First American Financial Corp
Form 10-Q
October 26, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2017

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 No 1

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

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

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

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes 1 No 1

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

On October 20, 2017, there were 110,817,359 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.

2

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

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

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

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

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements.
FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Balance Sheets

(in thousands, except par values)

(unaudited)

	September 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	$ 1,141,915	$ 1,006,138
Accounts and accrued income receivable, net	341,395	299,799
Income taxes receivable	11,102	67,970
Investments:		
Deposits with banks	20,940	21,222
Debt securities, includes pledged securities of $100,681 and $110,647	4,803,484	4,553,363
Equity securities	446,185	404,085
Other investments	120,514	162,029
	5,391,123	5,140,699
Property and equipment, net	438,136	434,050
Title plants and other indexes	566,599	564,309
Deferred income taxes	20,037	20,037
Goodwill	1,145,464	1,017,417
Other intangible assets, net	75,126	78,898
Other assets	216,150	202,460
	$ 9,347,047	$ 8,831,777
Liabilities and Equity		
Deposits	$ 2,965,426	$ 2,779,478
Accounts payable and accrued liabilities	741,569	793,955
Deferred revenue	250,917	228,905
Reserve for known and incurred but not reported claims	1,021,648	1,025,863
Income taxes payable	92,841	10,376
Deferred income taxes	242,158	242,158
Notes and contracts payable	734,091	736,693
	6,048,650	5,817,428
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—
Common stock, $0.00001 par value; Authorized—300,000 shares; Outstanding—110,817 shares and 109,944 shares	1	1

Additional paid-in capital	2,226,691	2,191,756
Retained earnings	1,128,981	1,046,822
Accumulated other comprehensive loss	(61,779)	(230,400)
Total stockholders' equity	3,293,894	3,008,179
Noncontrolling interests	4,503	6,170
Total equity	3,298,397	3,014,349
	$ 9,347,047	$ 8,831,777

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Revenues				
Direct premiums and escrow fees	$651,104	$649,726	$1,819,193	$1,775,615
Agent premiums	629,186	625,953	1,757,796	1,653,990
Information and other	201,819	188,727	586,179	526,575
Net investment income	44,460	34,422	117,109	92,717
Net realized investment (losses) gains	(7,001)	9,516	10,763	22,692
	1,519,568	1,508,344	4,291,040	4,071,589
Expenses				
Personnel costs	599,380	438,692	1,458,928	1,239,129
Premiums retained by agents	497,911	495,130	1,387,608	1,303,838
Other operating expenses	218,959	219,959	649,182	622,995
Provision for policy losses and other claims	120,349	137,015	333,695	366,473
Depreciation and amortization	36,000	24,491	96,292	70,905
Premium taxes	19,900	18,288	52,527	48,692
Interest	9,107	7,838	26,812	23,427
	1,501,606	1,341,413	4,005,044	3,675,459
Income before income taxes	17,962	166,931	285,996	396,130
Income tax (benefit) expense	(3,224)	59,539	84,846	133,615
Net income	21,186	107,392	201,150	262,515
Less: Net (loss) income attributable to noncontrolling interests	(197)	72	(772)	545
Net income attributable to the Company	$21,383	$107,320	$201,922	$261,970
Net income per share attributable to the Company's stockholders (Note 8):				
Basic	$0.19	$0.97	$1.81	$2.37
Diluted	$0.19	$0.96	$1.80	$2.36
Cash dividends declared per share	$0.38	$0.34	$1.06	$0.86
Weighted-average common shares outstanding (Note 8):				
Basic	111,799	110,571	111,578	110,423
Diluted	112,575	111,251	112,254	111,006

See notes to condensed consolidated financial statements.

