,743

(1) At December 31, 2012, the $26.7 million amortized cost is net of $3.6 million in other-than-temporary impairments determined to be credit related which have been recognized in earnings for the year ended December 31, 2012. At September 30, 2013, the $3.8 million gross unrealized losses include $3.7 million of unrealized losses for securities determined to be other-than-temporarily impaired and $0.1 million of unrealized losses for securities for which an other-than-temporary impairment has not been recognized. At December 31, 2012, the $4.8 million gross unrealized losses include $4.4 million of unrealized losses for securities determined to be other-than-temporarily impaired and $0.4 million of unrealized losses for securities for which an other-than-temporary impairment has not been recognized. The $20.7 million other-than-temporary impairments recorded in accumulated other comprehensive income (AOCI) through September 30, 2013 and December 31, 2012 represent the amount of other-than-temporary impairment losses recognized in AOCI which were not included in earnings due to the fact that the losses were not considered to be credit related. Other-than-temporary impairments were recognized in AOCI for non-agency mortgage-backed securities only.

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

		Gross unrealized		Estimated
(in thousands)	Cost	Gains	Losses	fair value
September 30, 2013				
Preferred stocks	$ 15,926	$ 1,273	$ (1,404)	$ 15,795
Common stocks	224,946	12,706	(2,922)	234,730
	$ 240,872	$ 13,979	$ (4,326)	$ 250,525
December 31, 2012				
Preferred stocks	$ 13,326	$ 752	$ (41)	$ 14,037
Common stocks	177,844	6,447	(408)	183,883
	$ 191,170	$ 7,199	$ (449)	$ 197,920

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES
Notes to Condensed Consolidated Financial Statements (Continued)
(unaudited)

The Company had the following net unrealized gains (losses) as of September 30, 2013 and December 31, 2012:

(in thousands)	As of September 30, 2013	As of December 31, 2012
Debt securities for which an other-than-temporary impairment has been recognized	$ (3,735)	$ (4,435)
Debt securities all other	(18,038)	43,041
Equity securities	9,653	6,750
	$ (12,120)	$ 45,356

Sales of debt and equity securities resulted in realized gains of $3.4 million and $48.3 million and realized losses of $9.7 million and $32 thousand for the three months ended September 30, 2013 and 2012, respectively. Sales of debt and equity securities resulted in realized gains of $15.6 million and $63.9 million and realized losses of $11.7 million and $0.3 million for the nine months ended September 30, 2013 and 2012, respectively.

The Company had the following gross unrealized losses as of September 30, 2013 and December 31, 2012:

	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, 2013						
Debt securities:						
U.S. Treasury bonds	$ 52,796	$ (470)	$	$	$ 52,796	$ (470)
Municipal bonds	238,119	(9,970)	9,925	(293)	248,044	(10,263)
Foreign bonds	76,103	(597)	4,577	(52)	80,680	(649)
Governmental agency bonds	221,531	(4,582)	135	(22)	221,666	(4,604)
Governmental agency mortgage-backed	727,202	(16,564)	66,365	(1,762)	793,567	(18,326)

securities						
Non-agency mortgage-backed securities			20,303	(3,782)	20,303	(3,782)
Corporate debt securities	137,150	(2,952)	8,163	(243)	145,313	(3,195)
Total debt securities	1,452,901	(35,135)	109,468	(6,154)	1,562,369	(41,289)
Equity securities	99,080	(4,050)	1,287	(276)	100,367	(4,326)
Total	$ 1,551,981	$ (39,185)	$ 110,755	$ (6,430)	$ 1,662,736	$ (45,615)
December 31, 2012						
Debt securities:						
U.S. Treasury bonds	$ 27,219	$ (50)	$	$	$ 27,219	$ (50)
Municipal bonds	60,229	(557)	451	(49)	60,680	(606)
Foreign bonds	58,262	(183)	1,031	(14)	59,293	(197)
Governmental agency bonds	60,882	(318)			60,882	(318)
Governmental agency mortgage-backed securities	135,354	(889)	22,112	(246)	157,466	(1,135)
Non-agency mortgage-backed securities	6,544	(1,498)	15,302	(3,312)	21,846	(4,810)
Corporate debt securities	35,537	(227)	996	(98)	36,533	(325)
Total debt securities	384,027	(3,722)	39,892	(3,719)	423,919	(7,441)
Equity securities	34,258	(447)	98	(2)	34,356	(449)
Total	$ 418,285	$ (4,169)	$ 39,990	$ (3,721)	$ 458,275	$ (7,890)

