First American Financial Corp
Form 10-Q
July 21, 2016

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 June 30, 2016

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)

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

(714) 250-3000

(Registrant's telephone number, including area code)

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

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

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 1
Non-accelerated filer 1 (Do not check if a smaller reporting company)	Smaller reporting company 1

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 1 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 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 18, 2016, there were 109,717,650 shares of common stock outstanding.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

PART I: FINANCIAL INFORMATION

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

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

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

- INTEREST RATE FLUCTUATIONS;
- CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;
- VOLATILITY IN THE CAPITAL MARKETS;
- UNFAVORABLE ECONOMIC CONDITIONS;
- IMPAIRMENTS IN THE COMPANY’S GOODWILL OR OTHER INTANGIBLE ASSETS;
- FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;
- CHANGES IN APPLICABLE 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;
- THE CONSUMER FINANCIAL PROTECTION BUREAU’S EXERCISE OF ITS BROAD RULEMAKING AND SUPERVISORY POWERS;
- REGULATION OF TITLE INSURANCE RATES;
- REFORM OF GOVERNMENT-SPONSORED MORTGAGE ENTERPRISES;
- LIMITATIONS ON ACCESS TO PUBLIC RECORDS AND OTHER DATA;
- CHANGES IN RELATIONSHIPS WITH LARGE MORTGAGE LENDERS AND GOVERNMENT-SPONSORED ENTERPRISES;
- CHANGES IN MEASURES OF THE STRENGTH OF THE COMPANY’S TITLE INSURANCE UNDERWRITERS, INCLUDING RATINGS AND STATUTORY CAPITAL AND SURPLUS;
- LOSSES IN THE COMPANY’S INVESTMENT PORTFOLIO;
- 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 DAMAGE, FAILURES, INTERRUPTIONS AND INTRUSIONS, OR UNAUTHORIZED DATA DISCLOSURES;
- ERRORS AND FRAUD INVOLVING THE TRANSFER OF FUNDS;
- INABILITY TO REALIZE THE BENEFITS OF THE COMPANY’S OFFSHORE OPERATIONS;
- INABILITY OF THE COMPANY’S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS;

- INABILITY TO REALIZE THE BENEFITS OF, AND CHALLENGES ARISING FROM, THE COMPANY'S ACQUISITION STRATEGY; AND
- OTHER FACTORS DESCRIBED IN THIS QUARTERLY REPORT ON FORM 10-Q, INCLUDING UNDER THE CAPTION "RISK FACTORS" IN ITEM 1A OF PART II.

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.
FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

	June 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$1,241,814	$1,027,321
Accounts and accrued income receivable, net	285,519	256,731
Income taxes receivable	3,876	1,067
Investments:		
Deposits with banks	21,746	23,224
Debt securities, includes pledged securities of $117,647 and $122,441	4,542,421	4,279,347
Equity securities	362,266	321,285
Other investments	160,432	161,177
	5,086,865	4,785,033
Property and equipment, net	413,174	409,973
Title plants and other indexes	562,852	554,923
Deferred income taxes	22,020	22,020
Goodwill	982,834	964,342
Other intangible assets, net	50,932	48,114
Other assets	186,827	180,777
	$8,836,713	$8,250,301
Liabilities and Equity		
Deposits	$3,100,365	$2,699,015
Accounts payable and accrued liabilities	825,130	876,087
Deferred revenue	211,935	207,929
Reserve for known and incurred but not reported claims	994,764	983,880
Income taxes payable	47,976	7,576
Deferred income taxes	133,097	133,097
Notes and contracts payable	579,474	581,052
	5,892,741	5,488,636
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—
Common stock, $0.00001 par value; Authorized—300,000 shares; Outstanding—109,699 shares and 109,098 shares	1	1

Additional paid-in capital	2,173,632	2,150,813
Retained earnings	943,198	846,691
Accumulated other comprehensive loss	(175,769)	(239,003)
Total stockholders' equity	2,941,062	2,758,502
Noncontrolling interests	2,910	3,163
Total equity	2,943,972	2,761,665
	$8,836,713	$8,250,301

