First American Financial Corp
Form 10-K
February 20, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

OR

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

(Exact name of registrant as specified in its charter)

Delaware	26-1911571
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1 First American Way, Santa Ana, California 92707-5913

(Address of principal executive offices) (Zip Code)

(714) 250-3000

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2018 was $5,602,927,038.

On February 15, 2019, there were 111,476,203 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement with respect to the 2019 annual meeting of the stockholders are incorporated by reference in Part III of this report. The definitive proxy statement or an amendment to this Form 10-K will be filed no later than 120 days after the close of registrant’s fiscal year.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

INFORMATION INCLUDED IN REPORT

THIS ANNUAL REPORT ON FORM 10-K 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 RESULT,” OR OTHER SIMILAR WORDS AND PHRASES OR FUTURE OR CONDITIONAL VERBS SUCH AS “WILL,” “MAY,” “MIGHT,” “SHOULD,” “WOULD,” OR “COULD.” THESE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION, STATEMENTS REGARDING FUTURE OPERATIONS, PERFORMANCE, FINANCIAL CONDITION, PROSPECTS, PLANS AND STRATEGIES. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON CURRENT EXPECTATIONS AND ASSUMPTIONS THAT MAY PROVE TO BE INCORRECT.

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

- INTEREST RATE FLUCTUATIONS;
- CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;
- VOLATILITY IN THE CAPITAL MARKETS;
- UNFAVORABLE ECONOMIC CONDITIONS;
- FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;
- CHANGES IN APPLICABLE LAWS AND GOVERNMENT REGULATIONS, INCLUDING DATA PRIVACY LAWS;
- 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;
- INNOVATION EFFORTS OF THE COMPANY AND OTHER INDUSTRY PARTICIPANTS AND ANY RELATED MARKET DISRUPTION;
- ERRORS AND FRAUD INVOLVING THE TRANSFER OF FUNDS;
- THE COMPANY’S USE OF A GLOBAL WORKFORCE;
- INABILITY OF THE COMPANY’S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS; AND

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

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

Item 1. Business

The Company

First American Financial Corporation (the “Company”) was incorporated in the state of Delaware in January 2008 to hold the financial services businesses of the Company’s prior parent. On June 1, 2010, the Company’s common stock was listed on the New York Stock Exchange under the ticker symbol “FAF.” The businesses operated by the Company’s subsidiaries have, in some instances, been in existence since the late 1800s.

The Company has its executive offices at 1 First American Way, Santa Ana, California 92707-5913. The Company’s telephone number is (714) 250-3000.

General

The Company, through its subsidiaries, is engaged in the business of providing financial services through its title insurance and services segment and its specialty insurance segment. The title insurance and services segment provides title insurance, closing and/or escrow services and similar or related services domestically and internationally in connection with residential and commercial real estate transactions. It also provides products, services and solutions that are designed to mitigate risk in, or otherwise facilitate real estate transactions. Many of these products, services and solutions involve the use of real property-related data, including data derived from its proprietary databases. It maintains, manages and provides access to title plant records and images, and, in addition, provides banking, trust, document custodial and wealth management services. The specialty insurance segment issues property and casualty insurance policies and sells home warranty products. In addition, our corporate function consists of certain financing facilities as well as the corporate services that support our business operations.

The substantial majority of our business is dependent upon activity in the real estate and mortgage markets, which are cyclical and seasonal. In the current market environment, we are focused on growing our core title insurance and settlement services business, strengthening our enterprise through data and process advantages and managing and actively investing in complementary businesses that support and/or leverage our core title and settlement services business. We are also focused on continued improvement of our customers’ experiences with our products, services and solutions, and on enhancing our services offered to title agents. We remain committed to efficiently managing our business to market conditions throughout business cycles.

Title Insurance and Services Segment

Our title insurance and services segment issues title insurance policies on residential and commercial property in the United States and offers similar or related products and services internationally. This segment also provides closing and/or escrow services; accommodates tax-deferred exchanges of real estate; provides products, services and solutions designed to mitigate risk or otherwise facilitate real estate transactions, many of which products, services and solutions involve the use of real property-related data; maintains, manages and provides access to title plant records and images; and provides appraisals and other valuation-related products and services, lien release and document custodial services, warehouse lending services, default-related products and services, evidence of title, and banking, trust and wealth management services. In 2018, 2017 and 2016 the Company derived 91.9%, 91.7% and 92.1% of its consolidated revenues, respectively, from this segment.

Overview of Title Insurance Industry

In most instances mortgage lenders and purchasers of real estate desire to be protected from loss or damage in the event of defects in the title of the subject property. Title insurance is a means of providing such protection.

Title Policies. Title insurance policies insure the interests of owners or lenders against defects in the title to real property. These defects include adverse ownership claims, liens, encumbrances or other matters affecting title. Title insurance policies generally are issued on the basis of a title report, which is typically prepared after a search of one or more of public records, maps, documents and prior title policies to ascertain the existence of easements, restrictions, rights of way, conditions, encumbrances or other matters affecting the title to, or use of, real property. In certain limited instances, a visual inspection of the property is also made. To facilitate the preparation of title reports, copies and/or abstracts of public records, maps, documents and prior title policies may be compiled and indexed to specific properties in an area. This compilation is known as a "title plant."

The beneficiaries of title insurance policies usually are real estate buyers and mortgage lenders. A title insurance policy indemnifies the named insured and certain successors in interest against title defects, liens and encumbrances existing as of the date of the policy and not specifically excepted from its provisions. The policy typically provides coverage for the real property mortgage lender in the amount of its outstanding mortgage loan balance and for the buyer in the amount of the purchase price of the property. In some cases the policy might provide insurance in a greater amount, or for automatic increases in coverage over time. The potential for claims under a title insurance policy issued to a mortgage lender generally ceases upon repayment of the mortgage loan. The potential for claims under a title insurance policy issued to a buyer generally ceases upon the sale or transfer of the insured property.

Before issuing title policies, title insurers typically seek to limit their risk of loss by accurately performing title searches and examinations and, in many instances, curing title defects identified therein. These searches, examinations and curative efforts distinguish title insurers from other insurers, such as property and casualty insurers. Whereas title insurers generally insure against losses arising out of circumstances existing as of the date of the policy, property and casualty insurers generally insure against losses arising out of events that occur subsequent to policy issuance. As a result of these differences, title insurers typically experience relatively low claims, as a percentage of premiums, when compared to property and casualty insurers, but have relatively high expenses. The primary costs of a title insurer issuing a policy directly pertain to personnel and other costs associated with the search and examination process, the curative process, the preparation of preliminary reports or commitments, title plant maintenance, and sales, as well as technology and other administrative expenses. Where the policy is issued by an agent, the premium retained by the agent is also a primary expense.

The Closing Process. In the United States, title insurance is essential to the real estate closing process in most transactions involving real property mortgage lenders. In a typical residential real estate sale transaction where title insurance is issued, a real estate broker, lawyer, developer, lender, closer or other participant involved in the transaction orders the title insurance on behalf of an insured. Once the order has been placed, a title insurance company or an agent typically conducts a title search to determine the current status of the title to the property. When the search is complete, the title insurer or agent prepares, issues and circulates a commitment or preliminary report. The commitment or preliminary report identifies the conditions, exceptions and/or limitations that the title insurer intends to attach to the policy and identifies items appearing on the title that must be eliminated prior to closing.

In the United States, the closing or settlement function, sometimes called an escrow in the western states, is, depending on the local custom in the region, performed by a lawyer, an escrow company or a title insurance company or agent, generally referred to as a “closer.” Once documentation has been prepared and signed, and any required mortgage lender payoff demands are obtained, the transaction closes. The closer typically records the appropriate title documents and arranges the transfer of funds to pay off prior loans and extinguish the liens securing such loans. Title policies are then issued, typically insuring the priority of the mortgage of the real property mortgage lender in the amount of its mortgage loan and the buyer in the amount of the purchase price. The time between the opening of the title order and the issuance of the title policy is usually between 30 and 90 days. Before a closing takes place, however, the closer typically requests that the title insurer or agent provide an update to the commitment to discover any adverse matters affecting title and, if any are found, works with the seller to eliminate them so that the title insurer or agent issues the title policy subject only to those exceptions to coverage which are acceptable to the title insurer, the buyer and the buyer’s lender.

Issuing the Policy: Direct vs. Agency. A title insurance policy can be issued directly by a title insurer or indirectly on behalf of a title insurer through agents, which usually operate independently of the title insurer and typically issue policies for more than one insurer. Where the policy is issued by a title insurer, the search is performed by or on behalf of the title insurer, and the premium is collected and retained by the title insurer. Where the policy is issued by an agent, the search is typically performed by or on behalf of the agent, and the agent collects, and retains a portion of, the premium. The agent remits the remainder of the premium to the title insurer as compensation for the insurer bearing the risk of loss in the event a claim is made under the policy and for other services the insurer may provide. The percentage of the premium retained by an agent varies by geography and from agent to agent. A title insurer is obligated to pay title claims in accordance with the terms of its policies, regardless of whether it issues its policy directly or indirectly through an agent. In addition, when a title insurer has issued a commitment to insure a particular transaction, it may be requested to issue a closing protection letter that protects a lender or borrower, or in some states also a seller, from a loss of funds, under certain conditions, caused by the actions of the title insurer or its agent. When a loss to the title insurer occurs under a policy issued through an agent or a closing protection letter, under certain circumstances the title insurer may seek recovery of all or a portion of the loss from the agent or the agent's errors and omissions insurance carrier.

Premiums. The premium for title insurance is typically due and earned in full when the real estate transaction is closed. Premiums generally are calculated with reference to the policy amount. The premium charged by a title insurer or an agent is subject to regulation in most areas. Such regulations vary from state to state.

Our Title Insurance Operations

Overview. We conduct our title insurance and closing business through a network of direct operations and agents. Through this network, we issue policies in the 49 states that permit the issuance of title insurance policies, the District of Columbia and certain United States territories. We also offer title insurance, closing services and similar or related products and services, either directly or through third parties in other countries, including Canada, the United Kingdom, Australia, South Korea and various other established and emerging markets as described in the "International Operations" section below.

Customers, Sales and Marketing. The mortgage market in the United States is concentrated. We believe that the top five mortgage lenders by volume collectively originate or are involved in approximately 28% of the mortgage origination volume in the United States. These institutions purchase title insurance policies and other products and services from us. These institutions also benefit from our products and services which are purchased for their benefit by others, such as title insurance policies purchased by borrowers as a condition to the making of a loan. The refusal of one or more of these or other significant lending institutions to purchase products and services from us or to accept our products and services that are to be purchased for their benefit could have a material adverse effect on the title insurance and services segment.

We distribute our title insurance policies and related products and services through our direct and agent channels. In our direct channel, the distribution of our policies and related products and services occurs through sales representatives located at numerous offices throughout the United States where real estate transactions are handled. Title insurance policies issued and other products and services delivered through this channel are primarily delivered in connection with sales and refinances of residential and commercial real property.

Within the direct channel, our sales and marketing efforts are focused on the primary sources of business referrals. For residential business referred by local or decentralized customers, we market to real estate agents and brokers, mortgage brokers, real estate attorneys, mortgage originators, homebuilders and escrow service providers. We also market directly to firms that purchase and sell residential real estate on a large-scale basis. For refinance and default-related business referred by customers with centrally managed platforms, we market to mortgage originators, servicers and government-sponsored enterprises. For the commercial business we market primarily to commercial real estate investors, including real estate investment trusts, insurance brokers, insurance companies and asset managers, as well as to law firms, commercial banks, investment banks, mortgage brokers and the owners of commercial real estate. In some instances we may supplement the efforts of our sales force with general marketing. Our marketing efforts emphasize our product offerings, the quality and timeliness of our services, our financial strength, process innovation and our national presence. We also provide educational information on our website and through other means to help consumers better understand our services and the homebuying/settlement process in general.

Underwriting. Before a title insurance policy is issued, a number of underwriting decisions are made. For example, matters of record revealed during the title search may require a determination as to whether an exception should be taken in the policy. We believe that it is important for the underwriting function to operate efficiently and effectively at all decision-making levels so that transactions may proceed in a timely manner. To perform this function, we have underwriters at the regional, divisional and corporate levels with varying levels of underwriting authority. In an attempt to enhance efficiency and reduce risk, certain underwriting functions are increasingly being automated.

Agency Operations. As described above, we also issue title insurance policies through a network of agents. Our agreements with our issuing agents typically state the conditions under which the agent is authorized to issue our title insurance policies. The agency agreement also typically prescribes the circumstances under which the agent may be liable to us if a policy loss occurs, as well as the services we provide to the agent and the price for those services. Those services vary by geography and from agent to agent. We are continuing to seek to provide additional services to our agents, including banking services and closing-related services, in an effort to reduce risk and enhance relationships with our agents. Agency agreements typically are terminable without cause after a specified notice period has been met and are terminable immediately for cause. As is standard in our industry, our agents typically operate with a substantial degree of independence from us and typically act as agents for other title insurers. We evaluate the profitability of our agency relationships on an ongoing basis, including a review of premium splits, deductibles and claims. As a result, from time to time we may terminate or renegotiate the terms of some of our agency relationships.

In determining whether to engage an independent agent, we often obtain information about the agent, including the agent's experience and background. We maintain loss experience records for each agent and also maintain agent representatives and agent auditors. Our agents typically are subject to audit or examination. In addition to routine examinations, other examinations may be triggered if certain "warning signs" are evident. Adverse findings in an agency audit may result in various actions, including, if warranted, termination of the agency relationship.

International Operations. We provide products and services in a number of countries outside of the United States, and our international operations accounted for approximately 5.6% of our title insurance and services segment revenues in 2018. Today we have direct operations and a physical presence in several countries, including Canada, the United Kingdom, South Korea and Australia, as well as in Hong Kong. While reliable data are not available, we believe that we have the largest market share for title insurance outside of the United States.

Our range of international products and services is designed to lower our clients' risk profiles and reduce their operating costs through enhanced operational efficiencies. In established markets, primarily British Commonwealth countries, we have combined title insurance with customized processing offerings to enhance the speed and efficiency of the mortgage and conveyancing processes. In these markets we also offer products designed to mitigate risk and otherwise facilitate real estate transactions.

Our international operations present risks that may not exist to the same extent in our domestic operations, including those associated with differences in the nature of the products provided, the scope of coverage provided by those products and the manner in which risk is underwritten. In instances where we have limited claims experience in a foreign jurisdiction it makes it more difficult to set prices and reserve rates. There may also be risks associated with differences in legal systems and/or unforeseen regulatory changes.

Title Plants. Our title plants constitute one of our principal assets. A title plant is a collection of data and records on, or which impact, title to real property. A title search is typically conducted by searching the abstracted information from public records or utilizing a title plant holding information abstracted from public records. While public title records generally are indexed by reference to the names of the parties to a given recorded document, our title plants primarily arrange their records on a geographic basis. Because of this difference, title plant records generally may be searched more effectively, which we believe reduces the risk of errors associated with the search. Many of our title plants also index prior policies, adding to searching efficiency. Certain locations utilize jointly owned plants or utilize a plant under a joint user agreement with other title companies. In addition to these ownership interests, we are in the business of maintaining, managing and providing access to title plant records and images that may be owned by us or other parties. We believe that our title plants, whether wholly or partially owned or utilized under a joint user agreement, are among the most comprehensive in the industry.

Reserves for Claims and Losses. We provide for losses associated with title insurance policies, closing protection letters and other risk-based products based upon our historical experience and other factors by a charge to expense when the related premium revenue is recognized. The resulting reserve for incurred but not reported claims, together with the reserve for known claims, reflects management's best estimate of the total costs required to settle all claims reported to us and claims incurred but not reported, and are considered to be adequate for such purpose. Each period the reasonableness of the estimated reserves is assessed; if the estimate requires adjustment, such an adjustment is recorded.

Reinsurance and Coinsurance. We plan to continue our practice of assuming and ceding large title insurance risks through reinsurance. In reinsurance arrangements, the primary insurer retains a certain amount of risk under a policy and cedes the remainder of the risk under the policy to the reinsurer. The primary insurer pays the reinsurer a premium in exchange for accepting this risk of loss. The primary insurer generally remains liable to its insured for the total risk, but is reinsured under the terms of the reinsurance agreement. In addition to reinsurance arrangements involving other industry participants, we maintain a global reinsurance program involving treaty reinsurance provided by a global syndicate of highly rated non-industry reinsurers. Subject to the treaty limits and certain other limitations, the program generally covers claims made while the program is in effect.

We also serve as a coinsurer in connection with certain commercial transactions. In a coinsurance scenario, two or more insurers are selected by the insured and each coinsurer is liable for its specified percentage share of the total liability.

Competition. The business of providing title insurance and related products and services is highly competitive. The number of competing companies and the size of such companies vary in the different areas in which we conduct business. Generally, in areas of major real estate activity, such as metropolitan and suburban localities, we compete with many other title insurers and agents. Our major nationwide competitors in our principal markets include Fidelity National Financial, Inc., Stewart Title Guaranty Company, Old Republic International Corporation and their affiliates. In addition to these national competitors, small nationwide, regional and local competitors, as well as numerous agency operations throughout the country, provide aggressive competition on the local level. We are currently the second largest provider of title insurance in the United States, based on the most recent American Land Title Association market share data.

We believe that competition for title insurance, closing services and related products and services is based primarily on service, quality, price, customer relationships and the timeliness of the delivery of our products. Customer service is an important competitive factor because parties to real estate transactions are usually concerned with time schedules and costs associated with delays in closing transactions. In certain transactions, such as those involving commercial properties, financial strength and scope of coverage are also important. In addition, we regularly evaluate our pricing and agent splits, and based on competitive, market and regulatory conditions and claims history, among other factors, adjust our prices and agent splits as and where appropriate.

Trust, Wealth Management and Banking Services. Our federal savings bank subsidiary offers trust, wealth management and deposit products and related services, including fund transfer services. The bank does not originate loans. As of December 31, 2018, the bank administered fiduciary and custody assets having a market value of $3.6 billion, which includes managed assets of $1.5 billion. The bank’s balance sheet had assets of $4.1 billion, with deposits of $3.8 billion and stockholder’s equity of $286.9 million. The bank’s deposits have traditionally consisted almost entirely of funds deposited by its affiliates, but increasingly the bank is seeking deposits from title agents that are not affiliates. While the majority of the bank’s deposited funds are associated with commercial and residential real estate transactions being serviced by its customers that are in the title and/or settlement service business, the bank also maintains other deposits, including operating funds deposited by its affiliates.

Specialty Insurance Segment

Property and Casualty Insurance. Our property and casualty insurance business provides insurance coverage to residential homeowners and renters for liability losses and typical hazards such as fire, theft, vandalism and other types of property damage. We are licensed to issue policies in all 50 states and the District of Columbia and actively issue policies in 47 states. The majority of policy liability is in the western United States, including approximately 62% in California. In certain markets we also offer preferred risk auto insurance to better compete with other carriers offering bundled home and auto insurance. We market our property and casualty insurance business using both direct distribution channels, including marketing through our existing real estate closing-service activities, and through a network of independent brokers. We purchase reinsurance to limit risk associated with large losses from single events.

Home Warranties. Our home warranty business provides residential service contracts that cover residential systems, such as heating and air conditioning systems, and certain appliances against failures that occur as the result of normal usage during the coverage period. Coverage is typically for one year and is renewable annually at the option of the contract holder and upon our approval. Coverage and pricing typically vary by geographic region. Fees for the warranties generally are paid at the closing of the home purchase or directly by the consumer. Renewal premiums may be paid by a number of different options. In addition, under the contract, the holder is responsible for a service fee for each trade call. First year warranties primarily are marketed through real estate brokers and agents, and we also market directly to consumers. We generally sell renewals directly to consumers. Our home warranty business currently operates in 36 states and the District of Columbia.

Corporate

The Company’s corporate function consists primarily of certain financing facilities as well as the corporate services that support our business operations.

Regulation

Many of our subsidiaries are subject to extensive regulation by applicable domestic or foreign regulatory agencies. The extent of such regulation varies based on the industry involved, the nature of the business conducted by the subsidiary (for example, licensed title insurers are subject to a heightened level of regulation compared to underwritten title companies or agencies), the subsidiary's jurisdiction of organization and the jurisdictions in which it operates. In addition, the Company is subject to regulation as both an insurance holding company and a savings and loan holding company.

Our domestic subsidiaries that operate in the title insurance industry or the property and casualty insurance industry are subject to regulation by state insurance regulators. Each of our underwriters, or insurers, is regulated primarily by the insurance department or equivalent governmental body within the jurisdiction of its organization, which oversees compliance with the laws and regulations pertaining to such insurer. For example, our primary title insurance underwriter, First American Title Insurance Company, is a Nebraska corporation and, accordingly, is primarily regulated by the Nebraska Department of Insurance. Insurance regulations typically place limits on, among other matters, the ability of the insurer to pay dividends to its parent company or to enter into transactions with affiliates. They also may require approval of the insurance commissioner prior to a third party directly or indirectly acquiring "control" of the insurer.

In addition, our insurers are subject to the laws of other jurisdictions in which they transact business, which laws typically establish supervisory agencies with broad administrative powers relating to issuing and revoking licenses to transact business; regulating trade practices; licensing agents; approving policy forms, accounting practices and financial practices; establishing requirements pertaining to reserves and capital and surplus as regards policyholders; requiring the deferral of a portion of all premiums in a reserve for the protection of policyholders and the segregation of investments in a corresponding amount; establishing parameters regarding suitable investments for reserves, capital and surplus; and approving rate schedules. The manner in which rates are established or changed ranges from states which promulgate rates, to states where individual companies or associations of companies prepare rate filings which are submitted for approval, to a few states in which rate changes do not need to be filed for approval. In addition, each of our insurers is subject to periodic examination by regulatory authorities both within its jurisdiction of organization as well as the other jurisdictions where it is licensed to conduct business.

Our foreign insurance subsidiaries are regulated primarily by regulatory authorities in the regions, provinces and/or countries in which they operate and may secondarily be regulated by the domestic regulator of First American Title Insurance Company as a part of the First American insurance holding company system. Each of these regions, provinces and countries has established a regulatory framework with respect to the oversight of compliance with its laws and regulations. Therefore, our foreign insurance subsidiaries generally are subject to regulatory review, examination, investigation and enforcement in a similar manner as our domestic insurance subsidiaries, subject to local variations.

Our underwritten title companies, agencies and property and casualty insurance agencies are also subject to certain regulation by insurance regulatory or banking authorities, including, but not limited to, minimum net worth requirements, licensing requirements, statistical reporting requirements, rate filing requirements and marketing restrictions.

In addition to state-level regulation, our domestic subsidiaries that operate in the insurance business, as well as our home warranty, banking and certain other subsidiaries, are subject to regulation by federal agencies, including the Consumer Financial Protection Bureau (“CFPB”). The CFPB has broad authority to regulate, among other areas, the mortgage and real estate markets, including our domestic subsidiaries, in matters which impact consumers. This authority includes the enforcement of federal consumer financial laws, including the Real Estate Settlement Procedures Act. Regulations issued by the CFPB, or the manner in which it interprets and enforces existing consumer protection laws, have impacted and could continue to impact the way in which we conduct our businesses and the profitability of those businesses.

In addition, our home warranty and settlement services businesses are subject to regulation in some states by insurance authorities or other applicable regulatory entities. Our federal savings bank is regulated by the Office of the Comptroller of the Currency, with the Federal Reserve Board supervising its parent holding company, and is subject to regulation by the Federal Deposit Insurance Corporation.

Investment Policies

The Company’s investment portfolio activities, such as policy setting, compliance reporting, portfolio reviews, and strategy, are overseen by an investment committee made up of certain senior executives. Additionally, certain of the Company’s regulated subsidiaries have established and maintain investment committees to oversee their own investment portfolios. The Company’s investment policies are designed to comply with regulatory requirements and to align the investment portfolio asset allocation with strategic objectives. For example, our federal savings bank is required to maintain at least 65% of its asset portfolio in loans or securities that are secured by real estate. Our federal savings bank currently does not make real estate loans, and therefore fulfills this regulatory requirement through investments in mortgage-backed securities. In addition, applicable law imposes certain restrictions upon the types and amounts of investments that may be made by our regulated insurance subsidiaries.