6

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	$21,186	$107,392	$201,150	$262,515
Other comprehensive income (loss), net of tax:				
Unrealized gains on securities	13,929	2,579	52,014	52,087
Foreign currency translation adjustment	11,415	(3,459)	23,558	3,066
Pension benefit adjustment	85,891	3,602	93,061	10,819
Total other comprehensive income, net of tax	111,235	2,722	168,633	65,972
Comprehensive income	132,421	110,114	369,783	328,487
Less: Comprehensive (loss) income attributable to noncontrolling interests	(192)	77	(760)	566
Comprehensive income attributable to the Company	$132,613	$110,037	$370,543	$327,921

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statement of Stockholders' Equity

(in thousands)

(unaudited)

	First American Financial Corporation Stockholders							
	Shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Total stockholders' equity	Noncontrolling interests	Total
Balance at December 31, 2016	109,944	$1	$2,191,756	$1,046,822	$(230,400)	$3,008,179	$6,170	$3,014,349
Net income (loss) for nine months ended September 30, 2017	—	—	—	201,922	—	201,922	(772)	201,150
Dividends on common shares	—	—	—	(117,174)	—	(117,174)	—	(117,174)
Shares issued in connection with share-based compensation plans	873	—	3,784	(2,589)	—	1,195	—	1,195
Share-based compensation	—	—	31,196	—	—	31,196	—	31,196
Net activity related to noncontrolling interests	—	—	(45)	—	—	(45)	(907)	(952)
Other comprehensive income (Note 12)	—	—	—	—	168,621	168,621	12	168,633
Balance at September 30, 2017	110,817	$1	$2,226,691	$1,128,981	$(61,779)	$3,293,894	$4,503	$3,298,397

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2017	2016
Cash flows from operating activities:		
Net income	$201,150	$262,515
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for policy losses and other claims	333,695	366,473
Depreciation and amortization	96,292	70,905
Amortization of premiums and accretion of discounts on debt securities, net	25,013	20,267
Excess tax benefits from share-based compensation	—	(3,197)
Net realized investment gains	(10,763)	(22,692)
Share-based compensation	31,196	28,096
Equity in earnings of affiliates, net	(4,550)	(5,771)
Dividends from equity method investments	9,593	7,953
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:		
Claims paid, including assets acquired, net of recoveries	(351,397)	(351,349)
Net change in income tax accounts	34,462	20,765
Increase in accounts and accrued income receivable	(11,907)	(43,454)
Increase (decrease) in accounts payable and accrued liabilities	95,383	(99,777)
Increase in deferred revenue	20,313	23,342
Other, net	(12,953)	(21,857)
Cash provided by operating activities	455,527	252,219
Cash flows from investing activities:		
Net cash effect of acquisitions/dispositions	(82,993)	(73,173)
Net decrease in deposits with banks	1,171	608
Purchases of debt and equity securities	(1,276,401)	(1,490,824)
Proceeds from sales of debt and equity securities	599,365	494,717
Proceeds from maturities of debt securities	457,334	744,411
Net change in other investments	2,555	2,798
Capital expenditures	(103,064)	(103,735)
Proceeds from sales of property and equipment	9,882	9,218
Cash used for investing activities	(392,151)	(415,980)
Cash flows from financing activities:		
Net change in deposits	185,948	519,113
Net proceeds from issuance of debt	—	160,000
Repayment of debt	(4,128)	(3,745)
Net activity related to noncontrolling interests	(964)	(1,004)
Excess tax benefits from share-based compensation	—	3,197

Net proceeds (payments) in connection with share-based compensation plans	1,195	(754)
Purchase of Company shares	—	(454)
Cash dividends	(117,174)	(94,202)
Cash provided by financing activities	64,877	582,151
Effect of exchange rate changes on cash	7,524	(2,399)
Net increase in cash and cash equivalents	135,777	415,991
Cash and cash equivalents—Beginning of period	1,006,138	1,027,321
Cash and cash equivalents—End of period	$1,141,915	$1,443,312
Supplemental information:		
Cash paid during the period for:		
Interest	$24,619	$21,097
Premium taxes	$55,233	$54,151
Income taxes, less refunds of $52,828 and $2,731	$50,264	$112,401

See notes to condensed consolidated financial statements.