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, 2016	2015	Six Months Ended June 30, 2016	2015
Revenues				
Direct premiums and escrow fees	$623,975	$609,606	$1,125,889	$1,111,018
Agent premiums	515,792	501,613	1,028,037	934,533
Information and other	182,771	180,838	337,848	337,985
Net investment income	30,925	27,864	58,295	48,422
Net realized investment gains	8,070	3,868	13,176	2,915
	1,361,533	1,323,789	2,563,245	2,434,873
Expenses				
Personnel costs	417,725	407,452	800,437	773,575
Premiums retained by agents	403,669	395,278	808,708	738,014
Other operating expenses	216,361	211,824	403,036	411,982
Provision for policy losses and other claims	122,360	122,870	229,458	224,424
Depreciation and amortization	23,994	21,463	46,414	42,317
Premium taxes	16,027	16,012	30,404	29,481
Interest	7,790	7,268	15,589	14,510
	1,207,926	1,182,167	2,334,046	2,234,303
Income before income taxes	153,607	141,622	229,199	200,570
Income taxes	51,156	48,043	74,076	69,195
Net income	102,451	93,579	155,123	131,375
Less: Net income attributable to noncontrolling interests	302	232	473	396
Net income attributable to the Company	$102,149	$93,347	$154,650	$130,979
Net income per share attributable to the Company's stockholders (Note 8):				
Basic	$0.92	$0.86	$1.40	$1.21
Diluted	$0.92	$0.85	$1.40	$1.19
Cash dividends declared per share	$0.26	$0.25	$0.52	$0.50
Weighted-average common shares outstanding (Note 8):				
Basic	110,480	108,459	110,327	108,102
Diluted	110,978	109,796	110,842	109,586

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,	
	2016	2015	2016	2015
Net income	$102,451	$93,579	$155,123	$131,375
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on securities	17,681	(28,506)	49,508	(8,432)
Foreign currency translation adjustment	(5,579)	4,866	6,525	(13,794)
Pension benefit adjustment	3,621	4,601	7,217	9,202
Total other comprehensive income (loss), net of tax	15,723	(19,039)	63,250	(13,024)
Comprehensive income	118,174	74,540	218,373	118,351
Less: Comprehensive income attributable to noncontrolling interests	272	227	489	390
Comprehensive income attributable to the Company	$117,902	$74,313	$217,884	$117,961

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

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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, 2015	109,098	$ 1	$ 2,150,813	$ 846,691	$ (239,003)	$ 2,758,502	$ 3,163	$ 2,761,665
Net income for six months ended June 30, 2016	—	—	—	154,650	—	154,650	473	155,123
Dividends on common shares	—	—	—	(56,897)	—	(56,897)	—	(56,897)
Purchase of Company shares	(14)	—	(454)	—	—	(454)	—	(454)
Shares issued in connection with share-based compensation plans	615	—	1,331	(1,246)	—	85	—	85
Share-based compensation	—	—	21,968	—	—	21,968	—	21,968
Net activity related to noncontrolling interests	—	—	(26)	—	—	(26)	(742)	(768)
Other comprehensive income (Note 12)	—	—	—	—	63,234	63,234	16	63,250
Balance at June 30, 2016	109,699	$ 1	$ 2,173,632	$ 943,198	$ (175,769)	$ 2,941,062	$ 2,910	$ 2,943,972