The Company's investment policies further provide that investments are to be managed to maximize long-term returns consistent with liquidity, regulatory and risk objectives, and that investments should not expose the Company to excessive levels of credit, liquidity, and interest rate risks.

As of December 31, 2018, 94% of our investment portfolio consisted of debt securities. As of that date, 69% of our debt securities portfolio was either United States government-backed or rated AAA, and 97% was either rated or classified as investment grade. Percentages are based on the estimated fair values of the securities. Credit ratings 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.

In addition to our debt and equity securities portfolio, we maintain certain money-market and other short-term investments. We also hold strategic equity investments in companies engaged in our businesses or similar or related businesses.

Employees

As of December 31, 2018, the Company employed 18,251 people on either a part-time or full-time basis.

Available Information

The Company maintains a website, www.firstam.com, which includes financial information and other information for investors, including open and closed title insurance orders (which typically are posted approximately 10 to 12 days after the end of each calendar month). The Company’s Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge through the “Investors” page of the website as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission. The Company’s website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K, or any other filing with the Securities and Exchange Commission unless the Company expressly incorporates such materials.

Item 1A. Risk Factors

You should carefully consider each of the following risk factors and the other information contained in this Annual Report on Form 10-K. The Company faces risks other than those listed here, including those that are unknown to the Company and others of which the Company may be aware but, at present, considers immaterial. Because of the following factors, as well as other variables affecting the Company’s operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

1. Conditions in the real estate market generally impact the demand for a substantial portion of the Company’s products and services and the Company’s claims experience

Demand for a substantial portion of the Company’s products and services generally decreases as the number of real estate transactions in which its products and services are purchased decreases. The number of real estate transactions in which the Company’s products and services are purchased decreases in the following situations, among others:

- when mortgage interest rates are high or rising;
- when the availability of credit, including commercial and residential mortgage funding, is limited; and
- when real estate values are declining.

These circumstances, particularly declining real estate values and the increase in foreclosures that often results therefrom, also tend to adversely impact the Company’s title claims experience.

2. Unfavorable economic conditions could adversely affect the Company

Historically, uncertainty and negative trends in general economic conditions in the United States and abroad, including significant tightening of credit markets and a general decline in the value of real property, have created a difficult operating environment for the Company’s businesses and other companies in its industries. In addition, the Company holds investments in entities, such as title agencies and settlement service providers, as well as securities in its investment portfolio, which may be negatively impacted by these conditions. The Company also owns a federal savings bank into which it deposits some of its own funds and some funds held in trust for third parties. This bank invests those funds and any realized losses incurred will be reflected in the Company's consolidated results. The likelihood of such losses, which generally would not occur if the Company were to deposit these funds in an unaffiliated entity, increases when economic conditions are unfavorable. Depending upon the ultimate severity and duration of any economic downturn, the resulting effects on the Company could be materially adverse, including a significant reduction in revenues, earnings and cash flows, challenges to the Company's ability to satisfy covenants or otherwise meet its obligations under debt facilities, difficulties in obtaining access to capital, challenges to the Company's ability to pay dividends at currently anticipated levels, deterioration in the value of its investments and increased credit risk from customers and others with obligations to the Company.

3. Failures at financial institutions at which the Company deposits funds could adversely affect the Company

The Company deposits substantial funds in financial institutions. These funds include amounts owned by third parties, such as escrow deposits. Should one or more of the financial institutions at which deposits are maintained fail, there is no guarantee that the Company would recover the funds deposited, whether through Federal Deposit Insurance Corporation coverage or otherwise. In the event of any such failure, the Company also could be held liable for the funds owned by third parties.

4. Changes in government regulation could prohibit or limit the Company's operations, make it more burdensome to conduct such operations or result in decreased demand for the Company's products and services

Many of the Company's businesses, including its title insurance, property and casualty insurance, home warranty, banking, trust and wealth management businesses, are regulated by various federal, state, local and foreign governmental agencies. These and other of the Company's businesses also operate within statutory guidelines. The industry in which the Company operates and the markets into which it sells its products are also regulated and subject to statutory guidelines. Changes in the applicable regulatory environment, statutory guidelines or interpretations of existing regulations or statutes, enhanced governmental oversight or efforts by governmental agencies to cause customers to refrain from using the Company's products or services could prohibit or limit its future operations or make it more burdensome to conduct such operations or result in decreased demand for the Company's products and services or a change in our competitive position. The impact of these changes would be more significant if they involve jurisdictions in which the Company generates a greater portion of its title premiums, such as the states of Arizona, California, Florida, Michigan, New York, Ohio, Pennsylvania and Texas. These changes may compel the Company to reduce its prices, may restrict its ability to implement price increases or acquire assets or businesses, may limit the manner in which the Company conducts its business or otherwise may have a negative impact on its ability to generate revenues, earnings and cash flows.

5. Scrutiny of the Company's businesses and the industries in which it operates by governmental entities and others could adversely affect the Company

The real estate settlement services industry, an industry in which the Company generates a substantial portion of its revenue and earnings, is subject to continuous scrutiny by regulators, legislators, the media and plaintiffs' attorneys. Though often directed at the industry generally, these groups may also focus their attention directly on the Company's businesses. In either case, this scrutiny may result in changes which could adversely affect the Company's operations and, therefore, its financial condition and liquidity.

Governmental entities have routinely inquired into certain practices in the real estate settlement services industry to determine whether certain of the Company's businesses or its competitors have violated applicable laws, which include, among others, the insurance codes of the various jurisdictions and the Real Estate Settlement Procedures Act and similar state, federal and foreign laws. The Consumer Financial Protection Bureau ("CFPB"), for example, has actively utilized its regulatory authority over the mortgage and real estate markets by bringing enforcement actions against various participants in the mortgage and settlement industries. Departments of insurance in the various states, the CFPB and other federal regulators and applicable regulators in international jurisdictions, either separately or together, also periodically conduct targeted inquiries into the practices of title insurance companies and other settlement services providers in their respective jurisdictions.

Further, from time to time plaintiffs' lawyers may target the Company and other members of the Company's industry with lawsuits claiming legal violations or other wrongful conduct. These lawsuits may involve large groups of plaintiffs and claims for substantial damages. Any of these types of inquiries or proceedings may result in a finding of a violation of the law or other wrongful conduct and may result in the payment of fines or damages or the imposition of restrictions on the Company's conduct which could impact its operations and financial condition. Moreover, these laws and standards of conduct often are ambiguous and, thus, it may be difficult to ensure compliance. This ambiguity may force the Company to mitigate its risk by settling claims or by ending practices that generate revenues, earnings and cash flows.

6. The use of social media by the Company and other parties could result in damage to the Company's reputation or otherwise adversely affect the Company

The Company increasingly utilizes social media to communicate with current and potential customers and employees, as well as other individuals interested in the Company. Information delivered by the Company, or by third parties about the Company, via social media can be easily accessed and rapidly disseminated, and could result in reputational harm, decreased customer loyalty or other issues that could diminish the value of the Company's brand or result in significant liability.

7. Regulation of title insurance rates could adversely affect the Company

Title insurance rates are subject to extensive regulation, which varies from state to state. In many states the approval of the applicable state insurance regulator is required prior to implementing a rate change. This regulation could hinder the Company's ability to promptly adapt to changing market dynamics through price adjustments, which could adversely affect its results of operations, particularly in a rapidly declining market.

8. Changes in certain laws and regulations, and in the regulatory environment in which the Company operates, could adversely affect the Company

Federal and state officials are currently discussing various potential changes to laws and regulations that could impact the Company's businesses, including the reform of government-sponsored enterprises such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and data privacy regulations, among others. Changes in these areas, and more generally in the regulatory environment in which the Company and its customers operate, could adversely impact the volume of mortgage originations in the United States and the Company's competitive position and results of operations.

9. Recent and pending data privacy laws and regulations could adversely affect the Company

An increasing number of federal, state, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer, and other processing of personal data, including the California Consumer Privacy Act and the European Union General Data Protection Regulation. We believe that other jurisdictions are considering similar laws. The effects of these privacy laws, including the cost of compliance, are not fully known and are potentially significant, and the failure to comply could adversely affect the Company.

10. The Company may find it difficult to acquire necessary data

Certain data used and supplied by the Company are subject to regulation by various federal, state and local regulatory authorities. Compliance with existing federal, state and local laws and regulations with respect to such data has not had a material adverse effect on the Company's results of operations to date. Nonetheless, federal, state and local laws and regulations in the United States designed to protect the public from the misuse of personal information in the marketplace and adverse publicity or potential litigation concerning the commercial use of such information may affect the Company's operations and could result in substantial regulatory compliance expense, litigation expense and a loss of revenue. The suppliers of data to the Company face similar burdens. As a result of these and other factors, the Company may find it financially burdensome to acquire necessary data.

11. Changes in the Company's relationships with large mortgage lenders or government–sponsored enterprises could adversely affect the Company

The mortgage market in the United States is concentrated. Due to the consolidated nature of the industry, the Company derives a significant percentage of its revenues from a relatively small base of lenders, and their borrowers, which enhances the negotiating power of these lenders with respect to the pricing and the terms on which they purchase the Company's products and other matters. Similarly, government-sponsored enterprises, because of their significant role in the mortgage process, have significant influence over the Company and other service providers. These circumstances could adversely affect the Company's revenues and profitability. Changes in the Company's relationship with any of these lenders or government-sponsored enterprises, the loss of all or a portion of the business the Company derives from these parties, any refusal of these parties to accept the Company's products and services, the modification of the government-sponsored enterprises' requirement for title insurance in connection with mortgages they purchase or the use of alternatives to the Company's products and services, could have a material adverse effect on the Company.

12. A downgrade by ratings agencies, reductions in statutory capital and surplus maintained by the Company's title insurance underwriters or a deterioration in other measures of financial strength could adversely affect the Company

Certain of the Company's customers use measurements of the financial strength of the Company's title insurance underwriters, including, among others, ratings provided by ratings agencies and levels of statutory capital and surplus maintained by those underwriters, in determining the amount of a policy they will accept and the amount of reinsurance required. Each of the major ratings agencies currently rates the Company's title insurance operations. The Company's principal title insurance underwriter's financial strength ratings are "A2" by Moody's Investor Services, Inc., "A" by Fitch Ratings, Inc., "A-" by Standard & Poor's Ratings Services and "A" by A.M. Best Company, Inc. These ratings provide the agencies' perspectives on the financial strength, operating performance and cash generating ability of those operations. These agencies continually review these ratings and the ratings are subject to change. Statutory capital and surplus, or the amount by which statutory assets exceed statutory liabilities, is also a measure of financial strength. The Company's principal title insurance underwriter maintained $1.2 billion of total statutory capital and surplus as of December 31, 2018. Accordingly, if the ratings or statutory capital and surplus of these title insurance underwriters are reduced from their current levels, or if there is a deterioration in other measures of financial strength, the Company's results of operations, competitive position and liquidity could be adversely affected.

13. The Company's investment portfolio is subject to certain risks and could experience losses

The Company maintains a substantial investment portfolio, primarily consisting of fixed income debt securities. The investment portfolio also includes adjustable-rate debt securities, common and preferred stock, as well as money-market and other short-term investments. Securities in the Company's investment portfolio are subject to certain economic and financial market risks, such as credit risk, interest rate (including call, prepayment and extension) risk and/or liquidity risk. The risk of loss associated with the portfolio is increased during periods of instability in credit markets and economic conditions. Debt and equity securities are carried at fair value on the Company's balance sheet. Changes in the fair value of debt securities is recorded as a component of accumulated other comprehensive loss on the balance sheet. For debt securities in an unrealized loss position, where the loss is deemed to be other-than-temporary, the Company records the loss in earnings. Starting in 2018, changes in the fair value of equity securities are recognized in earnings. Changes in the fair value of securities in the Company's investment portfolio could have a material adverse effect on the Company's results of operations, statutory surplus, financial condition and cash flow.

14. Actual claims experience could materially vary from the expected claims experience reflected in the Company's reserve for incurred but not reported claims

The Company maintains a reserve for incurred but not reported ("IBNR") claims pertaining to its title, escrow and other insurance and guarantee products. The majority of this reserve pertains to title insurance policies, which are long-duration contracts with the majority of the claims reported within the first few years following the issuance of the policy. Generally, 70% to 80% of claim amounts become known in the first six years of the policy life, and the majority of IBNR reserves relate to the six most recent policy years. Changes in expected ultimate losses and corresponding loss rates for recent policy years are considered likely and could result in a material adjustment to the IBNR reserves. Based on historical experience, management believes a 50 basis point change to the loss rates for recent policy years, positive or negative, is reasonably likely given the long duration nature of a title insurance policy. For example, if the expected ultimate losses for each of the last six policy years increased or decreased by 50 basis points, the resulting impact on the Company's IBNR reserve would be an increase or decrease, as the case may be, of $122.4 million. A material change in expected ultimate losses and corresponding loss rates for older policy years is also possible, particularly for policy years with loss ratios exceeding historical norms. The estimates made by management in determining the appropriate level of IBNR reserves could ultimately prove to be materially different from actual claims experience.

15. The issuance of the Company's title insurance policies and related activities by title agents, which operate with substantial independence from the Company, could adversely affect the Company

The Company's title insurance subsidiaries issue a significant portion of their policies through title agents that operate with a substantial degree of independence from the Company. While these title agents are subject to certain contractual limitations that are designed to limit the Company's risk with respect to their activities, there is no guarantee that the agents will fulfill their contractual obligations to the Company. In addition, regulators are increasingly seeking to hold the Company responsible for the actions of these title agents and, under certain circumstances, the Company may be held liable directly to third parties for actions (including defalcations) or omissions of these agents. Case law in certain states also suggests that the Company is liable for the actions or omissions of its agents in those states, regardless of contractual limitations. As a result, the Company's use of title agents could result in increased claims on the Company's policies issued through agents and an increase in other costs and expenses.

16. The Company's risk management framework could prove inadequate, which could adversely affect the Company

The Company's risk management framework is designed to identify, monitor and mitigate risks that could have a negative impact on the Company's financial condition or reputation. This framework includes departments or groups dedicated to enterprise risk management, information security, disaster recovery and other information technology-related risks, business continuity, legal and compliance, compensation structures and other human resources matters, vendor management and internal audit, among others. While many of the processes overseen by these departments function at the enterprise level, many also function through, or rely to a certain degree upon, risk mitigation efforts in local operating groups. Similarly, with respect to the risks the Company assumes in the ordinary course of its business through the issuance of title insurance policies and the provision of related products and services, the Company employs localized as well as centralized risk mitigation efforts. These efforts include the implementation of underwriting policies and procedures and other mechanisms for assessing risk. Underwriting title insurance policies and making other risk-assumption decisions frequently involves a substantial degree of individual judgment and, accordingly, underwriters are maintained at the regional, divisional and corporate levels with varying degrees of underwriting authority. These individuals may be encouraged by customers or others to assume risks or to expeditiously make risk determinations. If the Company's risk mitigation efforts prove inadequate, the Company could be adversely affected.

17. Systems damage, failures, interruptions and intrusions, and unauthorized data disclosures may disrupt the Company's business, harm the Company's reputation, result in material claims for damages or otherwise adversely affect the Company

The Company uses computer systems and other technologies (collectively referred to as "systems"), some of which it owns and manages and some of which are owned and/or managed by third parties, including providers of distributed computing infrastructure platforms commonly known as the "cloud." The Company and its agents, suppliers, service providers, and customers use these systems to receive, process, store and transmit business information, including highly sensitive non-public personal information as well as data from suppliers and other information upon which the Company's business relies. The Company also uses these systems to manage substantial cash, investment assets, bank deposits, trust assets and escrow account balances on behalf of itself and its customers, among other activities. Many of the Company's products, services and solutions involving the use of real property related data are fully reliant on these systems and are only available electronically. Accordingly, for a variety of reasons, the integrity of these systems and the protection of the information that resides thereon are critically important to the Company's successful operation.

These systems have been subject to, and are likely to continue to be the target of, computer viruses, cyber attacks, phishing attacks and other malicious activity. These attacks have increased in frequency and sophistication in recent years. Further, certain other potential causes of system damage or other negative system-related events are wholly or partially beyond the Company's control, such as natural disasters, vendor failures to satisfy service level requirements and power or telecommunications failures. These incidents, regardless of their underlying causes, could expose the Company to system-related damages, failures, interruptions, and other negative events or could otherwise disrupt the Company's business and could also result in the loss or unauthorized release, gathering, monitoring or destruction of confidential, proprietary and other information pertaining to the Company, its customers, employees, agents or suppliers.

Certain laws and contracts the Company has entered into require it to notify various parties, including consumers or customers, in the event of certain actual or potential data breaches or systems failures. These notifications can result, among other things, in the loss of customers, lawsuits, adverse publicity, diversion of management's time and energy, the attention of regulatory authorities, fines and disruptions in sales. Further, the Company's financial institution customers have obligations to safeguard their systems and sensitive information and the Company may be bound contractually and/or by regulation to comply with the same requirements. If the Company fails to comply with applicable regulations and contractual requirements, it could be exposed to lawsuits, governmental proceedings or the imposition of fines, among other consequences.

Accordingly, any inability to prevent or adequately respond to the issues described above could disrupt the Company's business, inhibit its ability to retain existing customers or attract new customers and/or result in financial losses, litigation, increased costs or other adverse consequences that could be material to the Company.

18. The Company is pursuing various innovative initiatives, which could result in increased title claims or otherwise adversely affect the Company

In an effort to speed the delivery of its products, increase efficiency, improve quality, improve the customer experience and decrease risk, the Company is increasingly utilizing decision science, artificial intelligence and other innovative technologies, processes and techniques. These efforts include streamlining the closing process by converting certain manual processes into digital ones, in an endeavor to improve the customer experience by simplifying and reducing the time it takes to close a transaction, reducing the risk of fraud and improving communication. The Company increasingly is employing advanced technologies to automate various processes, including various processes related to the building, maintaining and updating of title plants and other data assets, as well as the search and examination of information in connection with the issuance of title insurance policies. Risks from these and other innovative initiatives include those associated with potential defects in the design and development of the technologies used to automate processes, misapplication of technologies, the reliance on data that may prove inadequate, and failure to meet customer expectations, among others. As a result of these risks the Company could experience increased claims, reputational damage or other adverse effects, which could be material to the Company.

19. Potentially disruptive innovation in the real estate industry could adversely affect the Company

In addition to the Company's innovative activities, other participants in the real estate industry are seeking to innovate in ways that could adversely impact the Company's businesses. These participants include certain of the Company's sources of business, competitors and ultimate customers. Innovations of these participants may change the demand for the Company's products and services, the manner in which the Company's products and services are ordered or fulfilled and the revenue or profitability derived from the products and services. The Company's efforts to anticipate and participate in these transformations could require significant additional investment and may not succeed, resulting in a reduction in market share or profitability. Accordingly, these efforts, and the manner in which the Company, its agents and other industry participants respond to them, could have an adverse effect on the Company.

20. Errors and fraud involving the transfer of funds may adversely affect the Company

The Company relies on its systems, employees and domestic and international banks to transfer its own funds and the funds of third parties. In addition to relying on third-party banks to transfer these funds, the Company's federal savings bank subsidiary transfers funds on behalf of the Company as well as title agents that are not affiliates of the Company. These transfers are susceptible to user input error, fraud, system interruptions, incorrect processing and similar errors that could result in lost funds or delayed transactions. The Company's email and computer systems and systems used by its agents, customers and other parties involved in a transaction have been subject to, and are likely to continue to be the target of, fraudulent attacks, including attempts to cause the Company or its agents to improperly transfer funds. These attacks have increased in frequency and sophistication in recent years. Funds transferred to a fraudulent recipient are often not recoverable. In certain instances the Company may be liable for those unrecovered funds. The controls and procedures used by the Company to prevent transfer errors and fraud may prove inadequate, resulting in financial losses, reputational harm, loss of customers or other adverse consequences which could be material to the Company.

21. The Company's use of a global workforce involves risks that could adversely affect the Company

The Company utilizes lower cost labor in countries such as India and the Philippines, among others. These countries are subject to relatively high degrees of political and social instability and may lack the infrastructure to withstand natural disasters. Such disruptions could decrease efficiency and increase the Company's costs. Weakness of the United States dollar in relation to the currencies used in these countries may also reduce the savings achievable through this strategy. Furthermore, the practice of utilizing labor based in other countries is subject to heightened scrutiny in the United States and, as a result, the Company could face pressure to decrease its use of labor based outside the United States. Laws or regulations that require the Company to use labor based in the United States or effectively increase the cost of the Company's labor costs abroad also could be enacted. The Company may not be able to pass on these increased costs to its customers.

22. As a holding company, the Company depends on distributions from its subsidiaries, and if distributions from its subsidiaries are materially impaired, the Company's ability to declare and pay dividends may be adversely affected; in addition, insurance and other regulations limit the amount of dividends, loans and advances available from the Company's insurance subsidiaries

The Company is a holding company whose primary assets are investments in its operating subsidiaries. The Company's ability to pay dividends is dependent on the ability of its subsidiaries to pay dividends or repay funds. If the Company's operating subsidiaries are not able to pay dividends or repay funds, the Company may not be able to fulfill parent company obligations and/or declare and pay dividends to its stockholders. Moreover, pursuant to insurance and other regulations under which the Company's insurance subsidiaries operate, the amount of dividends, loans and advances available is limited. As of December 31, 2018, under such regulations, the maximum amount available in 2019 from these insurance subsidiaries, without prior approval from applicable regulators, was dividends of $291.2 million and loans and advances of $98.6 million.

23. Certain provisions of the Company's bylaws and certificate of incorporation may reduce the likelihood of any unsolicited acquisition proposal or potential change of control that the Company's stockholders might consider favorable

The Company's bylaws and certificate of incorporation contain provisions that could be considered "anti-takeover" provisions because they make it harder for a third-party to acquire the Company without the consent of the Company's incumbent board of directors. Under these provisions:

- election of the Company's board of directors is staggered such that only one-third of the directors are elected by the stockholders each year and the directors serve three year terms prior to reelection;
- stockholders may not remove directors without cause, change the size of the board of directors or, except as may be provided for in the terms of preferred stock the Company issues in the future, fill vacancies on the board of directors;
- stockholders may act only at stockholder meetings and not by written consent;
- stockholders must comply with advance notice provisions for nominating directors or presenting other proposals at stockholder meetings; and
- the Company's board of directors may without stockholder approval issue preferred shares and determine their rights and terms, including voting rights, or adopt a stockholder rights plan.

While the Company believes that they are appropriate, these provisions, which may only be amended by the affirmative vote of the holders of approximately 67% of the Company's issued voting shares, could have the effect of discouraging an unsolicited acquisition proposal or delaying, deferring or preventing a change of control transaction that might involve a premium price or otherwise be considered favorably by the Company's stockholders.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Each of our business segments uses our executive offices in Santa Ana, California. This office campus consists of five office buildings, a technology center and a two-story parking structure, totaling approximately 490,000 square feet. Three office buildings, totaling approximately 210,000 square feet, and the fixtures thereto and underlying land, are subject to a deed of trust and security agreement securing payment of a promissory note evidencing a loan made in October 2003, to our principal title insurance subsidiary in the original sum of $55.0 million. This loan is payable in monthly installments of principal and interest, is fully amortizing and matures November 1, 2023. The outstanding principal balance of this loan was $19.2 million as of December 31, 2018.

The office facilities we occupy are, in all material respects, in good condition and adequate for their intended use.

Item 3. Legal Proceedings

The Company and its subsidiaries are parties to a number of non-ordinary course lawsuits. These lawsuits frequently are similar in nature to other lawsuits pending against the Company's competitors.

For those non-ordinary course lawsuits where the Company has determined that a loss is both probable and reasonably estimable, a liability representing the best estimate of the Company's financial exposure based on known facts has been recorded. Actual losses may materially differ from the amounts recorded.

