First American Financial Corp
Form 10-K
February 25, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013

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)

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

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

(Address of principal executive offices) (Zip Code)

(714) 250-3000

Registrant's telephone number, including area code

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

| | |
|---|---|
| Common | New York Stock Exchange |
| (Title of each class) | (Name of each exchange on which registered) |

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  x    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  x

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

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

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, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2013 was $2,335,324,033.

On February 18, 2014, there were 106,143,775 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement with respect to the 2014 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

PART I



PART II

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

- THE COMPANY'S PURSUIT OF GROWTH OPPORTUNITIES IN ITS CORE BUSINESS AND THE BUILDING OF ITS RELATED BUSINESSES, INCLUDING THROUGH ACQUISITIONS;
- THE MAKING OF INVESTMENTS DESIGNED TO IMPROVE THE CUSTOMER EXPERIENCE;
- THE EFFECT OF A DECREASE IN PRODUCTS OR SERVICES PURCHASED BY OR FOR THE BENEFIT OF THE COMPANY'S MOST SIGNIFICANT CUSTOMERS;
- FUTURE ACTIONS TO BE TAKEN IN CONNECTION WITH THE COMPANY'S REVIEW OF ITS AGENCY RELATIONSHIPS;
- THE COMPANY'S CONTINUED PRACTICE OF ASSUMING AND CEDING LARGE TITLE INSURANCE RISKS THROUGH REINSURANCE;
- CONTINUED PRICE AND AGENCY SPLIT ADJUSTMENTS;
- THE ADEQUACY OF THE ALLOWANCE AGAINST PROBABLE LOAN LOSSES;
- THE LIKELIHOOD OF CHANGES IN EXPECTED ULTIMATE LOSSES AND CORRESPONDING LOSS RATES AND RELATED ASSUMPTIONS;
- THE EFFECT OF LAWSUITS, REGULATORY AUDITS AND INVESTIGATIONS AND OTHER LEGAL PROCEEDINGS ON THE COMPANY'S FINANCIAL CONDITION, RESULTS OF OPERATIONS OR CASH FLOWS;
- FUTURE PAYMENT OF DIVIDENDS;
- THE HOLDING OF AND EXPECTED CASH FLOW FROM DEBT SECURITIES AND ASSUMPTIONS RELATING THERETO;
- POTENTIAL FUTURE IMPAIRMENT CHARGES AND RELATED ASSUMPTIONS;
- THE EFFECT OF PENDING ACCOUNTING PRONOUNCEMENTS ON THE COMPANY'S FINANCIAL STATEMENTS;
- THE EFFECTS OF FUTURE ACTIONS OR INACTION OF THE UNITED STATES GOVERNMENT OR RELATED AGENCIES, INCLUDING THOSE RELATED TO THE UNITED STATES DEBT CEILING, A SHUTDOWN OF THE FEDERAL GOVERNMENT, OR MONETARY POLICY;
- EXPENSE MANAGEMENT EFFORTS;
- THE COMPANY'S CONTINUED MONITORING OF ORDER VOLUMES AND RELATED STAFFING LEVELS, AND ADJUSTMENTS TO STAFFING LEVELS AS NECESSARY;
- EXPECTED FORECLOSURES AND FORECLOSURE PROCESSING ACTIVITY;
- ULTIMATE LOSS EMERGENCE AND CLAIMS RESERVES FOR THE GUARANTEED VALUATION PRODUCT OFFERED IN CANADA;
- UNCERTAINTY AND VOLATILITY IN THE CURRENT ECONOMIC ENVIRONMENT AND ITS EFFECT ON TITLE CLAIMS;
- THE VARIANCE BETWEEN ACTUAL CLAIMS EXPERIENCE AND PROJECTIONS AND FUTURE RESERVE ADJUSTMENTS BASED ON UPDATED ESTIMATES OF FUTURE CLAIMS;
- IMPROVEMENT OF SPECIALTY INSURANCE PROFIT MARGINS AS REVENUES INCREASE;
- THE SUFFICIENCY OF THE COMPANY'S RESOURCES TO SATISFY OPERATIONAL CASH REQUIREMENTS;
- THE PLANNED ACQUISITION OF A COMPANY THAT PROVIDES LOAN QUALITY ANALYTICS, DECISION SUPPORT TOOLS AND LOAN REVIEW SERVICES FOR THE MORTGAGE INDUSTRY AND ITS ANTICIPATED CLOSING AND FINANCING THROUGH THE COMPANY'S CREDIT FACILITY;
- THE TIMING OF CLAIM, PENSION AND SUPPLEMENTAL BENEFIT PLAN PAYMENTS;

- EXPECTED MATURITY DATES OF CERTAIN ASSETS AND LIABILITIES THAT ARE SENSITIVE TO CHANGES IN INTEREST RATES;
- THE UNITED STATES GOVERNMENT'S COMMITMENT TO ENSURING THAT FANNIE MAE AND FREDDIE MAC HAVE SUFFICIENT CAPITAL TO PERFORM UNDER GUARANTEES ISSUED AND TO MEET THEIR DEBT OBLIGATIONS;
- ASSUMPTIONS UNDERLYING GOODWILL VALUATIONS;
- THE REALIZATION OF TAX BENEFITS ASSOCIATED WITH CERTAIN LOSSES, POTENTIAL TAX PROVISIONS IN CONNECTION WITH THE EARNINGS OF FOREIGN SUBSIDIARIES AND THE ADEQUACY OF TAX AND RELATED INTEREST ESTIMATES IN CONNECTION WITH EXAMINATIONS BY TAX AUTHORITIES;
- NET ACTUARIAL LOSS AND PRIOR SERVICE CREDIT RELATING TO PENSION PLANS;
- EXPECTED BENEFIT AND PENSION PLAN CONTRIBUTIONS, PAYMENTS AND INVESTMENT STRATEGY AND ASSET AND LIABILITY ASSUMPTIONS; AND
- COMPENSATION COST RECOGNITION ASSOCIATED WITH UNVESTED RESTRICTED STOCK UNITS AND STOCK OPTIONS,

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 CONT "WILL LIKELY RESULT," OR OTHER SIMILAR WORDS AND PHRASES.

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

- INTEREST RATE FLUCTUATIONS;
- CHANGES IN THE PERFORMANCE OF THE REAL ESTATE MARKETS;
- VOLATILITY IN THE CAPITAL MARKETS;
- UNFAVORABLE ECONOMIC CONDITIONS;
- IMPAIRMENTS IN THE COMPANY'S GOODWILL OR OTHER INTANGIBLE ASSETS;
- FAILURES AT FINANCIAL INSTITUTIONS WHERE THE COMPANY DEPOSITS FUNDS;
- CHANGES IN APPLICABLE GOVERNMENT REGULATIONS;
- HEIGHTENED SCRUTINY BY LEGISLATORS AND REGULATORS OF THE COMPANY'S TITLE INSURANCE AND SERVICES SEGMENT AND CERTAIN OTHER OF THE COMPANY'S BUSINESSES;
- REGULATION OF TITLE INSURANCE RATES;
- REFORM OF GOVERNMENT-SPONSORED MORTGAGE ENTERPRISES;
- LIMITATIONS ON ACCESS TO PUBLIC RECORDS AND OTHER DATA;
- CHANGES IN RELATIONSHIPS WITH LARGE MORTGAGE LENDERS 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;
- EXPENSES OF AND FUNDING OBLIGATIONS TO THE PENSION PLAN;
- MATERIAL VARIANCE BETWEEN ACTUAL AND EXPECTED CLAIMS EXPERIENCE;

- DEFALCATIONS, INCREASED CLAIMS OR OTHER COSTS AND EXPENSES ATTRIBUTABLE TO THE COMPANY'S USE OF TITLE AGENTS;
- ANY INADEQUACY IN THE COMPANY'S RISK MITIGATION EFFORTS;
- SYSTEMS INTERRUPTIONS AND INTRUSIONS, WIRE TRANSFER ERRORS OR UNAUTHORIZED DATA DISCLOSURES;
- INABILITY TO REALIZE THE BENEFITS OF THE COMPANY'S OFFSHORE STRATEGY;
- INABILITY OF THE COMPANY'S SUBSIDIARIES TO PAY DIVIDENDS OR REPAY FUNDS;
- CHALLENGES AND ADVERSE EFFECTS ARISING FROM ACQUISITIONS; AND
- OTHER FACTORS DESCRIBED IN THIS ANNUAL REPORT ON FORM 10-K.

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 serve as the holding company of The First American Corporation’s (“TFAC’s”) financial services businesses following the spin-off of those businesses from TFAC (the “Separation”). The Separation was consummated on June 1, 2010, at which time 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 involving the use of real property related data, including data derived from its proprietary database, designed to mitigate risk or otherwise facilitate real estate transactions. It maintains, manages and provides access to title plant records and images and, in addition, provides banking, trust and investment advisory 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. Financial information regarding these business segments and the corporate function is included in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Item 8. Financial Statements and Supplementary Data” of Part II of this report.

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 business and building our related businesses to enhance the breadth of our offerings to our existing customers. We also remain focused on operating efficiency and continued improvement of our customers’ experiences with our products, services and solutions.

### 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 involving the use of real property related data designed to mitigate risk or otherwise facilitate real estate transactions; maintains, manages and provides access to title plant records and images; and provides banking, trust and investment advisory services. In 2013, 2012, and 2011 the Company derived 92.9%, 92.5% and 92.7% 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 they acquire. 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 where the buyer anticipates constructing improvements on the property. 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. The major expenses of a title company typically relate to such searches and examinations, the preparation of preliminary reports or commitments and the maintenance of title plants, as well as related sales and administrative expenses, and not from claim losses as in the case of property and casualty insurers.

The Closing Process. 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 or closer 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 to the parties to the transaction. 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.

The closing function, sometimes called an escrow in the western United 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 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 often 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 agent typically performs the search, examines the title, collects the premium 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 from region to region. 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, as part of the policy, a title insurer may issue a closing protection letter that protects a lender from certain misuse of funds by the title insurer’s 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 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 and the District of Columbia. We also offer title insurance, closing services and similar or related products and services, either directly or through third parties in foreign countries, including Canada, the United Kingdom, Australia and various other established and emerging markets as described in the "International Operations" section below.

Customers, Sales and Marketing. We believe that two institutions, Wells Fargo & Company and JPMorgan Chase & Co., together with their affiliates, originate or are involved in over 30% of the mortgages in the United States. Each of these institutions purchases title insurance policies and other products and services from us. These institutions also benefit from 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. For refinance and default related business referred by customers with centrally managed platforms, we market to mortgage originators, servicers, and governmental sponsored enterprises. For the commercial business we market primarily to investors, including real estate investment trusts, insurance companies and asset managers, as well as to law firms, commercial banks, investment banks, mortgage brokers and the owners of commercial real estate. We also market directly to national homebuilders focused on newly constructed residential property. In some instances we may supplement the efforts of our sales force with general marketing. Our marketing efforts emphasize the quality and timeliness of our services, our financial strength, process innovation and our national presence.

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.

Agency Operations. As described above, we also issue title insurance policies through a network of agents. Our agreements with our agents state the conditions under which the agent is authorized to issue title insurance policies on our behalf. The agency agreement also prescribes the circumstances under which the agent may be liable to us if a policy loss occurs. Such 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 frequently 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 numerous countries outside of the United States, and our international operations accounted for approximately 7.0% of our title insurance and services segment revenues in 2013. Today we have direct operations and a physical presence in several countries, including Canada, the United Kingdom and Australia. Additionally, through local companies we have provided products and services in many other countries. While reliable data are not available, we believe that we have the largest market share for title insurance outside of the United States. The Company's revenues from external customers and long-lived assets are broken down between domestic and foreign operations in Note 22 Segment Financial Information to the consolidated financial statements included in "Item 8. Financial Statements and Supplementary Data" of Part II of this report.

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. Limited claims experience in foreign jurisdictions 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 collection of title plants constitutes one of our principal assets. 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 efficiently, 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 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. Prior to 2010, our title insurance arrangements primarily involved other industry participants. Beginning in January of 2010, we established a global reinsurance program involving treaty reinsurance provided by a global syndicate of highly rated non-industry reinsurers. Subject to certain limitations, the program generally covers claims made while the program is in effect.

We also serve as a coinsurer in connection with certain transactions. In a coinsurance scenario, two or more insurers are selected by the insured and typically issue separate policies with respect to the subject property, with each coinsurer liable to the extent provided in the policy that it issues.