FIRST AMERICAN FINANCIAL CORPORATION
AND SUBSIDIARY COMPANIES

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 – Basis of Condensed Consolidated Financial Statements

Basis of Presentation

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

Out-of-Period Adjustments

During the third quarter of 2017, the Company identified certain title plant assets within its title insurance and services segment that should have been previously written off, and certain title plant imaging assets that were misclassified as title plant assets. To correct for these errors, the Company recorded adjustments to net realized investment gains, depreciation and amortization and title plants and other indexes. The impact of these adjustments included an increase to depreciation and amortization of $4.7 million, a decrease to net realized investment gains of $1.8 million and a decrease to title plant and other indexes of $6.5 million. In addition, during the third quarter of 2017, the Company recorded adjustments to correct for errors in recording certain personnel costs within its title insurance and services segment. The impact of these adjustments included an increase to personnel costs of $9.0 million, a decrease to other assets of $8.5 million and an increase in accounts payable and accrued liabilities of $0.5 million.

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

Recently Adopted Accounting Pronouncements

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

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

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

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

Pending Accounting Pronouncements

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

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

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

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

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

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

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

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

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

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.

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

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

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

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $7.9 billion and $6.8 billion at September 30, 2017 and December 31, 2016, respectively, of which $2.8 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 $3.5 billion and $3.2 billion at September 30, 2017 and December 31, 2016, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. However, the Company could be held contingently liable for the disposition of these assets.

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

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 $2.3 billion and $2.0 billion at September 30, 2017 and December 31, 2016, respectively. The like-kind exchange deposits are held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying condensed consolidated balance sheets. All such amounts are placed in deposit accounts insured, up to applicable limits, by the Federal Deposit Insurance Corporation. The Company could be held contingently liable to the customer for the transfers of property, disbursements of proceeds and the returns on such proceeds.

Note 3 – Debt and Equity Securities

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

	Amortized	Gross unrealized		Estimated
(in thousands)	cost	Gains	Losses	fair value
September 30, 2017				
U.S. Treasury bonds	$145,396	$1,484	$(1,427)	$145,453
Municipal bonds	1,068,611	14,546	(10,795)	1,072,362
Foreign government bonds	162,550	556	(1,457)	161,649
Governmental agency bonds	223,546	1,063	(2,891)	221,718
Governmental agency mortgage-backed securities	2,238,222	4,098	(16,400)	2,225,920
U.S. corporate debt securities	716,299	13,400	(2,771)	726,928
Foreign corporate debt securities	244,777	5,201	(524)	249,454
	$4,799,401	$40,348	$(36,265)	$4,803,484
December 31, 2016				
U.S. Treasury bonds	$155,441	$416	$(4,466)	$151,391
Municipal bonds	1,004,659	6,340	(26,666)	984,333
Foreign government bonds	141,887	600	(2,439)	140,048
Governmental agency bonds	197,343	691	(4,166)	193,868
Governmental agency mortgage-backed securities	2,187,482	2,983	(26,792)	2,163,673
U.S. corporate debt securities	675,683	8,282	(5,441)	678,524
Foreign corporate debt securities	240,526	2,490	(1,490)	241,526

$4,603,021	$21,802	$(71,460)	$4,553,363

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

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

(in thousands)	Cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
September 30, 2017				
Preferred stocks	$19,269	$202	$(944)	$18,527
Common stocks	381,622	47,204	(1,168)	427,658
	$400,891	$47,406	$(2,112)	$446,185
December 31, 2016				
Preferred stocks	$18,926	$—	$(3,344)	$15,582
Common stocks	367,169	26,034	(4,700)	388,503
	$386,095	$26,034	$(8,044)	$404,085

Sales of debt and equity securities resulted in realized gains of $1.7 million and $8.9 million, and realized losses of $0.7 million and $0.2 million for the three months ended September 30, 2017 and 2016, respectively, and realized gains of $21.8 million and $22.1 million, and realized losses of $5.9 million and $7.2 million for the nine months ended September 30, 2017 and 2016, respectively.

