
Texas Property and Casualty Insurance Guaranty Association

**Financial Report
with Additional Information
December 31, 2016**

Texas Property and Casualty Insurance Guaranty Association

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Independent Auditor's Report

To the Board of Directors
Texas Property and Casualty
Insurance Guaranty Association

We have audited the accompanying financial statements of Texas Property and Casualty Insurance Guaranty Association (the "Association"), which comprise the balance sheet as of December 31, 2016 and 2015, and the related statements of income and comprehensive income, equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Texas Property and Casualty Insurance Guaranty Association as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

April 24, 2017

Texas Property and Casualty Insurance Guaranty Association

Balance Sheet

December 31, 2016 and 2015

	2016	2015
Assets		
Investments in debt securities	\$ 432,108,747	\$ 433,472,144
Cash and cash equivalents	16,034,185	16,364,014
Accounts receivable - Other	16,612	18,611
Accrued interest income	2,409,341	2,326,342
Loans receivable - Net of allowance for uncollectible loans of \$291,362,257 and \$269,531,814 in 2016 and 2015, respectively	-	-
Property and equipment - Net	332,574	375,263
Collateral from securities lending	34,281,109	41,926,447
Total assets	<u>\$ 485,182,568</u>	<u>\$ 494,482,821</u>
Liabilities and Equity		
Liabilities		
Accounts payable and accrued expenses	\$ 1,927,528	\$ 1,360,923
Obligations under securities lending	34,281,109	41,926,447
Unpaid claims and claims adjustment expenses	422,632,919	422,995,417
Early access distributions	19,980,656	22,190,639
Payable for securities	1,096,140	2,543,676
Total liabilities	479,918,352	491,017,102
Equity	5,264,216	3,465,719
Total liabilities and equity	<u>\$ 485,182,568</u>	<u>\$ 494,482,821</u>

Texas Property and Casualty Insurance Guaranty Association

Statement of Income and Comprehensive Income

Years Ended December 31, 2016 and 2015

	2016	2015
Revenue		
Distributions	\$ 17,782,342	\$ 31,427,730
Assessments	20,091,552	-
Net investment income	8,274,703	7,958,375
Realized capital gains - Net	1,817,410	859,148
Gain on disposal of asset	-	400
Total revenue	47,966,007	40,245,653
Expenses		
Claims incurred (recovered) - Net	41,928,334	(23,697,895)
Subrogation and salvage recoveries	(4,964,488)	(4,024,953)
Operating expenses	6,131,912	6,287,155
Total expenses	43,095,758	(21,435,693)
Net Income	4,870,249	61,681,346
Other Comprehensive Loss		
Unrealized holding losses on securities arising during the year	(1,254,342)	(1,319,394)
Reclassification adjustment for gains included in net income	(1,817,410)	(859,148)
Total other comprehensive loss	(3,071,752)	(2,178,542)
Comprehensive Income	\$ 1,798,497	\$ 59,502,804

Texas Property and Casualty Insurance Guaranty Association

Statement of Equity

Years Ended December 31, 2016 and 2015

	Unassigned Funds	Accumulated Other Comprehensive Income (Loss)	Equity (Deficit)
Balance - January 1, 2015	\$ (59,704,579)	\$ 3,667,494	\$ (56,037,085)
Net income	61,681,346	-	61,681,346
Other comprehensive loss	-	(2,178,542)	(2,178,542)
Balance - December 31, 2015	1,976,767	1,488,952	3,465,719
Net income	4,870,249	-	4,870,249
Other comprehensive loss	-	(3,071,752)	(3,071,752)
Balance - December 31, 2016	<u>\$ 6,847,016</u>	<u>\$ (1,582,800)</u>	<u>\$ 5,264,216</u>

Texas Property and Casualty Insurance Guaranty Association

Statement of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities		
Net income	\$ 4,870,249	\$ 61,681,346
Adjustments to reconcile net income to net cash and cash equivalents from operating activities:		
Depreciation and amortization	86,571	114,967
Net amortization of premiums and discounts on debt securities	1,185,477	1,689,610
Realized capital gains - Net	(1,817,410)	(859,148)
Changes in operating assets and liabilities which provided (used) cash and cash equivalents:		
Accounts receivable - Other	1,999	15,470
Accrued interest income	(82,999)	21,008
Unpaid claims and claims adjustment expenses	(362,498)	(72,142,368)
Accounts payable and accrued expenses	566,605	404,416
Early access distributions	(2,209,983)	(4,888,101)
Net cash and cash equivalents provided by (used in) operating activities	2,238,011	(13,962,800)
Cash Flows from Investing Activities		
Purchase of property and equipment	(43,882)	(56,682)
Purchases of investments	(246,461,059)	(308,785,772)
Proceeds from sales and maturities of investments in available-for-sale securities	243,937,101	317,272,884
Net cash and cash equivalents (used in) provided by investing activities	(2,567,840)	8,430,430
Net Decrease in Cash and Cash Equivalents	(329,829)	(5,532,370)
Cash and Cash Equivalents - Beginning of year	16,364,014	21,896,384
Cash and Cash Equivalents - End of year	\$ 16,034,185	\$ 16,364,014