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 the quality, price and timeliness of the preparation and issuance of the insurance policy and the provision of the related products and services. 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 is also important. As part of our on-going strategy, 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 and Investment Advisory Services. Our federal savings bank subsidiary offers trust and investment advisory services, deposit services and asset management services. As of December 31, 2013 this company administered fiduciary and custodial assets having a market value in excess of $3.0 billion which includes managed assets of $1.4 billion, had assets of $1.8 billion, deposits of $1.7 billion and stockholder's equity of $135.0 million.

Lending and Deposit Products. During the third quarter of 2011, we began the multi-year process of winding-down the operations of our industrial bank, First Security Business Bank. Prior to initiating the wind-down, our industrial bank subsidiary accepted deposits and used these deposits to purchase or originate loans secured by commercial properties primarily in Southern California. Currently, the industrial bank continues to accept and service deposits and to service its existing loan portfolio, but is generally no longer originating or purchasing new loans. As of December 31, 2013, the industrial bank had approximately $48.6 million of deposits and $73.8 million of loans outstanding.

The average loan balance outstanding at December 31, 2013 was $490 thousand. The industrial bank has made loans only on a secured basis, at loan-to-value percentages generally less than 70%. The majority of the industrial bank's loans were made on a fixed-to-floating rate basis. The average yield on the industrial bank's loan portfolio for the year ended December 31, 2013 was 6.04%. A number of factors are included in the determination of average yield, principal among which are loan fees and closing points amortized to income, prepayment penalties recorded as income, and amortization of discounts on purchased loans. The industrial bank's average loan to value was approximately 41% at December 31, 2013.

The performance of the industrial bank's loan portfolio is evaluated on an ongoing basis by management of the industrial bank. The industrial bank generally places a loan on non-accrual status when more than three contractual payments are missed, which usually represent past due payments of between 60 to 90 days or more. The industrial bank's general policy is to reverse from income previously accrued but unpaid interest. While a loan is classified under non-accrual status and the future collectability of the recorded loan balance is doubtful, collections of interest and principal are generally applied as a reduction to principal outstanding. Income on such loans is subsequently recognized only to the extent that cash is received and future collection of principal is probable. Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time. Interest income on non-accrual loans that would have been recognized during the year ended December 31, 2013, if all of such loans had been current in accordance with their original terms, totaled $134 thousand.

The following table sets forth the amount of the industrial bank's non-performing loans as of the dates indicated.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| | (in thousands) | | | | |
| Nonperforming Assets: | | | | | |
| Loans accounted for on a non-accrual basis | $2,058 | $2,597 | $4,910 | $2,441 | $603 |
| Total | $2,058 | $2,597 | $4,910 | $2,441 | $603 |

Based on a variety of factors concerning the creditworthiness of its borrowers, the industrial bank determined that it had four non-performing assets as of December 31, 2013.

The industrial bank's allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. Loan losses are charged to, and recoveries are credited to, the allowance for loan losses. The provision for loan losses is determined after considering various factors, such as loan loss experience, maturity of the portfolio, size of the portfolio, borrower credit history, the existing allowance for loan losses, current charges and recoveries to the allowance for loan losses, the overall quality of the loan portfolio, and current economic conditions, as determined by management of the industrial bank, regulatory agencies and independent credit review specialists. While many of these factors are essentially a matter of judgment and may not be reduced to a mathematical formula, we believe that, in light of the collateral securing its loan portfolio, the industrial bank's current allowance for loan losses is an adequate allowance against probable losses incurred as of December 31, 2013.

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The following table provides certain information with respect to the industrial bank's allowance for loan losses as well as charge-off and recovery activity.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| | (in thousands, except percentages) | | | | |
| Allowance for Loan Losses: | | | | | |
| Balance at beginning of year | $3,893 | $4,171 | $3,271 | $2,071 | $1,600 |
| Charge-offs: | | | | | |
| Real estate—mortgage | (43 ) | (278 ) | — | — | — |
| Other | (21 ) | — | — | — | — |
| | (64 ) | (278 ) | — | — | — |
| Recoveries: | | | | | |
| Real estate—mortgage | 2 | — | — | — | — |
| Other | 10 | — | — | — | — |
| | 12 | — | — | — | — |
| Net (charge-offs) recoveries | (52 ) | (278 ) | — | — | — |
| Provision for loan losses | (215 ) | — | 900 | 1,200 | 471 |
| Balance at end of year | $3,626 | $3,893 | $4,171 | $3,271 | $2,071 |
| Ratio of net charge-offs during the year to average loans outstanding during the year | 0.07 % | 0.23 % | — % | — % | — % |

The adequacy of the industrial bank's allowance for loan losses is based on formula allocations and specific allocations. Formula allocations are made on a percentage basis, which is dependent on the underlying collateral, the type of loan, general economic conditions and historical losses. Specific allocations are made as problem or potential problem loans are identified and are based upon an evaluation by the industrial bank's management of the status of such loans. Specific allocations may be revised from time to time as the status of problem or potential problem loans changes.

The following table shows the allocation of the industrial bank's allowance for loan losses and the percent of loans in each category to total loans at the dates indicated.

| | Year Ended December 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2013 | | 2012 | | 2011 | | 2010 | | 2009 | |
| | Allowance | % of Loans | Allowance | % of Loans | Allowance | % of Loans | Allowance | % of Loans | Allowance | % of Loans |
| | (in thousands, except percentages) | | | | | | | | | |
| Loan Categories: | | | | | | | | | | |
| Real estate-mortgage | $3,601 | 99 | $3,854 | 99 | $4,142 | 99 | $3,254 | 99 | $2,062 | 99 |
| Other | 25 | 1 | 39 | 1 | 29 | 1 | 17 | 1 | 9 | 1 |
| | $3,626 | 100 | $3,893 | 100 | $4,171 | 100 | $3,271 | 100 | $2,071 | 100 |

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 46 states. 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 cross-selling through our existing closing-service activities, and through a network of independent brokers. Reinsurance is used extensively to limit risk associated with natural disasters such as windstorms, winter storms, wildfires and earthquakes.

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. Most of these policies are issued on resale residences, although policies are also available in some instances for new homes. 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, the contract holder is responsible for a service fee for each trade call. First year warranties primarily are marketed through real estate brokers and agents, although we also market directly to consumers. We generally sell renewals directly to consumers. Our home warranty business currently operates in 39 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 is a California corporation and, accordingly, is primarily regulated by the California Department of Insurance. Insurance regulations pertaining to insurers 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 are generally 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 subsidiaries 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 in matters pertaining to consumers. This authority includes the enforcement of the Real Estate Settlement Procedures Act formerly placed with the Department of Housing and Urban Development. In addition to other activities, the CFPB has proposed and implemented regulations related to, among other things, the simplification of financing documentation and the required delivery of documentation by the lender to consumers in connection with the closing of a real estate transaction.

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 and industrial bank are both subject to regulation by the Federal Deposit Insurance Corporation. Our federal savings bank is regulated by the Office of the Comptroller of the Currency, with the Federal Reserve Board supervising its parent holding companies. The industrial bank is regulated by the California Department of Financial Institutions.

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, the Company's regulated subsidiaries, including title insurance underwriters, property and casualty insurance companies and banking entities, have established and maintain an investment committee to oversee their own investment portfolios. The Company's investment policies are designed to comply with regulatory requirements and to align the investment portfolio strategy 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 balance earnings, liquidity, regulatory and risk objectives, and that investments should not expose the Company to excessive levels of credit risk, interest risk or liquidity risk.

As of December 31, 2013, our debt and equity investment securities portfolio consists of approximately 90% of fixed income securities. As of that date, approximately 68% of our fixed income investments are held in securities that are United States government-backed or rated AAA, and approximately 99% of the fixed income portfolio is rated or classified as investment grade. Percentages are based on the amortized cost basis of the securities. Credit ratings are based on Standard & Poor's Ratings Services and Moody's Investor Services, Inc. published ratings. If a security was rated differently by both rating agencies, the lower of the two ratings was selected.

In addition to our debt and equity investment 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, 2013, the Company employed 17,292 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 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:

- 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 may have a material adverse effect on the Company

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, historically 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, settlement service providers and property and casualty insurance companies, and instruments, such as mortgage-backed securities, 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. Unfavorable economic or other conditions could cause the Company to write off a portion of its goodwill and other intangible assets

The Company performs an impairment test of the carrying value of goodwill and other indefinite-lived intangible assets annually in the fourth quarter, or sooner if circumstances indicate a possible impairment. Finite-lived intangible assets are subject to impairment tests on a periodic basis. Factors that may be considered in connection with this review include, without limitation, underperformance relative to historical or projected future operating results, reductions in the Company's stock price and market capitalization, increased cost of capital and negative macroeconomic, industry and company-specific trends. These and other factors could lead to a conclusion that goodwill or other intangible assets are no longer fully recoverable, in which case the Company would be required to write off the portion believed to be unrecoverable. Total goodwill and other intangible assets reflected on the Company's consolidated balance sheet as of December 31, 2013 are $892.4 million. Any substantial goodwill and other intangible asset impairments that may be required could have a material adverse effect on the Company's results of operations and financial condition.

4. 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.

5. 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 investment 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. 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 and the province of Ontario, Canada. 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.

6. Scrutiny of the Company's businesses and the industries in which it operates by governmental entities and others could adversely affect its operations and financial condition

The real estate settlement services industry, an industry in which the Company generates a substantial portion of its revenue and earnings, is subject to heightened 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. Departments of insurance in the various states, 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.

We increasingly utilize social media to communicate with customers, vendors and other individuals interested in our Company.  Information delivered via social media can be easily accessed and rapidly disseminated, and the use of social media by us and other parties 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's results of operations

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. Reform of government-sponsored enterprises could negatively impact the Company

Historically, a substantial proportion of home loans originated in the United States were sold to and, generally, resold in a securitized form by, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). As a condition to the purchase of a home loan Fannie Mae and Freddie Mac generally required the purchase of title insurance for their benefit and, as applicable, the benefit of the holders of home loans they may have securitized. The federal government currently is considering various alternatives to reform Fannie Mae and Freddie Mac. The role, if any, that these enterprises or other enterprises fulfilling a similar function will play in the mortgage process following the adoption of any reforms is not currently known. The timing of the adoption and, thereafter, the implementation of the reforms is similarly unknown. Due to the significance of the role of these enterprises, the mortgage process itself may substantially change as a result of these reforms and related discussions. It is possible that these entities, as reformed, or the successors to these entities may require changes to the way title insurance is priced or delivered, changes to standard policy terms or other changes which may make the title insurance business less profitable. These reforms may also alter the home loan market, such as by causing higher mortgage interest rates due to decreased governmental support of mortgage-backed securities. These consequences could be materially adverse to the Company and its financial condition.

9. 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, financial condition or liquidity 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.

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

A relatively small number of lenders originate a majority of the mortgages in the United States and Canada. 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 or any refusal of these parties to accept the Company's products and services could have a material adverse effect on the Company.

11. 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 may negatively affect the Company's results of operations and competitive position

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 "A3" by Moody's Investor Services, Inc., "A" by Fitch Ratings Ltd., "BBB+" 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 $996.0 million of total statutory capital and surplus as of December 31, 2013. 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.

12. 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 securities (including mortgage-backed securities). The investment portfolio also includes money-market and other short-term investments, as well as preferred and common stock. 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. If the carrying value of the investments exceeds the fair value, and the decline in fair value is deemed to be other-than-temporary, the Company will be required to write down the value of the investments, which could have a material adverse effect on the Company's results of operations, statutory surplus and financial condition.

13. The Company's pension plan is currently underfunded and pension expenses and funding obligations could increase significantly as a result of weak performance of financial markets and its effect on plan assets

The Company is responsible for the obligations of its defined benefit pension plan, which it assumed from its former parent, The First American Corporation, on June 1, 2010 in connection with the spin-off transaction which was consummated on that date. The plan was closed to new entrants effective December 31, 2001 and amended to "freeze" all benefit accruals as of April 30, 2008. The Company's future funding obligations for this plan depend upon, among other factors, the future performance of assets held in trust for the plan and interest rates. The pension plan was underfunded as of December 31, 2013 by $68.6 million and the Company may need to make significant contributions to the plan. In addition, pension expenses and funding requirements may also be greater than currently anticipated if the market values of the assets held by the pension plan decline or if the other assumptions regarding plan earnings, expenses and interest rates require adjustment. The Company's obligations under this plan could have a material adverse effect on its results of operations, financial condition and liquidity.