Gross unrealized losses on investments in debt and equity 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
September 30, 2017						
Debt securities:						
U.S. Treasury bonds	$61,500	$(584)	$20,177	$(843)	$81,677	$(1,427)
Municipal bonds	124,976	(775)	247,001	(10,020)	371,977	(10,795)
Foreign government bonds	97,341	(1,058)	10,471	(399)	107,812	(1,457)
Governmental agency bonds	106,783	(778)	81,053	(2,113)	187,836	(2,891)
Governmental agency mortgage-backed securities	686,814	(4,572)	832,251	(11,828)	1,519,065	(16,400)
U.S. corporate debt securities	113,028	(1,484)	50,152	(1,287)	163,180	(2,771)
Foreign corporate debt securities	62,671	(457)	3,492	(67)	66,163	(524)
Total debt securities	1,253,113	(9,708)	1,244,597	(26,557)	2,497,710	(36,265)
Equity securities	36,407	(485)	28,115	(1,627)	64,522	(2,112)
Total	$1,289,520	$(10,193)	$1,272,712	$(28,184)	$2,562,232	$(38,377)
December 31, 2016						
Debt securities:						
U.S. Treasury bonds	$111,748	$(4,466)	$—	$—	$111,748	$(4,466)

Municipal bonds	635,531	(26,317)	16,485	(349)	652,016	(26,666)
Foreign government bonds	63,044	(2,371)	324	(68)	63,368	(2,439)
Governmental agency bonds	148,112	(4,166)	—	—	148,112	(4,166)
Governmental agency mortgage-backed securities	1,295,790	(19,097)	432,349	(7,695)	1,728,139	(26,792)
U.S. corporate debt securities	193,533	(4,560)	24,499	(881)	218,032	(5,441)
Foreign corporate debt securities	78,658	(1,150)	8,154	(340)	86,812	(1,490)
Total debt securities	2,526,416	(62,127)	481,811	(9,333)	3,008,227	(71,460)
Equity securities	70,261	(1,173)	59,019	(6,871)	129,280	(8,044)
Total	$2,596,677	$(63,300)	$540,830	$(16,204)	$3,137,507	$(79,504)

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

Investments in debt securities at September 30, 2017, 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	$ 24,966	$48,269	$28,318	$43,843	$145,396
Estimated fair value	$ 24,937	$48,104	$28,338	$44,074	$145,453
Municipal bonds					
Amortized cost	$ 61,831	$314,910	$254,976	$436,894	$1,068,611
Estimated fair value	$ 61,960	$318,703	$259,744	$431,955	$1,072,362
Foreign government bonds					
Amortized cost	$ 7,772	$129,408	$9,699	$15,671	$162,550
Estimated fair value	$ 7,783	$128,568	$9,864	$15,434	$161,649
Governmental agency bonds					
Amortized cost	$ 15,430	$106,826	$55,085	$46,205	$223,546
Estimated fair value	$ 15,415	$105,946	$54,607	$45,750	$221,718
U.S. corporate debt securities					
Amortized cost	$ 29,681	$299,209	$314,805	$72,604	$716,299
Estimated fair value	$ 29,800	$302,345	$319,329	$75,454	$726,928
Foreign corporate debt securities					
Amortized cost	$ 14,843	$120,804	$93,769	$15,361	$244,777
Estimated fair value	$ 14,869	$121,807	$96,350	$16,428	$249,454
Total debt securities excluding mortgage-backed securities					
Amortized cost	$ 154,523	$1,019,426	$756,652	$630,578	$2,561,179
Estimated fair value	$ 154,764	$1,025,473	$768,232	$629,095	$2,577,564
Total mortgage-backed securities					
Amortized cost					$2,238,222
Estimated fair value					$2,225,920
Total debt securities					
Amortized cost					$4,799,401
Estimated fair value					$4,803,484

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.