December 31, 2016 and 2015

Note 1 - Nature of Business

Texas Property and Casualty Insurance Guaranty Association (the "Association") is a nonprofit organization formed under the Texas Property and Casualty Insurance Guaranty Act (the "Act"). The Association was formed to protect holders of covered claims, contracts of reinsurance, assumption of liabilities, or other insurance-related items arising from insolvent insurance companies within the state of Texas.

Membership in the Association is mandatory for any insurance company authorized in the state of Texas to transact any kind of insurance business to which the Act applies. Membership assessments are made by the board of directors of the Association based on estimates of amounts necessary to provide funds to carry out the purpose of the Act with respect to impaired insurers. Any amount in excess of guaranty obligations and continuing expenses of the Association may be refunded by an equitable method at the discretion of the board of directors. If the maximum assessment and the Association's other assets are insufficient in a year to make all necessary payments, the money available shall be prorated and the Association shall pay the unpaid portion as soon as money becomes available.

Note 2 - Significant Accounting Policies

Basis of Presentation

The financial statements of the Association have been prepared on the basis of generally accepted accounting principles (GAAP).

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in the financial statements include investment valuation, allowance for uncollectible loans, and unpaid claims and claims adjustment expenses.

Cash and Cash Equivalents

Cash consists of demand accounts and cash equivalents include securities maturing within three months or less at the time of acquisition or amounts readily convertible to cash. The Association's cash equivalents consist of money market funds reported at fair value.

Early Access Distributions

Early access distributions represent distributions from receiverships in excess of claims and claims adjustment expenses paid for the specific estate. These distributions are used to fund future claims and claims adjustment expense payments.

Investments

Debt securities purchased to be held for an indefinite period of time are classified as available-for-sale securities. Available-for-sale securities are reported at fair value with unrealized gains and temporary losses reported in other comprehensive income.

Amortization of premiums and accretion of discounts on debt securities are determined using the effective interest method. Interest is recognized on an accrual basis. Realized capital gains and losses are determined using the specific identification method and include gains and losses on investment sales in addition to write-downs in value due to other-than-temporary declines in value, if any. Inflation adjustments on Treasury Inflation-Protected Securities (TIPS) are recognized as unrealized gains until such time as they are paid, at which time they are recognized as realized gains. Deflation adjustments are only recognized to the extent the inflation factor is not reduced to an amount less than 1.00 as the Association is guaranteed (by the U.S. government) to receive at least the par amount of the securities at maturity.

December 31, 2016 and 2015

Note 2 - Significant Accounting Policies (Continued)

The Association's investments are exposed to various risks, such as market risk, credit, and overall market volatility. Due to the level of risk associated with certain securities, it is at least reasonably possible that changes in the value of securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

The Association's available-for-sale investments are subject to a periodic impairment review. Investments are considered to be impaired when the fair value of the security is less than its amortized cost. Impairments are then assessed to determine whether they are other than temporary.

When an other-than-temporary impairment of a debt security has occurred, the entire loss is recognized in earnings if the Association intends to sell the security, or it is more likely than not that the Association will be required to sell the security before recovery of its amortized cost. If the Association does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security before recovery of its amortized cost, the portion of the other-than-temporary impairment related to credit loss is recognized in earnings and the amount of other-than-temporary impairment related to all other factors is recognized in other comprehensive income. Any subsequent recoveries in fair value of available-for-sale debt securities are recognized in other comprehensive income.

Securities Lending Arrangements

The Association engages in transactions whereby certain securities in its portfolio are loaned to other institutions, generally for a short period of time. The Association enters into securities lending transactions and recognizes the cash collateral received and the corresponding liability to return the cash collateral. Cash received for collateral is reinvested in various short-term investments (primarily certificates of deposit and commercial paper).

Property and Equipment

The Association's policy is to depreciate or amortize the cost of property and equipment over the estimated useful lives of the assets using the straight-line method. The cost of leasehold improvements is amortized over the shorter of the estimated useful life of the asset at inception or the remaining lease term. The cost of maintenance and repairs is charged to expenses when incurred.