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All securities in the Company s non-agency mortgage-backed portfolio are senior tranches and were investment grade at the time of purchase, however, all have been downgraded to below investment grade since initial purchase. The table below summarizes the composition of the Company s non-agency mortgage-backed securities by collateral type, year of issuance and current credit ratings. Percentages are based on the amortized cost basis of the securities and credit ratings are based on Standard & Poor s Ratings Services (S&P) and Moody s Investor Service, Inc. (Moody s) published ratings.

If a security was rated differently by either rating agency, the lower of the two ratings was selected. All amounts and ratings are as of September 30, 2013.

(in thousands, except percentages and number of securities)	Number of Securities	Amortized Cost	Estimated Fair Value	Non-Investment Grade/ Not Rated
Non-agency mortgage-backed securities:				
Prime single family residential:				
2007	1	$ 4,010	$ 3,005	100.0%
2006	3	10,629	8,743	100.0%
2005	1	1,446	1,399	100.0%
Alt-A single family residential:				
2007	1	8,000	7,156	100.0%
	6	$ 24,085	$ 20,303	100.0%

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The amortized cost and estimated fair value of debt securities at September 30, 2013, 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	$ 5,301	$ 61,142	$ 18,928	$ 7,606	$ 92,977
Estimated fair value	$ 5,362	$ 61,578	$ 18,956	$ 7,623	$ 93,519
Municipal bonds					
Amortized cost	$ 9,653	$ 154,925	$ 176,891	$ 129,299	$ 470,768
Estimated fair value	$ 9,684	$ 155,684	$ 176,098	$ 124,521	$ 465,987
Foreign bonds					
Amortized cost	$ 33,287	$ 168,762	$ 16,114	$ 1,012	$ 219,175
Estimated fair value	$ 33,405	$ 169,779	$ 15,810	$ 1,027	$ 220,021
Governmental agency bonds					
Amortized cost	$ 6,099	$ 147,134	$ 132,032	$ 11,304	$ 296,569
Estimated fair value	$ 6,108	$ 146,756	$ 128,320	$ 11,197	$ 292,381
Corporate debt securities					
Amortized cost	$ 14,560	$ 230,120	$ 111,715	$ 10,704	$ 367,099
Estimated fair value	$ 14,749	$ 233,371	$ 112,757	$ 10,813	$ 371,690
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 68,900	$ 762,083	$ 455,680	$ 159,925	$ 1,446,588
Estimated fair value	$ 69,308	$ 767,168	$ 451,941	$ 155,181	$ 1,443,598

Total mortgage-backed securities	
Amortized cost	$ 1,418,944
Estimated fair value	$ 1,400,161
Total debt securities	
Amortized cost	$ 2,865,532
Estimated fair value	$ 2,843,759

Other-than-temporary impairment debt securities

If the Company intends to sell a debt security in an unrealized loss position or determines that it is more likely than not that the Company will be required to sell a debt security before it recovers its amortized cost basis, the debt security is other-than-temporarily impaired and it is written down to fair value with all losses recognized in earnings. As of September 30, 2013, the Company did not intend to sell any debt securities in an unrealized loss position and it is not more likely than not that the Company will be required to sell debt securities before recovery of their amortized cost basis.