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

The composition of the investment portfolio at September 30, 2017, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
	Estimated		Estimated		Estimated		Estimated	
(in thousands, except percentages)	fair value	Percentage	fair value	Percentage	fair value	Percentage	fair value	Percentage
September 30, 2017								
Debt securities:								
U.S. Treasury bonds	$145,453	100.0	$—	—	$—	—	$145,453	100.0
Municipal bonds	999,995	93.2	54,521	5.1	17,846	1.7	1,072,362	100.0
Foreign government bonds	133,945	82.9	22,184	13.7	5,520	3.4	161,649	100.0
Governmental agency bonds	221,718	100.0	—	—	—	—	221,718	100.0
Governmental agency mortgage-backed securities	2,225,920	100.0	—	—	—	—	2,225,920	100.0
U.S. corporate debt securities	249,320	34.3	262,936	36.2	214,672	29.5	726,928	100.0
Foreign corporate debt securities	123,674	49.6	96,553	38.7	29,227	11.7	249,454	100.0
Total debt securities	4,100,025	85.3	436,194	9.1	267,265	5.6	4,803,484	100.0
Preferred stocks	—	—	13,616	73.5	4,911	26.5	18,527	100.0
Total	$4,100,025	85.1	$449,810	9.3	$272,176	5.6	$4,822,011	100.0

As of September 30, 2017, the estimated fair value of total debt securities included $144.3 million of bank loans, of which $133.7 million was non-investment grade; $106.7 million of high yield corporate debt securities, all of which was non-investment grade; and $74.3 million of emerging market debt securities, of which $9.0 million was non-investment grade.

The composition of the investment portfolio in an unrealized loss position at September 30, 2017, by credit rating, is as follows:

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

September 30, 2017								
Debt securities:								
U.S. Treasury bonds	$81,677	100.0	$—	—	$—	—	$81,677	100.0
Municipal bonds	355,301	95.6	15,057	4.0	1,619	0.4	371,977	100.0
Foreign government bonds	95,300	88.4	9,663	9.0	2,849	2.6	107,812	100.0
Governmental agency bonds	187,836	100.0	—	—	—	—	187,836	100.0
Governmental agency mortgage-backed securities	1,519,065	100.0	—	—	—	—	1,519,065	100.0
U.S. corporate debt securities	46,440	28.5	80,803	49.5	35,937	22.0	163,180	100.0
Foreign corporate debt securities	40,649	61.4	23,108	34.9	2,406	3.7	66,163	100.0
Total debt securities	2,326,268	93.1	128,631	5.1	42,811	1.8	2,497,710	100.0
Preferred stocks	—	—	7,990	66.3	4,063	33.7	12,053	100.0
Total	$2,326,268	92.7	$136,621	5.4	$46,874	1.9	$2,509,763	100.0

As of September 30, 2017, the estimated fair value of total debt securities in an unrealized loss position included $26.4 million of bank loans, of which $26.0 million was non-investment grade; $11.6 million of high yield corporate debt securities, all of which was non-investment grade; and $15.4 million of emerging market debt securities, of which $3.6 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.

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

Note 4 – Goodwill

A summary of the changes in the carrying amount of goodwill, by operating segment, for the nine months ended September 30, 2017, is as follows:

(in thousands)	Title Insurance and Services	Specialty Insurance	Total
Balance as of December 31, 2016	$970,652	$46,765	$1,017,417
Acquisitions	123,954	—	123,954
Foreign currency translation	4,391	—	4,391
Other adjustments	(298)	—	(298)
Balance as of September 30, 2017	$1,098,699	$46,765	$1,145,464

The Company’s four reporting units for purposes of assessing goodwill for impairment are title insurance, home warranty, property and casualty insurance and trust and other services. During the nine months ended September 30, 2017 there were no triggering events that would more likely than not reduce the fair value of any reporting unit below its carrying amount.

For further discussion about the Company’s acquisitions for the three and nine months ended September 30, 2017, see Note 14 Business Combinations.

Note 5 – Other Intangible Assets

Other intangible assets consist of the following:

(in thousands)	September 30, 2017	December 31, 2016
Finite-lived intangible assets:		
Customer relationships	$ 77,600	$ 78,542
Noncompete agreements	10,210	10,007
Trademarks	7,210	6,472

Internal-use software licenses	27,632	16,038
Patents	2,840	2,840
	125,492	113,899
Accumulated amortization	(67,250)	(51,885)
	58,242	62,014
Indefinite-lived intangible assets:		
Licenses	16,884	16,884
	$ 75,126	$ 78,898

Amortization expense for finite-lived intangible assets was $7.0 million and $19.7 million for the three and nine months ended September 30, 2017, respectively, and $3.7 million and $9.3 million for the three and nine months ended September 30, 2016, respectively.