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

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Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	$155,123	$131,375
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	229,458	224,424
Depreciation and amortization	46,414	42,317
Amortization of premiums and accretion of discounts on debt securities, net	13,082	14,045
Excess tax benefits from share-based compensation	(3,137)	(8,417)
Net realized investment gains	(13,176)	(2,915)
Share-based compensation	21,968	15,563
Equity in earnings of affiliates, net	(3,018)	(4,880)
Dividends from equity method investments	3,749	5,940
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(225,568)	(251,542)
Net change in income tax accounts	7,486	37,875
Increase in accounts and accrued income receivable	(24,946)	(20,961)
Decrease in accounts payable and accrued liabilities	(60,826)	(26,188)
Increase (decrease) in deferred revenue	3,895	(955)
Other, net	(4,118)	11,262
Cash provided by operating activities	146,386	166,943
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(18,432)	(25,929)
Net decrease in deposits with banks	968	2,959
Purchases of debt and equity securities	(899,629)	(1,207,037)
Proceeds from sales of debt and equity securities	259,915	344,170
Proceeds from maturities of debt securities	436,125	263,015
Net change in other investments	2,346	4,509
Capital expenditures	(60,939)	(61,837)
Proceeds from sales of property and equipment	8,787	16,608
Cash used for investing activities	(270,859)	(663,542)
Cash flows from financing activities:		
Net change in deposits	401,350	632,579
Repayment of debt	(2,329)	(2,623)
Net activity related to noncontrolling interests	(768)	(679)
Excess tax benefits from share-based compensation	3,137	8,417
Net payments in connection with share-based compensation plans	(3,052)	(4,328)

Purchase of Company shares	(454)	—
Cash dividends	(56,897)	(54,121)
Cash provided by financing activities	340,987	579,245
Effect of exchange rate changes on cash	(2,021)	(3,066)
Net increase in cash and cash equivalents	214,493	79,580
Cash and cash equivalents—Beginning of period	1,027,321	1,190,080
Cash and cash equivalents—End of period	$1,241,814	$1,269,660
Supplemental information:		
Cash paid during the period for:		
Interest	$14,537	$14,664
Premium taxes	$40,340	$34,043
Income taxes, less refunds of $699 and $713	$66,562	$30,973

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, 2015. The condensed consolidated financial statements included herein are unaudited; however, in the opinion of management, they contain all normal recurring adjustments necessary for a fair statement of the consolidated results for the interim periods. All material intercompany transactions and balances have been eliminated upon consolidation.

Reclassifications and revisions

Certain 2015 amounts have been reclassified to conform to the 2016 presentation.

During the fourth quarter of 2015, the Company reclassified certain revenues and expenses related to closing protection letters and temporary labor costs. The impact to the Company's title insurance and services segment for the three and six months ended June 30, 2015 included decreases to direct premiums and escrow fees and increases to agent premiums of $8.5 million and $15.1 million, increases to personnel costs of $10.5 million and $18.5 million, increases to premiums retained by agents of $0.5 million and $0.7 million and decreases to other operating expenses of $11.0 million and $19.2 million, respectively. The impact to the Company's specialty insurance segment for the three and six months ended June 30, 2015 included increases to personnel costs and decreases to other operating expenses of $0.3 million and $0.5 million, respectively.

Also, during the fourth quarter of 2015, the Company identified certain non-risk based revenues included within direct premiums and escrow fees that should have been reflected in information and other. To correct for this error, these revenues were reclassified from direct premiums and escrow fees to information and other. The revision to the Company's title insurance and services segment for the three and six months ended June 30, 2015 resulted in a decrease to direct premiums and escrow fees and an increase to information and other of $10.3 million and $20.8 million, respectively.

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

Recently Adopted Accounting Pronouncements

In September 2015, the Financial Accounting Standards Board ("FASB") issued updated guidance intended to simplify the accounting for adjustments made to provisional amounts recognized in a business combination and eliminates the requirement to retrospectively account for those adjustments. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015 and applies prospectively to adjustments made to provisional amounts that occur after the effective date of this guidance with early adoption permitted for financial statements that have not been issued. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

In August 2015, the FASB issued updated guidance relating to the Securities and Exchange Commission Staff Announcement at the June 18, 2015 Emerging Issues Task Force meeting on the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. The updated guidance allows for the deferral and presentation of debt issuance costs as an asset which may be amortized ratably over the term of the line-of-credit arrangement, regardless of whether there are any related outstanding borrowings. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
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Notes to Condensed Consolidated Financial Statements – (Continued)
(unaudited)