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, 75 to 85% 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 the most 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 $105.8 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. 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 mitigation efforts may prove inadequate

The Company assumes risks in the ordinary course of its business, including through the issuance of title insurance policies and the provision of other products and services.  The Company mitigates these risks through a number of different means, including the implementation of underwriting policies and procedures and other mechanisms for assessing risk.  However, underwriting of title insurance policies and other risk-assumption decisions frequently involves a substantial degree of individual judgment.  The Company's risk mitigation efforts or the reliability of any necessary judgment may prove inadequate, especially in situations where the Company or individuals involved in risk taking decisions are encouraged by customers or others, or because of competitive pressures, to assume risks or to expeditiously make risk determinations.  This circumstance could have an adverse effect on the Company's results of operations, financial condition and liquidity.

17. Systems interruptions and intrusions, wire transfer errors and unauthorized data disclosures may impair the delivery of the Company's products and services, harm the Company's reputation, result in material claims for damages or otherwise adversely affect the Company

Systems interruptions and intrusions may impair the delivery of the Company's products and services, resulting in a loss of customers and a corresponding loss in revenue. The Company's businesses depend heavily upon computer systems located in data centers, which are maintained and managed by a third party. Certain events beyond the Company's control, including natural disasters, telecommunications failures and intrusions into the Company's systems by third parties could temporarily or permanently interrupt the delivery of products and services. These interruptions also may interfere with suppliers' ability to provide necessary data and employees' ability to attend work and perform their responsibilities. The Company also relies on its systems, employees and domestic and international banks to transfer funds. These transfers are susceptible to user input error, fraud, system interruptions or intrusions, incorrect processing and similar errors that could result in lost funds that may be significant. As part of its business, the Company maintains non-public personal information on consumers. There can be no assurance that unauthorized disclosure will not occur either through system intrusions or the actions of third parties or employees. Unauthorized disclosures could adversely affect the Company's reputation and expose it to material claims for damages.

18. The Company may not be able to realize the benefits of its offshore strategy

The Company utilizes lower cost labor in foreign 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 in these countries. Weakness of the United States dollar in relation to the currencies used in these foreign countries may also reduce the savings achievable through this strategy. Furthermore, the practice of utilizing labor based in foreign countries is subject to heightened scrutiny in the United States and, as a result, some of the Company's customers may require it to use labor based in 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 foreign labor also could be enacted. The Company may not be able to pass on these increased costs to its customers.

19. Acquisitions may have an adverse effect on our business

The Company has in the past acquired, and is expected to acquire in the future, other businesses. When businesses are acquired, the Company may not be able to integrate or manage these businesses in such a manner as to realize the anticipated synergies or otherwise produce returns that justify the investment. Acquired businesses may subject the Company to increased regulatory or compliance requirements. The Company may not be able to successfully retain employees of acquired businesses or integrate them, and could lose customers, suppliers or other partners as a result of the acquisitions. For these and other reasons, including changes in market conditions, the projections used to value the acquired businesses may prove inaccurate. In addition, the Company might incur unanticipated liabilities from acquisitions. These and other factors related to acquisitions could have a material adverse effect on the Company's results of operations, financial condition and liquidity. The Company's management also will continue to be required to dedicate substantial time and effort to the integration of its acquisitions. These efforts could divert management's focus and resources from other strategic opportunities and operational matters.

20. 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, 2013, under such regulations, the maximum amount of dividends, loans and advances available in 2014 from these insurance subsidiaries, without prior approval from applicable regulators, was $314.9 million.

21. 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

We maintain our executive offices at MacArthur Place 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 $34.3 million as of December 31, 2013. The technology center referred to above is maintained by a third party and houses technical infrastructure belonging to a third party, in addition to the physically segregated technical infrastructure belonging to the Company.

One of our subsidiaries in the title insurance and services segment leases an aggregate of approximately 135,000 square feet of office space in three buildings of the International Technology Park in Bangalore, India pursuant to various lease agreements. Most of the space is leased pursuant to agreements that expire in 2014 and the current term of the other leases expire in 2015 and 2016.

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. Frequently these lawsuits 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 minimus). 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, one of its subsidiaries and/or one of its agents:

- charged an improper rate for title insurance in a refinance transaction, including
- Haskins v. First American Title Insurance Company, filed on September 29, 2010 and pending in the United States District Court of New Jersey,
- Levine v. First American Title Insurance Company, filed on February 26, 2009 and pending in the United States District Court of Pennsylvania,
- Lewis v. First American Title Insurance Company, filed on November 28, 2006 and pending in the United States District Court for the District of Idaho,
- Raffone v. First American Title Insurance Company, filed on February 14, 2004 and pending in the Circuit Court, Nassau County, Florida, and
- Slapikas v. First American Title Insurance Company, filed on December 19, 2005 and pending in the United States District Court for the Western District of Pennsylvania.

All of these lawsuits are putative class actions. A court has only granted class certification in Lewis, Raffone and Slapikas. For the reasons stated above, the Company has been unable 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 immaterial to the consolidated financial statements as a whole.

- purchased minority interests in title insurance agents as an inducement to refer title insurance underwriting business to the Company or gave items of value to title insurance agents and others for referrals of business, in each case in violation of the Real Estate Settlement Procedures Act, including

- Edwards v. First American Financial Corporation, filed on June 12, 2007 and pending in the United States District Court for the Central District of California.

In Edwards a narrow class has been certified. For the reasons stated above, the Company has been unable to estimate the possible loss or the range of loss.

- engaged in the unauthorized practice of law, including
- Gale v. First American Title Insurance Company, et al., filed on October 16, 2006 and pending in the United States District Court of Connecticut, and
- Hamilton v. First American Title Insurance Company, et al., filed on August 25, 2008 and pending in the Superior Court of the State of North Carolina, Wake County.

The class in Hamilton was certified. The class originally certified in Gale was subsequently decertified. 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.

- overcharged or improperly charged fees for products and services provided in connection with the closing of real estate transactions, denied home warranty claims, recorded telephone calls, and gave items of value to developers, builders and others as inducements to refer business in violation of certain other laws, such as consumer protection laws and laws generally prohibiting unfair business practices, and certain obligations, including
- Bushman v. First American Title Insurance Company, et al., filed on November 21, 2013 and pending in the Circuit Court of the State of Michigan, County of Washtenaw,
- Carrera v. First American Home Buyers Protection Corporation, filed on September 23, 2009 and pending in the United States District Court for the Southern District of California,
- Chassen v. First American Financial Corporation, et al., filed on January 22, 2009 and pending in the United States District Court of New Jersey,
- Coleman v. First American Home Buyers Protection Corporation, et al., filed on August 24, 2009 and pending in the Superior Court of the State of California, County of Los Angeles,
- Diaz v. First American Home Buyers Protection Corporation, filed on March 10, 2009 and pending in the United States District Court for the Southern District of California,
- Gunning v. First American Title Insurance Company, filed on July 14, 2008 and pending in the United States District Court for the Eastern District of Kentucky,
- Kaufman v. First American Financial Corporation, et al., filed on December 21, 2007 and pending in the Superior Court of the State of California, County of Los Angeles,
- Kirk v. First American Financial Corporation, filed on June 15, 2006 and pending in the Superior Court of the State of California, County of Los Angeles,
- Muehling v. First American Title Company, filed on December 11, 2012 and pending in the Superior Court of the State of California, County of Alameda,
- Sjobring v. First American Financial Corporation, et al., filed on February 25, 2005 and pending in the Superior Court of the State of California, County of Los Angeles,
- Smith v. First American Title Insurance Company, filed on November 23, 2011 and pending in the United States District Court for the Western District of Washington,
- Tavenner v. Talon Group, filed on August 18, 2009 and pending in the United States District Court for the Western District of Washington, 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, except Kirk, Kaufman, and Tavenner, are putative class actions for which a class has not been certified. In Kaufman a class was certified but that certification was subsequently vacated. A trial of the Kirk matter, subject to the outcome of an outstanding evidentiary matter, has concluded and the determination of the court is pending. 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 immaterial 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 investment advisory 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 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 18, 2014, was 2,786.

High and low stock prices and dividends declared for 2013 and 2012 are set forth in the table below.

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Period | High-low range | Cash dividends | High-low range | Cash dividends |
| Quarter Ended March 31 | $22.78-$25.82 | $ 0.12 | $12.45-$16.96 | $ 0.08 |
| Quarter Ended June 30 | $20.39-$27.40 | $ 0.12 | $15.17-$17.91 | $ 0.08 |
| Quarter Ended September 30 | $20.85-$24.71 | $ 0.12 | $16.40-$22.49 | $ 0.08 |
| Quarter Ended December 31 | $23.60-$28.57 | $ 0.12 | $21.35-$24.98 | $ 0.12 |

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, industry practice, 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, 2013, 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, which has no expiration date, the Company may repurchase up to $150.0 million of the Company's issued and outstanding common stock. During the quarter ended December 31, 2013, the Company did not repurchase any shares under this plan. Cumulatively the Company has repurchased $67.1 million (including commissions) of its shares and has the authority to repurchase an additional $82.9 million (including commissions) under the plan.

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 2000 Financial Services Index and a peer group index for the period from June 2, 2010, the first day the Company's common stock traded in the regular way market on the New York Stock Exchange, through December 31, 2013. The comparison assumes an investment of $100 on June 2, 2010 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 (1)(2) | Russell 2000 Financial Services Index (1) |
|---|---|---|---|
| June 2, 2010 | $ 100 | $ 100 | $ 100 |
| December 31, 2010 | $ 104 | $ 105 | $ 112 |
| December 31, 2011 | $ 90 | $ 110 | $ 109 |
| December 31, 2012 | $ 174 | $ 129 | $ 132 |
| December 31, 2013 | $ 208 | $ 185 | $ 173 |

(1) As calculated by Bloomberg Financial Services, to include reinvestment of dividends.
(2) The peer group consists of the following companies: American Financial Group, Inc.; Assurant, Inc.; Cincinnati Financial Corporation; Fidelity National Financial, Inc.; The Hanover Insurance Group, Inc.; Kemper Corporation; Lender Processing Services, Inc.; Mercury General Corporation; Old Republic International Corp.; White Mountains Insurance Group Ltd.; 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.

Item 6. Selected Financial Data

The selected historical consolidated financial data for First American Financial Corporation (the "Company") as of and for the five-year period ended December 31, 2013, have been derived from the Company's consolidated and combined financial statements. The selected historical consolidated financial data should be read in conjunction with the Consolidated Financial Statements and Notes thereto, "Item 1—Business," and "Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Company became a publicly traded company in connection with its spin-off from its prior parent, The First American Corporation ("TFAC"), on June 1, 2010 (the "Separation"). The Company's historical financial statements prior to June 1, 2010 have been derived from the consolidated financial statements of TFAC and represent carve-out stand-alone combined financial statements. The combined financial statements prior to June 1, 2010 include items attributable to the Company and allocations of general corporate expenses from TFAC. As a result, the Company's selected historical consolidated financial data prior to June 1, 2010 do not necessarily reflect what its financial position or results of operations would have been if it had been operated as a stand-alone public entity during the periods covered prior to June 1, 2010, and may not be indicative of the Company's future results of operations and financial position.