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

Year	(in thousands)
Remainder of 2017	$ 7,975
2018	$ 15,920
2019	$ 9,210
2020	$ 5,221
2021	$ 2,976
2022	$ 2,380

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

Note 6 – 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)	Nine months ended September 30, 2017	2016
Balance at beginning of period	$1,025,863	$983,880
Provision related to:		
Current year	330,342	345,556
Prior years	3,353	20,917
	333,695	366,473
Payments, net of recoveries, related to:		
Current year	165,914	160,693
Prior years	185,483	190,656
	351,397	351,349
Other	13,487	19,036
Balance at end of period	$1,021,648	$1,018,040

The provision for title insurance losses, expressed as a percentage of title insurance premiums and escrow fees, was 4.0% for the three and nine months ended September 30, 2017 compared to 5.5% for the three and nine months ended September 30, 2016. 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 third quarter of 2016 rate of 5.5% reflected the ultimate loss rate of 5.0% for the 2016 policy year and a $5.8 million net increase in the loss reserve estimates for prior policy years.

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

(in thousands, except percentages)	September 30, 2017		December 31, 2016	
Known title claims	$74,755	7.3 %	$83,805	8.1 %
Incurred but not reported claims	889,079	87.0 %	888,126	86.6 %
Total title claims	963,834	94.3 %	971,931	94.7 %
Non-title claims	57,814	5.7 %	53,932	5.3 %
Total loss reserves	$1,021,648	100.0 %	$1,025,863	100.0 %

Note 7 – Income Taxes

The Company's effective income tax rates (income tax expense as a percentage of income before income taxes) were -17.9% and 29.7% for the three and nine months ended September 30, 2017, respectively, and 35.7% and 33.7% for the three and nine months ended September 30, 2016, respectively. The Company's effective tax rates differ from the statutory federal rate of 35% 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 and changes in the ratio of permanent differences to income before income taxes. The Company's effective tax rates for 2017 also reflect state tax benefits relating to the termination of the Company's pension plan, as well as the release of reserves relating to tax positions taken on prior year tax returns. In addition, the Company's effective tax rates for 2017 reflect the adoption of new accounting guidance related to the accounting for share-based payment transactions, which requires, among other items, that all excess tax benefits and tax deficiencies associated with share-based payment transactions be recorded in income tax expense rather than in additional paid-in capital, as previously required. The impact to the Company of adopting this guidance was a reduction in income tax expense of $0.1 million and $2.8 million for the three and nine months ended September 30, 2017, respectively. See Note 1 Basis of Condensed Consolidated Financial Statements for further discussion of the new guidance. The Company's effective tax rates for 2016 also reflect the resolution of certain tax authority examinations and tax credits claimed in 2016 and in prior years.

In connection with the Company's June 2010 spin-off from its prior parent, which subsequently assumed the name CoreLogic, Inc. ("CoreLogic"), it entered into a tax sharing agreement which governs the Company's and CoreLogic's respective rights, responsibilities and obligations for certain tax related matters. At September 30, 2017 and December 31, 2016, the Company had a net payable to CoreLogic of $13.0 million and $16.3 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 decrease during the current year was primarily due to payments made 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 September 30, 2017 and December 31, 2016, the liability for income taxes associated with uncertain tax positions was $12.8 million and $18.1 million, respectively. The net decrease in the liability during 2017 was primarily attributable to settlements with taxing authorities relating to tax positions taken by the Company on prior year tax returns. As of September 30, 2017 and December 31, 2016, the liability could be reduced by $5.4 million and $5.7 million, respectively, due to offsetting tax benefits associated with the correlative effects of potential adjustments, including timing adjustments and state income taxes. The net amounts of $7.4 million and $12.4 million as of September 30, 2017 and December 31, 2016, 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 September 30, 2017 and December 31, 2016, the Company had accrued $4.5 million and $4.1 million, respectively, of interest and penalties (net of tax benefits of $2.0 million and $1.8 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. During 2016, the Company concluded U.S. federal income tax examinations for calendar years 2005 through 2013. The Company is generally no longer subject to U.S. federal, state and non-U.S. income tax examinations for years prior to 2005.