In May 2015, the FASB issued updated guidance intended to eliminate the diversity in practice surrounding how investments measured at net asset value under the practical expedient with future redemption dates have been categorized in the fair value hierarchy. Under the updated guidance, investments for which fair value is measured at net asset value per share using the practical expedient should no longer be categorized in the fair value hierarchy. The updated guidance requires retrospective adoption for all periods presented and is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

In April 2015, the FASB issued updated guidance intended to clarify the accounting treatment for cloud computing arrangements that include software licenses. Under the updated guidance, if a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The Company elected to adopt the updated guidance prospectively for all arrangements entered into or materially modified after the effective date. The adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements. The financial statement line items impacted by the adoption of the updated guidance include other intangible assets, net and depreciation and amortization. See Note 5 Other Intangible Assets for further information on the Company's internal-use software licenses.

In April 2015, the FASB issued updated guidance intended to simplify, and provide consistency to, the presentation of debt issuance costs. The new standard requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements.

In February 2015, the FASB issued updated guidance which changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

In June 2014, the FASB issued updated guidance intended to eliminate the diversity in practice regarding share-based payment awards that include terms which provide for a performance target that affects vesting being achieved after the requisite service period. The new standard requires that a performance target which affects vesting and could be achieved after the requisite service period be treated as a performance condition that affects vesting and should not be reflected in estimating the grant-date fair value. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this guidance had no impact on the Company's condensed consolidated financial statements.

Pending Accounting Pronouncements

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.

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

In May 2016, the FASB issued updated guidance intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance includes narrow-scope improvements intended to address implementation issues and to provide additional practical expedients in the guidance. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In April 2016, the FASB issued updated guidance intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance is intended to reduce the cost and complexity of applying the guidance on identifying promised goods or services in a contract and to improve the operability and understandability of the implementation guidance regarding the licensing of intellectual property. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In March 2016, the FASB issued updated guidance intended to simplify and improve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of such awards as either equity or liabilities and classification on the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

In March 2016, the FASB issued updated guidance intended to clarify the guidance previously issued in May 2014 related to the recognition of revenue from contracts with customers. The updated guidance is intended to improve the operability and understandability of the implementation guidance regarding principal versus agent considerations in a contract. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted for interim and annual reporting periods beginning after December 15, 2016. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In March 2016, the FASB issued updated guidance intended to simplify the accounting treatment for investments that become qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company expects the adoption of this guidance to have no impact 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. The Company is currently assessing the impact of the new guidance on its 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, with early adoption permitted in certain circumstances. While the Company expects the adoption of this guidance to impact its condensed consolidated statements of income, the materiality of the impact will depend upon the size of, and level of volatility experienced within, the Company’s equity portfolio.

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

In May 2015, the FASB issued updated disclosure guidance related to short-duration contracts issued by insurance entities. The updated guidance is intended to increase the transparency of significant estimates made in measuring liabilities for unpaid claims and claim adjustment expenses and to provide additional insight into an insurance entity's ability to underwrite and anticipate costs associated with claims. The updated guidance is effective for annual reporting periods beginning after December 15, 2015 and for interim periods within annual periods beginning after December 15, 2016, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to impact its condensed consolidated financial statements.

In May 2014, the FASB issued updated guidance for recognizing revenue from contracts with customers to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within and across industries, and across capital markets. The new revenue standard contains principles that an entity will apply to determine the measurement of revenue and the timing of 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. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption prohibited. In August 2015, the FASB issued updated guidance which defers the effective date of this guidance by one year to interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted as of the original effective date. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

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

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $8.0 billion and $6.6 billion at June 30, 2016 and December 31, 2015, respectively, of which $3.0 billion and $2.6 billion, respectively, were held at the Company's federal savings bank subsidiary, First American Trust, FSB. The escrow deposits held at First American Trust, FSB are temporarily invested in cash and cash equivalents and debt securities, with offsetting liabilities included in deposits in the accompanying condensed consolidated balance sheets. The remaining escrow deposits were held at third-party financial institutions.