For a substantial majority of these lawsuits, however, it is not possible to assess the probability of loss. Most of these lawsuits are putative class actions which require a plaintiff to satisfy a number of procedural requirements before proceeding to trial. These requirements include, among others, demonstration to a court that the law proscribes in some manner the Company's activities, the making of factual allegations sufficient to suggest that the Company's activities exceeded the limits of the law and a determination by the court—known as class certification—that the law permits a group of individuals to pursue the case together as a class. In certain instances the Company may also be able to compel the plaintiff to arbitrate its claim on an individual basis. If these procedural requirements are not met, either the lawsuit cannot proceed or, as is the case with class certification or compelled arbitration, the plaintiffs lose the financial incentive to proceed with the case (or the amount at issue effectively becomes de minimis). Frequently, a court's determination as to these procedural requirements is subject to appeal to a higher court. As a result of, among other factors, ambiguities and inconsistencies in the myriad laws applicable to the Company's business and the uniqueness of the factual issues presented in any given lawsuit, the Company often cannot determine the probability of loss until a court has finally determined that a plaintiff has satisfied applicable procedural requirements.

Furthermore, because most of these lawsuits are putative class actions, it is often impossible to estimate the possible loss or a range of loss amounts, even where the Company has determined that a loss is reasonably possible. Generally class actions involve a large number of people and the effort to determine which people satisfy the requirements to become plaintiffs—or class members—is often time consuming and burdensome. Moreover, these lawsuits raise complex factual issues which result in uncertainty as to their outcome and, ultimately, make it difficult for the Company to estimate the amount of damages which a plaintiff might successfully prove. In addition, many of the Company's businesses are regulated by various federal, state, local and foreign governmental agencies and are subject to numerous statutory guidelines. These regulations and statutory guidelines often are complex, inconsistent or ambiguous, which results in additional uncertainty as to the outcome of a given lawsuit—including the amount of damages a plaintiff might be afforded—or makes it difficult to analogize experience in one case or jurisdiction to another case or jurisdiction.

Most of the non-ordinary course lawsuits to which the Company and its subsidiaries are parties challenge practices in the Company's title insurance business, though a limited number of cases also pertain to the Company's other businesses. These lawsuits include, among others, cases alleging, among other assertions, that the Company or one of its subsidiaries engaged in improper debt collection practices, improperly charged fees for products and services, participated in the conveyance of illusory property interests, failed to pay overtime and provide break periods, improperly handled property and casualty claims and gave items of value to builders as inducements to refer business in violation of certain laws, such as consumer protection laws and laws generally prohibiting unfair business practices, and certain obligations, including:

- Bartine v. First American Title Insurance Company, et al., filed on August 17, 2018 and pending in the United States District Court for the Middle District of Florida,
- Brackens v. First American Home Warranty Corporation, filed on November 28, 2018 and pending in the United States District Court for the District of Arizona,
- Lennen v. First American Financial Corporation, et al., filed on May 19, 2016 and pending in the United States District Court for the Middle District of Florida,

- Leramo v. First American Title Insurance Company, et al., filed on December 19, 2018 and pending in the United States District Court for the Eastern District of California,
- Simons v. First American Title Insurance Company, filed on December 14, 2018 and pending in the United States District Court for the Middle District of Florida,
- Tenefufu vs. First American Specialty Insurance Company, filed on June 1, 2017 and pending in the Superior Court of the State of California, County of Sacramento, and
- Wilmot v. First American Financial Corporation, et al., filed on April 20, 2007 and pending in the Superior Court of the State of California, County of Los Angeles.

All of these lawsuits are putative class or collective actions for which a class or collective has not been certified. For the reasons described above, the Company has not yet been able to assess the probability of loss or estimate the possible loss or the range of loss or, where the Company has been able to make an estimate, the Company believes the amount is not material to the consolidated financial statements as a whole.

While some of the lawsuits described above may be material to the Company's operating results in any particular period if an unfavorable outcome results, the Company does not believe that any of these lawsuits will have a material adverse effect on the Company's overall financial condition or liquidity.

The Company also is a party to non-ordinary course lawsuits other than those described above. With respect to these lawsuits, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the consolidated financial statements as a whole.

The Company's title insurance, property and casualty insurance, home warranty, banking, thrift, trust and wealth management businesses are regulated by various federal, state and local governmental agencies. Many of the Company's other businesses operate within statutory guidelines. Consequently, the Company may from time to time be subject to examination or investigation by such governmental agencies. Currently, governmental agencies are examining or investigating certain of the Company's operations. These exams or investigations include inquiries into, among other matters, pricing and rate setting practices in the title insurance industry, competition in the title insurance industry, real estate settlement service, customer acquisition and retention practices and agency relationships. With respect to matters where the Company has determined that a loss is both probable and reasonably estimable, the Company has recorded a liability representing its best estimate of the financial exposure based on known facts. While the ultimate disposition of each such exam or investigation is not yet determinable, the Company does not believe that individually or in the aggregate they will have a material adverse effect on the Company's financial condition, results of operations or cash flows. These exams or investigations could, however, result in changes to the Company's business practices which could ultimately have a material adverse impact on the Company's financial condition, results of operations or cash flows.

The Company's Canadian operations provide certain services to lenders which it believes to be exempt from excise tax under applicable Canadian tax laws. However, in October 2014, the Canadian taxing authority provided internal guidance that the services in question should be subject to the excise tax. The Company believes it will receive an assessment related to this matter in the first half of 2019. While the amount of such assessment is not currently known, based on preliminary discussions with the taxing authority, the Company expects the assessment to be in the range of $12.0 million to $12.8 million, plus interest charges. As the Company does not believe that the services in question are subject to excise tax, it intends to avail itself of avenues of appeal after the assessment is received, and it believes it is reasonably likely that the Company will prevail on the merits. Based on the current facts and circumstances, the Company does not believe a loss is probable, therefore no liability has been recorded.

The Company and its subsidiaries also are involved in numerous ongoing routine legal and regulatory proceedings related to their operations. With respect to each of these proceedings, the Company has determined either that a loss is not reasonably possible or that the estimated loss or range of loss, if any, is not material to the consolidated financial statements as a whole.

Item 4. Mine Safety Disclosures
Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Stock Market Prices and Dividends

The Company's common stock trades on the New York Stock Exchange (ticker symbol FAF). The approximate number of record holders of common stock on February 15, 2019, was 2,358.

In January 2019, the Company's board of directors declared a cash dividend of $0.42 per share. We expect that the Company will continue to pay quarterly cash dividends at or above the current level. The timing, declaration and payment of future dividends, however, falls within the discretion of the Company's board of directors and will depend upon many factors, including the Company's financial condition and earnings, the capital requirements of our businesses, restrictions imposed by applicable law and any other factors the board of directors deems relevant from time to time. In addition, the ability to pay dividends also is potentially affected by the restrictions described in Note 2 Statutory Restrictions on Investments and Stockholders' Equity to the consolidated financial statements included in "Item 8. Financial Statements and Supplementary Data" of Part II of this report.

Unregistered Sales of Equity Securities

During the year ended December 31, 2018, the Company did not issue any unregistered common stock.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Pursuant to the share repurchase program initially announced by the Company on March 16, 2011 and expanded on March 11, 2014, which program has no expiration date, the Company may repurchase up to $250.0 million of the Company's issued and outstanding common stock. The following table describes purchases by the Company under the share repurchase program that settled during each period set forth in the table. Prices in column (b) include commissions. Cumulatively, as of December 31, 2018, the Company had repurchased $86.4 million (including commissions) of its shares and had the authority to repurchase an additional $163.6 million (including commissions) under the program.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2018 to October 31, 2018	70,000	$ 44.16	70,000	$ 179,346,548
November 1, 2018 to November 30, 2018	153,739	44.94	153,739	172,437,668
December 1, 2018 to December 31, 2018	201,394	43.70	201,394	163,637,006
Total	425,133	$ 44.22	425,133	$ 163,637,006

Stock Performance Graph

The following performance graph and related information shall not be deemed "soliciting material" or "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, except to the extent that it is specifically incorporated by reference into such filing.

The following graph compares the cumulative total stockholder return on the Company's common stock with the corresponding cumulative total returns of the Russell 1000 Index and two industry peer groups for the period from December 31, 2013 through December 31, 2018. The comparison assumes an investment of $100 on December 31, 2013 and reinvestment of dividends. This historical performance is not indicative of future performance.

Comparison of Cumulative Total Return

	First American Financial Corporation (FAF) (1)	Custom Peer Group (new) (1)(2)	Custom Peer Group (prior) (1)(2)	Russell 1000 Index (1)
December 31, 2013	$ 100	$ 100	$ 100	$ 100
December 31, 2014	$ 124	$ 104	$ 111	$ 113
December 31, 2015	$ 135	$ 113	$ 125	$ 114
December 31, 2016	$ 142	$ 134	$ 148	$ 128
December 31, 2017	$ 224	$ 154	$ 179	$ 156
December 31, 2018	$ 184	$ 153	$ 175	$ 148

(1) As calculated by Bloomberg Financial Services, where available, to include reinvestment of dividends.
(2) The new custom peer group consists of the following companies: American Financial Group, Inc.; Assurant, Inc.; Axis Capital Holdings Limited; Cincinnati Financial Corporation; Everest Re Group, Ltd.; Fidelity National Financial, Inc.; Genworth Financial, Inc.; The Hanover Insurance Group, Inc.; Kemper Corporation; Mercury General Corporation; Old Republic International Corp.; and W.R. Berkley Corporation each of which operates in a business similar to a business operated by the Company. The compensation committee of the Company utilizes the compensation practices of these companies as benchmarks in setting the compensation of its executive officers. The prior custom peer group also included White Mountains Insurance Group Ltd., which was dropped after it divested a large business unit, but did not include Axis Capital Holdings Limited, Everest Re Group, Ltd. and Genworth Financial, Inc., each of which was added by the compensation committee at the time White Mountains Insurance Group was dropped.

Item 6. Selected Financial Data

The selected historical consolidated financial data for First American Financial Corporation (the "Company") as of and for each of the five years in the period ended December 31, 2018, have been derived from the Company's consolidated financial statements. The selected historical consolidated financial data should be read in conjunction with "Item 8. Financial Statements and Supplementary Data," "Item 1—Business," and "Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations."

First American Financial Corporation and Subsidiary Companies

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(in thousands, except percentages, per share amounts and employee data)				
Revenues	$5,747,844	$5,772,363	$5,575,846	$5,175,456	$4,677,949
Net income	$475,898	$421,863	$343,476	$288,870	$234,215
Net income (loss) attributable to noncontrolling interests	$1,402	$(1,186)	$483	$784	$681
Net income attributable to the Company	$474,496	$423,049	$342,993	$288,086	$233,534
Total assets	$10,630,635	$9,573,222	$8,831,777	$8,236,715	$7,647,889
Notes and contracts payable	$732,019	$732,810	$736,693	$581,052	$582,712
Stockholders' equity	$3,741,881	$3,479,955	$3,008,179	$2,749,960	$2,564,375
Return on average stockholders' equity	13.1 %	13.0 %	11.9 %	10.8 %	9.3 %
Dividends on common shares	$178,487	$159,284	$131,541	$108,524	$89,939
Per share of common stock (Note A)—					
Net income attributable to the Company:					
Basic	$4.21	$3.79	$3.10	$2.65	$2.18
Diluted	$4.19	$3.76	$3.09	$2.62	$2.15
Stockholders' equity	$33.56	$31.37	$27.36	$25.21	$23.85
Cash dividends declared	$1.60	$1.44	$1.20	$1.00	$0.84
Number of common shares outstanding					
Weighted-average during the year:					
Basic	112,613	111,668	110,548	108,427	106,884
Diluted	113,279	112,435	111,156	109,826	108,688
End of year	111,496	110,925	109,944	109,098	107,541
Other Operating Data (unaudited):					
Title orders opened (Note B)	982	1,069	1,281	1,262	1,156
Title orders closed (Note B)	731	824	958	882	816
Number of employees (Note C)	18,251	18,705	19,531	17,955	17,103

Note A—Per share information relating to net income is based on weighted-average number of shares outstanding for the years presented. Per share information relating to stockholders' equity is based on shares outstanding at the end of each year.

Note B—Title order volumes are those processed by the direct domestic title operations of the Company and do not include orders processed by agents.

Note C—Number of employees is based on actual employee headcount.

22

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

CERTAIN STATEMENTS IN THIS ANNUAL REPORT ON FORM 10-K ARE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS MAY CONTAIN THE WORDS "BELIEVE," "ANTICIPATE," "EXPECT," "PLAN," "PREDICT," "ESTIMATE," "PROJECT," "WILL BE," "WILL CONTINUE," "WILL LIKELY RESULT," OR OT SIMILAR WORDS AND PHRASES.

RISKS AND UNCERTAINTIES EXIST THAT MAY CAUSE RESULTS TO DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD-LOOKING STATEMENTS. FACTORS THAT COULD CAUSE THE ANTICIPATED RESULTS TO DIFFER FROM THOSE DESCRIBED IN THE FORWARD-LOOKING STATEMENTS INCLUDE THE FACTORS SET FORTH ON PAGES 3-4 OF THIS ANNUAL REPORT. 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.

This Management's Discussion and Analysis contains certain financial measures that are not presented in accordance with generally accepted accounting principles ("GAAP"), including adjusted information and other revenues, adjusted personnel costs, and adjusted other operating expenses, in each case excluding the effects of recent acquisitions. The Company is presenting these non-GAAP financial measures because they provide the Company's management and readers of this Annual Report on Form 10-K with additional insight into the operational performance of the Company relative to earlier periods. The Company does not intend for these non-GAAP financial measures to be a substitute for any GAAP financial information. In this Annual Report on Form 10-K, these non-GAAP financial measures have been presented with, and reconciled to, the most directly comparable GAAP financial measures. Readers of this Annual Report on Form 10-K should use these non-GAAP financial measures only in conjunction with the comparable GAAP financial measures.

Principles of Consolidation

The consolidated financial statements have been prepared in accordance with GAAP and reflect the consolidated operations of the Company. The consolidated financial statements include the accounts of First American Financial Corporation and all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated. Investments in affiliates in which the Company exercises significant influence, but does not control and is not the primary beneficiary, are accounted for using the equity method. Investments in affiliates in which the Company does not exercise significant influence over the investee are accounted for under the cost method.

Reportable Segments

The Company consists of the following reportable segments and a corporate function:

- The Company's title insurance and services segment issues title insurance policies on residential and commercial property in the United States and offers similar or related products and services internationally. This segment also provides closing and/or escrow services; accommodates tax-deferred exchanges of real estate; provides products, services and solutions designed to mitigate risk or otherwise facilitate real estate transactions, many of which products, services and solutions involve the use of real property-related data; maintains, manages and provides access to title plant records and images; and provides appraisals and other valuation-related products and services, lien release and document custodial services, warehouse lending services, default-related products and services, evidence of title, and banking, trust and wealth management services. The Company, through its principal title insurance subsidiary and such subsidiary's affiliates, transacts its title insurance business through a network of direct operations and agents. Through this network, the Company issues policies in the 49 states that permit the issuance of title insurance policies, the District of Columbia and certain United States territories. The Company also offers title insurance, closing services and similar or related products and services, either directly or through third parties in other countries, including Canada, the United Kingdom, Australia, South Korea and various other established and emerging markets.

- The Company's specialty insurance segment issues property and casualty insurance policies and sells home warranty products. The property and casualty insurance business provides insurance coverage to residential homeowners and renters for liability losses and typical hazards such as fire, theft, vandalism and other types of property damage. This business is licensed to issue policies in all 50 states and the District of Columbia and actively issues policies in 47 states. The majority of policy liability is in the western United States, including approximately 62% in California. In certain markets it also offers preferred risk auto insurance to better compete with other carriers offering bundled home and auto insurance. The home warranty business provides residential service contracts that cover residential systems, such as heating and air conditioning systems, and certain appliances against failures that occur as the result of normal usage during the coverage period. This business currently operates in 36 states and the District of Columbia.

The corporate function consists primarily of certain financing facilities as well as the corporate services that support the Company's business operations.

Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires the application of accounting policies that often involve a significant degree of judgment. The Company's management considers the accounting policies described below to be the most dependent on the application of estimates and assumptions in preparing the Company's consolidated financial statements. See Note 1 Basis of Presentation and Significant Accounting Policies to the consolidated financial statements for a more detailed description of the Company's significant accounting policies.

Provision for policy losses. The Company provides for title insurance losses through a charge to expense when the related premium revenue is recognized. The amount charged to expense is generally determined by applying a rate (the loss provision rate) to total title insurance premiums and escrow fees. The Company's management estimates the loss provision rate at the beginning of each year and reassesses the rate quarterly to ensure that the resulting incurred but not reported ("IBNR") loss reserve and known claims reserve included in the Company's consolidated balance sheets together reflect management's best estimate of the total costs required to settle all IBNR and known claims. If the ending IBNR reserve is not considered adequate, an adjustment is recorded.

The process of assessing the loss provision rate and the resulting IBNR reserve involves an evaluation of the results of an in-house actuarial review. The Company's in-house actuary performs a reserve analysis utilizing generally accepted actuarial methods that incorporate cumulative historical claims experience and information provided by in-house claims and operations personnel. Current economic and business trends are also reviewed and used in the reserve analysis. These include conditions in the real estate and mortgage markets, changes in residential and commercial real estate values, and changes in the levels of defaults and foreclosures that may affect claims levels and patterns of emergence, as well as any company-specific factors that may be relevant to past and future claims experience. Results from the analysis include, but are not limited to, a range of IBNR reserve estimates and a single point estimate for IBNR as of the balance sheet date.

For recent policy years at early stages of development (generally the last three years), IBNR is generally estimated using a combination of expected loss rate and multiplicative loss development factor calculations. For more mature policy years, IBNR generally is estimated using multiplicative loss development factor calculations. The expected loss rate method estimates IBNR by applying an expected loss rate to total title insurance premiums and escrow fees, and adjusting for policy year maturity using estimated loss development patterns. Multiplicative loss development factor calculations estimate IBNR by applying factors derived from loss development patterns to losses realized to date. The expected loss rate and loss development patterns are based on historical experience and the relationship of the history to the applicable policy years.

The Company's management uses the IBNR point estimate from the in-house actuary's analysis and other relevant information concerning claims to determine what it considers to be the best estimate of the total amount required for the IBNR reserve.

The volume and timing of title insurance claims are subject to cyclical influences from both the real estate and mortgage markets. Title policies issued to lenders constitute a large portion of the Company's title insurance volume. These policies insure lenders against losses on mortgage loans due to title defects in the collateral property. Even if an underlying title defect exists that could result in a claim, often, the lender must realize an actual loss, or at least be likely to realize an actual loss, for a title insurance liability to exist. As a result, title insurance claims exposure is sensitive to lenders' losses on mortgage loans and is affected in turn by external factors that affect mortgage loan losses, particularly macroeconomic factors.

A general decline in real estate prices can expose lenders to greater risk of losses on mortgage loans, as loan-to-value ratios increase and defaults and foreclosures increase. Title insurance claims exposure for a given policy year is also affected by the quality of mortgage loan underwriting during the corresponding origination year. The Company believes that the sensitivity of claims to external conditions in the real estate and mortgage markets is an inherent feature of title insurance's business economics that applies broadly to the title insurance industry.

Title insurance policies are long-duration contracts with the majority of the claims reported to the Company within the first few years following the issuance of the policy. Generally, 70% to 80% of claim amounts become known in the first six years of the policy life, and the majority of IBNR reserves relate to the six most recent policy years. Changes in expected ultimate losses and corresponding loss rates for recent policy years are considered likely and could result in a material adjustment to the IBNR reserves. Based on historical experience, management believes a 50 basis point change to the loss rates for recent policy years, positive or negative, is reasonably likely given the long duration nature of a title insurance policy. For example, if the expected ultimate losses for each of the last six policy years increased or decreased by 50 basis points, the resulting impact on the Company's IBNR reserve would be a corresponding increase or decrease of $122.4 million. A material change in expected ultimate losses and corresponding loss rates for older policy years is also possible, particularly for policy years with loss rates exceeding historical norms. The estimates made by management in determining the appropriate level of IBNR reserves could ultimately prove to be materially different from actual claims experience.

The reserve for property and casualty insurance losses reflects management's best estimate of the amount necessary to settle all reported and unreported claims for the ultimate cost of insured losses, based upon the facts of each case and the Company's experience with similar cases. The Company also utilizes the services of an independent actuary as part of its reserve analysis. Because the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process, the ultimate cost of insured losses may be more or less than the reserve amount. Reserve estimates are regularly analyzed and updated to reflect the most current information available.

The Company provides for claims losses relating to its home warranty business based on the average cost per claim and historical loss experience as applied to the total of new claims incurred. The average cost per home warranty claim is calculated using the average of the most recent 12 months of claims experience adjusted for estimated future increases in costs.

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

(in thousands, except percentages)	December 31, 2018		December 31, 2017	
Known title claims	$80,306	7.7 %	$83,094	8.1 %
IBNR title claims	877,134	84.1 %	875,724	85.1 %
Total title claims	957,440	91.8 %	958,818	93.2 %
Non-title claims	85,239	8.2 %	70,115	6.8 %
Total loss reserves	$1,042,679	100.0%	$1,028,933	100.0%

Activity in the reserve for known title claims is summarized as follows:

	December 31,		
	2018	2017	2016
	(in thousands)		
Balance at beginning of year	$83,094	$83,805	$87,543

Provision transferred from IBNR title claims related to:			
Current year	17,770	17,471	15,098
Prior years	147,271	180,602	188,066
	165,041	198,073	203,164
Payments, net of recoveries, related to:			
Current year	14,338	14,835	12,420
Prior years	151,433	185,515	197,821
	165,771	200,350	210,241
Other	(2,058)	1,566	3,339
Balance at end of year	$80,306	$83,094	$83,805

The provision transferred from IBNR title claims related to current year increased by $0.3 million in 2018 from 2017 and increased by $2.4 million in 2017 from 2016 and payments, net of recoveries, related to current year decreased by $0.5 million in 2018 from 2017 and increased by $2.4 million in 2017 from 2016, reflecting variability in claims volumes characteristic of a policy year during its first year of development.

The provision transferred from IBNR title claims related to prior years decreased by $33.3 million, or 18.5%, in 2018 from 2017 and decreased by $7.5 million, or 4.0%, in 2017 from 2016. Payments, net of recoveries, related to prior years decreased by $34.1 million, or 18.4%, in 2018 from 2017 and decreased by $12.3 million, or 6.2%, in 2017 from 2016. Generally, the provision transferred from IBNR title claims and payments are expected to decline with the runoff of older policy years that have higher expected ultimate losses, particularly policy years 2005 through 2008.

Activity in the reserve for IBNR title claims is summarized as follows:

	December 31,		
	2018	2017	2016
	(in thousands)		
Balance at beginning of year	$875,724	$888,126	$844,364
Provision related to:			
Current year	173,520	175,322	193,109
Prior years	—	—	42,552
	173,520	175,322	235,661
Provision transferred to known title claims related to:			
Current year	17,770	17,471	15,098
Prior years	147,271	180,602	188,066
	165,041	198,073	203,164
Other	(7,069)	10,349	11,265
Balance at end of year	$877,134	$875,724	$888,126

“Other” primarily includes foreign currency translation gains and losses and ceded reinsurance claims.

The provision related to current year decreased by $1.8 million, or 1.0%, in 2018 from 2017. This decrease was attributable to a decrease in title premiums and escrow fees in 2018 from 2017.

The provision related to current year decreased by $17.8 million, or 9.2%, in 2017 from 2016. This decrease was attributable to a lower current year loss rate of 4.0% in 2017 when compared to 4.5% in 2016, partly offset by a 2.1% increase in title premiums and escrow fees in 2017 from 2016.

For further discussion of title provision recorded in 2018, 2017 and 2016, see Results of Operations, pages 37 and 38.

Fair value of investment portfolio. The Company categorizes the fair values of its debt and equity securities using a three-level hierarchy for fair value measurements that distinguishes between market participant assumptions developed based on market data obtained from sources independent of the 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 each security in the Company’s investment portfolio was based on management's assessment of the transparency and reliability of the inputs used to estimate the fair values at the measurement date. See Note 14 Fair Value Measurements to the consolidated financial statements for a more detailed description of the three-level hierarchy and a description for each level.