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

Note 8 – Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share amounts)	2017	2016	2017	2016
Numerator				
Net income attributable to the Company	$21,383	$107,320	$201,922	$261,970
Denominator				
Basic weighted-average shares	111,799	110,571	111,578	110,423
Effect of dilutive employee stock options and restricted stock units ("RSUs")	776	680	676	583
Diluted weighted-average shares	112,575	111,251	112,254	111,006
Net income per share attributable to the Company's stockholders				
Basic	$0.19	$0.97	$1.81	$2.37
Diluted	$0.19	$0.96	$1.80	$2.36

For the three and nine months ended September 30, 2017, 1 thousand RSUs and 8 thousand RSUs, respectively, were excluded from weighted-average diluted common shares outstanding due to their antidilutive effect. For the three months ended September 30, 2016, no RSUs had an antidilutive effect on weighted-average diluted common shares outstanding, and for the nine months ended September 30, 2016, 17 thousand RSUs were excluded from 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 9 – 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 September 30,		Nine Months Ended September 30,	
(in thousands)	2017	2016	2017	2016
Expense:				
Service costs	$184	$260	$551	$781
Interest costs	2,086	5,999	11,185	18,000

Settlement costs	152,388	—	152,388	—
Expected return on plan assets	—	(3,083)	(4,740)	(9,250)
Amortization of net actuarial loss	1,958	7,043	15,792	21,153
Amortization of prior service credit	(1,045)	(1,211)	(3,268)	(3,633)
	$155,571	$9,008	$171,908	$27,051

Pension termination and settlement

In May 2016, the Company's board of directors terminated the Company's funded defined benefit pension plan known as the First American Financial Corporation Pension Plan, effective as of July 31, 2016. The pension plan was closed to new entrants effective December 31, 2001 and amended to "freeze" all benefit accruals as of April 30, 2008. Also, in May 2016, a subsidiary of the Company terminated its small regional funded defined benefit pension plan effective as of August 31, 2016. All financial impacts discussed below reflect the termination of both pension plans.

The pension plans offered participants annuity payments based on a number of factors and, for certain participants, an alternative lump sum distribution option. During 2016, the Company made additional cash contributions of $84.8 million above scheduled amounts and offered lump sum distributions to certain participants. The lump sum distributions were settled through distributions of pension plan assets in the fourth quarter totaling $127.2 million for which the Company recognized $66.3 million in settlement costs.

The Company made cash contributions of $34.0 million in March 2017 to fully fund its pension obligation. In July 2017, the Company completed the transfer of all remaining benefit obligations related to the pension plans to a highly rated insurance company and recognized $152.4 million in settlement costs in the condensed consolidated statements of income in the third quarter of 2017.

Note 10 – 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 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.

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

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 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 September 30, 2017 and December 31, 2016:

(in thousands)	Total	Level 1	Level 2	Level 3
September 30, 2017				
Assets:				
Debt securities:				
U.S. Treasury bonds	$145,453	$—	$145,453	$—
Municipal bonds	1,072,362	—	1,072,362	—
Foreign government bonds	161,649	—	161,649	—
Governmental agency bonds	221,718	—	221,718	—
Governmental agency mortgage-backed securities	2,225,920	—	2,225,920	—
U.S. corporate debt securities	726,928	—	714,419	12,509
Foreign corporate debt securities	249,454	—	248,581	873
	4,803,484	—	4,790,102	13,382
Equity securities:				
Preferred stocks	18,527	18,527	—	—
Common stocks	427,658	427,658	—	—
	446,185	446,185	—	—
Total assets	$5,249,669	$446,185	$4,790,102	$13,382

(in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2016				
Assets:				
Debt securities:				
U.S. Treasury bonds	$151,391	$ —	$151,391	$ —
Municipal bonds	984,333	—	984,333	—

Foreign government bonds	140,048	—