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

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

The Company determines if a non-agency mortgage-backed security in a loss position is other-than-temporarily impaired by comparing the present value of the cash flows expected to be collected from the security to its amortized cost basis. If the present value of the cash flows expected to be collected exceed the amortized cost of the security, the Company concludes that the security is not other-than-temporarily impaired. The Company performs this analysis on all non-agency mortgage-backed securities in its portfolio that are in an unrealized loss position. For the securities that were determined not to be other-than-temporarily impaired at September 30, 2013, the present value of the cash flows expected to be collected exceeded the amortized cost of each security.

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

The table below summarizes the primary assumptions used at September 30, 2013 in estimating the cash flows expected to be collected for these securities.

	Weighted average	Range
Prepayment speeds	7.5%	6.5% 8.8%
Default rates	2.3%	0.4% 3.4%
Loss severity	16.9%	1.3% 23.9%

As a result of the Company s security-level review, it did not recognize any other-than-temporary impairments considered to be credit related for the three and nine months ended September 30, 2013. The Company did not recognize any other-than-temporary impairments considered to be credit related for the three months ended September 30, 2012, and recognized $3.6 million in earnings for the nine months ended September 30, 2012. It is possible that the Company could recognize additional other-than-temporary impairment losses on some securities it owns at September 30, 2013 if future events or information cause it to determine that a decline in value is other-than-temporary.

The following table presents the change in the credit portion of the other-than-temporary impairments recognized in earnings on debt securities for which a portion of the other-than-temporary impairments related to other factors was recognized in other comprehensive income (loss) for the three and nine months ended September 30, 2013 and 2012.

(in thousands)	For the Three Months Ended September 30, 2013	For the Three Months Ended September 30, 2012	For the Nine Months Ended September 30, 2013	For the Nine Months Ended September 30, 2012
Cumulative credit loss on debt securities held at beginning of period	$ 16,478	$ 25,927	$ 16,478	$ 33,656
Addition to credit loss for which an other-than-temporary impairment was previously recognized				3,564
Accumulated losses on securities that matured or were sold during the period		(1,932)		(13,225)
Cumulative credit loss on debt securities held as of September 30	$ 16,478	$ 23,995	$ 16,478	$ 23,995

Other-than-temporary impairment   equity securities

When a decline in the fair value of an equity security, including common and preferred stock, is considered to be other-than-temporary, such equity security is written down to its fair value. When assessing if a decline in value is other-than-temporary, the factors considered include the length of time and extent to which fair value has been below cost, the probability that the Company will be unable to collect all amounts due under the contractual terms of the security, the seniority of the securities,

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issuer-specific news and other developments, the financial condition and prospects of the issuer (including credit ratings), macro-economic changes (including the outlook for industry sectors, which includes government policy initiatives) and the Company s ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

When an equity security has been in an unrealized loss position for greater than twelve months, the Company s review of the security includes the above noted factors as well as the evidence, if any exists, that supports the Company s view that the security will recover its value in the foreseeable future, typically within the next twelve months. If objective, substantial evidence does not indicate a likely recovery during that timeframe, the Company s policy is that such losses are considered other-than-temporary and therefore an impairment loss is recorded. The Company did not record any other-than-temporary impairment losses related to its equity securities for the three and nine months ended September 30, 2013 and 2012.

Fair value measurement

The Company classifies the fair value of its debt and equity securities using a three-level hierarchy for fair value measurements that distinguishes between market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and the reporting entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The hierarchy level assigned to each security in the Company s available-for-sale portfolio is based on management s assessment of the transparency and reliability of the inputs used in the valuation of such instrument at the measurement date. The three hierarchy levels are defined as follows:

Level 1 Valuations based on unadjusted quoted market prices in active markets for identical securities.