The valuation techniques and inputs used to estimate the fair values of the Company’s debt and equity securities are summarized as follows:

Fair value of 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 values of the debt securities held by the Company. The Company obtains an understanding of the valuation models and assumptions utilized by the services and has controls in place to determine that the values provided represent fair values. The Company’s validation procedures include comparing prices received from the pricing services to quotes received from other third party sources for certain securities with market prices that are readily verifiable. If the price comparison results in differences over a predefined threshold, the Company will assess the reasonableness of the changes relative to prior periods given the prevailing market conditions and assess changes in the issuers’ credit worthiness, performance of any underlying collateral and prices of the instrument relative to similar issuances. To date, the Company has not made any material adjustments to the fair value measurements provided by the pricing services.

Typical inputs and assumptions to pricing models used to value the Company’s 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.

Other-than-temporary impairment–debt securities

If the Company intends to sell a debt security in an unrealized loss position or determines that it is more likely than not that the Company will be required to sell a debt security before it recovers its amortized cost basis, the debt security is other-than-temporarily impaired and it is written down to fair value with all losses recognized in earnings. As of December 31, 2018, the Company did not intend to sell any debt securities in an unrealized loss position and it is not more likely than not that the Company will be required to sell any debt securities before recovery of their amortized cost basis.

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

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

The Company did not recognize any other-than-temporary impairment losses related to its debt securities for 2018 and 2017 and recognized $0.5 million of other-than-temporary impairment losses considered to be credit related for 2016.

Fair value of 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.

Litigation and regulatory contingencies. The Company and its subsidiaries are parties to a number of ongoing routine and non-ordinary course legal proceedings. For those lawsuits where the Company has determined that a loss is both probable and reasonably estimable, a liability representing the best estimate of the Company's financial exposure based on known facts has been recorded. Actual losses may materially differ from the amounts recorded. For a substantial majority of these lawsuits it is not possible to assess the probability of loss. Most of these lawsuits are putative class actions which require a plaintiff to satisfy a number of procedural requirements before proceeding to trial. As a result of, among other factors, ambiguities and inconsistencies in the myriad laws applicable to the Company's business and the uniqueness of the factual issues presented in any given lawsuit, the Company often cannot determine the probability of loss until a court has finally determined that a plaintiff has satisfied applicable procedural requirements. Furthermore, because most of these lawsuits are putative class actions, it is often impossible to estimate the possible loss or a range of loss, even where the Company has determined that a loss is reasonably possible. In addition, many of the Company's businesses are regulated by various federal, state, local and foreign governmental agencies and are subject to numerous statutory guidelines. These regulations and statutory guidelines often are complex, inconsistent or ambiguous, which results in additional uncertainty as to the outcome of a given lawsuit—including the amount of damages a plaintiff might be afforded—or makes it difficult to analogize experience in one case or jurisdiction to another case or jurisdiction.

Business Combinations. The Company allocates the fair value of purchase consideration to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets.

Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows, useful lives and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, may differ from actual results. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed.

Impairment assessment for goodwill. The Company is required to perform an annual goodwill impairment assessment for each reporting unit for which goodwill has been allocated. Those reporting units include title insurance, home warranty and property and casualty insurance. The Company's trust and other services reporting unit has no allocated goodwill and is, therefore, not assessed for impairment. The Company has elected to perform this annual assessment in the fourth quarter of each fiscal year or sooner if circumstances indicate possible impairment. Based on accounting guidance, the Company has the option to perform a qualitative assessment to determine if the fair value is more likely than not (i.e., a likelihood of greater than 50%) less than the carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test, or may choose to forego a qualitative assessment and perform a quantitative impairment test. The qualitative factors considered in this assessment may include macroeconomic conditions, industry and market considerations, overall financial performance as well as other relevant events and circumstances as determined by the Company. The Company evaluates the weight of each factor to determine whether it is more likely than not that impairment may exist. If the results of a qualitative assessment indicate the more likely than not threshold was not met, the Company may choose not to perform a quantitative impairment test. If, however, the more likely than not threshold is met, the Company will perform a quantitative test as required and discussed below.

Management's quantitative impairment testing process includes two steps. The first step ("Step 1") compares the fair value of each reporting unit to its carrying amount. The fair value of each reporting unit is determined by using discounted cash flow analysis and market approach valuations. If the fair value of the reporting unit exceeds its carrying amount, the goodwill is not considered impaired and no additional analysis is required. However, if the carrying amount is greater than the fair value, a second step (“Step 2”) must be completed to determine if the fair value of the goodwill exceeds the carrying amount of goodwill.

Step 2 involves calculating an implied fair value of goodwill for each reporting unit for which Step 1 indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in Step 1, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment loss is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

The quantitative impairment test for goodwill utilizes a variety of valuation techniques, all of which require the Company to make estimates and judgments. Fair value is determined by employing an expected present value technique, which utilizes expected cash flows and an appropriate discount rate. The use of comparative market multiples (the “market approach”) compares the reporting unit to other comparable companies (if such comparables are present in the marketplace) based on valuation multiples to arrive at a fair value. In assessing the fair value, the Company utilizes the results of the valuations (including the market approach to the extent comparables are available) and considers the range of fair values determined under all methods and the extent to which the fair value exceeds the carrying amount of the reporting unit.

The valuation of each reporting unit includes the use of assumptions and estimates of many critical factors, including revenue growth rates and operating margins, discount rates and future market conditions, determination of market multiples and the establishment of a control premium, among others. Forecasts of future operations are based, in part, on operating results and the Company’s expectations as to future market conditions. These types of analyses contain uncertainties because they require the Company to make assumptions and to apply judgments to estimate industry economic factors and the profitability of future business strategies. However, if actual results are not consistent with the Company’s estimates and assumptions, the Company may be exposed to future impairment losses that could be material.

For 2018 and 2017, the Company chose to perform qualitative assessments for its title insurance and home warranty reporting units and performed a quantitative impairment test for its property and casualty insurance reporting unit. Based on the results of its quantitative impairment tests for 2018 and 2017, the Company determined that the fair value of its property and casualty insurance reporting unit exceeded the carrying amount and, therefore, no additional analysis was required. The results of the Company’s qualitative assessments for its title insurance and home warranty reporting units for 2018 and 2017 supported the conclusion that their fair values were not more likely than not less than their carrying amounts and, therefore, a quantitative impairment test was not considered necessary. For 2016, the Company chose to perform a quantitative impairment test for all three reporting units and, based on the results, determined that the fair values of its reporting units exceeded their carrying amounts and, therefore, no additional analysis was required. As a result of the Company’s annual goodwill impairment assessments, the Company did not record any goodwill impairment losses for 2018, 2017 or 2016.

Impairment assessment for other intangible assets. Management uses estimated future cash flows (undiscounted and excluding interest) to measure the recoverability of intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If the undiscounted cash flow analysis indicates that the carrying amount is not recoverable, an impairment loss is recorded for the excess of the carrying amount over its fair value.

Management’s impairment assessment for indefinite-lived other intangible assets may involve calculating the fair value by using a discounted cash flow analysis or through a market approach valuation. If the fair value exceeds its carrying amount, the asset is not considered impaired and no additional analysis is required. However, if the carrying amount is greater than the fair value, an impairment loss is recorded equal to the excess.

Impairment of equity method investments. The carrying value of investments accounted for under the equity method of accounting is written down, or impaired, to fair value when a decline in value is considered to be other-than-temporary. In making the determination as to whether an individual investment is impaired, the Company assesses the current and expected financial condition of each relevant entity, including, but not limited to, the anticipated ability of the entity to make its contractually required payments to the Company (with respect to debt obligations to the Company), the results of valuation work performed with respect to the entity, the entity's anticipated ability to generate sufficient cash flows and the market conditions in the industry in which the entity is operating.

Impairment of property and equipment. Management uses estimated future cash flows (undiscounted and excluding interest) to measure the recoverability of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. If the undiscounted cash flow analysis indicates that the carrying amount is not recoverable, an impairment loss is recorded for the excess of the carrying amount over its fair value. Impairment losses on property and equipment, which primarily related to impairments of internally developed software, were $41 thousand, $0.5 million and $5.2 million for 2018, 2017 and 2016, respectively.

Income taxes. The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company evaluates the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is considered more likely than not that some or all of the deferred tax assets will not be realized.

The Company recognizes the effect of income tax positions only if sustaining those positions is considered more likely than not. Changes in recognition or measurement of uncertain tax positions are reflected in the period in which a change in judgment occurs. The Company recognizes interest and penalties, if any, related to uncertain tax positions in income tax expense.

Employee benefit plans. The Company recognizes the underfunded status of its unfunded supplemental benefit plans as a liability on its consolidated balance sheets. Actuarial gains and losses and prior service costs and credits that have not been recognized as a component of net periodic benefit cost previously are recorded as a component of accumulated other comprehensive loss. Plan obligations are measured annually as of December 31.

The assumption that has had the most significant impact to net periodic costs for the unfunded supplemental benefit plans is the discount rate. The discount rate assumption reflects the yield available on high-quality, fixed-income debt securities that match the expected timing of the benefit obligation payments.

The weighted-average discount rate assumptions used to determine net periodic benefit costs for the Company's unfunded supplemental benefits plans for 2018, 2017 and 2016, were as follows:

	Year ended December 31,		
	2018	2017	2016
Discount rate for projected benefit obligation	3.61%	4.03%	4.33%
Discount rate for service cost	3.78%	4.32%	4.69%
Discount rate for interest cost	3.23%	3.43%	3.56%

The weighted-average discount rate assumption used to determine the projected benefit obligation for the Company's unfunded supplemental benefits plans at December 31, 2018 and 2017, was as follows:

December 31,

	2018	2017
Discount rate	4.32 %	3.61 %

During 2016, the Company terminated its funded defined benefit pension plans and, in 2017, transferred all remaining benefit obligations relating to the pension plans to a highly rated insurance company. See Note 13 Employee Benefit Plans to the consolidated financial statements for further discussion of the termination of the Company's funded defined benefit pension plans.

Recently Adopted Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board ("FASB") issued updated guidance intended to reduce diversity in practice by clarifying which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company's 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. The Company adopted this change in accounting principle at the beginning of 2018 and applied the change retrospectively. As a result, other components of net benefit cost totaling $175.0 million and $101.5 million were reclassified from personnel costs to other operating expenses on the consolidated statements of income for the years ended December 31, 2017 and 2016, respectively. See Note 13 Employee Benefit Plans to the consolidated financial statements for further information on the Company's net periodic pension costs.

In January 2017, the FASB issued updated guidance to clarify the definition of a business with the objective of providing guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company's consolidated financial statements.

In November 2016, the FASB issued updated guidance intended to reduce the diversity in practice on presenting restricted cash and restricted cash equivalents in the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company's 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. The adoption of this guidance had no impact on the Company's 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. The adoption of this guidance had no impact on the Company's consolidated financial statements.

In January 2016, the FASB issued updated guidance intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. In addition to making other targeted improvements to current guidance, the updated guidance also requires all equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in the fair value recognized through net income. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted this guidance at the beginning of 2018 and recognized cumulative net unrealized gains, net of taxes, of $40.6 million related to its investments in equity securities, previously classified as available-for-sale, through a cumulative-effect adjustment to retained earnings. Changes in the fair values of these investments are reflected in net realized investment gains/losses on the

Company’s consolidated statements of income. See Note 3 Debt and Equity Securities to the consolidated financial statements for further discussion of the Company’s investments in equity securities.

In May 2014, the FASB issued updated guidance for recognizing revenue from contracts with customers to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within and across industries, and across capital markets. The new revenue standard contains principles that an entity will apply to determine the measurement of revenue and the timing of recognition. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. Revenue from insurance contracts is not within the scope of this guidance. In 2016, the FASB issued additional updates to the new guidance primarily to clarify, among other things, the implementation guidance related to principal versus agent considerations, identifying performance obligations, accounting for licenses of intellectual property, and to provide narrow-scope improvements and additional practical expedients. In February 2017, the FASB issued an additional update to the new guidance to clarify the scope of derecognition guidance for nonfinancial assets and to provide guidance for partial sales of nonfinancial assets. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company elected to adopt the new guidance under the modified retrospective approach, which did not have a material impact on its consolidated financial statements. See Note 1 Basis of Presentation and Significant Accounting Policies to the consolidated financial statements for further information about the Company's revenues within the scope of the new guidance.

Pending Accounting Pronouncements

In August 2018, the FASB issued updated guidance that is intended to reduce potential diversity in practice in accounting for the costs of implementing cloud computing arrangements (i.e., hosting arrangements) that are service contracts. The updated guidance aligns the requirements for capitalizing implementation costs for these arrangements with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its consolidated financial statements.

In August 2018, the FASB issued updated guidance as part of its disclosure framework project intended to improve the effectiveness of disclosures in the notes to the financial statements. The updated guidance eliminates, adds and modifies certain disclosure requirements related to fair value measurements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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

In June 2016, the FASB issued updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its 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. The updated guidance may either be adopted using a modified retrospective transition approach or may be initially applied on the adoption date with the recognition of a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company has elected to initially apply the guidance as of the adoption date, January 1, 2019, and expects to record on its balance sheet right-of-use assets and lease liabilities of approximately $350 million and an immaterial cumulative-effect adjustment to retained earnings. The Company expects the new guidance to have an insignificant impact on its consolidated statements of income and statements of cash flows.

Results of Operations

Overview

A substantial portion of the revenues for the Company's title insurance and services segment results from the sale and refinancing of residential and commercial real estate. In the Company's specialty insurance segment, revenues associated with the initial year of coverage in both the home warranty and property and casualty operations are impacted by volatility in residential purchase transactions. Traditionally, the greatest volume of real estate activity, particularly residential purchase activity, has occurred in the spring and summer months. However, changes in interest rates, as well as other changes in general economic conditions in the United States and abroad, can cause fluctuations in the traditional pattern of real estate activity.

The Company's total revenues for 2018 were $5.7 billion, which reflected a decrease of $24.5 million, or 0.4%, when compared with $5.8 billion for 2017. This decrease was attributable to lower agent premiums in the title insurance and services segment and a higher level of net realized investment losses, partially offset by higher net investment income and direct premiums and escrow fees. The increase in direct premiums and escrow fees attributable to the title insurance and services segment was $30.6 million, or 1.5%. Direct premiums and escrow fees from domestic commercial and residential purchase transactions increased $57.5 million and $22.6 million, or 8.3% and 2.5%, respectively, while direct premiums and escrow fees from domestic residential refinance transactions decreased $49.3 million, or 21.4%, in 2018 when compared to 2017.

According to the Mortgage Bankers Association's February 11, 2019 Mortgage Finance Forecast (the "MBA Forecast"), residential mortgage originations in the United States (based on the total dollar value of the transactions) decreased 6.6% in 2018 when compared with 2017. According to the MBA Forecast, the dollar amount of purchase originations increased 3.7% and refinance originations decreased 25.6%. This volume of domestic residential mortgage origination activity contributed to an increase in direct premiums and escrow fees for the Company's direct title operations of 2.5% from domestic residential purchase transactions and a 21.4% decrease in direct premiums and escrow fees from domestic refinance transactions in 2018 when compared to 2017.

During 2018, the level of domestic title orders opened per day by the Company's direct title operations decreased 8.5% when compared to 2017. Residential refinance and purchase opened orders per day decreased 25.2% and 1.5%, respectively, while commercial opened orders per day increased 2.8% in 2018 when compared to 2017.

During the fourth quarter of 2018, the level of domestic residential purchase title orders opened per day by the Company's direct title operations decreased 4.5% when compared to the same quarter in 2017. This trend continued in January 2019 as open purchase orders declined 4.0% when compared to January 2018. The Company expects the ongoing decline in the residential purchase market to continue in 2019 but also anticipates rising investment income. Based on current orders and market conditions, the Company also expects its commercial business to continue to perform well. During the fourth quarter of 2018, the Company adjusted its cost structure to position itself for 2019.

The Company adopted new accounting guidance on January 1, 2018, which requires investments in equity securities with readily determinable fair values to be measured at fair value with changes in the fair value recognized through net income. Previously, changes in the fair value where recognized through accumulated other comprehensive loss on the consolidated balance sheets. Beginning in the first quarter of 2018, the Company records changes in the fair values of its equity securities as a component of net realized investment gains (losses) on the consolidated statements of income. See Note 1 Basis of Presentation and Significant Accounting Policies to the consolidated financial statements for further discussion of the new guidance.

During 2018, the Company completed acquisitions for an aggregate purchase price of $82.9 million, which are included in the Company's title insurance and services segment. These acquisitions enable the Company to offer its customers new ways to reduce risk and increase efficiency.

The Company is increasingly utilizing decision science, artificial intelligence and other innovative technologies, processes and techniques to speed the delivery of its products, increase efficiency and otherwise improve the customer experience. These efforts include streamlining the closing process by converting certain manual processes into digital ones, which improves the customer experience by simplifying and reducing the time it takes to close a transaction, reducing the risk of fraud and improving communication. These efforts also include the automation of many of the tasks required to build and update title plants and to search and examine title records, among others. While many of these initiatives are also designed to decrease risk, they present risks of their own. The degree to which these innovative efforts will be successful, and their ultimate impact on the Company's results of operations, is not currently known.

In addition to the Company's innovative activities, other participants in the real estate and mortgage industries are seeking to innovate in ways that could impact the Company's businesses. These participants include certain of the Company's sources of business, competitors and ultimate customers. Innovations of these participants may change the demand for the Company's products and services, the manner in which the Company's products and services are ordered or fulfilled and the revenue or profitability derived from the products and services. The Company's efforts to anticipate and participate in these transformations could require significant additional investment and may not succeed, resulting in a reduction in market share or profitability. The ultimate degree to which these and other innovations in the real estate industry will impact the Company's business and results of operations is not currently known.

On December 22, 2017, comprehensive tax reform legislation known as the Tax Cuts and Jobs Act (the "Tax Reform Act") was signed into law. The Tax Reform Act amended the Internal Revenue Code to reduce U.S. tax rates and modify policies, credits and deductions for individuals and businesses. The changes resulting from the Tax Reform Act had an overall favorable impact on the Company's effective tax rate, and the Company expects the Tax Reform Act will continue to have an overall favorable impact on its effective tax rate in the future.

Additionally, the Company continues to monitor developments in its regulatory environment. Currently, federal officials are discussing various potential changes to laws and regulations that could impact the Company's businesses, including the reform of government-sponsored enterprises such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) and data privacy regulations, among others. In addition, the Tax Reform Act included changes that could affect the real estate and mortgage markets, including changes to the mortgage interest deduction, the increase in the standard deduction (which limits the benefit of itemizing and deducting mortgage interest separately) and the limitation of state and local tax deductions, among others. The full extent of the impact of the Tax Reform Act on volumes of real estate transactions and mortgage originations is not currently known. Other changes in these areas, and more generally in the regulatory environment in which the Company and its customers operate, could similarly impact the volume of mortgage originations in the United States and the Company's competitive position and results of operations.

Title Insurance and Services

	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
				$ Change	% Change	$ Change	% Change
	(in thousands, except percentages)						
Revenues							
Direct premiums and escrow fees	$2,052,951	$2,022,384	$2,004,686	$30,567	1.5	$17,698	0.9
Agent premiums	2,284,906	2,360,659	2,286,630	(75,753)	(3.2)	74,029	3.2
Information and other	770,725	766,018	713,137	4,707	0.6	52,881	7.4
Net investment income	223,318	137,439	110,757	85,879	62.5	26,682	24.1
Net realized investment (losses) gains	(49,119)	6,656	18,915	(55,775)	NM 1	(12,259)	(64.8)
	5,282,781	5,293,156	5,134,125	(10,375)	(0.2)	159,031	3.1
Expenses							
Personnel costs	1,671,846	1,636,429	1,578,130	35,417	2.2	58,299	3.7
Premiums retained by agents	1,799,836	1,863,356	1,801,571	(63,520)	(3.4)	61,785	3.4
Other operating expenses	793,364	788,074	764,502	5,290	0.7	23,572	3.1
Provision for policy losses and other claims	173,520	175,322	235,661	(1,802)	(1.0)	(60,339)	(25.6)
Depreciation and amortization	119,053	121,540	93,069	(2,487)	(2.0)	28,471	30.6
Premium taxes	62,646	62,545	59,464	101	0.2	3,081	5.2
Interest	7,513	3,526	2,856	3,987	113.1	670	23.5
	4,627,778	4,650,792	4,535,253	(23,014)	(0.5)	115,539	2.5
Income before income taxes	$655,003	$642,364	$598,872	$12,639	2.0	$43,492	7.3
Margins	12.4 %	12.1 %	11.7 %	0.3 %	2.5	0.4 %	3.4

(1) Not meaningful

Direct premiums and escrow fees increased $30.6 million, or 1.5%, in 2018 from 2017 and $17.7 million, or 0.9%, in 2017 from 2016. The increases in direct premiums and escrow fees in 2018 from 2017 and in 2017 from 2016 were primarily due to an increase in domestic average revenues per order closed, partially offset by a decrease in the domestic title orders closed by the Company’s direct title operations. The domestic average revenues per order closed were $2,600, $2,264 and $1,931 for 2018, 2017 and 2016, respectively. The 14.8% increase in average revenues per order closed in 2018 from 2017 and the 17.2% increase in average revenues per order closed in 2017 from 2016 were primarily due to a shift in the mix of direct revenues generated from lower premium residential refinance products to higher premium commercial products, higher average revenues per order from commercial transactions, higher residential real estate values, and premium and fee increases related to residential purchase transactions. The Company’s direct title operations closed 730,800, 823,700 and 958,400 domestic title orders during 2018, 2017 and 2016, respectively. The 11.3% decrease in orders closed in 2018 from 2017 and the 14.1% decrease in orders closed in 2017 from 2016 were generally consistent with the changes in residential mortgage origination activity in the United States as reported in the MBA Forecast.

Agent premiums decreased $75.8 million, or 3.2%, in 2018 from 2017 and increased $74.0 million, or 3.2%, in 2017 from 2016. Agent premiums are recorded when notice of issuance is received from the agent, which is generally when cash payment is received by the Company. As a result, there is generally a delay between the agent's issuance of a title policy and the Company's recognition of agent premiums. Therefore, full year agent premiums typically reflect mortgage origination activity from the fourth quarter of the prior year through the third quarter of the current year. The decrease in agent premiums in 2018 from 2017 was generally consistent with the 1.0% increase in the Company's direct premiums and escrow fees in the twelve months ended September 30, 2018 as compared with the twelve months ended September 30, 2017. The increase in agent premiums in 2017 from 2016 was generally consistent with the 3.0% increase in the Company's direct premiums and escrow fees in the twelve months ended September 30, 2017 as compared with the twelve months ended September 30, 2016.

Information and other revenues primarily consist of revenues generated from fees associated with title search and related reports, title and other real property records and images, other non-insured settlement services, and risk mitigation products and services. These revenues generally trend with direct premiums and escrow fees but are typically less volatile since a portion of the revenues are subscription based and do not fluctuate with transaction volumes.

Information and other revenues increased $4.7 million, or 0.6%, in 2018 from 2017 and $52.9 million, or 7.4%, in 2017 from 2016. The increases were driven by recent acquisitions. Excluding the $42.2 million impact of new acquisitions for the year ended December 31, 2018, information and other revenues decreased $37.5 million, or 4.9%, in 2018 compared to 2017. The decrease in 2018 from 2017, adjusted for the impact of new acquisitions, was primarily due to lower demand for the Company's valuation services, fulfillment services, and automated products driven by a decrease in mortgage origination volumes and, to a lesser extent, lower demand for the Company's default information products driven by a decrease in loss mitigation activities. Excluding the $77.4 million impact of new acquisitions for the year ended December 31, 2017, information and other revenues decreased $24.5 million, or 3.4%, in 2017 compared to 2016. The decrease in 2017 from 2016, adjusted for the impact of new acquisitions, was due to lower demand for the Company's default information products driven by a decrease in loss mitigation activities and lower demand for the Company's valuation services, fulfillment services, and automated products driven by a decrease in mortgage origination volumes, partially offset by higher fees earned on non-insured products related to commercial transactions.