First American Financial Corporation and Subsidiary Companies

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2010 | 2009 |
| | (in thousands, except percentages, per share amounts and employee data) | | | | |
| Revenues | $4,956,077 | $4,541,821 | $3,820,574 | $3,906,612 | $4,046,834 |
| Net income | $187,064 | $301,728 | $78,579 | $128,956 | $134,277 |
| Net income attributable to noncontrolling interests | $697 | $687 | $303 | $1,127 | $11,888 |
| Net income attributable to the Company | $186,367 | $301,041 | $78,276 | $127,829 | $122,389 |
| Total assets | $6,520,600 | $6,050,847 | $5,362,210 | $5,821,612 | $5,530,281 |
| Notes and contracts payable | $310,285 | $229,760 | $299,975 | $293,817 | $119,313 |
| Allocated portion of TFAC debt (Note A) | $— | $— | $— | $— | $140,000 |
| Stockholders' equity or TFAC's invested equity (Note B) | $2,453,049 | $2,348,065 | $2,028,600 | $1,980,017 | $2,019,800 |
| Return on average stockholders' equity or TFAC's invested equity | 7.8 % | 13.8 % | 3.9 % | 6.4 % | 6.3 % |
| Dividends on common shares (Note C) | $51,324 | $37,612 | $24,784 | $18,553 | $— |
| Per share of common stock (Note D)— | | | | | |
| Net income attributable to the Company: | | | | | |
| Basic | $1.74 | $2.83 | $0.74 | $1.22 | $1.18 |
| Diluted | $1.71 | $2.77 | $0.73 | $1.20 | $1.18 |
| Stockholders' equity or TFAC's invested equity | $23.16 | $21.90 | $19.24 | $18.96 | $19.42 |
| Cash dividends declared | $0.48 | $0.36 | $0.24 | $0.18 | $— |
| Number of common shares outstanding (Note E)— | | | | | |
| Weighted average during the year: | | | | | |
| Basic | 106,991 | 106,307 | 105,197 | 104,134 | 104,006 |
| Diluted | 109,102 | 108,542 | 106,914 | 106,177 | 104,006 |
| End of year | 105,900 | 107,239 | 105,410 | 104,457 | 104,006 |
| Other Operating Data (unaudited): | | | | | |
| Title orders opened (Note F) | 1,385 | 1,635 | 1,249 | 1,469 | 1,771 |
| Title orders closed (Note F) | 1,103 | 1,192 | 913 | 1,079 | 1,301 |

| | | | | | |
|---|---|---|---|---|---|
| Number of employees (Note G) | 17,292 | 17,312 | 16,117 | 16,879 | 13,963 |

Note A—Prior to the Separation, a portion of TFAC's combined debt, in the amount of $140.0 million, was allocated to the Company based on amounts directly incurred for the Company's benefit. In connection with the Separation, the Company borrowed $200.0 million under its revolving credit facility and transferred such funds to CoreLogic, which fully satisfied the Company's $140.0 million allocated portion of TFAC debt.

Note B—Stockholders' equity refers to the stockholders of the Company and excludes noncontrolling interests. TFAC's invested equity refers to the net assets of the Company which reflects TFAC's investment in the Company prior to the Separation and excludes noncontrolling interests.

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Note C—The Company did not declare and/or pay dividends prior to the Separation as it was not a stand-alone publicly traded company until the Separation.

Note D—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 E—Number of common shares outstanding for 2010 and 2009 were computed using the number of shares of common stock outstanding immediately following the Separation, as if such shares were outstanding for the entire period prior to the Separation.

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

Note G—Number of employees is based on actual employee headcount. The increase in headcount in 2010 was due to certain offshore functions being performed internally by the Company that prior to the Separation were performed by TFAC. This increase in headcount is substantially related to employees located outside of the United States.

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

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

Principles of Consolidation

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 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 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 involving the use of real property related data designed to mitigate risk or otherwise facilitate real estate transactions; maintains, manages and provides access to title plant records and images; and provides banking, trust and investment advisory 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 and the District of Columbia. The Company also offers title insurance and other insurance and guarantee products, as well as related settlement services in foreign countries, including Canada, the United Kingdom, Australia 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 46 states. 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 39 states and the District of Columbia.

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

Critical Accounting Policies and Estimates

The Company's management considers the accounting policies described below to be critical in preparing the Company's consolidated financial statements. These policies require management to make estimates and judgments that affect the reported amounts of certain assets, liabilities, revenues, expenses and related disclosures of contingencies. See Note 1 Description of the Company to the consolidated financial statements for a more detailed description of the Company's accounting policies.

Revenue recognition. Title premiums on 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. Revenues from title policies issued by independent agents are recorded when notice of issuance is received from the agent, which is generally when cash payment is received by the Company. Revenues earned by the Company's title plant management business are recognized at the time of delivery, as the Company has no significant ongoing obligation after delivery.

Direct premiums of the Company's specialty insurance segment include revenues from home warranty contracts which are generally recognized ratably over the 12-month duration of the contracts, and revenues from property and casualty insurance policies which are also recognized ratably over the 12-month duration of the policies.

Revenues earned by the Company's trust operations are recognized at the time of delivery, as the Company has no significant ongoing obligation after delivery.

Provision for policy losses. The Company provides for title insurance losses by 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 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 real estate and mortgage markets conditions, 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 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 it may have concerning claims to determine what it considers to be the best estimate of the total amount required for the IBNR reserve.

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, 75 to 85% 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 the most 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 $105.8 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.

The Company provides for property and casualty insurance losses when the insured event occurs. The Company provides for claims losses relating to its home warranty business based on the average cost per claim 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.

A summary of the Company’s loss reserves, broken down into its components of known title claims, incurred but not reported and non-title claims, follows:

| (in thousands, except percentages) | December 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| Known title claims | $135,478 | 13.3 % | $133,070 | 13.6 % |
| IBNR | 840,104 | 82.5 % | 805,430 | 82.5 % |
| Total title claims | 975,582 | 95.8 % | 938,500 | 96.1 % |
| Non-title claims | 42,783 | 4.2 % | 37,962 | 3.9 % |
| Total loss reserves | $1,018,365 | 100.0% | $976,462 | 100.0% |

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

| | December 31, 2013 | 2012 | 2011 |
|---|---|---|---|
| | (in thousands) | | |
| Balance at beginning of year | $133,070 | $162,019 | $192,268 |
| Provision transferred from IBNR title claims related to: | | | |
| Current year | 17,720 | 18,592 | 21,962 |
| Prior years | 280,373 | 233,258 | 295,608 |
| | 298,093 | 251,850 | 317,570 |
| Payments, net of recoveries, related to: | | | |
| Current year | 15,355 | 16,044 | 13,934 |
| Prior years | 280,627 | 269,166 | 333,885 |
| | 295,982 | 285,210 | 347,819 |
| Other | 297 | 4,411 | — |
| Balance at end of year | $135,478 | $133,070 | $162,019 |

The provision transferred from IBNR title claims related to current year decreased by $0.9 million in 2013 from 2012 and $3.4 million in 2012 from 2011 and payments, net of recoveries, related to current year decreased by $0.7 million in 2013 from 2012 and increased by $2.1 million in 2012 from 2011, 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 increased by $47.1 million and payments, net of recoveries, related to prior years increased by $11.5 million in 2013 from 2012. These increases were primarily attributable to increased domestic lenders claims for policy years 2004 through 2008 and, to a lesser extent, large commercial claims above expected levels, mainly from mechanics liens. The increase in domestic lenders claims was primarily due to mortgage lenders and servicers processing a large volume of foreclosures during 2013. As foreclosure processing increases, lenders claims generally increase, because lenders claims typically come from foreclosures in which the lender suffers a loss.

The provision transferred from IBNR title claims related to prior years decreased by $62.4 million and payments, net of recoveries, related to prior years decreased by $64.7 million in 2012 from 2011. These decreases were consistent with runoff of older policy years that have higher expected ultimate losses, in particular policy years 2005 through 2008, which, on a combined basis, accounted for $46.0 million of the decrease in provision transferred from IBNR title claims related to prior years and $56.8 million of the decrease in payments, net of recoveries, related to prior years.

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

| | December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| | (in thousands) | | |
| Balance at beginning of year | $805,430 | $816,603 | $875,627 |
| Provision related to: | | | |
| Current year | 196,275 | 173,335 | 157,477 |
| Prior years | 148,454 | 62,620 | 111,711 |
| | 344,729 | 235,955 | 269,188 |
| Provision transferred to known title claims related to: | | | |
| Current year | 17,720 | 18,592 | 21,962 |
| Prior years | 280,373 | 233,258 | 295,608 |
| | 298,093 | 251,850 | 317,570 |
| Other | (11,962 ) | 4,722 | (10,642 ) |
| Balance at end of year | $840,104 | $805,430 | $816,603 |

The provision related to current year increased by $22.9 million, or 13.2%, in 2013 from 2012. This increase was attributable to a 12.9% increase in title premiums and escrow fees in 2013 from 2012.

The provision related to current year increased by $15.9 million, or 10.1%, in 2012 from 2011. This increase was attributable to a 21.1% increase in title premiums and escrow fees in 2012 from 2011, partially offset by a lower ultimate loss rate for the current policy year in 2012 when compared to 2011. At December 31, 2012, the ultimate loss rate for policy year 2012 was 5.1%. At December 31, 2011, the ultimate loss rate for policy year 2011 was 5.6%.

For further discussion of title provision recorded in 2013, 2012 and 2011, see Results of Operations, pages 37 through 39.

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

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

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

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

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

Fair value of debt securities

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

Typical inputs and assumptions to pricing models used to value the Company's U.S. Treasury bonds, municipal bonds, foreign bonds, governmental agency bonds, governmental agency mortgage-backed securities and corporate debt securities include, but are not limited to, benchmark yields, reported trades, broker-dealer quotes, credit spreads, credit ratings, bond insurance (if applicable), benchmark securities, bids, offers, reference data and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include the structure of issuance, characteristics of the issuer, collateral attributes and prepayment speeds. The fair value of non-agency mortgage-backed securities was obtained from the independent pricing services referenced above and subject to the Company's validation procedures discussed above. However, since these securities were not actively traded, there were fewer observable inputs available requiring the pricing services to use more judgment in determining the fair value of the securities, therefore the Company classified non-agency mortgage-backed securities as Level 3.

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

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, 2013, the Company did not intend to sell any debt securities in an unrealized loss position and it is not more likely than not that the Company will be required to sell debt securities before recovery of their amortized cost basis.

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

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

The table below summarizes the primary assumptions used at December 31, 2013 in estimating the cash flows expected to be collected for these securities.

| | Weighted average | | Range |
|---|---|---|---|
| Prepayment speeds | 7.9 | % | 6.7%—9.8% |
| Default rates | 2.6 | % | 1.7%—3.7% |
| Loss severity | 19.4 | % | 4.4%—25.7% |

Fair value of equity securities

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

Other-than-temporary impairment–equity securities

When a decline in the fair value of an equity security including common and preferred stock is considered to be other-than-temporary, such equity security is written down to its fair value. When assessing if a decline in value is other-than-temporary, the factors considered include the length of time and extent to which fair value has been below cost, the probability that the Company will be unable to collect all amounts due under the contractual terms of the security, the seniority of the securities, issuer-specific news and other developments, the financial condition and prospects of the issuer (including credit ratings), macro-economic changes (including the outlook for industry sectors, which includes government policy initiatives) and the Company's ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery.

When an equity security has been in an unrealized loss position for greater than twelve months, the Company's review of the security includes the above noted factors as well as other evidence that might exist supporting the view that the security will recover its value in the foreseeable future, typically within the next twelve months. If objective, substantial evidence does not indicate a likely recovery during that timeframe, the Company's policy is that such losses are considered other-than-temporary and therefore an impairment loss is recorded.

Impairment assessment for goodwill. The Company is required to perform an annual goodwill impairment assessment for each reporting unit. The Company's four reporting units are title insurance, home warranty, property and casualty insurance and trust and other services. 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 current 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 the qualitative assessment and perform the 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 performs the 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 multiple cash flow scenarios that reflect a range of possible outcomes 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. The Company also uses certain of these valuation techniques in accounting for business combinations, primarily in the determination of the fair value of acquired assets and liabilities. 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 equity or asset.

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.

The Company's assessments for 2013, 2012 and 2011 did not indicate impairment in any of its reporting units.

Impairment assessment for other indefinite-lived intangible assets. The Company's other indefinite-lived intangible assets consist of licenses which are not amortized but rather assessed for impairment by comparing the fair value of the license with its carrying value at least annually or when an indicator of potential impairment has occurred. Management's impairment assessment involves calculating the fair value by using a discounted cash flow analysis and market approach valuations. If the fair value of the asset 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. The impairment loss establishes a new basis and the subsequent reversal of impairment losses is not permitted.

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

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 tax expense.

Depreciation and amortization lives for assets. Management is required to estimate the useful lives of several asset classes, including property and equipment, internally developed software and other intangible assets. The estimation of useful lives requires a significant amount of judgment related to matters such as future changes in technology, legal issues related to allowable uses of data and other matters.

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. The share-based compensation expense recognized is based on the number of shares ultimately expected to vest, net of forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

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 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.

In addition, the Company has 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.