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

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

If the inputs used to measure fair value fall into different levels of the fair value hierarchy, a financial security s hierarchy level is based upon the lowest level of input that is significant to the fair value measurement. The valuation techniques and inputs used to estimate the fair value of the Company s debt and equity securities are summarized as follows:

Debt Securities

The fair value of debt securities was based on the market values obtained from independent pricing services that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and price quotes from well-established independent broker-dealers. The independent pricing services monitor market indicators, industry and economic events, and for broker-quoted only securities, obtain quotes from market makers or broker-dealers that they recognize to be market participants. The pricing services utilize the market approach in determining the fair value of the debt securities held by the Company. The Company obtains an understanding of the valuation models and assumptions utilized by the services and has controls in place to determine that the values provided represent fair value. The Company s validation procedures include comparing prices received from the pricing services to quotes received from other third party sources for certain securities with market prices that are readily verifiable. If the price comparison results in differences over a predefined threshold, the Company will assess the reasonableness of the changes relative to prior periods given the prevailing market conditions and assess changes in the issuers credit worthiness, performance of any underlying collateral and prices of the instrument relative to similar issuances. To date, the Company has not made any material adjustments to the fair value measurements provided by the pricing services.

Typical inputs and assumptions to pricing models used to value the Company s U.S. Treasury bonds, governmental agency bonds, governmental agency mortgage-backed securities, municipal bonds, foreign bonds and corporate debt securities include, but are not limited to, benchmark yields, reported trades, broker-dealer quotes, credit spreads, credit ratings, bond insurance (if applicable), benchmark securities, bids, offers, reference data and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include the structure of issuance, characteristics of the issuer, collateral attributes and prepayment speeds. The fair value of non-agency mortgage-backed securities was obtained from the

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independent pricing services referenced above and subject to the Company s validation procedures discussed above. However, due to the fact that these securities were not actively traded, there were fewer observable inputs available requiring the pricing services to use more judgment in determining the fair value of the securities, therefore the Company classified non-agency mortgage-backed securities as Level 3.

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

Equity Securities

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

The following table presents the Company s available-for-sale investments measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, classified using the three-level hierarchy for fair value measurements:

(in thousands)	Estimated fair value as of September 30, 2013	Level 1	Level 2	Level 3
Debt securities:				
U.S. Treasury bonds	$ 93,519	$	$ 93,519	$
Municipal bonds	465,987		465,987	
Foreign bonds	220,021		220,021	
Governmental agency bonds	292,381		292,381	
Governmental agency mortgage-backed securities	1,379,858		1,379,858	
Non-agency mortgage-backed securities	20,303			20,303
Corporate debt securities	371,690		371,690	
	2,843,759		2,823,456	20,303

Equity securities:						
Preferred stocks		15,795	15,795			
Common stocks		234,730	234,730			
		250,525	250,525			
	$	3,094,284	$ 250,525	$ 2,823,456	$ 20,303	

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(in thousands)	Estimated fair value as of December 31, 2012	Level 1	Level 2	Level 3
Debt securities:				
U.S. Treasury bonds	$ 82,175	$	$ 82,175	$
Municipal bonds	375,822		375,822	
Foreign bonds	238,745		238,745	
Governmental agency bonds	325,450		325,450	
Governmental agency mortgage-backed securities	1,281,532		1,281,532	
Non-agency mortgage-backed securities	21,846			21,846
Corporate debt securities	326,311		326,311	
	2,651,881		2,630,035	21,846
Equity securities:				
Preferred stocks	14,037	14,037		
Common stocks	183,883	183,883		
	197,920	197,920		
	$ 2,849,801	$ 197,920	$ 2,630,035	$ 21,846

The Company did not have any transfers in and out of Level 1 and Level 2 measurements during the three and nine months ended September 30, 2013 and 2012. The Company s policy is to recognize transfers between levels in the fair value hierarchy at the end of the reporting period.