Net investment income increased $85.9 million, or 62.5%, in 2018 from 2017 and $26.7 million, or 24.1%, in 2017 from 2016. The increase in 2018 from 2017 was mainly attributable to higher average balances due primarily to strength in our commercial business and rising short-term interest rates, which drove higher income from the Company's cash and investment portfolio, tax-deferred property exchange business and escrow balances. The increase in 2017 from 2016 was primarily attributable to the increase in short-term interest rates which drove higher income from the Company's cash and investment portfolio, tax-deferred property exchange business and escrow balances.

Net realized investment losses were $49.1 million for 2018 and were primarily from a decrease in the fair values of equity securities of $32.6 million and losses from the sales of debt securities. Net realized investment gains totaled $6.7 million for 2017 and were primarily from the sales of debt and equity securities, partially offset by a $6.6 million loss recognized when the Company purchased the remaining equity ownership in an investment in an affiliate during the third quarter of 2017. Net realized investment gains were $18.9 million for 2016 and were primarily from the sales of debt and equity securities. Net realized investment gains for 2018, 2017 and 2016 included $1.1 million, $0.8 million and $3.3 million, respectively, of gains from the sale of real estate. In addition, net realized investment gains for 2018, 2017 and 2016 included impairment losses of $1.1 million, $3.0 million and $5.2 million, respectively. The impairment losses in 2018, 2017 and 2016 were primarily related to the retirement of a trade name, title plants and internally developed software, respectively.

The title insurance and services segment (primarily direct operations) is labor intensive; accordingly, a major expense component is personnel costs. This expense component is affected by two primary factors: the need to monitor personnel changes to match the level of corresponding or anticipated new orders and the need to provide quality service.

Personnel costs increased $35.4 million, or 2.2%, in 2018 from 2017 and $58.3 million, or 3.7%, in 2017 from 2016. The increases were largely driven by recent acquisitions. Excluding the $28.3 million impact of new acquisitions for the year ended December 31, 2018, personnel costs increased $7.1 million, or 0.4%, in 2018 compared to 2017. The slight increase in 2018 from 2017, adjusted for the impact of new acquisitions, was primarily attributable to higher employee benefit, salary, severance and stock-based compensation expenses, partially offset by lower incentive compensation, overtime and temporary labor expenses. The increase in employee benefit costs was due to a higher 401(k) savings plan match. The higher salary expense was due to one additional payroll day and higher average headcount in our international operations. Excluding the $57.5 million impact of new acquisitions for the year ended December 31, 2017, personnel costs increased $0.8 million, or were essentially flat, in 2017 compared to 2016. The minor increase in 2017 from 2016, adjusted for the impact of new acquisitions, was primarily attributable to higher salary, incentive compensation and employee retention costs, mostly offset by lower temporary labor costs and overtime expense. The higher salary cost was due to an increase in average salaries, partially offset by lower average headcount. The increase in incentive compensation expense was due to higher profitability. Personnel costs included severance expense of $15.2 million, $10.1 million and $8.3 million for 2018, 2017 and 2016, respectively.

The Company continues to closely monitor order volumes and related staffing levels and intends to adjust staffing levels as considered necessary. The Company's direct title operations opened 981,800, 1,069,000 and 1,281,400 domestic title orders in 2018, 2017 and 2016, respectively, representing decreases of 8.2% in 2018 from 2017 and 16.6% in 2017 from 2016.

A summary of premiums retained by agents and agent premiums is as follows:

	2018	2017	2016
	(in thousands, except percentages)		
Premiums retained by agents	$1,799,836	$1,863,356	$1,801,571
Agent premiums	$2,284,906	$2,360,659	$2,286,630
% retained by agents	78.8 %	78.9 %	78.8 %

The premium split between underwriter and agents is in accordance with the respective agency contracts and can vary from region to region due to divergences in real estate closing practices and state regulations. As a result, the percentage of title premiums retained by agents can vary due to the geographic mix of revenues from agency operations. The changes in the percentage of title premiums retained by agents in 2018 from 2017 and in 2017 from 2016 were primarily due to changes in the geographic mix of agency revenues.

Other operating expenses (principally related to direct operations) increased $5.3 million, or 0.7%, in 2018 from 2017 and $23.6 million, or 3.1%, in 2017 from 2016. The increases were driven by recent acquisitions. Excluding the $19.6 million impact of new acquisitions for the year ended December 31, 2018, other operating expenses decreased $14.3 million, or 1.8%, in 2018 compared to 2017. The decrease in 2018 from 2017, adjusted for the impact of new acquisitions, was primarily attributable to a reduction in discretionary spending, an increase in earnings credits and small decreases across several expense categories, partially offset by higher software expense and foreign currency exchange losses. The decrease was also related to the $8.5 million out-of-period adjustment recorded in 2017, which is further discussed below. Excluding the $32.4 million impact of new acquisitions for the year ended December 31, 2017, other operating expenses decreased $8.8 million, or 1.2%, in 2017 compared to 2016. The decrease in 2017 from 2016, adjusted for the impact of new acquisitions, was primarily attributable to lower production related costs driven by lower order volumes, higher foreign currency exchange gains, and declines in furniture and equipment costs, software related costs and litigation related costs. The decreases were partially offset by increased occupancy expense and the first quarter of 2016 benefitting from the recovery of an insurance claim. In addition, other operating expenses increased by $8.5 million due to an out-of-period adjustment recorded to write-off certain uncollectible balances related to fees that should have been previously written off. To correct for this error, the Company recorded the $8.5 million adjustment in the fourth quarter of 2017. For further discussion of the out-of-period adjustments see Note 1 Basis of Presentation and Significant Accounting Policies to the consolidated financial statements.

The provision for policy losses and other claims, expressed as a percentage of title insurance premiums and escrow fees, was 4.0% for the years ended December 31, 2018 and 2017 and 5.5% for the year ended December 31, 2016.

The current year 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.

As of December 31, 2018, the IBNR claims reserve for the title insurance and services segment was $877.1 million, which reflected management’s best estimate. The Company’s internal actuary determined a range of reasonable estimates of $737.7 million to $925.8 million. The range limits are $139.4 million below and $48.7 million above management’s best estimate, respectively, and represent an estimate of the range of variation among reasonable estimates of the IBNR reserve. Actuarial estimates are sensitive to assumptions used in models, as well as the structures of the models themselves, and to changes in claims payment and incurral patterns, which can vary materially due to economic conditions, among other factors.

The 2017 rate of 4.0% reflected the ultimate loss rate for policy year 2017 and no change in the loss reserve estimates for prior policy years.

The 2016 rate of 5.5% reflected an ultimate loss rate of 4.5% for policy year 2016 and a $42.6 million net increase in loss reserve estimates for prior policy years. The increase in loss reserve estimates for prior policy years was primarily attributable to potential uncertainty with respect to the Company's exposure to large title claims. A large title claim is defined as a title claim with a total ultimate loss in excess of $2.5 million. This uncertainty was due to the following factors, among others: (i) the volatility associated with the timing and severity of large title claims, (ii) the potential of incurring one or more large title claims that significantly exceed estimated ultimate losses indicated by current historical trends, and (iii) the complexity associated with handling large title claims which makes it difficult to estimate the ultimate outcome. While the Company believed its claims reserve attributable to large title claims was reasonable, this uncertainty increased the potential for adverse loss development.

As of December 31, 2018, the projected ultimate loss rates for policy years 2018, 2017 and 2016 were 4.0%, 3.9% and 3.8%, respectively.

Depreciation and amortization expense decreased $2.5 million, or 2.0%, in 2018 from 2017 and increased $28.5 million, or 30.6%, in 2017 from 2016. The decrease in 2018 from 2017 was primarily attributable to 2017 being impacted by $5.3 million of accelerated amortization charges and $4.7 million in out-of-period adjustments, both of which are further discussed below. The decrease in 2018 was partially offset by $7.7 million of amortization expense related to recent acquisitions. The increase in 2017 from 2016 was primarily attributable to higher amortization expense associated with internally developed technology and purchased software licenses, $6.5 million related to recent acquisitions, and $4.7 million in out-of-period adjustments to fully amortize certain title plant imaging assets that were misclassified as title plants assets. The higher amortization expense related to internally developed technology included $5.3 million of accelerated amortization for 2017, resulting from a shortened useful life for a software interface. For further discussion of the out-of-period adjustments see Note 1 Basis of Presentation and Significant Accounting Policies to the consolidated financial statements.

Insurers generally are not subject to state income or franchise taxes. However, in lieu thereof, a premium tax is imposed on certain operating revenues, as defined by statute. Tax rates and bases vary from state to state; accordingly, the total premium tax burden is dependent upon the geographical mix of operating revenues. The Company's noninsurance subsidiaries are subject to state income tax and do not pay premium tax. Accordingly, the Company's total tax burden at the state level for the title insurance and services segment is composed of a combination of premium taxes and state income taxes. Premium taxes as a percentage of title insurance premiums and escrow fees were 1.4% for the years ended December 31, 2018, 2017 and 2016.

Interest expense increased $4.0 million, or 113.1%, in 2018 from 2017 and $670 thousand, or 23.5%, in 2017 from 2016. The increase in 2018 from 2017 was primarily attributable to higher interest paid related to customer deposits at the Company's banking subsidiary, First American Trust, FSB, and secured financings payable. The increase in interest paid on customer deposits is due to an increase in average balances and higher interest rates paid. The secured financings payable relate to a specialized warehouse lender that the Company acquired in 2018.

The profit margins for the title insurance business reflect the high cost of performing the essential services required before insuring title, whereas the corresponding revenues are subject to regulatory and competitive pricing restraints. Due to the relatively high proportion of fixed costs, title insurance profit margins generally improve as closed order volumes increase. Title insurance profit margins are also impacted by the segment's net investment income and net realized investment gains or losses, which may not move in the same direction as closed order volumes. Title insurance profit margins are affected by the composition (residential or commercial) and type (resale, refinancing or new construction) of real estate activity. Title insurance profit margins are also affected by the percentage of title insurance premiums generated by agency operations. Profit margins from direct operations are generally higher than from agency operations due primarily to the large portion of the premium that is retained by the agent. The pre-tax margins were 12.4%, 12.1% and 11.7% for the years ended December 31, 2018, 2017 and 2016, respectively.

Specialty Insurance

	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
				$ Change	% Change	$ Change	% Change
	(in thousands, except percentages)						
Revenues							
Direct premiums	$454,718	$439,470	$411,353	$15,248	3.5	$28,117	6.8
Information and other	11,802	11,259	10,877	543	4.8	382	3.5
Net investment income	10,190	9,713	9,476	477	4.9	237	2.5
Net realized investment (losses) gains	(7,368)	4,578	4,138	(11,946)	(260.9)	440	10.6
	469,342	465,020	435,844	4,322	0.9	29,176	6.7
Expenses							
Personnel costs	75,355	71,604	67,733	3,751	5.2	3,871	5.7
Other operating expenses	74,025	67,813	62,610	6,212	9.2	5,203	8.3
Provision for policy losses and other claims	279,113	275,088	252,940	4,025	1.5	22,148	8.8
Depreciation and amortization	6,721	6,351	5,593	370	5.8	758	13.6
Premium taxes	7,129	7,256	6,894	(127)	(1.8)	362	5.3
	442,343	428,112	395,770	14,231	3.3	32,342	8.2
Income before income taxes	$26,999	$36,908	$40,074	$(9,909)	(26.8)	$(3,166)	(7.9)
Margins	5.8 %	7.9 %	9.2 %	(2.1)%	(26.6)	(1.3)%	(14.1)

Direct premiums increased $15.2 million, or 3.5%, in 2018 from 2017 and $28.1 million, or 6.8%, in 2017 from 2016. The increases were due to higher premiums earned in the home warranty business driven by an increase in the number of home warranty residential service contracts issued and an increase in the average price charged per contract.

Net realized investment losses for the specialty insurance segment were $7.4 million for 2018 and were primarily from a decrease in the fair values of equity securities of $6.1 million and losses from the sales of debt securities. Net realized investment gains totaled $4.6 million and $4.1 million for 2017 and 2016, respectively, and were primarily from the sales of debt and equity securities, and for 2016, included $2.3 million of gains from the sale of real estate.

Personnel costs and other operating expenses increased $10.0 million, or 7.1%, in 2018 from 2017 and $9.1 million, or 7.0%, in 2017 from 2016. The increase in 2018 from 2017 was primarily attributable to higher salary expense due to higher average salaries, higher allocations related to corporate shared services, and higher advertising, sales tax, and employee benefit expenses. The increase in 2017 from 2016 was primarily attributable to higher salary expense due to higher average headcount, higher incentive compensation in the home warranty business on higher revenue and profitability, and higher offshore labor expense related to increased customer support activities associated with increased volume in the home warranty business. The increase was also related to a $3.5 million benefit recorded in 2016 from higher deferred acquisition costs associated with the change in how the Company reports installment fees related to home warranty residential service contracts.

The provision for home warranty claims, expressed as a percentage of home warranty premiums, was 53.8% in 2018, 53.5% in 2017 and 60.7% in 2016. The slight increase in rate in 2018 from 2017 was primarily attributable to an increase in claims severity, mostly offset by a decrease in claims frequency. The increase in claims severity was primarily due to higher claims management costs driven in part by the mix of claims. The decrease in rate in 2017 from 2016 was primarily attributable to a decrease in the frequency and severity of claims and, to a lesser extent, an increase in average revenue per contract. The decrease in the severity of claims was primarily due to more efficient claims management, which was mainly driven by improved rates with contractors and more efficient allocation of claims to contractors. The severity and frequency of home warranty claims also benefited from milder weather conditions in 2017 when compared to 2016.

The provision for property and casualty claims, expressed as a percentage of property and casualty insurance premiums, was 82.3% in 2018, 85.0% in 2017 and 63.3% in 2016. The decrease in rate in 2018 from 2017 was primarily attributable to the occurrence of one event in 2018 compared with two events in 2017 with losses exceeding property and casualty's reinsurance retention limit of $5.0 million for each event. During the fourth quarter of 2018 there was one wildfire in California that exceeded the reinsurance retention limit compared to two separate wildfires during the fourth quarter of 2017 that exceeded the reinsurance retention limit. The increase in rate in 2017 from 2016 was primarily attributable to an increase in the severity and, to a lesser extent, frequency of claims. The increase in claims severity was primarily due to wildfires in California, including the two separate wildfires with losses exceeding the reinsurance retention limit for each event, and rainstorms in the western portion of the United States.

Premium taxes as a percentage of specialty insurance segment premiums were 1.6% in 2018 and were 1.7% in 2017 and 2016.

A large part of the revenues for the specialty insurance businesses are generated by renewals and are not dependent on the level of real estate activity in the year of renewal. With the exception of loss expense, the majority of the expenses for this segment are variable in nature and therefore generally fluctuate consistent with revenue fluctuations. Accordingly, profit margins for this segment (before loss expense) are relatively constant, although as a result of some fixed expenses, profit margins (before loss expense) should nominally improve as premium revenues increase. Specialty insurance profit margins are also impacted by the segment's net investment income and net realized investment gains or losses, which may not move in the same direction as premium revenues. Pre-tax margins were 5.8%, 7.9% and 9.2% for the years ended December 31, 2018, 2017 and 2016, respectively.

Corporate

	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
				$ Change	% Change	$ Change	% Change
	(in thousands, except percentages)						
Revenues							
Net investment (losses) income	$(3,115)	$15,326	$5,946	$(18,441)	(120.3)	$9,380	157.8
	(3,115)	15,326	5,946	(18,441)	(120.3)	9,380	157.8
Expenses							
Personnel costs	1,748	15,506	9,301	(13,758)	(88.7)	6,205	66.7
Other operating expenses	33,879	201,062	128,222	(167,183)	(83.1)	72,840	56.8
Depreciation and amortization	153	162	385	(9)	(5.6)	(223)	(57.9)
Interest	33,569	32,537	29,403	1,032	3.2	3,134	10.7
	69,349	249,267	167,311	(179,918)	(72.2)	81,956	49.0
Loss before income taxes	$(72,464)	$(233,941)	$(161,365)	$161,477	69.0	$(72,576)	(45.0)

Net investment losses totaled $3.1 million in 2018 and net investment income totaled $15.3 million and $5.9 million in 2017 and 2016, respectively. The change in net investment income for all three years was primarily attributable to fluctuations in earnings on investments associated with the Company's deferred compensation plan.

Corporate personnel costs and other operating expenses were $35.6 million, $216.6 million and $137.5 million in 2018, 2017 and 2016, respectively. The change in personnel costs and other operating expenses for all three years was primarily attributable to pension settlement costs that the Company recognized related to the termination of its funded defined benefit pension plans of $152.4 million and $66.3 million in 2017 and 2016, respectively.

Interest expense increased $1.0 million, or 3.2%, in 2018 from 2017 and $3.1 million, or 10.7%, in 2017 from 2016. The increase in 2018 from 2017 was due to an increase in the interest rate on borrowings under the Company's credit facility. Borrowings under the credit facility bear interest at a variable rate, which increased in 2018 when compared to 2017. The increase in 2017 from 2016 was due to the Company borrowing $160.0 million under its credit facility during September 2016.

Eliminations

The Company's inter-segment eliminations were not material for the years ended December 31, 2018, 2017 and 2016.

Income Taxes

Income taxes differ from the amounts computed by applying the federal income tax rates of 21% for 2018 and 35.0% for 2017 and 2016. A reconciliation of these differences is as follows:

	Year ended December 31,					
	2018		2017		2016	
	(in thousands, except percentages)					
Taxes calculated at federal rate	$128,003	21.0%	$155,866	35.0 %	$167,153	35.0%
State taxes, net of federal benefit	9,941	1.6	(872)	(0.2)	3,703	0.8
Change in liability for tax positions	875	0.1	(3,482)	(0.8)	(10,512)	(2.2)
Foreign income taxed at different rates	7,287	1.2	(6,163)	(1.3)	(7,983)	(1.7)
Federal tax credits	—	—	—	—	(12,265)	(2.6)
Tax reform impact	(6,804)	(1.1)	(129,139)	(29.0)	—	—
Unremitted foreign earnings	(146)	—	14,997	3.3	—	—
Other items, net	(5,516)	(0.9)	(7,739)	(1.7)	(5,991)	(1.2)
	$133,640	21.9%	$23,468	5.3 %	$134,105	28.1%

The Company’s effective income tax rates (income tax expense as a percentage of income before income taxes) were 21.9% for 2018, 5.3% for 2017 and 28.1% for 2016. The differences in the effective tax rates year over year are typically 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 rate for 2018 also includes a reduction in the federal tax rate from 35% to 21% as a result of the Tax Reform Act. In addition, the Company’s effective tax rate for 2018 reflects the adjustment made to its initial 2017 estimates for the Tax Reform Act. The Company’s effective tax rate for 2017 reflects the estimated impact of the Tax Reform Act, state tax benefits relating to the termination of the Company’s pension plan, and the release of reserves relating to tax positions taken on prior year tax returns. For further discussion of the impact of the Tax Reform Act on the Company’s consolidated financial statements, see Note 11 Income Taxes to the consolidated financial statements. In addition, the Company’s effective tax rates for 2018 and 2017 reflected 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 Company’s effective tax rate for 2016 reflects the resolution of certain tax authority examinations and tax credits claimed in 2016 and in prior years.

Net Income and Net Income Attributable to the Company

Net income and per share information are summarized as follows:

	Year ended December 31,		
	2018	2017	2016
	(in thousands, except per share amounts)		
Net income attributable to the Company	$ 474,496	$ 423,049	$ 342,993
Net income per share attributable to the Company’s stockholders:			
Basic	$ 4.21	$ 3.79	$ 3.10
Diluted	$ 4.19	$ 3.76	$ 3.09

Weighted-average common shares outstanding:			
Basic	112,613	111,668	110,548
Diluted	113,279	112,435	111,156

See Note 12 Earnings Per Share to the consolidated financial statements for further discussion of earnings per share.

Liquidity and Capital Resources

Cash requirements. The Company generates cash primarily from the sale of its products and services and investment income. The Company's current cash requirements include operating expenses, taxes, payments of principal and interest on its debt, capital expenditures, dividends on its common stock, and may include business acquisitions and repurchases of its common stock. Management forecasts the cash needs of the holding company and its primary subsidiaries and regularly reviews their short-term and long-term projected sources and uses of funds, as well as the asset, liability, investment and cash flow assumptions underlying such forecasts. Based on the Company's ability to generate cash flows from operations, its liquid-asset position and amounts available on its revolving credit facility, management believes that its resources are sufficient to satisfy its anticipated operational cash requirements and obligations for at least the next twelve months.

The substantial majority of the Company's business is dependent upon activity in the real estate and mortgage markets, which are cyclical and seasonal. Periods of increasing interest rates and reduced mortgage financing availability generally have an adverse effect on residential real estate activity and therefore typically decrease the Company's revenues. In contrast, periods of declining interest rates and increased mortgage financing availability generally have a positive effect on residential real estate activity, which typically increases the Company's revenues. Residential purchase activity is typically slower in the winter months with increased volumes in the spring and summer months. Residential refinance activity is typically more volatile than purchase activity and is highly impacted by changes in interest rates. Commercial real estate volumes are less sensitive to changes in interest rates, but fluctuate based on local supply and demand conditions for space and mortgage financing availability.

Cash provided by operating activities totaled $793.2 million, $632.1 million and $489.4 million for the years ended December 31, 2018, 2017 and 2016, respectively, after claim payments, net of recoveries, of $450.8 million, $472.0 million and $463.0 million, respectively. The principal nonoperating uses of cash and cash equivalents for the years ended December 31, 2018, 2017 and 2016 were purchases of debt and equity securities, dividends to common stockholders, capital expenditures and business acquisitions, and for the year ended December 31, 2018, advances and repayments under secured financing agreements. The most significant nonoperating sources of cash and cash equivalents for the years ended December 31, 2018, 2017 and 2016 were proceeds from the sales and maturities of debt and equity securities and increases in the deposit balances at the Company's banking operations, and, for the years ended December 31, 2018 and 2016, borrowings and collections under secured financing agreements and net proceeds from the issuance of notes and contracts payable, respectively. The net effect of all activities on total cash and cash equivalents were increases of $79.9 million and $381.1 million for the years ended December 31, 2018 and 2017, respectively, and a decrease of $21.2 million for the year ended December 31, 2016.

The Company continually assesses its capital allocation strategy, including decisions relating to dividends, stock repurchases, capital expenditures, acquisitions and investments. In August 2018, the Company's board of directors approved an increase in the Company's quarterly cash dividend to 42 cents per common share, representing an 11% increase from the prior level of 38 cents per common share. The dividend increase became effective beginning with the September 2018 dividend. In January 2019, the Company's board of directors approved a first quarter cash dividend of 42 cents per common share. Management expects that the Company will continue to pay quarterly cash dividends at or above the current level. The timing, declaration and payment of future dividends, however, falls within the discretion of the Company's board of directors and will depend upon many factors, including the Company's financial condition and earnings, the capital requirements of the Company's businesses, restrictions imposed by applicable law and any other factors the board of directors deems relevant from time to time.

In March 2014, the Company's board of directors approved an increase in the size of the Company's stock repurchase plan from $150.0 million to $250.0 million, of which $163.6 million remained as of December 31, 2018. Purchases may be made from time to time by the Company in the open market at prevailing market prices or in privately negotiated transactions. During the year ended December 31, 2018, the Company repurchased and retired 425 thousand shares of its common stock for a total purchase price of $18.8 million and, as of December 31, 2018, had repurchased and retired 3.6 million shares of its common stock under the current authorization for a total purchase price of $86.4 million. In January 2019, the Company repurchased and retired 47 thousand shares of its common stock for a total purchase price of $2.1 million.