Employee benefit plans. The Company recognizes the overfunded or underfunded status of defined benefit postretirement plans as an asset or liability on its consolidated balance sheets and recognizes changes in the funded status in the year in which changes occur, through accumulated other comprehensive loss. The funded status is measured as the difference between the fair value of plan assets and benefit obligation (the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for the other postretirement plans). 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 assets and obligations are measured as of December 31.

Recently Adopted Accounting Pronouncements

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

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

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

Pending Accounting Pronouncements

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

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 economic factors, can cause fluctuations in the traditional pattern of real estate activity. In addition, future actions or inaction of the United States government or related agencies, such as a failure to increase the United States debt ceiling, a shutdown of the federal government, or actions to tighten monetary policy, may lead to significant increases in interest rates or otherwise negatively impact consumer spending and the overall economy or may make it more difficult to originate and/or close real estate transactions. These circumstances may adversely impact real estate markets where the Company operates.

The interest rate environment for much of the first half of 2013 was historically low, which coupled with a gradual improvement in both the general economy and availability of mortgage credit, resulted in an increase in mortgage origination activity during the first half of 2013 when compared to the first half of 2012. However, interest rates increased beginning in May 2013, which significantly reduced refinance activity during the third and fourth quarters of 2013.

According to the Mortgage Bankers Association's February 18, 2014 Mortgage Finance Forecast (the "MBA Forecast"), residential mortgage originations in the United States (based on the total dollar value of the transactions) decreased 14.1% in 2013 when compared with 2012. According to the MBA Forecast, the dollar amount of purchase originations increased 11.0% and refinance originations decreased 24.3%. This residential mortgage origination activity resulted in an 11.2% increase in domestic residential resale orders closed per day and a 20.4% decrease in domestic refinance orders closed per day by the Company's direct title operations in 2013 when compared to 2012.

The level of domestic title orders opened per day by the Company's direct title operations during 2013 decreased by 15.3% when compared with 2012. The order mix continued to shift toward residential resale and commercial transactions, which typically generate higher premiums than refinance transactions. Residential resale orders per day increased 11.7% and commercial orders per day increased 8.3%, while refinance open orders per day decreased 33.4%. Due to the continued decline in refinance activity during the fourth quarter of 2013, the Company continued making adjustments to its cost structure, primarily in business units tied to refinance transactions. The Company reduced its employee headcount and use of temporary labor in the fourth quarter of 2013, resulting in severance expense of $5.3 million for the three months ended December 31, 2013.

Title Insurance and Services

| | 2013 | 2012 | 2011 | 2013 vs. 2012 | | 2012 vs. 2011 | |
|---|---|---|---|---|---|---|---|
| | | | | $ Change | % Change | $ Change | % Change |
| | (in thousands, except percentages) | | | | | | |
| Revenues | | | | | | | |
| Direct premiums and escrow fees | $1,855,270 | $1,745,687 | $1,360,512 | $109,583 | 6.3 | $385,175 | 28.3 |
| Agent premiums | 2,044,862 | 1,709,905 | 1,491,943 | 334,957 | 19.6 | 217,962 | 14.6 |
| Information and other | 626,016 | 643,433 | 619,951 | (17,417) | (2.7) | 23,482 | 3.8 |
| Investment income | 76,606 | 71,350 | 72,028 | 5,256 | 7.4 | (678) | (0.9) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net realized investment gains | 3,334 | 33,709 | 5,753 | (30,375 ) | (90.1 ) | 27,956 | N/M [1] |
| Net other-than-temporary impairment losses recognized in earnings | — | (3,564 ) | (9,068 ) | 3,564 | 100.0 | 5,504 | 60.7 |
| | 4,606,088 | 4,200,520 | 3,541,119 | 405,568 | 9.7 | 659,401 | 18.6 |
| Expenses | | | | | | | |
| Personnel costs | 1,338,361 | 1,233,203 | 1,085,871 | 105,158 | 8.5 | 147,332 | 13.6 |
| Premiums retained by agents | 1,636,694 | 1,370,193 | 1,195,282 | 266,501 | 19.4 | 174,911 | 14.6 |
| Other operating expenses | 816,870 | 769,477 | 702,508 | 47,393 | 6.2 | 66,969 | 9.5 |
| Provision for policy losses and other claims | 343,461 | 237,427 | 270,697 | 106,034 | 44.7 | (33,270 ) | (12.3 ) |
| Depreciation and amortization | 66,956 | 67,610 | 69,259 | (654 ) | (1.0 ) | (1,649 ) | (2.4 ) |
| Premium taxes | 50,980 | 46,283 | 40,972 | 4,697 | 10.1 | 5,311 | 13.0 |
| Interest | 2,601 | 2,646 | 2,949 | (45 ) | (1.7 ) | (303 ) | (10.3 ) |
| | 4,255,923 | 3,726,839 | 3,367,538 | 529,084 | 14.2 | 359,301 | 10.7 |
| Income before income taxes | $350,165 | $473,681 | $173,581 | $(123,516) | (26.1 ) | $300,100 | 172.9 |
| Margins | 7.6 % | 11.3 % | 4.9 % | (3.7 )% | (32.7 ) | 6.4 % | 130.6 |

(1) Not meaningful

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Direct premiums and escrow fees increased 6.3% in 2013 from 2012 and 28.3% in 2012 from 2011. The increase in direct premiums and escrow fees in 2013 from 2012 was primarily due to an increase in domestic average revenues per order closed, partially offset by a decrease in the number of domestic title orders closed by the Company's direct operations. The increase in 2012 from 2011 was primarily due to an increase in the number of domestic title orders closed by the Company's direct operations and, to a lesser extent, an increase in domestic average revenues per order closed. The domestic average revenues per order closed were $1,513, $1,309 and $1,278 for 2013, 2012 and 2011, respectively. The 15.6% increase in average revenues per order closed in 2013 from 2012 was primarily due to an increase in the mix of direct revenues generated from higher premium residential resale and commercial transactions, higher real estate values and a greater number of large commercial deals that closed in 2013 when compared to 2012. The slight increase of 2.4% in average revenues per order closed in 2012 from 2011 was primarily attributable to higher average revenues per commercial order closed in 2012 when compared to 2011. The Company's direct title operations closed 1,103,400, 1,191,800 and 912,700 domestic title orders during 2013, 2012 and 2011, respectively. The 7.4% decrease in orders closed in 2013 from 2012 and the 30.6% increase in orders closed in 2012 from 2011 were generally consistent with residential mortgage origination activity in the United States as reported in the MBA Forecast.

Agent premiums increased 19.6% in 2013 from 2012 and 14.6% in 2012 from 2011. 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 one quarter 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 increase in agent premiums in 2013 from 2012 was consistent with the 19.7% increase in the Company's direct premiums and escrow fees in the twelve months ended September 30, 2013 as compared with the twelve months ended September 30, 2012. The increase in agent premiums in 2012 from 2011 was consistent with the 16.6% increase in the Company's direct premiums and escrow fees in the twelve months ended September 30, 2012 as compared with the twelve months ended September 30, 2011. The Company continuously analyzes the terms and profitability of its title agency relationships and, where it deems it necessary, amends agent agreements to the extent possible.

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, and other non-insured settlement 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 decreased 2.7% in 2013 from 2012 and increased 3.8% in 2012 from 2011. The decrease in 2013 from 2012 was primarily attributable to lower demand for title related services in Canada due to a decline in mortgage transactions resulting primarily from lower refinance transactions and lower demand for the Company's title information products as a result of the decrease in domestic mortgage origination activity, partially offset by higher demand for the Company's default information products as a result of the increase in domestic loss mitigation activity. The increase in 2012 from 2011 was primarily attributable to higher demand for the Company's title and default information products as a result of the increase in domestic mortgage origination activity, partially offset by lower demand for title related services in Canada due to a decline in mortgage transactions resulting primarily from tightening of lending requirements.

Investment income increased 7.4% in 2013 from 2012 and decreased 0.9% in 2012 from 2011. The increase in 2013 from 2012 was primarily attributable to increased dividend and interest income from the investment portfolio due to higher average volumes of equity and debt securities and investments in equity funds with higher dividend yields when comparing 2013 to 2012. The slight decrease in 2012 compared to 2011 was primarily attributable to increased impairment losses on non-marketable investments accounted for using the equity method and lower interest income from the investment portfolio due to lower yields, partially offset by higher equity earnings from non-marketable investments accounted for using the equity method and increased dividend income. Investment income for 2013, 2012 and 2011 included impairment losses recognized on certain non-marketable investments accounted for using the equity method of $5.8 million, $5.9 million and $3.8 million, respectively.

Net realized investment gains for the title insurance and services segment totaled $3.3 million, $33.7 million and $5.8 million for 2013, 2012 and 2011, respectively, and were primarily from the sales of debt and equity securities. The 2012 net realized investment gains included $15.0 million in gains resulting from the sale of CoreLogic common stock during the third quarter of 2012. Net realized investment gains for 2013, 2012 and 2011 included impairment losses of $1.1 million, $0.8 million and $4.8 million, respectively, primarily related to certain non-marketable investments accounted for using the cost method of accounting, notes receivable and software.

The title insurance and services segment recognized no other-than-temporary impairment losses in 2013. Other-than-temporary impairment losses totaled $3.6 million and $9.1 million for 2012 and 2011, respectively. The net other-than-temporary impairment losses recognized in 2012 and 2011 related to the Company's non-agency mortgage-backed securities portfolio.

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 8.5% in 2013 from 2012 and 13.6% in 2012 from 2011. The increase in 2013 compared with 2012 was primarily attributable to higher staffing levels and incentive compensation driven by increased revenues when compared to the prior year. The increase in 2012 compared with 2011 was primarily attributable to higher incentive compensation driven by improved revenues and profitability and higher staffing levels required to support increased order volume. Personnel costs included severance expense of $17.5 million, $5.5 million and $13.2 million for 2013, 2012 and 2011, respectively.

The Company continues to closely monitor order volumes and related staffing levels and will adjust staffing levels as considered necessary. The Company's direct title operations opened 1,384,600, 1,634,900 and 1,249,100 domestic title orders in 2013, 2012 and 2011, respectively, representing a decrease of 15.3% in 2013 from 2012 and an increase of 30.9% in 2012 from 2011.

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

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| | (in thousands, except percentages) | | |
| Premiums retained by agents | $1,636,694 | $1,370,193 | $1,195,282 |
| Agent premiums | $2,044,862 | $1,709,905 | $1,491,943 |
| % retained by agents | 80.0 % | 80.1 % | 80.1 % |

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, as well as rating structures. As a result, the percentage of title premiums retained by agents can vary due to the geographical mix of revenues from agency operations. The percentage of title premiums retained by agents for 2013, 2012 and 2011 was essentially unchanged.

Other operating expenses (principally related to direct operations) increased 6.2% in 2013 from 2012 and 9.5% in 2012 from 2011. The increase in 2013 from 2012 was primarily attributable to increased production related expenses and higher legal and software related costs. The increase in 2012 from 2011 was primarily attributable to increased production related expenses and higher temporary labor driven by the increase in order volumes, partially offset by a decline in legal expenses.

The provision for policy losses and other claims, expressed as a percentage of title insurance premiums and escrow fees, was 8.8%, 6.9% and 9.5% for the years ended December 31, 2013, 2012 and 2011, respectively.

The current year rate of 8.8% reflected an ultimate loss rate of 5.0% for the current policy year and a net increase in the loss reserve estimates for prior policy years of $148.5 million. The increase in loss reserve estimates for prior policy years reflected claims development above expected levels during 2013, primarily from domestic lenders policies, commercial policies and the Company's guaranteed valuation product offered in Canada. The reserve strengthening associated with domestic lenders policies was $67.4 million and was primarily attributable to increased claims frequency for policy years 2004 through 2008. The increased claims frequency was primarily due to mortgage lenders and servicers processing a large volume of foreclosures during 2013. As foreclosure processing increases, lenders claims generally increase, because lenders claims typically come from foreclosures in which the lender suffers a loss. The Company expects the high level of foreclosure processing to continue in the near term as mortgage lenders and servicers work through their foreclosure inventory. The reserve strengthening associated with domestic lenders policies reflects these expectations. The reserve strengthening associated with commercial policies was $38.8 million and was primarily attributable to several large commercial claims, mainly from mechanics liens, and primarily related to policy years 2007 and 2008. The reserve strengthening associated with the guaranteed valuation product offered in Canada was $21.7 million and was primarily attributable to claims frequency exceeding the Company’s expectations during 2013. The increase in frequency primarily related to policy years 2007 and 2010. There is substantial uncertainty as to the ultimate loss emergence for the guaranteed valuation product due to the following factors, among others, (i) claims associated with this product are generally made only after a foreclosure on the related property and foreclosure rates in Canada are difficult to predict and (ii) limited historical loss data exists as a result of the relatively recent introduction of this product in 2003. While the Company believes its claims reserve attributable to the guaranteed valuation product is adequate, this uncertainty increases the potential for adverse loss development relative to this product.