Trust assets held or managed by First American Trust, FSB totaled $3.1 billion and $3.0 billion at June 30, 2016 and December 31, 2015, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. However, the Company could be held contingently liable for the disposition of these assets.

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

The Company facilitates tax-deferred property exchanges for customers pursuant to Section 1031 of the Internal Revenue Code and tax-deferred reverse exchanges pursuant to Revenue Procedure 2000-37. As a facilitator and intermediary, the Company holds the proceeds from sales transactions and takes temporary title to property identified by the customer to be acquired with such proceeds. Upon the completion of each such exchange, the identified property is transferred to the customer or, if the exchange does not take place, an amount equal to the sales proceeds or, in the case of a reverse exchange, title to the property held by the Company is transferred to the customer. Like-kind exchange funds held by the Company totaled $2.2 billion and $2.8 billion at June 30, 2016 and December 31, 2015, 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.

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Note 3 – Debt and Equity Securities

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

(in thousands)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
June 30, 2016				
U.S. Treasury bonds	$121,611	$2,777	$—	$124,388
Municipal bonds	743,942	23,407	(434)	766,915
Foreign government bonds	141,315	2,058	(56)	143,317
Governmental agency bonds	338,201	3,554	—	341,755
Governmental agency mortgage-backed securities	2,207,589	15,830	(5,607)	2,217,812
U.S. corporate debt securities	701,935	19,582	(3,135)	718,382
Foreign corporate debt securities	226,227	4,736	(1,111)	229,852
	$4,480,820	$71,944	$(10,343)	$4,542,421
December 31, 2015				
U.S. Treasury bonds	$130,252	$421	$(1,301)	$129,372
Municipal bonds	692,000	12,640	(845)	703,795
Foreign government bonds	129,984	1,132	(1,015)	130,101
Governmental agency bonds	419,869	1,023	(2,801)	418,091
Governmental agency mortgage-backed securities	2,065,728	4,984	(15,039)	2,055,673
U.S. corporate debt securities	642,869	4,297	(12,483)	634,683
Foreign corporate debt securities	210,162	1,248	(3,778)	207,632
	$4,290,864	$25,745	$(37,262)	$4,279,347

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

(in thousands)	Cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
June 30, 2016				
Preferred stocks	$19,558	$195	$(4,584)	$15,169
Common stocks	340,638	14,421	(7,962)	347,097
	$360,196	$14,616	$(12,546)	$362,266
December 31, 2015				
Preferred stocks	$18,305	$420	$(3,258)	$15,467
Common stocks	307,429	13,103	(14,714)	305,818
	$325,734	$13,523	$(17,972)	$321,285

Sales of debt and equity securities resulted in realized gains of $12.2 million and $1.5 million and realized losses of $4.6 million and $0.4 million for the three months ended June 30, 2016 and 2015, respectively, and realized gains of $13.2 million and $5.1 million and realized losses of $7.0 million and $6.6 million for the six months ended June 30, 2016 and 2015, respectively.

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Notes to Condensed Consolidated Financial Statements – (Continued)
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Gross unrealized losses on investments in debt and equity securities are as follows:

	Less than 12 months		12 months or longer		Total	
(in thousands)	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
June 30, 2016						
Debt securities:						
Municipal bonds	$41,605	$(312)	$13,668	$(122)	$55,273	$(434)
Foreign government bonds	8,389	(11)	3,506	(45)	11,895	(56)
Governmental agency mortgage-backed securities	749,708	(2,898)	281,816	(2,709)	1,031,524	(5,607)
U.S. corporate debt securities	73,749	(1,192)	51,399	(1,943)	125,148	(3,135)
Foreign corporate debt securities	24,080	(549)	20,101	(562)	44,181	(1,111)
Total debt securities	897,531	(4,962)	370,490	(5,381)	1,268,021	(10,343)
Equity securities	41,343	(1,199)	72,578	(11,347)	113,921	(12,546)
Total	$938,874	$(6,161)	$443,068	$(16,728)	$1,381,942	$(22,889)
December 31, 2015						
Debt securities:						
U.S. Treasury bonds	$105,701	$(1,285)	$1,654	$(16)	$107,355	$(1,301)
Municipal bonds	133,465	(733)	13,190	(112)	146,655	(845)
Foreign government bonds	13,601	(890)	267	(125)	13,868	(1,015)
Governmental agency bonds	191,035	(2,497)	18,237	(304)	209,272	(2,801)
Governmental agency mortgage-backed securities	1,096,301	(9,424)	213,020	(5,615)	1,309,321	(15,039)
U.S. corporate debt securities	361,842	(11,272)	13,511	(1,211)	375,353	(12,483)
Foreign corporate debt securities	102,801	(2,725)	11,246	(1,053)	114,047	(3,778)
Total debt securities	2,004,746	(28,826)	271,125	(8,436)	2,275,871	(37,262)
Equity securities	191,248	(12,068)	31,974	(5,904)	223,222	(17,972)
Total	$2,195,994	$(40,894)	$303,099	$(14,340)	$2,499,093	$(55,234)

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Investments in debt securities at June 30, 2016, by contractual maturities, are as follows:

(in thousands)	Due in one year or less	Due after one through five years	Due after five through ten years	Due after ten years	Total
U.S. Treasury bonds					
Amortized cost	$ 27,855	$ 64,029	$ 13,800	$ 15,927	$ 121,611
Estimated fair value	$ 27,870	$ 64,603	$ 14,331	$ 17,584	$ 124,388
Municipal bonds					
Amortized cost	$ 44,059	$ 326,255	$ 223,201	$ 150,427	$ 743,942
Estimated fair value	$ 44,127	$ 333,004	$ 231,647	$ 158,137	$ 766,915
Foreign government bonds					
Amortized cost	$ 12,314	$ 109,665	$ 10,968	$ 8,368	$ 141,315
Estimated fair value	$ 12,347	$ 110,912	$ 11,318	$ 8,740	$ 143,317
Governmental agency bonds					
Amortized cost	$ 20,842	$ 207,230	$ 73,135	$ 36,994	$ 338,201
Estimated fair value	$ 20,864	$ 207,870	$ 73,760	$ 39,261	$ 341,755
U.S. corporate debt securities					
Amortized cost	$ 15,137	$ 324,828	$ 287,199	$ 74,771	$ 701,935
Estimated fair value	$ 15,205	$ 331,095	$ 292,749	$ 79,333	$ 718,382
Foreign corporate debt securities					
Amortized cost	$ 7,109	$ 110,605	$ 95,282	$ 13,231	$ 226,227
Estimated fair value	$ 7,103	$ 111,978	$ 96,637	$ 14,134	$ 229,852
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 127,316	$ 1,142,612	$ 703,585	$ 299,718	$ 2,273,231
Estimated fair value	$ 127,516	$ 1,159,462	$ 720,442	$ 317,189	$ 2,324,609
Total mortgage-backed securities					
Amortized cost					$ 2,207,589
Estimated fair value					$ 2,217,812
Total debt securities					
Amortized cost					$ 4,480,820
Estimated fair value					$ 4,542,421

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

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The composition of the investment portfolio at June 30, 2016, by credit rating, is as follows:

(in thousands, except percentages)	A- Ratings or higher Estimated fair value	Percentage	BBB+ to BBB- Ratings Estimated fair value	Percentage	Non-Investment Grade Estimated fair value	Percentage	Total Estimated fair value	Percentage
June 30, 2016								