Holding company. First American Financial Corporation is a holding company that conducts all of its operations through its subsidiaries. The holding company's current cash requirements include payments of principal and interest on its debt, taxes, payments in connection with employee benefit plans, dividends on its common stock and other expenses. The holding company is dependent upon dividends and other payments from its operating subsidiaries to meet its cash requirements. The Company's target is to maintain a cash balance at the holding company equal to at least twelve months of estimated cash requirements. At certain points in time, the actual cash balance at the holding company may vary from this target due to, among other factors, the timing and amount of cash payments made and dividend payments received. Pursuant to insurance and other regulations under which the Company's insurance subsidiaries operate, the amount of dividends, loans and advances available to the holding company is limited, principally for the protection of policyholders. As of December 31, 2018, under such regulations, the maximum amount available to the holding company from its insurance subsidiaries in 2019, without prior approval from applicable regulators, was dividends of $291.2 million and loans and advances of $98.6 million. However, the timing and amount of dividends paid by the Company's insurance subsidiaries to the holding company falls within the discretion of each insurance subsidiary's board of directors and will depend upon many factors, including the level of total statutory capital and surplus required to support minimum financial strength ratings by certain rating agencies. Such restrictions have not had, nor are they expected to have, an impact on the holding company's ability to meet its cash obligations.

The Tax Reform Act amended the Internal Revenue Code to reduce U.S. tax rates and modify policies, credits and deductions for individuals and businesses. The changes resulting from the Tax Reform Act had an overall favorable impact on the Company's effective tax rate, resulting in less cash required for tax payments, and the Company expects the Tax Reform Act will continue to have an overall favorable impact on its effective tax rate and tax payments in future periods. In addition, the Tax Reform Act moves the U.S. to a partial territorial tax system, which as a result, will reduce the tax costs associated with future distributions of earnings from foreign subsidiaries.

As of December 31, 2018, the holding company's sources of liquidity included $327.3 million of cash and cash equivalents and $540.0 million available on the Company's revolving credit facility. Management believes that liquidity at the holding company is sufficient to satisfy anticipated cash requirements and obligations for at least the next twelve months.

Financing. The Company maintains a credit agreement with JPMorgan Chase Bank, N.A. in its capacity as administrative agent and the lenders party thereto. The credit agreement is comprised of a $700.0 million revolving credit facility. Unless terminated earlier, the revolving loan commitments under the credit agreement will terminate and outstanding borrowings will become due and payable on May 14, 2019. The obligations of the Company under the credit agreement are neither secured nor guaranteed. Proceeds under the credit agreement may be used for general corporate purposes. At December 31, 2018, outstanding borrowings under the facility totaled $160.0 million at an interest rate of 4.15%.

The credit agreement includes an expansion option that permits the Company, subject to satisfaction of certain conditions, to increase the revolving commitments and/or add term loan tranches ("Incremental Term Loans") in an aggregate amount not to exceed $150.0 million. Incremental Term Loans, if made, may not mature prior to the revolving commitment termination date, provided that amortization may occur prior to such date.

At the Company's election, borrowings under the credit agreement bear interest at (a) the Alternate Base Rate plus the applicable spread or (b) the Adjusted LIBOR rate plus the applicable spread (in each case as defined in the agreement). The Company may select interest periods of one, two, three or six months or (if agreed to by all lenders) such other number of months for Eurodollar borrowings of loans. The applicable spread varies depending upon the debt rating assigned by Moody's Investor Service, Inc. and/or Standard & Poor's Rating Services. The minimum applicable spread for Alternate Base Rate borrowings is 0.625% and the maximum is 1.00%. The minimum applicable spread for Adjusted LIBOR rate borrowings is 1.625% and the maximum is 2.00%. The rate of interest on Incremental Term Loans will be established at or about the time such loans are made and may differ from the rate of interest on revolving loans.

The credit agreement includes representations and warranties, reporting covenants, affirmative covenants, negative covenants, financial covenants and events of default customary for financings of this type. Upon the occurrence of an event of default the lenders may accelerate the loans. Upon the occurrence of certain insolvency and bankruptcy events of default the loans will automatically accelerate. As of December 31, 2018, the Company was in compliance with the financial covenants under the credit agreement.

The Company anticipates that it will enter into a successor credit agreement prior to the current agreement's termination on May 14, 2019. If necessary, the Company has sufficient liquidity available at its holding company to repay the outstanding balance of $160.0 million without causing significant liquidity issues.

In addition to amounts available under its credit facility, certain subsidiaries of the Company are parties to master repurchase agreements which are used as part of the Company's liquidity management activities and to support its risk management activities. In particular, securities loaned or sold under repurchase agreements may be used as short-term funding sources. During 2018, the Company financed securities for funds received totaling $10.0 million under these agreements. As of December 31, 2018, no amounts remained outstanding under these agreements.

In addition to being a party to master repurchase agreements, the Company's federal savings bank subsidiary, First American Trust, FSB, maintains a secured line of credit with the Federal Home Loan Bank and federal funds lines of credit with certain correspondent institutions. As of December 31, 2018, no amounts remained outstanding under any of these facilities.

The Company's debt to capitalization ratio was 17.8% and 17.4% at December 31, 2018 and 2017, respectively. The increase in 2018 reflects the debt assumed in connection with the Company's 2018 acquisition of a specialized warehouse lender.

Investment portfolio. The Company maintains a high quality, liquid investment portfolio that is primarily held at its insurance and banking subsidiaries. As of December 31, 2018, 94% of the Company's investment portfolio consisted of debt securities, of which 69% were either United States government-backed or rated AAA and 97% were either rated or classified as investment grade. Percentages are based on the estimated fair values of the securities. Credit ratings 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. For further information on the credit quality of the Company's investment portfolio at December 31, 2018, see Note 3 Debt and Equity Securities to the consolidated financial statements.

In addition to its debt and equity securities portfolio, the Company maintains certain money-market and other short-term investments.

Capital expenditures. Capital expenditures are primarily related to software development costs and purchases of property and equipment and software licenses. Capital expenditures totaled $125.5 million, $136.7 million and $132.3 million for 2018, 2017 and 2016, respectively.

Contractual obligations. A summary of the Company's contractual obligations at December 31, 2018, by due date, is as follows:

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(in thousands)				
Notes and contracts payable	$735,038	$165,384	$10,031	$259,507	$300,116
Interest on notes and contracts payable	129,761	27,888	50,604	39,734	11,535
Secured financings payable	76,313	76,313	—	—	—
Operating leases	334,793	76,375	122,879	70,807	64,732
Deposits	3,786,183	3,786,183	—	—	—
Claims losses	1,042,679	273,255	222,635	151,442	395,347
Employee benefit plans	399,886	14,588	31,620	32,741	320,937
	$6,504,653	$4,419,986	$437,769	$554,231	$1,092,667

The timing of payments related to claims losses is estimated and is not set contractually. Nonetheless, based on historical claims experience, the Company anticipates the above payment patterns. Changes in future claims settlement patterns, judicial decisions, legislation, economic conditions and other factors could affect the timing and amount of actual claims payments. The timing and amount of payments in connection with employee benefit plans are based on the Company's current estimates and require the use of significant assumptions. Changes in significant assumptions could affect the amount and timing of employee benefit plan payments. The Company is not able to reasonably estimate the timing of payments, or the amount by which the liability for the Company's uncertain tax positions will increase or decrease over time; therefore the liability of $13.3 million has not been included in the contractual obligations table.

Off-balance sheet arrangements. The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $7.6 billion and $7.5 billion at December 31, 2018 and 2017, respectively, of which $3.6 billion and $2.9 billion, respectively, were held at 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 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 $3.6 billion and $3.7 billion at December 31, 2018 and 2017, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying 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 as income or a reduction in expense, as appropriate, in the consolidated statements of income 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 $2.7 billion and $2.6 billion at December 31, 2018 and 2017, respectively. The like-kind exchange deposits are held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying 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.

Item 7A.Quantitative and Qualitative Disclosures About Market Risk

The Company's assets and liabilities include financial instruments subject to the risk of loss from adverse changes in market rates and prices. The Company's primary market risk exposures relate to interest rate risk, equity price risk, foreign currency risk and credit risk.

The Company manages its primary market risk exposures through an investment committee made up of certain senior executives which is advised by an experienced investment management staff.

While the hypothetical scenarios below are considered to be near-term reasonably possible changes demonstrating potential risk, they are for illustrative purposes only and do not reflect the Company's expectations about future market changes.

Interest Rate Risk

The Company monitors its risk associated with fluctuations in interest rates and makes investment decisions to manage accordingly. The Company does not currently use derivative financial instruments in any material amount to hedge these risks.

The Company's exposure to interest rate changes primarily results from the Company's significant portfolio of debt securities, which includes a high proportion of fixed income securities, and from its financing activities. In general, the fair value of fixed income securities increases or decreases inversely with changes in market interest rates. The Company also considers its investments in preferred stock to be exposed to interest rate risk. The fair values of the Company's debt securities portfolio at December 31, 2018 and 2017 were $5.7 billion and $4.8 billion, respectively. One means of assessing the exposure of the Company's debt securities portfolio to interest rate changes is a duration-based analysis that measures the potential changes in fair value resulting from a hypothetical parallel and instantaneous shift in interest rates across all maturities. Under this model, with all other factors held constant, the Company estimates that increases in interest rates of 100 and 200 basis points could cause the fair value of its debt securities portfolio (including investments in preferred stock) at December 31, 2018 to decrease by approximately $198 million, or 3.5%, and $408 million, or 7.1%, respectively, and at December 31, 2017 to decrease by approximately $172 million, or 3.6%, and $344 million, or 7.2%, respectively.

With respect to adjustable-rate debt, the Company is primarily exposed to the effects of changes in prevailing interest rates through its variable rate credit facility and its interest bearing escrow deposit liabilities. As of December 31, 2018 and 2017, the Company had $160.0 million outstanding under its credit facility. Assuming the full utilization of available funds under the facility of $700.0 million at December 31, 2018 and 2017, and assuming that the borrowings were outstanding for the entire year, increases of 50 and 100 basis points in the prevailing interest rate on the Company's credit facility would result in increases in interest expense of $3.5 million and $7.0 million for 2018 and 2017.

The Company's interest bearing escrow deposit liabilities totaled $2.5 billion and $2.1 billion at December 31, 2018 and 2017, respectively. These variable rate customer savings accounts are subject to market rate fluctuations. The weighted-average interest rate was 0.12% and 0.10% for 2018 and 2017, respectively. Assuming increases in interest rates of 25 and 50 basis points and that the deposit amounts at December 31, 2018 and 2017 are held constant for the entire year, interest expense for 2018 would be higher by $6.2 million and $12.5 million, respectively, and 2017 would be higher by $5.1 million and $10.3 million, respectively.

Equity Price Risk

The Company is also subject to equity price risk related to its equity securities portfolio. The fair value of the Company's equity securities portfolio (excluding preferred stock of $14.2 million and $19.0 million) was $339.4 million and $447.5 million as of December 31, 2018 and 2017, respectively. Assuming broad-based declines in equity market prices of 10% and 20%, with all other factors held constant, the fair value of the Company's equity securities at December 31, 2018 could decrease by $33.9 million and $67.9 million, respectively, and at December 31, 2017 could decrease by $44.8 million and $89.5 million, respectively.

Foreign Currency Risk

Although the Company has exchange rate risk for its operations in certain foreign countries, this risk is not material to the Company’s financial condition or results of operations. The Company does not currently use derivative financial instruments in any material amount to hedge its foreign exchange risk.

Credit Risk

The Company’s debt securities portfolio is subject to credit risk. The Company manages its credit risk through actively monitoring issuer financial reports, credit spreads, security pricing and credit rating migration. Further, diversification and concentration limits by asset type and credit rating are established and monitored by the Company’s investment committee.

The Company holds a large concentration in U.S. government agency securities, including agency mortgage-backed securities. In the event of discontinued U.S. government support of its federal agencies, material credit risk could be observed in the portfolio. The Company views that scenario as unlikely but possible. The federal government currently is considering various alternatives to reform the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The nature and timing of the reforms is unknown, however, the federal government reiterated its commitment to ensuring that Fannie Mae and Freddie Mac have sufficient capital to perform under any guarantees issued now, or in the future, and the ability to meet any of their debt obligations.

The Company’s overall investment securities portfolio maintains an average credit quality of AA. For further information on the credit quality of the Company’s investment portfolio at December 31, 2018, see Note 3 Debt and Equity Securities to the consolidated financial statements.

Item 8. Financial Statements and Supplementary Data
INDEX

Financial statement schedules not listed are either omitted because they are not applicable or the required information is shown in the consolidated financial statements or in the notes thereto.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

First American Financial Corporation

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of First American Financial Corporation and its subsidiaries (the “Company”) as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, equity and cash flows for each of the three years in the period ended December 31, 2018, including the related notes and financial statement schedules listed in the accompanying index (collectively referred to as the “consolidated financial statements”). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018 based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for unrealized gains and losses associated with equity securities and the manner in which it accounts for other components of net periodic pension and postretirement benefit cost in 2018.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

Los Angeles, California

February 20, 2019

We have served as the Company's auditor since 2009.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except par values)

	December 31, 2018	2017
ASSETS		
Cash and cash equivalents	$1,467,129	$1,387,226
Accounts and accrued income receivable, less allowances of $22,841 and $23,066	325,686	311,084
Income taxes receivable	11,007	38,673
Investments:		
Deposits with banks	36,209	41,335
Debt securities, includes pledged securities of $110,975 and $108,427	5,713,811	4,752,684
Equity securities	353,535	466,516
Other investments	121,965	117,768
	6,225,520	5,378,303
Secured financings receivable	76,311	—
Property and equipment, net	457,840	439,569
Title plants and other indexes	577,467	568,452
Deferred income taxes	16,636	22,803
Goodwill	1,144,166	1,113,005
Other intangible assets, net	109,372	99,913
Other assets	219,501	214,194
	$10,630,635	$9,573,222
LIABILITIES AND EQUITY		
Deposits	$3,786,183	$3,070,566
Accounts payable and accrued liabilities:		
Accounts payable	47,079	68,460
Personnel costs	199,711	194,357
Pension costs and other retirement plans	386,264	401,083
Other	145,634	129,257
	778,688	793,157
Deferred revenue	243,280	240,822
Reserve for known and incurred but not reported claims	1,042,679	1,028,933
Income taxes payable	8,988	4,602
Deferred income taxes	217,097	219,307
Secured financings payable	76,313	—
Notes and contracts payable	732,019	732,810
	6,885,247	6,090,197
Commitments and contingencies (Notes 18 and 19)		
Stockholders' equity:		
Preferred stock, $0.00001 par value; Authorized—500 shares; Outstanding—none	—	—

Common stock, $0.00001 par value; Authorized—300,000 shares;		
Outstanding—111,496 shares and 110,925 shares	1	1
Additional paid-in capital	2,258,290	2,236,351
Retained earnings	1,644,165	1,311,112
Accumulated other comprehensive loss	(160,575)	(67,509)
Total stockholders' equity	3,741,881	3,479,955
Noncontrolling interests	3,507	3,070
Total equity	3,745,388	3,483,025
	$10,630,635	$9,573,222

See Notes to Consolidated Financial Statements

51

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

	Year Ended December 31,		
	2018	2017	2016
Revenues:			
Direct premiums and escrow fees	$2,507,669	$2,461,854	$2,416,039
Agent premiums	2,284,906	2,360,659	2,286,630
Information and other	781,467	776,214	723,990
Net investment income	230,289	162,402	126,134
Net realized investment (losses) gains	(56,487)	11,234	23,053
	5,747,844	5,772,363	5,575,846
Expenses:			
Personnel costs	1,748,949	1,723,539	1,655,164
Premiums retained by agents	1,799,836	1,863,356	1,801,571
Other operating expenses	900,208	1,055,886	955,310
Provision for policy losses and other claims	452,633	450,410	488,601
Depreciation and amortization	125,927	128,053	99,047
Premium taxes	69,775	69,801	66,358
Interest	40,978	35,987	32,214
	5,138,306	5,327,032	5,098,265
Income before income taxes	609,538	445,331	477,581
Income taxes	133,640	23,468	134,105
Net income	475,898	421,863	343,476
Less: Net income (loss) attributable to noncontrolling interests	1,402	(1,186)	483
Net income attributable to the Company	$474,496	$423,049	$342,993
Net income per share attributable to the Company's stockholders:			
Basic	$4.21	$3.79	$3.10
Diluted	$4.19	$3.76	$3.09
Cash dividends declared per share	$1.60	$1.44	$1.20
Weighted-average common shares outstanding:			
Basic	112,613	111,668	110,548
Diluted	113,279	112,435	111,156

See Notes to Consolidated Financial Statements

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Year Ended December 31,		
	2018	2017	2016
Net income	$475,898	$421,863	$343,476
Other comprehensive income (loss), net of tax:			
Unrealized (losses) gains on securities	(38,418)	63,563	(10,359)
Foreign currency translation adjustment	(26,796)	24,744	(6,334)
Pension benefit adjustment	12,680	74,597	25,300
Total other comprehensive (loss) income, net of tax	(52,534)	162,904	8,607
Comprehensive income	423,364	584,767	352,083
Less: Comprehensive income (loss) attributable to noncontrolling interests	1,384	(1,173)	487
Comprehensive income attributable to the Company	$421,980	$585,940	$351,596

See Notes to Consolidated Financial Statements

53

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF EQUITY

(in thousands)

	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	$838,149	$(239,003)	$2,749,960	$ 3,163	$2,753,123
Net income for 2016	—	—	—	342,993	—	342,993	483	343,476
Dividends on common shares	—	—	—	(131,541)	—	(131,541)	—	(131,541)
Purchase of Company shares	(14)	—	(454)	—	—	(454)	—	(454)
Shares issued in connection with share-based compensation	860	—	7,298	(2,779)	—	4,519	—	4,519
Share-based compensation	—	—	34,125	—	—	34,125	—	34,125
Net activity related to noncontrolling interests	—	—	(26)	—	—	(26)	2,520	2,494
Other comprehensive income	—	—	—	—	8,603	8,603	4	8,607
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 2017	—	—	—	423,049	—	423,049	(1,186)	421,863
Dividends on common shares	—	—	—	(159,284)	—	(159,284)	—	(159,284)
Shares issued in connection with share-based compensation	981	—	6,226	(3,494)	—	2,732	—	2,732
Share-based compensation	—	—	37,399	—	—	37,399	—	37,399
Net activity related to noncontrolling interests	—	—	970	—	—	970	(1,927)	(957)
Other	—	—	—	4,019	—	4,019	—	4,019

Other comprehensive income	—	—	—	—	162,891	162,891	13	162,904
Balance at December 31, 2017	110,925	1	2,236,351	1,311,112	(67,509)	3,479,955	3,070	3,483,025
Cumulative effect adjustment (Note 1)	—	—	—	40,550	(40,550)	—	—	—
Net income for 2018	—	—	—	474,496	—	474,496	1,402	475,898
Dividends on common shares	—	—	—	(178,487)	—	(178,487)	—	(178,487)
Purchase of Company shares	(425)	—	(18,801)	—	—	(18,801)	—	(18,801)
Shares issued in connection with share-based compensation	996	—	(599)	(3,506)	—	(4,105)	—	(4,105)
Share-based compensation	—	—	41,145	—	—	41,145	—	41,145
Net activity related to noncontrolling interests	—	—	194	—	—	194	(947)	(753)
Other comprehensive loss	—	—	—	—	(52,516)	(52,516)	(18)	(52,534)
Balance at December 31, 2018	111,496	$ 1	$2,258,290	$1,644,165	$(160,575)	$3,741,881	$ 3,507	$3,745,388

See Notes to Consolidated Financial Statements

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$475,898	$421,863	$343,476
Adjustments to reconcile net income to cash provided by operating activities:			
Provision for policy losses and other claims	452,633	450,410	488,601
Depreciation and amortization	125,927	128,053	99,047
Amortization of premiums and accretion of discounts on debt securities, net	26,994	31,211	28,325
Excess tax benefits from share-based compensation	—	—	(3,415)
Net realized investment losses (gains)	56,487	(11,234)	(23,053)
Share-based compensation	41,145	37,399	34,125
Equity in earnings of affiliates, net	(2,717)	(3,785)	(8,173)
Dividends from equity method investments	4,909	11,083	10,023
Changes in assets and liabilities excluding effects of acquisitions and noncash transactions:			
Claims paid, including assets acquired, net of recoveries	(450,756)	(472,047)	(462,999)
Net change in income tax accounts	42,079	(102,819)	17,601
Decrease (increase) in accounts and accrued income receivable	5,264	12,426	(10,017)
Increase (decrease) in accounts payable and accrued liabilities	15,303	127,683	(29,339)
Increase in deferred revenue	2,741	10,238	21,534
Other, net	(2,742)	(8,347)	(16,320)
Cash provided by operating activities	793,165	632,134	489,416
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net cash effect of acquisitions/dispositions	(79,171)	(82,993)	(106,719)
Net decrease (increase) in deposits with banks	3,361	(18,319)	712
Purchases of debt and equity securities	(3,157,893)	(1,970,597)	(2,062,743)
Proceeds from sales of debt and equity securities	1,501,402	1,163,765	731,146
Proceeds from maturities of debt securities	640,558	641,442	948,257
Net change in other investments	(6,792)	3,763	2,244
Advances under secured financing agreements	(2,380,878)	—	—
Collections of secured financings receivable	2,374,329	—	—
Capital expenditures	(118,170)	(134,206)	(132,265)
Proceeds from sales of property and equipment	2,630	9,977	9,220
Cash used for investing activities	(1,220,624)	(387,168)	(610,148)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in deposits	715,617	291,088	80,463
Borrowings under secured financing agreements	2,380,976	—	—
Repayments of secured financings payable	(2,374,426)	—	—

Net proceeds from issuance of notes and contracts payable	—	—	160,000
Repayment of notes and contracts payable	(5,294)	(5,543)	(5,171)
Net activity related to noncontrolling interests	(745)	(969)	(1,029)
Excess tax benefits from share-based compensation	—	—	3,415
Net (payments) proceeds in connection with share-based compensation	(4,105)	2,732	1,104
Purchase of Company shares	(18,801)	—	(454)
Payments of cash dividends	(178,487)	(159,284)	(131,541)
Cash provided by financing activities	514,735	128,024	106,787
Effect of exchange rate changes on cash	(7,373)	8,098	(7,238)
Net increase (decrease) in cash and cash equivalents	79,903	381,088	(21,183)
Cash and cash equivalents—Beginning of year	1,387,226	1,006,138	1,027,321
Cash and cash equivalents—End of year	$1,467,129	$1,387,226	$1,006,138
SUPPLEMENTAL INFORMATION:			
Cash paid during the year for:			
Interest	$39,183	$33,680	$30,125
Premium taxes	$68,526	$66,785	$65,506
Income taxes, less refunds of $7,255, $52,153 and $4,055	$91,745	$126,208	$116,309

See Notes to Consolidated Financial Statements

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Basis of Presentation and Significant Accounting Policies:

First American Financial Corporation (the "Company"), through its subsidiaries, is engaged in the business of providing financial services. The Company consists of the following reportable segments and a corporate function:

- The Company's title insurance and services segment issues title insurance policies on residential and commercial property in the United States and offers similar or related products and services internationally. This segment also provides closing and/or escrow services; accommodates tax-deferred exchanges of real estate; provides products, services and solutions designed to mitigate risk or otherwise facilitate real estate transactions, many of which products, services and solutions involve the use of real property-related data; maintains, manages and provides access to title plant records and images; and provides appraisals and other valuation-related products and services, lien release and document custodial services, warehouse lending services, default-related products and services, evidence of title, and banking, trust and wealth management services. The Company, through its principal title insurance subsidiary and such subsidiary's affiliates, transacts its title insurance business through a network of direct operations and agents. Through this network, the Company issues policies in the 49 states that permit the issuance of title insurance policies, the District of Columbia and certain United States territories. The Company also offers title insurance, closing services and similar or related products and services, either directly or through third parties in other countries, including Canada, the United Kingdom, Australia, South Korea and various other established and emerging markets.
- The Company's specialty insurance segment issues property and casualty insurance policies and sells home warranty products. The property and casualty insurance business provides insurance coverage to residential homeowners and renters for liability losses and typical hazards such as fire, theft, vandalism and other types of property damage. This business is licensed to issue policies in all 50 states and the District of Columbia and actively issues policies in 47 states. The majority of policy liability is in the western United States, including approximately 62% in California. In certain markets it also offers preferred risk auto insurance to better compete with other carriers offering bundled home and auto insurance. The home warranty business provides residential service contracts that cover residential systems, such as heating and air conditioning systems, and certain appliances against failures that occur as the result of normal usage during the coverage period. This business currently operates in 36 states and the District of Columbia.