As of December 31, 2013, the title insurance and services segment's IBNR reserve was $840.1 million, which reflected management's best estimate. The Company's internal actuary determined a range of reasonable estimates of $729.7 million to $1.0 billion. The range limits are $110.4 million below and $201.0 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 prior year rate of 6.9% reflected an ultimate loss rate of 5.1% for policy year 2012 and a net increase in the loss reserve estimates for prior policy years of $62.1 million. The increase in loss reserve estimates for prior policy years reflected claims development above expected levels during 2012, primarily from domestic lenders policies and international business, including the guaranteed valuation product offered in Canada. The reserve strengthening associated with domestic lenders policies was $25.6 million and was primarily attributable to policy years 2005 through 2007. This strengthening was primarily due to an increase in claims frequency experienced during 2012, partially offset by a slight decrease in severity. The reserve strengthening associated with the international business, excluding the guaranteed valuation product, was $15.6 million and was primarily related to increased severity experienced during 2012 for policy years 2003 through 2011. The reserve strengthening associated with the guaranteed valuation product was $11.8 million and reflected an increase in claims frequency experienced during the first half of 2012. The increase in frequency primarily related to policy years 2008 and 2009.

The 2011 rate of 9.5% reflected an ultimate loss rate of 5.6% for policy year 2011 and included a $45.3 million reserve strengthening adjustment related to the Company's guaranteed valuation product offered in Canada, a $32.2 million charge in connection with the settlement of Bank of America's lawsuit against the Company and $34.2 million in unfavorable development for certain prior policy years, primarily 2007. The reserve strengthening adjustment related to the guaranteed valuation product reflected a significant increase in claim frequency experienced in the first quarter of 2011. More specifically, the number of claims reported in the first quarter of 2011, when annualized, increased approximately 150% when compared with the number of claims reported in 2010. The increase in frequency primarily related to policy years 2005 through 2009 (reflecting the relatively long claims development lag for the guaranteed valuation product). These policy years began showing evidence of higher claims frequencies than prior policy years during the first quarter of 2011. In addition, adverse loss development in 2011 included higher-than-expected claims emergence for commercial and lenders policies, particularly for policy years 2005 through 2007. Management believes that these policy years have higher ultimate loss ratios than historical averages, and that they also have experienced accelerated reporting and payment of claims, particularly on lenders policies. Reasons for higher loss levels and acceleration of claims reporting and payment include adverse underwriting conditions in real estate markets during 2005 through 2007, declines in real estate prices, increased levels of foreclosures and increased mechanics lien exposure due to failures of development projects. For additional discussion regarding the Bank of America lawsuit see Note 20 Litigation and Regulatory Contingencies to the consolidated financial statements.

The current economic environment continues to show potential for volatility over the short term, which may affect title claims. Relevant contributing factors include continuing elevated foreclosure inventory and foreclosure processing, general economic uncertainty and government actions that may mitigate or exacerbate recent trends. Other factors, including factors not yet identified, may also influence claims development. At this point, real estate and financial market conditions appear to be improving, particularly increasing real estate prices and declining mortgage defaults, yet significant uncertainty remains, particularly in regard to governmental regulatory changes and fiscal policies which affect economic conditions broadly. The current environment continues to create an increased potential for actual claims experience to vary significantly from projections, in either direction, which would directly affect the claims provision. If actual claims vary significantly from expected, reserves may be adjusted to reflect updated estimates of future claims.

The volume and timing of title insurance claims are subject to cyclical influences from 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 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. The current environment is expected to have increased potential for claims on lenders title policies as foreclosure processing volumes are expected to remain elevated in the near term. 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 sensitivity of claims to external conditions in real estate and mortgage markets is an inherent feature of title insurance's business economics that applies broadly to the title insurance industry. Lenders have experienced high losses on mortgage loans from prior years, including loans that were originated during the years 2005 through 2008. These losses have led to higher title insurance claims on lenders policies, and also have accelerated the reporting of claims that would have been realized later under more normal conditions.

Loss ratios (projected to ultimate value) for policy years 2005 through 2008 are higher than loss ratios for policy years 1992 through 2004. The major causes of the higher loss ratios for those four policy years are believed to be confined mostly to that underwriting period. These causes included: rapidly increasing residential real estate prices which led to an increase in the incidences of fraud, lower mortgage loan underwriting standards and a higher concentration than usual of subprime mortgage loan originations.

The projected ultimate loss ratios, as of December 31, 2013, for policy years 2013, 2012 and 2011 were 5.0%, 4.1% and 5.0%, respectively, which are lower than the ratios for 2005 through 2008. These projections were based in part on an assumption that more favorable underwriting conditions existed in 2009 through 2013 than in 2005 through 2008, including, but not limited to, tighter loan underwriting standards. Current claims data from policy years 2009 through 2013, while still at an early stage of development, supports this assumption.

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 1.3%, 1.3% and 1.4% for the years ended December 31, 2013, 2012 and 2011, respectively.

In general, the title insurance business is a lower profit margin business when compared to the Company's specialty insurance segment. The lower profit margins 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 this relatively high proportion of fixed costs, title insurance profit margins generally improve as closed order volumes increase. 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 7.6%, 11.3% and 4.9% for the years ended December 31, 2013, 2012 and 2011, respectively.

Specialty Insurance

| | 2013 | 2012 | 2011 | 2013 vs. 2012 $ Change | 2013 vs. 2012 % Change | 2012 vs. 2011 $ Change | 2012 vs. 2011 % Change |
|---|---|---|---|---|---|---|---|
| | (in thousands, except percentages) | | | | | | |
| Revenues | | | | | | | |
| Direct premiums | $329,194 | $296,053 | $273,665 | $33,141 | 11.2 | $22,388 | 8.2 |
| Information and other | 1,652 | 1,605 | 1,531 | 47 | 2.9 | 74 | 4.8 |
| Investment income | 7,342 | 8,923 | 10,380 | (1,581 ) | (17.7 ) | (1,457 ) | (14.0 ) |
| Net realized investment gains | 1,425 | 8,590 | 1,406 | (7,165 ) | (83.4 ) | 7,184 | N/M [1] |
| | 339,613 | 315,171 | 286,982 | 24,442 | 7.8 | 28,189 | 9.8 |
| Expenses | | | | | | | |
| Personnel costs | 58,261 | 55,453 | 50,737 | 2,808 | 5.1 | 4,716 | 9.3 |
| Other operating expenses | 41,725 | 42,395 | 38,066 | (670 ) | (1.6 ) | 4,329 | 11.4 |
| Provision for policy losses and other claims | 186,895 | 160,290 | 149,439 | 26,605 | 16.6 | 10,851 | 7.3 |
| Depreciation and amortization | 4,865 | 4,553 | 4,197 | 312 | 6.9 | 356 | 8.5 |
| Premium taxes | 5,735 | 5,021 | 4,691 | 714 | 14.2 | 330 | 7.0 |
| | 297,481 | 267,712 | 247,130 | 29,769 | 11.1 | 20,582 | 8.3 |
| Income before income taxes | $42,132 | $47,459 | $39,852 | $(5,327 ) | (11.2 ) | $7,607 | 19.1 |
| Margins | 12.4 % | 15.1 % | 13.9 % | (2.7 )% | (17.9 ) | 1.2 % | 8.6 |

(1) Not meaningful

Direct premiums increased 11.2% in 2013 from 2012 and 8.2% in 2012 from 2011. These increases were primarily due to increases in the number of home warranty residential service contracts issued and, to a lesser extent, increases in property and casualty policies issued. The increases in the home warranty division were primarily in the real estate and renewal channels and the increases in the property and casualty division were primarily in the independent broker and renter insurance channels.

Net realized investment gains for the specialty insurance segment totaled $1.4 million in 2013, $8.6 million in 2012 and $1.4 million in 2011. The net gains were primarily driven by the sale of debt and equity securities.

Personnel costs and other operating expenses increased 2.2% in 2013 from 2012 and increased 10.2% in 2012 from 2011. The increase in 2013 from 2012 was primarily related to increased salary expense associated with higher employee headcount and higher commissions paid to agents and brokers associated with increased volume in the home warranty and property and casualty businesses, partially offset by an increase in deferred acquisition costs. The increase in 2012 from 2011 was primarily due to increased salary expense associated with higher employee headcount, increased incentive compensation, increased commissions associated with increased volume in the home warranty and property and casualty businesses and a decrease in deferred acquisition costs.

The provision for home warranty claims, expressed as a percentage of home warranty premiums, was 57.5% in 2013, 55.8% in 2012 and 56.1% in 2011. The increase in rate in 2013 from 2012 was primarily attributable to higher weather related claims in the summer season as compared to the previous year, which resulted in an increase in more costly air conditioning claims when compared to 2012. In addition, the frequency and severity of other types of claims increased in 2013 when compared to 2012. The loss rate in 2012 was essentially unchanged from 2011.

The provision for property and casualty claims, expressed as a percentage of property and casualty insurance premiums, was 55.4% in 2013, 51.1% in 2012 and 52.0% in 2011. The increase in rate in 2013 from 2012 was due to an increase in seasonal fire and storm claim events and an increase in the frequency and severity of routine or non-event core losses. The decrease in rate in 2012 from 2011 was primarily due to a reduction in seasonal claim events.

Premium taxes as a percentage of specialty insurance segment premiums were 1.7% in 2013, 2012 and 2011.

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. 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 revenues increase. Pre-tax margins were 12.4%, 15.1% and 13.9% for 2013, 2012 and 2011, respectively.

Corporate

| | 2013 | 2012 | 2011 | 2013 vs. 2012 | | 2012 vs. 2011 | |
|---|---|---|---|---|---|---|---|
| | | | | $ Change | % Change | $ Change | % Change |
| | (in thousands, except percentages) | | | | | | |
| Revenues | | | | | | | |
| Investment income (losses) | $8,556 | $4,120 | $(1,376) | $4,436 | 107.7 | $5,496 | N/M [1] |
| Net realized investment gains (losses) | 4,452 | 25,772 | (2,276) | (21,320) | (82.7) | 28,048 | N/M [1] |
| | 13,008 | 29,892 | (3,652) | (16,884) | (56.5) | 33,544 | N/M [1] |
| Expenses | | | | | | | |
| Personnel costs | 48,960 | 46,210 | 41,760 | 2,750 | 6.0 | 4,450 | 10.7 |
| Other operating expenses | 27,264 | 24,462 | 21,303 | 2,802 | 11.5 | 3,159 | 14.8 |
| Depreciation and amortization | 3,095 | 2,787 | 3,433 | 308 | 11.1 | (646) | (18.8) |
| Interest | 15,278 | 9,782 | 13,377 | 5,496 | 56.2 | (3,595) | (26.9) |
| | 94,597 | 83,241 | 79,873 | 11,356 | 13.6 | 3,368 | 4.2 |
| Loss before income taxes | $(81,589) | $(53,349) | $(83,525) | $(28,240) | (52.9) | $30,176 | 36.1 |

(1) Not meaningful

Investment income totaled $8.6 million and $4.1 million in 2013 and 2012, respectively. Investment losses totaled $1.4 million in 2011. The variance in investment income for all three years is primarily attributable to fluctuations in earnings on investments associated with the Company's deferred compensation plan.

Net realized investment gains totaled $4.5 million in 2013 and were primarily attributable to the sale of a non-marketable investment. Net realized investment gains totaled $25.8 million in 2012 and were attributable to the sale of CoreLogic stock during the third quarter of 2012. Net realized investment losses totaled $2.3 million in 2011 and were primarily attributable to the sale of a corporate fixed asset.

Corporate personnel costs and other operating expenses were $76.2 million, $70.7 million and $63.1 million in 2013, 2012 and 2011, respectively. These increases were primarily attributable to increased costs associated with the Company's deferred compensation plan and, to a lesser extent, increased expenses allocated to the corporate division.