The following table presents a summary of the changes in fair value of Level 3 available-for-sale investments for the three and nine months ended September 30, 2013 and 2012:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(in thousands)	2013	2012	2013	2012
Fair value at beginning of period	$ 20,611	$ 28,324	$ 21,846	$ 30,634

Total gains/(losses) (realized and unrealized):				
Included in earnings:				
Realized gains		110		110
Net other-than-temporary impairment losses recognized in earnings				(3,564)
Included in other comprehensive income	907	3,190	1,028	9,157
Settlements	(1,215)	(1,707)	(2,571)	(6,420)
Sales		(1,135)		(1,135)
Transfers into Level 3				
Transfers out of Level 3				
Fair value as of September 30	$ 20,303	$ 28,782	$ 20,303	$ 28,782
Unrealized gains (losses) included in earnings for the period relating to Level 3 available-for-sale investments that were still held at the end of the period:				
Net other-than-temporary impairment losses recognized in earnings	$	$	$	$ (3,564)

The Company did not purchase any non-agency mortgage-backed securities during the three and nine months ended September 30, 2013 and 2012.

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Note 4 Financing Receivables

Financing receivables are summarized as follows:

	September 30, 2013	December 31, 2012
	(in thousands)	
Loans receivable, net:		
Real estate mortgage		
Multi-family residential	$ 7,996	$ 8,768
Commercial	73,016	102,626
Other	531	598
	81,543	111,992
Allowance for loan losses	(3,830)	(3,893)
Participations sold	(641)	(761)
Deferred loan fees, net	(5)	14
Loans receivable, net	77,067	107,352
Other long-term investments:		
Notes receivable secured	10,585	11,358
Notes receivable unsecured	2,259	2,710
	12,844	14,068
Loss reserve	(2,613)	(2,902)
Notes receivable, net	10,231	11,166
Total financing receivables, net	$ 87,298	$ 118,518

Aging analysis of loans and notes receivable at September 30, 2013 is as follows:

	Total	Current	30-59 days past due	60-89 days past due	90 days or more past due	Non-accrual status
			(in thousands)			
Loans Receivable:						
Multi-family residential	$ 7,996	$ 7,996	$	$	$	$
Commercial	73,016	70,617			311	2,088
Other	531	531				
	$ 81,543	$ 79,144	$	$	$ 311	$ 2,088

Notes Receivable:						
Secured	$ 10,585	$ 6,140	$ 3,701	$	$ 232	$ 512
Unsecured	2,259	395	15		810	1,039
	$ 12,844	$ 6,535	$ 3,716	$	$ 1,042	$ 1,551

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Aging analysis of loans and notes receivable at December 31, 2012 is as follows:

	Total	Current	30-59 days past due	60-89 days past due	90 days or more past due	Non-accrual status
			(in thousands)			
Loans Receivable:						
Multi-family residential	$ 8,768	$ 8,768	$	$	$	$
Commercial	102,626	99,911		160		2,555
Other	598	556				42
	$ 111,992	$ 109,235	$	$ 160	$	$ 2,597
Notes Receivable:						
Secured	$ 11,358	$ 6,517	$ 3,912	$ 72	$ 16	$ 841
Unsecured	2,710	319			811	1,580
	$ 14,068	$ 6,836	$ 3,912	$ 72	$ 827	$ 2,421

Note 5 Goodwill

A summary of the changes in the carrying amount of goodwill by operating segment for the nine months ended September 30, 2013 is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance as of December 31, 2012	$ 799,092	$ 46,765	$ 845,857
Acquisitions	150		150
Foreign currency	(2,530)		(2,530)

exchange			
Balance as of September 30, 2013	$ 796,712	$ 46,765	$ 843,477

The Company s four reporting units for purposes of assessing impairment are title insurance, home warranty, property and casualty insurance and trust and other services. There is no accumulated impairment for goodwill as the Company has never recognized any impairment for its reporting units.

In accordance with accounting guidance and consistent with prior years, the Company s policy is to perform an annual assessment of goodwill for impairment for each reporting unit in the fourth quarter. An impairment analysis has not been performed during the nine months ended September 30, 2013 as no triggering events requiring such an analysis occurred.

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Note 6 Other Intangible Assets

Other intangible assets consist of the following:

(in thousands)	September 30, 2013	December 31, 2012
Finite-lived intangible assets:		
Customer lists	$ 77,166	$ 77,981
Covenants not to compete	27,112	26,842
Trademarks	10,048	10,070
Patents	2,840	