The corporate function consists primarily of certain financing facilities as well as the corporate services that support the Company's business operations.

Principles of Consolidation

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") and reflect the consolidated operations of the Company. The consolidated financial statements include the accounts of First American Financial Corporation and all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated. Equity investments in which the Company exercises significant influence, but does not control and is not the primary beneficiary, are accounted for using the equity method. Equity investments in which the Company does not exercise significant influence over the investee and without readily determinable fair values, are accounted for at cost, less impairment and are adjusted for any observable price changes.

Out-of-period adjustments

During 2017, the Company identified certain uncollectible balances related to fees within its title insurance and services segment, which primarily related to reporting periods prior to 2016, that should have been previously written off. To correct for this error, the Company recorded an adjustment in 2017, which increased other operating expenses and increased accounts payable and accrued liabilities by $8.5 million.

Also, during 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 in 2017 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.

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

Use of estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the statements. Actual results could differ from the estimates and assumptions used.

Cash equivalents

The Company considers cash equivalents to be all short-term investments that have an initial maturity of 90 days or less and are not restricted for statutory deposit or premium reserve requirements.

Accounts and accrued income receivable

Accounts and accrued income receivable are generally due within thirty days and are recorded net of an allowance for doubtful accounts. The Company considers accounts outstanding longer than the contractual payment terms as past due. The Company determines the allowance by considering a number of factors, including the length of time trade accounts receivable are past due, previous loss history, a specific customer’s ability to pay its obligations to the Company and the condition of the general economy and industry as a whole. Amounts are charged off in the period in which they are deemed to be uncollectible.

Investments

Deposits with banks

Deposits with banks are short-term investments with initial maturities of generally more than 90 days.

Debt securities

Debt securities are carried at fair value and consist primarily of investments in obligations of the United States Treasury, foreign governments, various U.S. and foreign corporations, certain state and political subdivisions and mortgage-backed securities. The Company classifies its publicly traded debt securities as available-for-sale with unrealized gains or losses recorded as a component of accumulated other comprehensive loss.

The Company maintains investments in debt securities in accordance with certain statutory requirements for the funding of statutory premium reserves and state deposits. At December 31, 2018 and 2017, the fair values of such investments totaled $111.0 million and $108.4 million, respectively. See Note 2 Statutory Restrictions on Investments and Stockholders' Equity for additional discussion of the Company's statutory restrictions.

Interest income, as well as the related amortization of premium and accretion of discount, on debt securities are recognized under the effective yield method and are included in the accompanying consolidated statements of income in net investment income. Realized gains and losses on sales of debt securities are determined on a first-in, first-out basis.

The Company evaluates its debt securities with unrealized losses on a quarterly basis for potential other-than-temporary impairments in value.

If the Company intends to sell a debt security in an unrealized loss position or determines that it is more likely than not that the Company will be required to sell a debt security before it recovers its amortized cost basis, the debt security is other-than-temporarily impaired and it is written down to fair value with all losses recognized in earnings. As of December 31, 2018, the Company did not intend to sell any debt securities in an unrealized loss position and it is not more likely than not that the Company will be required to sell any debt securities before recovery of their amortized cost basis.

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

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

As a result of its security-level review, the Company did not recognize any other-than-temporary impairment losses considered to be credit related for the years ended December 31, 2018 and 2017 and recognized $0.5 million of other-than-temporary impairment losses considered to be credit related for the year ended December 31, 2016. It is possible that the Company could recognize additional other-than-temporary impairment losses on securities it owns at December 31, 2018 if future events or information cause it to determine that a decline in fair value is other-than-temporary.

Equity securities

Equity securities are carried at fair value and consist primarily of investments in exchange traded funds, mutual funds and marketable common and preferred stocks of corporate entities.

The Company adopted new accounting guidance on January 1, 2018, which requires investments in equity securities with readily determinable fair values to be measured at fair value with changes in fair value recognized through net income. See Recently Adopted Accounting Pronouncements within this note for further discussion of the new guidance.

Other investments

Other investments consist primarily of equity investments in which the Company exercises significant influence, but does not control and is not the primary beneficiary; equity investments in which the Company does not exercise significant influence over the investee and without readily determinable fair values; investments in real estate; and notes receivable.

Equity investments in which the Company exercises significant influence, but does not control and is not the primary beneficiary, are accounted for under the equity method of accounting. These investments are initially measured at cost and are generally adjusted by the Company's share of equity in the income or losses of the investee. The carrying value of these investments is written down, or impaired, to fair value when a decline in value is considered to be other-than-temporary. In making the determination as to whether an individual investment is impaired, the Company assesses the current and expected financial condition of each relevant entity, including, but not limited to, the anticipated ability of the entity to make its contractually required payments to the Company (with respect to debt obligations to the Company), the results of valuation work performed with respect to the entity, the entity's anticipated ability to generate sufficient cash flows and the market conditions in the industry in which the entity is operating.

Equity investments in which the Company does not exercise significant influence over the investee and without readily determinable fair values are measured at cost, less impairment and are adjusted for any observable price changes.

Investments in real estate are classified as held for sale and carried at the lower of cost or fair value, less estimated selling costs.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Notes receivable are carried at cost, less reserves for losses. Loss reserves are established for notes receivable based upon an estimate of probable losses for the individual notes. A loss reserve is established on an individual note when it is deemed probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the note. The loss reserve is based upon the Company's assessment of the borrower's overall financial condition, resources and payment record; and, if appropriate, the realizable value of any collateral. These estimates consider all available evidence including the expected future cash flows, estimated fair value of collateral on secured notes, general economic conditions and trends, and other relevant factors, as appropriate. Notes are placed on non-accrual status when management determines that the collectibility of contractual amounts is not reasonably assured.

Secured financings receivable and payable

Secured financings receivable, which reflect financing transactions with correspondent mortgage lenders involved in residential real estate lending, are collateralized by mortgages on residential real estate. Collections of the receivable balance occur upon sale of the underlying mortgage loan to investors, generally within 30 days and more typically in less than 10 days. Secured financings receivable is stated at the principal balance outstanding and no allowance for doubtful accounts is maintained as the receivable balance is generally considered fully collectible. Interest income is recorded on an accrual basis during the period the principal balance remains outstanding.

Secured financings payable reflect borrowings under secured warehouse lending facilities with several banking institutions. Repayment of the warehouse borrowing occurs upon sale of the mortgage loan to investors as noted above. Interest expense is recorded during the period the borrowing remains outstanding.

See Note 20 Business Combinations for further information about the Company's 2018 acquisition of a specialized warehouse lender.

Property and equipment

Buildings and furniture and equipment are initially recorded at cost and are generally depreciated using the straight-line method over estimated useful lives ranging from 5 to 40 years and from 1 to 15 years, respectively. Leasehold improvements are initially recorded at cost and are amortized over the lesser of the remaining term of the respective lease or the estimated useful life, using the straight-line method. Computer software, which is acquired or developed for internal use and for use with the Company's products, is amortized over estimated useful lives ranging from 1 to 15 years using the straight-line method. Software development costs, which include certain payroll-related costs of employees directly associated with developing software in addition to incremental payments to third parties, are capitalized from the time technological feasibility is established until the software is ready for use.

Management uses estimated future cash flows (undiscounted and excluding interest) to measure the recoverability of property and equipment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. If the undiscounted cash flow analysis indicates that the carrying amount is not recoverable, an impairment loss is recorded for the excess of the carrying amount over its fair value. Impairment losses on property and equipment, which primarily related to impairments of internally developed software, were $41 thousand, $0.5 million and $5.2 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Title plants and other indexes

Title plants and other indexes included title plants of $530.4 million and $526.2 million and capitalized real estate data of $47.1 million and $42.3 million at December 31, 2018 and 2017, respectively. Title plants are carried at cost, with the costs of daily maintenance (updating) charged to expense as incurred. Because properly maintained title plants have indefinite lives and do not diminish in value with the passage of time, no provision has been made for depreciation or amortization. The Company analyzes its title plants at least annually for impairment. This analysis includes, but is not limited to, the effects of obsolescence, duplication, demand and other economic factors. Capitalized real estate data is initially recorded at cost and is amortized using the straight-line method over estimated useful lives ranging from 5 to 15 years.

Business Combinations

Amounts paid for acquisitions are allocated to the tangible and intangible assets acquired and liabilities assumed, and are based on their estimated fair values at the date of acquisition. The excess of the fair value of purchase consideration over the fair values of the identifiable assets and liabilities is recorded as goodwill. Acquisition-related costs are expensed in the periods in which the costs are incurred. The results of operations of acquired businesses are included in the consolidated financial statements from the date of acquisition.

Goodwill Impairment

The Company is required to perform an annual goodwill impairment assessment for each reporting unit for which goodwill has been allocated. Those reporting units include title insurance, home warranty and property and casualty insurance. The Company's trust and other services reporting unit has no allocated goodwill and is, therefore, not assessed for impairment. The Company has elected to perform this annual assessment in the fourth quarter of each fiscal year or sooner if circumstances indicate possible impairment. Based on accounting guidance, the Company has the option to perform a qualitative assessment to determine if the fair value is more likely than not (i.e., a likelihood of greater than 50%) less than the carrying amount as a basis for determining whether it is necessary to perform a quantitative impairment test, or may choose to forego a qualitative assessment and perform a quantitative impairment test. The qualitative factors considered in this assessment may include macroeconomic conditions, industry and market considerations, overall financial performance as well as other relevant events and circumstances as determined by the Company. The Company evaluates the weight of each factor to determine whether it is more likely than not that impairment may exist. If the results of the qualitative assessment indicate the more likely than not threshold was not met, the Company may choose not to perform the quantitative impairment test. If, however, the more likely than not threshold is met, the Company will perform a quantitative test as required and discussed below.

Management's quantitative impairment testing process includes two steps. The first step ("Step 1") compares the fair value of each reporting unit to its carrying amount. The fair value of each reporting unit is determined by using discounted cash flow analysis and market approach valuations. If the fair value of the reporting unit exceeds its carrying amount, the goodwill is not considered impaired and no additional analysis is required. However, if the carrying amount is greater than the fair value, a second step ("Step 2") must be completed to determine if the fair value of the goodwill exceeds the carrying amount of goodwill.

Step 2 involves calculating an implied fair value of goodwill for each reporting unit for which Step 1 indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in Step 1, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment loss is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted.

The quantitative impairment test for goodwill utilizes a variety of valuation techniques, all of which require the Company to make estimates and judgments. Fair value is determined by employing an expected present value technique, which utilizes expected cash flows and an appropriate discount rate. The use of comparative market multiples (the “market approach”) compares the reporting unit to other comparable companies (if such comparables are present in the marketplace) based on valuation multiples to arrive at a fair value. In assessing the fair value, the Company utilizes the results of the valuations (including the market approach to the extent comparables are available) and considers the range of fair values determined under all methods and the extent to which the fair value exceeds the carrying amount of the reporting unit.

The valuation of each reporting unit includes the use of assumptions and estimates of many critical factors, including revenue growth rates and operating margins, discount rates and future market conditions, determination of market multiples and the establishment of a control premium, among others. Forecasts of future operations are based, in part, on operating results and the Company's expectations as to future market conditions. These types of analyses contain uncertainties because they require the Company to make assumptions and to apply judgments to estimate industry economic factors and the profitability of future business strategies. However, if actual results are not consistent with the Company's estimates and assumptions, the Company may be exposed to future impairment losses that could be material.

For 2018 and 2017, the Company chose to perform qualitative assessments for its title insurance and home warranty reporting units and performed a quantitative impairment test for its property and casualty insurance reporting unit. Based on the results of its quantitative impairment tests for 2018 and 2017, the Company determined that the fair value of its property and casualty insurance reporting unit exceeded the carrying amount and, therefore, no additional analysis was required. The results of the Company's qualitative assessments for its title insurance and home warranty reporting units for 2018 and 2017 supported the conclusion that their fair values were not more likely than not less than their carrying amounts and, therefore, a quantitative impairment test was not considered necessary. For 2016, the Company chose to perform a quantitative impairment test for all three reporting units and, based on the results, determined that the fair values of its reporting units exceeded their carrying amounts and, therefore, no additional analysis was required. As a result of the Company's annual goodwill impairment assessments, the Company did not record any goodwill impairment losses for 2018, 2017 or 2016.

Other intangible assets

The Company's finite-lived intangible assets consist of customer relationships, noncompete agreements, trademarks, internal-use software licenses and patents. These assets are amortized on a straight-line basis over their useful lives ranging from 1 to 20 years and are subject to impairment assessments when there is an indication of a triggering event or abandonment. The Company's indefinite-lived other intangible assets consist of licenses which are not amortized but rather assessed for impairment by comparing the fair values to carrying amounts at least annually, and when an indicator of potential impairment has occurred.

Management uses estimated future cash flows (undiscounted and excluding interest) to measure the recoverability of intangible assets with finite lives, whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable. If the undiscounted cash flow analysis indicates that the carrying amount is not recoverable, an impairment loss is recorded for the excess of the carrying amount over its fair value. Management's impairment assessment for indefinite-lived other intangible assets may involve calculating the fair value by using a discounted cash flow analysis or through a market approach valuation. If the fair value exceeds its carrying amount, the asset is not considered impaired and no additional analysis is required. However, if the carrying amount is greater than the fair value, an impairment loss is recorded equal to the excess.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Reserve for known and incurred but not reported claims

The Company provides for title insurance losses through a charge to expense when the related premium revenue is recognized. The amount charged to expense is generally determined by applying a rate (the loss provision rate) to total title insurance premiums and escrow fees. The Company's management estimates the loss provision rate at the beginning of each year and reassesses the rate quarterly to ensure that the resulting incurred but not reported ("IBNR") loss reserve and known claims reserve included in the Company's consolidated balance sheets together reflect management's best estimate of the total costs required to settle all IBNR and known claims. If the ending IBNR reserve is not considered adequate, an adjustment is recorded.

The process of assessing the loss provision rate and the resulting IBNR reserve involves an evaluation of the results of an in-house actuarial review. The Company's in-house actuary performs a reserve analysis utilizing generally accepted actuarial methods that incorporate cumulative historical claims experience and information provided by in-house claims and operations personnel. Current economic and business trends are also reviewed and used in the reserve analysis. These include conditions in the real estate and mortgage markets, changes in residential and commercial real estate values, and changes in the levels of defaults and foreclosures that may affect claims levels and patterns of emergence, as well as any company-specific factors that may be relevant to past and future claims experience. Results from the analysis include, but are not limited to, a range of IBNR reserve estimates and a single point estimate for IBNR as of the balance sheet date.

For recent policy years at early stages of development (generally the last three years), IBNR is generally estimated using a combination of expected loss rate and multiplicative loss development factor calculations. For more mature policy years, IBNR generally is estimated using multiplicative loss development factor calculations. The expected loss rate method estimates IBNR by applying an expected loss rate to total title insurance premiums and escrow fees, and adjusting for policy year maturity using estimated loss development patterns. Multiplicative loss development factor calculations estimate IBNR by applying factors derived from loss development patterns to losses realized to date. The expected loss rate and loss development patterns are based on historical experience and the relationship of the history to the applicable policy years.

The Company's management uses the IBNR point estimate from the in-house actuary's analysis and other relevant information concerning claims to determine what it considers to be the best estimate of the total amount required for the IBNR reserve.

The volume and timing of title insurance claims are subject to cyclical influences from both the real estate and mortgage markets. Title policies issued to lenders constitute a large portion of the Company's title insurance volume. These policies insure lenders against losses on mortgage loans due to title defects in the collateral property. Even if an underlying title defect exists that could result in a claim, often, the lender must realize an actual loss, or at least be likely to realize an actual loss, for a title insurance liability to exist. As a result, title insurance claims exposure is sensitive to lenders' losses on mortgage loans and is affected in turn by external factors that affect mortgage loan losses, particularly macroeconomic factors.

A general decline in real estate prices can expose lenders to greater risk of losses on mortgage loans, as loan-to-value ratios increase and defaults and foreclosures increase. Title insurance claims exposure for a given policy year is also affected by the quality of mortgage loan underwriting during the corresponding origination year. The Company believes that the sensitivity of claims to external conditions in the real estate and mortgage markets is an inherent feature of title insurance's business economics that applies broadly to the title insurance industry.

Title insurance policies are long-duration contracts with the majority of the claims reported to the Company within the first few years following the issuance of the policy. Generally, 70% to 80% of claim amounts become known in the first six years of the policy life, and the majority of IBNR reserves relate to the six most recent policy years. Changes in expected ultimate losses and corresponding loss rates for recent policy years are considered likely and could result in a material adjustment to the IBNR reserves. A material change in expected ultimate losses and corresponding loss rates for older policy years is also possible, particularly for policy years with loss rates exceeding historical norms. The estimates made by management in determining the appropriate level of IBNR reserves could ultimately prove to be materially different from actual claims experience.

The reserve for property and casualty insurance losses reflects management's best estimate of the amount necessary to settle all reported and unreported claims for the ultimate cost of insured losses, based upon the facts of each case and the Company's experience with similar cases. The Company also utilizes the services of an independent actuary as part of its reserve analysis. Because the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process, the ultimate cost of insured losses may be more or less than the reserve amount. Reserve estimates are regularly analyzed and updated to reflect the most current information available.

The Company provides for claims losses relating to its home warranty business based on the average cost per claim and historical loss experience as applied to the total of new claims incurred. The average cost per home warranty claim is calculated using the average of the most recent 12 months of claims experience adjusted for estimated future increases in costs.

Contingent litigation and regulatory liabilities

Amounts related to contingent litigation and regulatory liabilities are accrued if it is probable that a liability has been incurred and an amount is reasonably estimable. The Company records legal fees in other operating expenses in the period incurred.

Revenues

Premiums on title policies issued directly by the Company are recognized on the effective date of the title policy and escrow fees are recorded upon close of the escrow.

Premiums on property and casualty insurance policies and home warranty contracts are generally recognized ratably over the 12-month duration of the contract or policy.

Revenues from title policies issued by agents are recorded when notice of issuance is received from the agent, which is generally when cash payment is received by the Company.

Information and other revenues and escrow fees are within the scope of new accounting guidance related to the recognition of revenue from contracts with customers, which the Company adopted effective January 1, 2018. Under the new guidance, revenue is recognized when control of the promised goods or services is transferred to the customer and in an amount that reflects the consideration the Company expects to be entitled to in exchange for these goods or services. See Recently Adopted Accounting Pronouncements within this note for further discussion of the new guidance.

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

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

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

The Company records a contract asset, and recognizes revenue, upon delivery of certain products related to the closing of a real property transaction where the Company's right to payment is subject to the closing of the real estate transaction. The Company records a contract liability for payments received in advance of revenue recognition for certain products or services. Contract assets and liabilities were not material at December 31, 2018. Revenues recognized during the year ended December 31, 2018 that were included in contract liabilities at the beginning of the period were not material.

For information about the Company's revenues disaggregated by reportable segment see Note 21 Segment Financial Information.

Premium taxes

Title insurance, property and casualty insurance and home warranty companies, like other types of insurers, are generally not subject to state income or franchise taxes. However, in lieu thereof, most states impose a tax based primarily on insurance premiums written. This premium tax is reported as a separate line item in the consolidated statements of income in order to provide a more meaningful disclosure of the taxation of the Company.

Income taxes

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company evaluates the need to establish a valuation allowance for deferred tax assets based upon the amount of existing temporary differences, the period in which they are expected to be recovered and expected levels of taxable income. A valuation allowance to reduce deferred tax assets is established when it is considered more likely than not that some or all of the deferred tax assets will not be realized.

The Company recognizes the effect of income tax positions only if sustaining those positions is considered more likely than not. Changes in recognition or measurement of uncertain tax positions are reflected in the period in which a change in judgment occurs. The Company recognizes interest and penalties, if any, related to uncertain tax positions in income tax expense.

Share-based compensation

The Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost is recognized in the Company's financial statements over the requisite service period of the award using the straight-line method for awards that contain only a service condition and the graded vesting method for awards that contain a performance or market condition. For awards with retirement eligibility provisions, the cost is recognized through the date the employee becomes eligible to retire and is no longer required to provide service to earn the award. The Company accounts for forfeitures as they occur.

The Company's primary means of providing share-based compensation is through the granting of restricted stock units ("RSUs"). RSUs granted generally have graded vesting features and include a service condition; and for certain key employees and executives, may also include either a performance or market condition. RSUs receive dividend equivalents in the form of RSUs having the same vesting requirements as the RSUs initially granted.

The Company also offers an employee stock purchase plan that allows eligible employees the option to purchase common stock of the Company at 85% of the lower of the closing price on either the first or last day of each offering period. The offering periods are three-month periods beginning on January 1, April 1, July 1 and October 1 of each fiscal year. The Company recognizes an expense in the amount equal to the value of the 15% discount and look-back feature over the three-month offering period.

Earnings per share

Basic earnings per share is computed by dividing net income available to the Company's stockholders by the weighted-average number of common shares outstanding. The computation of diluted earnings per share is similar to the computation of basic earnings per share, except that the weighted-average number of common shares outstanding is increased to include the number of additional common shares that would have been outstanding if dilutive stock options had been exercised and RSUs were vested.

Employee benefit plans

The Company recognizes the underfunded status of its unfunded supplemental benefit plans as a liability on its consolidated balance sheets. Actuarial gains and losses and prior service costs and credits that have not been recognized as a component of net periodic benefit cost previously are recorded as a component of accumulated other comprehensive loss. Plan obligations are measured annually as of December 31.

During 2016, the Company terminated its funded defined benefit pension plans and, in 2017, transferred all remaining benefit obligations relating to the pension plans to a highly rated insurance company. See Note 13 Employee Benefit Plans for further discussion of the termination of the Company's funded defined benefit pension plans.

The Company informally funds its nonqualified deferred compensation plan through tax-advantaged investments known as variable universal life insurance. The Company's deferred compensation plan assets are included as a component of other assets and the Company's deferred compensation plan liability is included as a component of pension costs and other retirement plans on the consolidated balance sheets. The income earned on the Company's deferred compensation plan assets is included as a component of net investment income and the income earned by the deferred compensation plan participants is included as a component of personnel costs on the consolidated statements of income.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Foreign currency

The Company operates in other countries, including Canada, the United Kingdom, Australia, South Korea and Hong Kong. The functional currencies of the Company's foreign subsidiaries are generally their respective local currencies. The financial statements of foreign subsidiaries with local currencies that were determined to be the functional currency are translated into U.S. dollars as follows: assets and liabilities at the exchange rate as of the balance sheet date, equity at the historical rates of exchange, and income and expense amounts at average rates prevailing during the period. Translation adjustments resulting from the translation of the subsidiaries' accounts are included in accumulated other comprehensive loss as a separate component of stockholders' equity. For those foreign subsidiaries where the U.S. dollar has been determined to be the functional currency, non-monetary assets and liabilities are translated using historical rates, while monetary assets and liabilities are translated at current rates, with remeasurement gains and losses included in other operating expenses. Gains and losses resulting from foreign currency transactions are included within other operating expenses.

Reinsurance

The Company assumes and cedes large title insurance risks through reinsurance. Additionally, the Company's property and casualty insurance business purchases reinsurance to limit risk associated with large losses from single events. In reinsurance arrangements, the primary insurer retains a certain amount of risk under a policy and cedes the remainder of the risk under the policy to the reinsurer. The primary insurer pays the reinsurer a premium in exchange for accepting this risk of loss. The primary insurer generally remains liable to its insured for the total risk, but is reinsured under the terms of the reinsurance agreement. The amount of premiums assumed and ceded is recorded as a component of direct premiums and escrow fees on the Company's consolidated statements of income. The total amount of premiums assumed and ceded in connection with reinsurance was less than 1.0% of consolidated premium and escrow fees for each of the three years in the period ended December 31, 2018. Payments and recoveries on reinsured losses for the Company's title insurance business were immaterial during the years ended December 31, 2018, 2017 and 2016. For information related to payments on reinsured losses for the Company's property and casualty insurance business see Note 8 Reserve for Known and Incurred But Not Reported Claims.