Interest expense increased $5.5 million in 2013 from 2012 and decreased $3.6 million in 2012 from 2011. Interest expense increased in 2013 from 2012 primarily due to the Company's issuance of $250.0 million of debt in January 2013. Interest expense decreased in 2012 from 2011 primarily due to the refinancing of the Company's credit facility to a lower interest rate in April 2012, a lower average outstanding balance on the credit facility and the pay down in December 2011 of an intercompany note payable to the title insurance and services segment. Interest expense related to intercompany notes payable to the title insurance and services and specialty insurance segments was $2.6 million, $3.2 million and $4.2 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Eliminations

Eliminations primarily represent interest income and related interest expense associated with intercompany notes between the Company's segments, which are eliminated in the consolidated financial statements. The Company's inter-segment eliminations were not material for the years ended December 31, 2013, 2012 and 2011.

Income Taxes

Income taxes differ from the amounts computed by applying the federal income tax rate of 35.0%. A reconciliation of this difference is as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| | (in thousands) | | |
| Taxes calculated at federal rate | $108,748 | $163,592 | $45,603 |
| State taxes, net of federal benefit | 11,480 | 9,525 | 2,499 |
| Change in liability for tax positions | 3,537 | 2,033 | 2,548 |
| Change in capital loss valuation allowance | — | (5,276) | — |
| Foreign income taxed at different rates | 8,567 | 2,881 | 1,805 |
| Foreign tax credit | (5,640) | (2,921) | — |
| Other items, net | (3,048) | (4,156) | (741) |
| | $123,644 | $165,678 | $51,714 |

The Company's effective income tax rate (income tax expense as a percentage of income before income taxes) was 39.8% for 2013, 35.4% for 2012 and 39.7% for 2011. The differences in the effective tax rates were primarily due to changes in the ratio of permanent differences to income before income taxes, changes in state and foreign income taxes resulting from fluctuations in the Company's noninsurance and foreign subsidiaries' contribution to pretax profits, and changes in the liability related to tax positions reported on the Company's tax returns. The effective tax rate for 2012 included the release of a valuation allowance recorded against capital losses. In addition, the effective tax rates for 2013 and 2012 reflected the generation of foreign tax credits.

Net Income and Net Income Attributable to the Company

Net income and per share information are summarized as follows:

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| | (in thousands, except per share amounts) | | |
| Net income | $ 187,064 | $ 301,728 | $ 78,579 |
| Less: Net income attributable to noncontrolling interests | 697 | 687 | 303 |
| Net income attributable to the Company | $ 186,367 | $ 301,041 | $ 78,276 |
| Net income per share attributable to the Company's stockholders: | | | |
| Basic | $ 1.74 | $ 2.83 | $ 0.74 |
| Diluted | $ 1.71 | $ 2.77 | $ 0.73 |
| Weighted-average common shares outstanding: | | | |
| Basic | 106,991 | 106,307 | 105,197 |
| Diluted | 109,102 | 108,542 | 106,914 |

See Note 13 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, potential business acquisitions and dividends on 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. Due to the Company's ability to generate cash flows from operations and its liquid-asset position, 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 amounted to $378.5 million, $429.7 million and $136.7 million for the years ended December 31, 2013, 2012 and 2011, respectively, after claim payments, net of recoveries, of $479.3 million, $446.0 million and $503.4 million, respectively. The principal nonoperating uses of cash and cash equivalents for the year ended December 31, 2013 were purchases of debt and equity securities, repayment of debt, capital expenditures, purchase of Company shares and payment of dividends to common stockholders. The principal nonoperating uses of cash and cash equivalents for the year ended December 31, 2012 were purchases of debt and equity securities, repayment of debt, capital expenditures and payment of dividends to common stockholders. The principal nonoperating uses of cash and cash equivalents for the year ended December 31, 2011 were purchases of debt and equity securities, decreases in demand deposits at the Company's banking operations, repayment of debt, capital expenditures and payment of dividends to common stockholders. The most significant nonoperating sources of cash and cash equivalents for the years ended December 31, 2013 and 2012 were proceeds from the sales and maturities of debt and equity securities, increases in the deposit balances at the Company's banking operations, proceeds from the issuance of debt and payments collected related to loans receivable. The most significant nonoperating sources of cash and cash equivalents for the year ended December 31, 2011 were proceeds from the sales and maturities of debt and equity securities, early payoff of the note receivable from CoreLogic, payments collected related to loans receivable and proceeds from the issuance of debt. The net effect of all activities on total cash and cash equivalents was an increase of $164.3 million for 2013, an increase of $225.8 million for 2012, and a decrease of $298.0 million for 2011.

The Company continually assesses its capital allocation strategy, including decisions relating to dividends, stock repurchases, capital expenditures, acquisitions and investments. 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, industry practice, restrictions imposed by applicable law and any other factors the board of directors deems relevant from time to time.

In March 2011, the Company's board of directors approved a stock repurchase plan which authorizes the repurchase of up to $150.0 million of the Company's common stock, of which $82.9 million remained as of December 31, 2013. 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, 2013, the Company repurchased and retired 3.0 million shares of its common stock for a total purchase price of $64.6 million, and as of December 31, 2013, had repurchased and retired 3.2 million shares of its common stock under the current authorization for a total purchase price of $67.1 million.

On February 5, 2014, the Company entered into a definitive agreement to acquire a company that provides loan quality analytics, decision support tools and loan review services for the mortgage industry for a purchase price of $155 million. The transaction is expected to close by March 31, 2014, subject to customary closing conditions, including certain regulatory reviews. The Company expects to draw $150 million on its credit facility, which is discussed below, to fund the acquisition.

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 potential 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, 2013, under such regulations, the maximum amount of dividends, loans and advances available to the holding company from its insurance subsidiaries in 2014, without prior approval from applicable regulators, was $314.9 million. Such restrictions have not had, nor are they expected to have, an impact on the holding company's ability to meet its cash obligations.

As of December 31, 2013, the holding company's sources of liquidity included $221.7 million of cash and cash equivalents and $600.0 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. ("JPMorgan") as administrative agent, and a syndicate of lenders. The credit agreement is comprised of a $600.0 million revolving credit facility, which will terminate on April 17, 2016, unless terminated earlier. Proceeds under the credit agreement may be used for general corporate purposes. At December 31, 2013, the Company had no outstanding borrowings under the facility.

In the event that the rating by Standard & Poor's Ratings Services ("S&P") is below BBB- (or there is no rating from S&P) and, in addition, such rating by Moody's Investor Services, Inc. ("Moody's") is lower than Baa3 (or there is no rating from Moody's), then the loan commitments are subject to mandatory reduction from (a) 50 percent of the net proceeds of certain equity issuances by any of the Company or certain subsidiaries of the Company (collectively, the "Designated Parties"), and (b) 50 percent of the net proceeds of certain debt incurred or issued by any of the Designated Parties, provided that the commitment reductions described above are only required to the extent necessary to reduce the total loan commitments to $300.0 million. The Company is only required to prepay loans to the extent that, after giving effect to any mandatory commitment reduction, the aggregate principal amount of all outstanding loans exceeds the remaining total loan commitments.

At the Company's election, borrowings under the credit agreement bear interest at (a) a base rate plus an applicable spread or (b) an adjusted LIBOR rate plus an applicable spread. The base rate is generally the greatest of (x) 0.50 percent in excess of the federal funds rate, (y) JPMorgan's prime rate, and (z) one-month LIBOR plus one percent. The adjusted LIBOR rate is generally LIBOR times JPMorgan's statutory reserve rate for Eurocurrency funding. The applicable spread varies depending upon the rating assigned by Moody's and S&P. The minimum applicable spread for base rate borrowings is 0.75 percent and the maximum is 1.50 percent. The minimum applicable spread for adjusted LIBOR rate borrowings is 1.75 percent and the maximum is 2.50 percent. 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 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 certain insolvency and bankruptcy events of default the loans automatically accelerate. As of December 31, 2013, the Company was in compliance with the financial covenants under the credit agreement.

On January 29, 2013, the Company issued $250.0 million of 4.30% 10-year senior unsecured notes due in 2023. The notes were priced at 99.638% to yield 4.345%. Interest is due semi-annually on February 1 and August 1, beginning August 1, 2013. The Company used a portion of the net proceeds from the sale to repay all borrowings outstanding under its credit facility, increasing the available capacity thereunder to the full $600.0 million size of the facility.

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 2013, the Company financed securities for funds received totaling $31.4 million under these agreements. As of December 31, 2013, no amounts remained outstanding under these agreements.

Notes and contracts payable as a percentage of total capitalization was 11.2% and 8.9% at December 31, 2013 and 2012, respectively. The increase in 2013 primarily reflected the Company's issuance of the senior unsecured notes during the first quarter of 2013. Notes and contracts payable are more fully described in Note 10 Notes and Contracts Payable to the consolidated financial statements.

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, 2013, the Company's portfolio of debt and equity investment securities consisted of approximately 90% of fixed income securities. As of that date, approximately 68% of the Company's fixed income investments were held in securities that are United States government-backed or rated AAA, and approximately 99% of the fixed income portfolio was rated or classified as investment grade. Percentages are based on the amortized cost basis of the securities. Credit ratings are based on S&P and Moody's published ratings. If a security was rated differently by both rating agencies, the lower of the two ratings was selected.

The Company's fixed income securities experienced a significant decrease in value during the year ended December 31, 2013, primarily due to an increase in long term rates during 2013.

The table below outlines the composition of the investment portfolio currently in an unrealized loss position by credit rating (percentages are based on the amortized cost basis of the investments) as of December 31, 2013. Credit ratings are based on S&P and Moody's published ratings and are exclusive of insurance effects. If a security was rated differently by both rating agencies, the lower of the two ratings was selected:

| | A-Ratings or Higher | BBB+ to BBB- Ratings | Non-Investment Grade/Not Rated |
|---|---|---|---|
| December 31, 2013 | | | |
| US Treasury bonds | 100.0 % | 0.0 % | 0.0 % |
| Municipal bonds | 100.0 % | 0.0 % | 0.0 % |
| Foreign bonds | 95.8 % | 0.2 % | 4.0 % |
| Governmental agency bonds | 100.0 % | 0.0 % | 0.0 % |
| Governmental agency mortgage-backed securities | 100.0 % | 0.0 % | 0.0 % |
| Non-agency mortgage-backed securities | 0.0 % | 0.0 % | 100.0 % |
| Corporate debt securities | 61.4 % | 38.6 % | 0.0 % |
| Preferred stock | 42.9 % | 57.1 % | 0.0 % |
| | 95.6 % | 3.4 % | 1.0 % |

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

Capital expenditures. Capital expenditures primarily consist of additions to property and equipment, capitalized software development costs and additions to title plants. Capital expenditures were $87.1 million, $83.9 million and $75.4 million for the years ended December 31, 2013, 2012 and 2011, respectively. The increase in 2013 over 2012 was primarily related to higher property and equipment additions, partially offset by lower title plant additions in 2013 when compared to 2012. The increase in 2012 over 2011 was primarily related to higher capitalized software development costs in 2012 when compared to 2011.

Contractual obligations. A summary, by due date, of the Company's total contractual obligations at December 31, 2013, is as follows:

| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|---|---|---|---|---|---|
| | (in thousands) | | | | |
| Notes and contracts payable | $310,285 | $13,667 | $19,002 | $8,619 | 268,997 |
| Interest on notes and contracts payable | 115,427 | 15,287 | 25,061 | 23,988 | 51,091 |
| Operating leases | 291,558 | 79,250 | 118,777 | 56,402 | 37,129 |
| Deposits | 1,692,932 | 1,686,149 | 6,783 | — | — |
| Claim losses | 1,018,365 | 275,306 | 271,890 | 156,033 | 315,136 |
| Pension and supplemental benefit plans | 496,187 | 41,639 | 65,422 | 37,540 | 351,586 |
| | $3,924,754 | $2,111,298 | $506,935 | $282,582 | $1,023,939 |

The timing of claim payments is estimated and is not set contractually. Nonetheless, based on historical claims experience, the Company anticipates the above payment patterns. Changes in future claim settlement patterns, judicial decisions, legislation, economic conditions and other factors could affect the timing and amount of actual claim payments. The timing and amount of payments in connection with pension and supplemental benefit plans are based on the Company's current estimate and require the use of significant assumptions. Changes in significant assumptions could affect the amount and timing of pension and supplemental benefit plan payments. See Note 14 Employee Benefit Plans to the consolidated financial statements for additional discussion of management's significant assumptions. 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 $47.8 million has not been included in the contractual obligations table. See Note 12 Income Taxes to the consolidated financial statements for additional discussion of the Company's liability for uncertain tax positions.

Off-balance sheet arrangements. The Company administers escrow deposits and trust assets as a service to its customers. Escrow deposits totaled $4.7 billion and $4.2 billion at December 31, 2013 and 2012, respectively, of which $1.6 billion and $1.2 billion, respectively, were held at the Company's federal savings bank subsidiary, First American Trust, FSB. The escrow deposits held at First American Trust, FSB, are included in the accompanying consolidated balance sheets in cash and cash equivalents and debt and equity securities, with offsetting liabilities included in deposits. The remaining escrow deposits were held at third-party financial institutions.

Trust assets totaled $3.0 billion and $2.8 billion at December 31, 2013 and 2012, respectively, and were held or managed by First American Trust, FSB. Escrow deposits held at third-party financial institutions and trust assets are not the Company's assets under U.S. generally accepted accounting principles 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. As a result of holding these customers' assets in escrow, the Company has ongoing programs for realizing economic benefits, including investment programs, borrowing agreements, and vendor services arrangements with various financial institutions. The effects of these programs are included in the consolidated financial statements as income or a reduction in expense, as appropriate, based on the nature of the arrangement and benefit received.

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

At December 31, 2013 and 2012, the Company was contingently liable for guarantees of indebtedness owed by affiliates and third parties to banks and others totaling $14.7 million and $23.2 million, respectively. The guarantee arrangements relate to promissory notes and other contracts, and contingently require the Company to make payments to the guaranteed party based on the failure of debtors to make scheduled payments according to the terms of the notes and contracts. The Company's maximum potential amount of future payments under these guarantees totaled $14.7 million and $23.2 million at December 31, 2013 and 2012, respectively, and is limited in duration to the terms of the underlying indebtedness. The Company has not incurred any costs as a result of these guarantees and has not recorded a liability on its consolidated balance sheets related to these guarantees at December 31, 2013 and 2012.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

The Company has interest rate risk associated with certain financial instruments. 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 table below provides information about certain assets and liabilities as of December 31, 2013 that are sensitive to changes in interest rates and presents cash flows and the related weighted average interest rates by expected maturity dates.

| | 2014 | 2015 | 2016 | 2017 | 2018 | Thereafter | Total | Fair Value |
|---|---|---|---|---|---|---|---|---|
| | (in thousands, except percentages) | | | | | | | |
| Assets | | | | | | | | |
| Deposits with banks | | | | | | | | |
| Book value | $23,492 | | | | | | $23,492 | $23,601 |
| Average interest rate | 1.39 % | | | | | | | |
| Debt securities | | | | | | | | |
| Amortized cost | $79,268 | 150,281 | 219,161 | 225,498 | 213,221 | 1,961,165 | $2,848,594 | $2,819,817 |
| Average interest rate | 3.48 % | 3.45 % | 3.23 % | 3.09 % | 3.75 % | 2.67 % | | |
| Notes receivable | | | | | | | | |
| Book value | $5,315 | 1,235 | 1,553 | 741 | 527 | 3,755 | $13,126 | $9,953 |
| Average interest rate | 4.16 % | 4.24 % | 4.56 % | 4.90 % | 4.96 % | 6.42 % | | |
| Loans receivable | | | | | | | | |
| Book value | $1,005 | 4,524 | 1,592 | 6,017 | 9,297 | 55,597 | $78,032 | $73,397 |
| Average interest rate | 5.58 % | 6.00 % | 6.59 % | 6.98 % | 6.02 % | 6.03 % | | |
| Liabilities | | | | | | | | |
| Interest bearing escrow deposits | | | | | | | | |
| Book value | $1,376,921 | | | | | | $1,376,921 | $1,376,921 |
| Average interest rate | 0.13 % | | | | | | | |
| Variable rate deposits | | | | | | | | |
| Book value | $22,015 | | | | | | $22,015 | $22,015 |
| Average interest rate | 0.50 % | | | | | | | |
| Fixed rate deposits | | | | | | | | |
| Book value | $19,813 | 5,648 | 1,135 | | | | $26,596 | $26,802 |
| Average interest rate | 0.96 % | 2.24 % | 1.94 % | | | | | |
| Notes and contracts payable | | | | | | | | |
| Book value | $13,667 | 15,020 | 3,982 | 5,190 | 3,429 | 268,997 | $310,285 | $301,007 |
| Average interest rate | 4.34 % | 4.35 % | 4.41 % | 4.39 % | 4.38 % | 4.37 % | | |

Equity Price Risk

The Company is also subject to equity price risk related to its equity securities portfolio. The Company manages its equity price risk through an investment committee made up of certain senior executives which is advised by an experienced investment management staff.

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 hedge its foreign exchange risk.

Credit Risk

The Company’s corporate, municipal, foreign, non-agency mortgage-backed and, to a lesser extent, its agency securities are 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 per issuer are established and monitored by the Company’s investment committee.

The Company’s non-agency mortgage-backed securities credit risk is analyzed by monitoring servicer reports and through utilization of sophisticated cash flow models to measure the default characteristics of the underlying collateral pools.

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.

## Item 8. Financial Statements and Supplementary Data

Separate financial statements for subsidiaries not consolidated and 50% or less owned persons accounted for by the equity method have been omitted because they would not constitute a significant subsidiary.

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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:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of First American Financial Corporation and its subsidiaries at December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, 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 these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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.

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

PricewaterhouseCoopers LLP

Los Angeles, California

February 25, 2014

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except par values)

| | December 31, 2013 | 2012 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | $834,837 | $670,529 |
| Accounts and accrued income receivable, less allowances of $31,831 and $30,917 | 236,895 | 259,779 |
| Income taxes receivable | 26,527 | 14,093 |
| Investments: | | |
| Deposits with banks | 23,492 | 27,875 |
| Debt securities, includes pledged securities of $123,956 and $105,849 | 2,819,817 | 2,651,881 |
| Equity securities | 358,043 | 197,920 |
| Other long-term investments | 183,976 | 192,563 |
| | 3,385,328 | 3,070,239 |
| Loans receivable, net | 73,755 | 107,352 |
| Property and equipment, net | 361,348 | 343,450 |
| Title plants and other indexes | 523,879 | 521,741 |
| Goodwill | 846,026 | 845,857 |
| Other intangible assets, net | 46,347 | 57,095 |
| Other assets | 185,658 | 160,712 |
| | $6,520,600 | $6,050,847 |
| LIABILITIES AND EQUITY | | |
| Deposits | $1,692,932 | $1,411,193 |
| Accounts payable and accrued liabilities: | | |
| Accounts payable | 26,378 | 27,854 |
| Personnel costs | 183,344 | 176,478 |
| Pension costs and other retirement plans | 388,993 | 483,272 |
| Other | 197,097 | 186,409 |
| | 795,812 | 874,013 |
| Deferred revenue | 192,184 | 170,663 |
| Reserve for known and incurred but not reported claims | 1,018,365 | 976,462 |
| Deferred income taxes | 54,779 | 36,987 |
| Notes and contracts payable | 310,285 | 229,760 |
| | 4,064,357 | 3,699,078 |
| Commitments and contingencies (Note 18) | | |
| Stockholders' equity: | | |
| Preferred stock, $0.00001 par value, Authorized—500 shares; Outstanding—none | — | — |
| Common stock, $0.00001 par value: | | |
| Authorized—300,000 shares; Outstanding—105,900 shares and 107,239 shares as of December 31, 2013 and 2012, respectively | 1 | 1 |
| Additional paid-in capital | 2,077,828 | 2,111,605 |
| Retained earnings | 520,764 | 387,015 |
| Accumulated other comprehensive loss | (145,544 ) | (150,556 ) |

| | | |
|---|---|---|
| Total stockholders' equity | 2,453,049 | 2,348,065 |
| Noncontrolling interests | 3,194 | 3,704 |
| Total equity | 2,456,243 | 2,351,769 |
| | $6,520,600 | $6,050,847 |

See Notes to Consolidated Financial Statements

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| Revenues: | | | |
| Direct premiums and escrow fees | $2,184,464 | $2,041,740 | $1,634,177 |
| Agent premiums | 2,044,862 | 1,709,905 | 1,491,943 |
| Information and other | 627,645 | 645,023 | 621,483 |
| Investment income | 89,895 | 81,031 | 76,771 |
| Net realized investment gains | 9,211 | 67,686 | 5,268 |
| Net other-than-temporary impairment (“OTTI”) losses recognized in earnings: | | | |
| Total OTTI losses on debt securities | — | (1,757) | (12,748) |
| Portion of OTTI losses on debt securities recognized in other comprehensive loss | — | (1,807) | 3,680 |
| | — | (3,564) | (9,068) |
| | 4,956,077 | 4,541,821 | 3,820,574 |
| Expenses: | | | |
| Personnel costs | 1,445,582 | 1,334,866 | 1,178,368 |
| Premiums retained by agents | 1,636,694 | 1,370,193 | 1,195,282 |
| Other operating expenses | 885,805 | 836,319 | 761,878 |
| Provision for policy losses and other claims | 530,356 | 397,717 | 420,136 |
| Depreciation and amortization | 74,916 | 74,950 | 76,889 |
| Premium taxes | 56,715 | 51,304 | 45,663 |
| Interest | 15,301 | 9,066 | 12,065 |
| | 4,645,369 | 4,074,415 | 3,690,281 |
| Income before income taxes | 310,708 | 467,406 | 130,293 |
| Income taxes | 123,644 | 165,678 | 51,714 |
| Net income | 187,064 | 301,728 | 78,579 |
| Less: Net income attributable to noncontrolling interests | 697 | 687 | 303 |
| Net income attributable to the Company | $186,367 | $301,041 | $78,276 |
| Net income per share attributable to the Company’s stockholders: | | | |
| Basic | $1.74 | $2.83 | $0.74 |
| Diluted | $1.71 | $2.77 | $0.73 |
| Cash dividends declared per share | $0.48 | $0.36 | $0.24 |
| Weighted-average common shares outstanding: | | | |
| Basic | 106,991 | 106,307 | 105,197 |
| Diluted | 109,102 | 108,542 | 106,914 |

See Notes to Consolidated Financial Statements

FIRST AMERICAN FINANCIAL CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| Net income | $187,064 | $301,728 | $78,579 |
| Other comprehensive income (loss), net of tax: | | | |
| Unrealized (loss) gain on securities | (32,992) | 31,445 | (12,316) |
| Unrealized gain on securities for which credit-related portion was recognized in earnings | 2,327 | 3,902 | 2,144 |
| Foreign currency translation adjustment | (13,650) | 5,131 | (6,167) |
| Pension benefit adjustment | 49,324 | (13,571) | (12,034) |
| Total other comprehensive income (loss), net of tax | 5,009 | 26,907 | (28,373) |
| Comprehensive income | 192,073 | 328,635 | 50,206 |
| Less: Comprehensive income attributable to noncontrolling interests | 694 | 691 | 233 |
| Comprehensive income attributable to the Company | $191,379 | $327,944 | $49,973 |

See Notes to Consolidated Financial Statements

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, 2010 | 104,457 | $ 1 | $ 2,057,098 | $ 72,074 | $ (149,156 ) | $ 1,980,017 | $ 13,704 | $ 1,993,721 |
| Net income for 2011 | — | — | — | 78,276 | — | 78,276 | 303 | 78,579 |
| Contribution from TFAC as a result of Separation | — | — | 5,164 | — | — | 5,164 | — | 5,164 |
| Dividends on common shares | — | — | — | (24,784 ) | — | (24,784 ) | — | (24,784 ) |
| Purchase of Company shares | (204 ) | — | (2,502 ) | — | — | (2,502 ) | — | (2,502 ) |
| Shares issued in connection with share-based compensation plans | 1,157 | — | 2,958 | (750 ) | — | 2,208 | — | 2,208 |
| Share-based compensation expense | — | — | 14,981 | — | — | 14,981 | — | 14,981 |
| Net activity related to noncontrolling interests | — | — | 3,543 | — | — | 3,543 | (7,598 ) | (4,055 ) |
| Other comprehensive income (Note19) | — | — | — | — | (28,303 ) | (28,303 ) | (70 ) | (28,373 ) |
| Balance at December 31, 2011 | 105,410 | 1 | 2,081,242 | 124,816 | (177,459 ) | 2,028,600 | | |