Escrow deposits and trust assets

The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $7.6 billion and $7.5 billion at December 31, 2018 and 2017, respectively, of which $3.6 billion and $2.9 billion, respectively, were held at 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 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 $3.6 billion and $3.7 billion at December 31, 2018 and 2017, respectively. Escrow deposits held at third-party financial institutions and trust assets are not considered assets of the Company and, therefore, are not included in the accompanying 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 as income or a reduction in expense, as appropriate, in the consolidated statements of income based on the nature of the arrangement and benefit received.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Like-kind exchanges

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 $2.7 billion and $2.6 billion at December 31, 2018 and 2017, respectively. The like-kind exchange deposits are held at third-party financial institutions and, due to the structure utilized to facilitate these transactions, the proceeds and property are not considered assets of the Company and, therefore, are not included in the accompanying 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.

Recently Adopted Accounting Pronouncements:

In May 2017, the Financial Accounting Standards Board (“FASB”) issued updated guidance intended to reduce diversity in practice by clarifying which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company’s 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. The Company adopted this change in accounting principle at the beginning of 2018 and applied the change retrospectively. As a result, other components of net benefit cost totaling $175.0 million and $101.5 million were reclassified from personnel costs to other operating expenses on the consolidated statements of income for the years ended December 31, 2017 and 2016, respectively. See Note 13 Employee Benefit Plans for further information on the Company’s net periodic pension costs.

In January 2017, the FASB issued updated guidance to clarify the definition of a business with the objective of providing guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company’s consolidated financial statements.

In November 2016, the FASB issued updated guidance intended to reduce the diversity in practice on presenting restricted cash and restricted cash equivalents in the statement of cash flows. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The adoption of this guidance had no impact on the Company’s 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. The adoption of this guidance had no impact on the Company's 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. The adoption of this guidance had no impact on the Company's consolidated financial statements.

In January 2016, the FASB issued updated guidance intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. In addition to making other targeted improvements to current guidance, the updated guidance also requires all equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in the fair value recognized through net income. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted this guidance at the beginning of 2018 and recognized cumulative net unrealized gains, net of taxes, of $40.6 million related to its investments in equity securities, previously classified as available-for-sale, through a cumulative-effect adjustment to retained earnings. Changes in the fair values of these investments are reflected in net realized investment gains/losses on the Company's consolidated statements of income. See Note 3 Debt and Equity Securities for further discussion of the Company's investments in equity securities.

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

Pending Accounting Pronouncements:

In August 2018, the FASB issued updated guidance that is intended to reduce potential diversity in practice in accounting for the costs of implementing cloud computing arrangements (i.e., hosting arrangements) that are service contracts. The updated guidance aligns the requirements for capitalizing implementation costs for these arrangements with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software and hosting arrangements that include an internal-use software license. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its consolidated financial statements.

In August 2018, the FASB issued updated guidance as part of its disclosure framework project intended to improve the effectiveness of disclosures in the notes to the financial statements. The updated guidance eliminates, adds and modifies certain disclosure requirements related to fair value measurements. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. Except for the disclosure requirements, the Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

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

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In June 2016, the FASB issued updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of this guidance on its 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. The updated guidance may either be adopted using a modified retrospective transition approach or may be initially applied on the adoption date with the recognition of a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company has elected to initially apply the guidance as of the adoption date, January 1, 2019, and expects to record on its balance sheet right-of-use assets and lease liabilities of approximately $350 million and an immaterial cumulative-effect adjustment to retained earnings. The Company expects the new guidance to have an insignificant impact on its consolidated statements of income and statements of cash flows.

NOTE 2. Statutory Restrictions on Investments and Stockholders’ Equity:

Investments totaling $129.2 million and $131.0 million were on deposit with state treasurers in accordance with statutory requirements for the protection of policyholders at December 31, 2018 and 2017, respectively.

Pursuant to insurance and other regulations under which the Company’s insurance subsidiaries operate, the amount of dividends, loans and advances available to the Company is limited, principally for the protection of policyholders. As of December 31, 2018, under such regulations, the maximum amount available to the Company from its insurance subsidiaries in 2019, without prior approval from applicable regulators, was dividends of $291.2 million and loans and advances of $98.6 million.

The Company’s principal title insurance subsidiary, First American Title Insurance Company (“FATICO”), maintained total statutory capital and surplus of $1.2 billion as of December 31, 2018 and 2017. Statutory net income for the years ended December 31, 2018, 2017 and 2016 was $258.4 million, $306.5 million and $150.0 million, respectively. FATICO was in compliance with the minimum statutory capital and surplus requirements as of December 31, 2018.

FATICO is domiciled in Nebraska and its statutory-based financial statements are prepared in accordance with accounting practices prescribed or permitted by the Nebraska Department of Insurance. The National Association of

Insurance Commissioners' ("NAIC") Accounting Practices and Procedures Manual ("NAIC SAP") has been adopted as a component of prescribed or permitted practices by the state of Nebraska. The state of Nebraska has adopted certain prescribed accounting practices that differ from those found in the NAIC SAP. Specifically, the timing of amounts released from the statutory premium reserve under Nebraska's required practice differs from NAIC SAP resulting in total statutory capital and surplus that was lower by $209.0 million and $148.5 million at December 31, 2018 and 2017, respectively, than if reported in accordance with NAIC SAP.

Statutory accounting principles differ in some respects from GAAP, and these differences include, but are not limited to, non-admission of certain assets (principally limitations on deferred tax assets, goodwill, capitalized furniture and other equipment, capitalized software, and premiums and other receivables 90 days past due), reporting of bonds at amortized cost, amortization of goodwill, deferral of premiums received as statutory premium reserve, supplemental reserve (if applicable) and exclusion of the incurred but not reported claims reserve. In addition, beginning in 2018, the changes in the fair values of equity securities are recorded through net income for GAAP, whereas statutory accounting principles continue to require these changes to be recorded on the balance sheet.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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
December 31, 2018				
U.S. Treasury bonds	$162,904	$741	$(1,139)	$162,506
Municipal bonds	1,050,134	7,210	(12,309)	1,045,035
Foreign government bonds	158,885	571	(2,159)	157,297
Governmental agency bonds	319,115	1,145	(4,093)	316,167
Governmental agency mortgage-backed securities	3,219,585	12,030	(29,016)	3,202,599
U.S. corporate debt securities	575,646	1,113	(15,499)	561,260
Foreign corporate debt securities	274,881	551	(6,485)	268,947
	$5,761,150	$23,361	$(70,700)	$5,713,811
December 31, 2017				
U.S. Treasury bonds	$173,049	$2,199	$(1,250)	$173,998
Municipal bonds	1,031,146	12,185	(7,394)	1,035,937
Foreign government bonds	170,220	489	(1,221)	169,488
Governmental agency bonds	212,731	1,061	(2,322)	211,470
Governmental agency mortgage-backed securities	2,172,377	3,168	(16,588)	2,158,957
U.S. corporate debt securities	734,409	11,768	(2,962)	743,215
Foreign corporate debt securities	256,430	4,145	(956)	259,619
	$4,750,362	$35,015	$(32,693)	$4,752,684

Sales of debt securities resulted in realized gains of $3.3 million, $5.4 million and $12.6 million, realized losses of $20.3 million, $16.4 million and $2.7 million, and proceeds of $1.3 billion, $821.0 million and $561.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

	Less than 12 months		12 months or longer		Total	
(in thousands)	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
December 31, 2018						
U.S. Treasury bonds	$19,749	$(85)	$55,615	$(1,054)	$75,364	$(1,139)
Municipal bonds	172,387	(1,772)	369,139	(10,537)	541,526	(12,309)
Foreign government bonds	23,654	(1,037)	42,119	(1,122)	65,773	(2,159)
Governmental agency bonds	56,270	(748)	90,631	(3,345)	146,901	(4,093)
Governmental agency mortgage-backed securities	850,459	(6,955)	982,610	(22,061)	1,833,069	(29,016)
U.S. corporate debt securities	374,473	(10,537)	109,844	(4,962)	484,317	(15,499)
Foreign corporate debt securities	175,762	(4,575)	50,802	(1,910)	226,564	(6,485)
	$1,672,754	$(25,709)	$1,700,760	$(44,991)	$3,373,514	$(70,700)
December 31, 2017						
U.S. Treasury bonds	$78,605	$(511)	$37,498	$(739)	$116,103	$(1,250)
Municipal bonds	279,292	(1,714)	226,895	(5,680)	506,187	(7,394)
Foreign government bonds	98,942	(972)	6,678	(249)	105,620	(1,221)
Governmental agency bonds	55,707	(409)	93,737	(1,913)	149,444	(2,322)
Governmental agency mortgage-backed securities	671,871	(4,868)	774,959	(11,720)	1,446,830	(16,588)
U.S. corporate debt securities	171,817	(1,568)	60,724	(1,394)	232,541	(2,962)
Foreign corporate debt securities	81,525	(821)	5,697	(135)	87,222	(956)
	$1,437,759	$(10,863)	$1,206,188	$(21,830)	$2,643,947	$(32,693)

Based on the Company's review of its debt securities in an unrealized loss position at December 31, 2018, it determined that the losses were primarily the result of changes in interest rates, which were considered to be temporary, rather than a deterioration in credit quality. The Company does not intend to sell and it is not more likely than not that the Company will be required to sell these securities prior to recovering their amortized cost. As such, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2018.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Investments in debt securities at December 31, 2018, by contractual maturities, are as follows:

(in thousands)	Due in one year or less	Due after one through five years	Due after five through ten years	Due after ten years	Total
U.S. Treasury bonds					
Amortized cost	$ 69,650	$ 67,223	$ 2,744	$ 23,287	$ 162,904
Estimated fair value	$ 69,504	$ 67,043	$ 2,716	$ 23,243	$ 162,506
Municipal bonds					
Amortized cost	$ 65,779	$ 232,548	$ 266,936	$ 484,871	$ 1,050,134
Estimated fair value	$ 65,708	$ 232,572	$ 266,724	$ 480,031	$ 1,045,035
Foreign government bonds					
Amortized cost	$ 20,304	$ 112,746	$ 14,336	$ 11,499	$ 158,885
Estimated fair value	$ 20,290	$ 112,629	$ 13,933	$ 10,445	$ 157,297
Governmental agency bonds					
Amortized cost	$ 21,574	$ 122,750	$ 127,392	$ 47,399	$ 319,115
Estimated fair value	$ 21,379	$ 121,397	$ 128,075	$ 45,316	$ 316,167
U.S. corporate debt securities					
Amortized cost	$ 29,561	$ 266,261	$ 250,275	$ 29,549	$ 575,646
Estimated fair value	$ 29,418	$ 261,369	$ 241,937	$ 28,536	$ 561,260
Foreign corporate debt securities					
Amortized cost	$ 17,889	$ 169,153	$ 79,443	$ 8,396	$ 274,881
Estimated fair value	$ 17,824	$ 166,460	$ 76,746	$ 7,917	$ 268,947
Total debt securities, excluding mortgage-backed securities					
Amortized cost	$ 224,757	$ 970,681	$ 741,126	$ 605,001	$ 2,541,565
Estimated fair value	$ 224,123	$ 961,470	$ 730,131	$ 595,488	$ 2,511,212
Total mortgage-backed securities					
Amortized cost					$ 3,219,585
Estimated fair value					$ 3,202,599
Total debt securities					
Amortized cost					$ 5,761,150
Estimated fair value					$ 5,713,811

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

Investments in equity securities are as follows:

(in thousands)	Cost	Estimated fair value
December 31, 2018		
Preferred stocks	$16,892	$14,162
Common stocks	341,460	339,373
	$358,352	$353,535
December 31, 2017		
Preferred stocks	$19,233	$18,990
Common stocks	394,439	447,526
	$413,672	$466,516

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Net losses (realized and unrealized) of $38.6 million were recognized for the year ended December 31, 2018 as a result of changes in the fair values of equity securities. Included in net losses during the year ended December 31, 2018 were net unrealized losses of $37.6 million related to equity securities still held at December 31, 2018. For the years ended December 31, 2017 and 2016, sales of equity securities resulted in realized gains of $30.2 million and $18.1 million and realized losses of $2.1 million and $7.0 million, respectively.

The composition of the investment portfolio at December 31, 2018, by credit rating, is as follows:

	A- or higher		BBB+ to BBB-		Non-Investment Grade		Total	
(in thousands, except percentages)	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage	Estimated fair value	Percentage
Debt securities:								
U.S. Treasury bonds	$162,506	100.0	$—	—	$—	—	$ 162,506	100.0
Municipal bonds	978,624	93.6	56,174	5.4	10,237	1.0	1,045,035	100.0
Foreign government bonds	128,759	81.9	24,888	15.8	3,650	2.3	157,297	100.0
Governmental agency bonds	316,167	100.0	—	—	—	—	316,167	100.0
Governmental agency mortgage-backed securities	3,202,599	100.0	—	—	—	—	3,202,599	100.0
U.S. corporate debt securities	242,100	43.1	172,633	30.8	146,527	26.1	561,260	100.0
Foreign corporate debt securities	119,565	44.4	118,029	43.9	31,353	11.7	268,947	100.0
Total debt securities	5,150,320	90.1	371,724	6.5	191,767	3.4	5,713,811	100.0
Preferred stocks	48	0.3	12,916	91.2	1,198	8.5	14,162	100.0
Total	$5,150,368	89.9	$384,640	6.7	$192,965	3.4	$5,727,973	100.0

Included in debt securities at December 31, 2018, were bank loans totaling $144.6 million, of which $133.2 million were non-investment grade; high yield corporate debt securities totaling $38.7 million, all of which were non-investment grade; and emerging market debt securities totaling $72.2 million, of which $9.6 million were non-investment grade.

The composition of the debt securities portfolio in an unrealized loss position at December 31, 2018, by credit rating, is as follows:

(in thousands, except percentages)	A- or higher Estimated fair value	Percentage	BBB+ to BBB- Estimated fair value	Percentage	Non-Investment Grade Estimated fair value	Percentage	Total Estimated fair value	Percentage
U.S. Treasury bonds	$75,364	100.0	$—	—	$—	—	$ 75,364	100.0
Municipal bonds	519,316	95.9	16,195	3.0	6,015	1.1	541,526	100.0
Foreign government bonds	38,237	58.1	23,886	36.3	3,650	5.6	65,773	100.0
Governmental agency bonds	146,901	100.0	—	—	—	—	146,901	100.0
Governmental agency mortgage-backed securities	1,833,069	100.0	—	—	—	—	1,833,069	100.0
U.S. corporate debt securities	193,758	40.0	148,054	30.6	142,505	29.4	484,317	100.0
Foreign corporate debt securities	88,816	39.2	107,806	47.6	29,942	13.2	226,564	100.0
Total	$2,895,461	85.8	$295,941	8.8	$182,112	5.4	$3,373,514	100.0

Debt securities in an unrealized loss position at December 31, 2018, included bank loans totaling $141.2 million, of which $129.8 million were non-investment grade; high yield corporate debt securities totaling $36.7 million, all of which were non-investment grade; and emerging market debt securities totaling $63.4 million, of which $9.6 million were non-investment grade.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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" rating category because the payments of principal and interest are guaranteed by the governmental agency that issued the security.

NOTE 4. Property and Equipment:

Property and equipment consists of the following:

	December 31, 2018	December 31, 2017
	(in thousands)	
Land	$25,472	$25,983
Buildings	257,159	255,389
Furniture and equipment	242,415	247,022
Capitalized software	667,667	621,203
	1,192,713	1,149,597
Accumulated depreciation and amortization	(734,873)	(710,028)
	$457,840	$439,569

NOTE 5. Goodwill:

A summary of the changes in the carrying amount of goodwill, by reportable segment, for the years ended December 31, 2018 and 2017, is as follows:

	Title Insurance and Services	Specialty Insurance	Total
	(in thousands)		
Balance as of December 31, 2016	$970,652	$46,765	$1,017,417
Acquisitions	91,516	—	91,516

Foreign currency translation	4,370	—	4,370
Other adjustments	(298)	—	(298)
Balance as of December 31, 2017	1,066,240	46,765	1,113,005
Acquisitions	36,806	—	36,806
Foreign currency translation	(5,017)	—	(5,017)
Other adjustments	(628)	—	(628)
Balance as of December 31, 2018	$1,097,401	$46,765	$1,144,166

For further discussion about the Company’s acquisitions in 2018 and 2017, see Note 20 Business Combinations.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 6. Other Intangible Assets:

Other intangible assets consist of the following:

	December 31, 2018	December 31, 2017
	(in thousands)	
Finite-lived intangible assets:		
Customer relationships	$114,603	$106,086
Noncompete agreements	14,402	11,509
Trademarks	10,753	9,229
Internal-use software licenses	29,394	28,956
Patents	2,840	2,840
	171,992	158,620
Accumulated amortization	(79,535)	(75,591)
	92,457	83,029
Indefinite-lived intangible assets:		
Licenses	16,915	16,884
	$109,372	$99,913

Amortization expense for finite-lived intangible assets was $30.4 million, $28.1 million and $15.4 million for the years ended December 31, 2018, 2017 and 2016, respectively.

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

Year	(in thousands)
2019	$ 25,620
2020	$ 14,294
2021	$ 10,967
2022	$ 10,330
2023	$ 9,859

NOTE 7. Deposits:

Deposit accounts are summarized as follows:

	December 31, 2018	2017
	(in thousands, except percentages)	
Escrow accounts:		
Interest bearing	$2,496,805	$2,058,596
Non-interest bearing	1,133,825	879,252
	3,630,630	2,937,848
Business checking and other deposits (1)	155,553	132,718
	$3,786,183	$3,070,566
Weighted-average interest rate:		
Interest bearing escrow accounts	0.12 %	0.10 %

(1) Business checking and other deposits primarily reflect non-interest bearing accounts.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

NOTE 8. 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:

	December 31,		
	2018	2017	2016
	(in thousands)		
Balance at beginning of year	$1,028,933	$1,025,863	$983,880
Provision related to:			
Current year	444,969	446,500	441,228
Prior years	7,664	3,910	47,373
	452,633	450,410	488,601
Payments, net of recoveries, related to:			
Current year	242,617	240,468	223,735
Prior years	208,139	231,579	239,264
	450,756	472,047	462,999
Other	11,869	24,707	16,381
Balance at end of year	$1,042,679	$1,028,933	$1,025,863

Current year payments, net of recoveries, include $228.3 million, $225.6 million and $211.3 million for the years ended December 31, 2018, 2017 and 2016, respectively, that relate to the Company's specialty insurance segment. Prior year payments, net of recoveries, include $56.7 million, $46.1 million and $41.4 million for the years ended December 31, 2018, 2017 and 2016, respectively, that relate to the Company's specialty insurance segment.

"Other" primarily includes foreign currency translation gains and losses and ceded reinsurance claims. Payments and recoveries on reinsured losses for the Company's title insurance business were immaterial during the years ended December 31, 2018, 2017 and 2016. Payments on reinsured losses for the Company's property and casualty insurance business totaled $15.3 million, $8.9 million, and $2.1 million, and recoveries totaled $20.3 million, $9.6 million, and $2.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.

The provision for title insurance losses, expressed as a percentage of title insurance premiums and escrow fees, was 4.0% for the years ended December 31, 2018 and 2017 and 5.5% for the year ended December 31, 2016.

The current year 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 2017 rate of 4.0% reflected the ultimate loss rate for policy year 2017 and no change in the loss reserve estimates for prior policy years.

The 2016 rate of 5.5% reflected an ultimate loss rate of 4.5% for policy year 2016 and a $42.6 million net increase in loss reserve estimates for prior policy years. The increase in loss reserve estimates for prior policy years was primarily attributable to potential uncertainty with respect to the Company's exposure to large title claims. A large title claim is defined as a title claim with a total ultimate loss in excess of $2.5 million. This uncertainty was due to the following factors, among others: (i) the volatility associated with the timing and severity of large title claims, (ii) the potential of incurring one or more large title claims that significantly exceed estimated ultimate losses indicated by current historical trends, and (iii) the complexity associated with handling large title claims which makes it difficult to estimate the ultimate outcome. While the Company believed its claims reserve attributable to large title claims was reasonable, this uncertainty increased the potential for adverse loss development.

As of December 31, 2018, the projected ultimate loss rates for policy years 2018, 2017 and 2016 were 4.0%, 3.9% and 3.8%, respectively.

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

(in thousands, except percentages)	December 31, 2018		December 31, 2017	
Known title claims	$80,306	7.7 %	$83,094	8.1 %
IBNR title claims	877,134	84.1 %	875,724	85.1 %
Total title claims	957,440	91.8 %	958,818	93.2 %
Non-title claims	85,239	8.2 %	70,115	6.8 %
Total loss reserves	$1,042,679	100.0%	$1,028,933	100.0%

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Specialty Insurance Segment

The following reflects information about incurred and paid claims development for the Company's specialty insurance segment as of December 31, 2018, net of reinsurance, as well as cumulative claims frequency, by claims event, and the total of incurred but not reported claims plus expected development on reported claims included with the net incurred claims amounts.

The information below about incurred and paid claims development for the years ended December 31, 2009 to 2015, is presented as supplementary information.

Incurred claims and allocated claim adjustment expenses, net of reinsurance | December 3

dent	Years ended December 31,									Total of IBNR liabilities plus expecte developmen on reported claims
	2009*	2010*	2011*	2012*	2013*	2014*	2015*	2016	2017	2018
	(in thousands)										
	$141,154	$139,580	$139,663	$139,266	$138,936	$139,090	$139,191	$139,216	$139,186	$139,186	$—
		140,621	139,966	139,991	139,639	140,128	140,641	140,353	140,308	140,324	—
			148,395	149,076	149,768	149,486	149,763	149,552	149,488	149,487	—
				157,287	158,981	159,918	160,579	160,517	160,911	161,650	—
					182,858	184,419	185,244	184,826	184,668	184,777	26
						190,985	190,738	191,120	191,025	190,944	123
							221,617	225,754	225,977	226,555	342
								245,859	249,358	251,506	939
									267,392	275,480	2,940
										264,088	11,329
									Total	$1,983,997	

*Amounts unaudited.

Cumulative paid claims and allocated claim adjustment expenses, net of reinsurance

Accident	Years ended December 31,									
Year	2009*	2010*	2011*	2012*	2013*	2014*	2015*	2016	2017	2018
	(in thousands)									
2009	$113,550	$134,606	$137,689	$138,293	$138,710	$138,963	$139,181	$139,186	$139,186	$139,186
2010		113,513	136,770	138,978	139,486	140,136	140,886	140,302	140,304	140,321
2011			123,116	144,367	146,952	148,984	149,358	149,495	149,485	149,486
2012				130,623	153,753	157,364	159,181	159,740	160,268	161,304
2013					151,377	180,277	182,565	183,957	184,473	184,711
2014						156,536	185,686	188,117	189,525	190,398
2015							181,445	217,618	223,045	225,041
2016								205,857	243,111	248,211
2017									220,218	266,653
2018										222,966
									Total	$1,928,277
			All outstanding liabilities before 2009, net of reinsurance							16
			Liabilities for claims and claims adjustment expenses, net of reinsurance							$55,736

*Amounts unaudited.

78

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

A reconciliation of the net incurred and paid claims development tables to the liability for claims and claim adjustment expense at December 31, 2018, is as follows:

	December 31, 2018 (in thousands)
Liability for unpaid claims and claim adjustment expenses, net of reinsurance:	
Specialty insurance	$55,736
Reinsurance recoverable on unpaid claims:	
Specialty insurance	28,290
Unallocated claims adjustment expenses:	
Specialty insurance	1,213
Insurance lines other than short-duration:	
Title insurance	957,440
Liability for unpaid claims and claims adjustment expenses	$1,042,679

The following reflects supplementary information about average historical claims duration for the Company's specialty insurance segment as of December 31, 2018:

Average annual percentage payout of incurred claims by age, net of reinsurance (unaudited)										
Years	1	2	3	4	5	6	7	8	9	10
Annual payout	82.6%	14.7%								