Unpaid Claims and Claims Adjustment Expenses

Unpaid claims and claims adjustment expenses represent the estimated net cost of all reported claims incurred through December 31, 2016 and 2015, respectively. The unpaid claims and claims adjustment expenses are estimated using past experience and statistical analysis. These estimates are based upon the facts in each case and the Association's experience with similar cases. Establishing amounts for claims and claim adjustment expenses is an estimation process. Many factors can ultimately affect the final settlement of a claim and, therefore, the amount that is needed in establishing the liability. Although considerable variability is inherent in such estimates, management believes the unpaid claims and claim adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are reflected in current operations as the need for such adjustments become apparent.

Member Assessments

The Association can fund its operations by assessing its member insurers and by then seeking reimbursement from the assets of the estate of the insolvent member insurer. There are two classes of assessment which may be made against member insurers: Class A (Administrative) and Class B (Insolvency).

- Class A assessments are made for the purpose of meeting general operating and administrative costs and expenses (e.g., general overhead expenses and "covered claims" adjustment expenses).

December 31, 2016 and 2015

Note 2 - Significant Accounting Policies (Continued)

- Class B assessments are made against solvent member insurers in order to provide the funds needed that enable the Association to fulfill its statutory obligations to protect Texas residents against loss due to failure in performance of contractual obligations ("covered claims" payments) due to the insolvency of a member insurer.

Assessments are determined by the board of directors of the Association and are made in the proportion that the net direct written premiums of the insurer for the calendar year preceding the assessment bear to the net direct written premiums of all member insurers for that year. In 2016, the Association issued a Class A assessment of \$20,091,522. No assessments were issued in 2015.

Revenue Recognition

Revenue is recognized when it is realized or realizable and earned. The Association considers revenue realized or realizable when assessed to the members of the Association. Distributions from receiverships are recognized when received by the Association to the extent they are not in excess of claims and claims adjustment expense paid for the specific estate (early access distributions).

Loans Receivables/Allowance for Uncollectible Loans

Loans receivable represent claims and claim adjustment expenses made on behalf of receiverships, for which a distribution has not been received. Due to the inherent uncertainty related to the collection of loans receivable, the Association has established an allowance for uncollectible loans equal to the balance of loans receivable as of December 31, 2016 and 2015. The Association writes off a loan receivable and its related allowance when a receivership is closed by the state. Repayments of loans receivable are recorded as revenue when received from receiverships.

Income Taxes

The Association is exempt from federal income tax under Section 501(c)(6) of the Internal Revenue Code. The Association is also exempt from payment of all fees and taxes levied by the State of Texas or any of its subdivisions, except taxes levied on real and personal property.

Other Comprehensive Loss

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, however, such as unrealized gains and losses on available-for-sale securities, are reported as a direct adjustment to the equity section of the balance sheet. Such items, along with net income, are considered components of comprehensive income.

Upcoming Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosures related to certain financial instruments, including requiring equity investments to be accounted for at fair value with changes recorded through earnings, the use of the exit price when measuring fair value, and disaggregation of financial assets and liabilities by category for disclosure purposes. The new guidance will be effective for the Association's year ending December 31, 2019. Early adoption is permitted as early as periods ending after December 31, 2017 with some additional options for early application such as the elimination of the requirement for nonpublic business entities to disclose the methods and significant assumptions used to estimate the disclosed fair value of financial instruments. The Association does not believe this new standard will have a significant impact as the Association does not invest in equity securities.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 2 - Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right-of-use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease-related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease guidance will be effective for the Association's year ending December 31, 2020 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The new lease guidance will primarily result in the increase in assets and liabilities based on the outstanding leases at the time of adoption with no anticipated impact on the Association's financial position.

Subsequent Events

The financial statements and related disclosures include evaluation of events up through and including April 24, 2017, which is the date the financial statements were available to be issued.

Note 3 - Investment Income

Investment income is composed of the following for the years ended December 31, 2016 and 2015:

	2016	2015
Investment income:		
Debt securities	\$ 8,826,363	\$ 8,494,602
Cash and cash equivalents	9,759	808
	<u>8,836,122</u>	<u>8,495,410</u>
Gross investment income	8,836,122	8,495,410
Investment expenses	<u>(561,419)</u>	<u>(537,035)</u>
Net investment income	<u>\$ 8,274,703</u>	<u>\$ 7,958,375</u>

Note 4 - Investments

The details of the Association's investments in debt securities at December 31 are as follows:

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Treasury	\$ 146,982,739	\$ 445,039	\$ (1,324,023)	\$ 146,103,755
U.S. government agencies	50,961,077	248,689	(852,615)	50,357,151
Corporate	106,949,183	491,089	(804,145)	106,636,127
Mortgage-backed U.S. government RMBS (primary FHLMC and FNMA pools)	61,311,212	539,910	(756,575)	61,094,547
Municipal	67,168,016	1,027,312	(278,161)	67,917,167
Total	<u>\$ 433,372,227</u>	<u>\$ 2,752,039</u>	<u>\$ (4,015,519)</u>	<u>\$ 432,108,747</u>

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 4 - Investments (Continued)

	2015			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Debt securities:				
U.S. Treasury	\$ 153,450,621	\$ 625,754	\$ (341,920)	\$ 153,734,455
U.S. government agencies	54,156,386	177,663	(174,955)	54,159,094
Corporate	94,878,441	468,374	(493,392)	94,853,423
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	63,744,833	635,926	(192,021)	64,188,738
Municipal	65,435,593	1,294,981	(194,140)	66,536,434
Total	<u>\$ 431,665,874</u>	<u>\$ 3,202,698</u>	<u>\$ (1,396,428)</u>	<u>\$ 433,472,144</u>

The amortized cost and fair value of the Association's investments in debt securities as of December 31, 2016 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Due to uncertainties related to prepayments of government RMBS, the Association does not project future cash flows for these securities.

	Amortized Cost	Fair Value
Due in one year or less	\$ 18,952,674	\$ 18,985,967
Due after one year through five years	253,277,564	253,024,303
Due after five years through ten years	97,916,216	96,835,845
Due after ten years	1,914,561	2,168,085
U.S. government RMBS	61,311,212	61,094,547
Total	<u>\$ 433,372,227</u>	<u>\$ 432,108,747</u>

During December 31, 2016 and 2015, respectively, sales proceeds and gross realized gains and losses on debt securities were as follows:

	2016	2015
Sales proceeds	\$ 232,467,101	\$ 303,168,148
Gross realized gains	1,960,346	994,771
Gross realized losses	(142,936)	(135,623)
Net realized gain	<u>\$ 1,817,410</u>	<u>\$ 859,148</u>

As of December 31, 2016 and 2015, the portfolio included 171 and 170 securities, respectively, that were in an unrealized loss position. Unrealized losses on securities were predominately due to changes in interest rates in the Association's U.S. Treasury and government securities, corporate, mortgage-backed U.S. government RMBS, and municipal securities. No other-than-temporary losses were recognized for any of the Association's investment securities during 2016 and 2015.

The following table shows the gross unrealized losses and fair value of the Association's investments with unrealized losses that are not deemed to be other-than-temporarily impaired. The amounts are segregated into those investments that have been in a continuous unrealized loss position for 12 months or greater and those in a continuous loss position for less than 12 months as of December 31, 2016 and 2015.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 4 - Investments (Continued)

	2016					
	Less than 12 Months		12 Months or Greater		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Debt securities:						
U.S. Treasury	\$ (1,120,890)	\$ 59,688,080	\$ (203,133)	\$ 21,550,667	\$ (1,324,023)	\$ 81,238,747
U.S. government agencies	(740,899)	22,484,587	(111,716)	8,159,756	(852,615)	30,644,343
Corporate	(717,114)	32,495,414	(87,031)	16,795,313	(804,145)	49,290,727
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	(665,531)	18,223,096	(91,044)	10,604,783	(756,575)	28,827,879
Municipal	(217,746)	6,725,235	(60,415)	17,607,606	(278,161)	24,332,841
Total	<u>\$ (3,462,180)</u>	<u>\$ 139,616,412</u>	<u>\$ (553,339)</u>	<u>\$ 74,718,125</u>	<u>\$ (4,015,519)</u>	<u>\$ 214,334,537</u>
	2015					
	Less than 12 Months		12 Months or Greater		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Debt securities:						
U.S. Treasury	\$ (316,037)	\$ 69,846,102	\$ (25,883)	\$ 16,136,004	\$ (341,920)	\$ 85,982,106
U.S. government agencies	(174,735)	33,537,890	(220)	96,536	(174,955)	33,634,426
Corporate	(227,092)	25,948,200	(266,300)	25,292,724	(493,392)	51,240,924
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	(119,596)	16,212,982	(72,425)	13,498,577	(192,021)	29,711,559
Municipal	(58,178)	11,299,595	(135,962)	16,657,022	(194,140)	27,956,617
Total	<u>\$ (895,638)</u>	<u>\$ 156,844,769</u>	<u>\$ (500,790)</u>	<u>\$ 71,680,863</u>	<u>\$ (1,396,428)</u>	<u>\$ 228,525,632</u>

Note 5 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

Fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Association has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Association's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 5 - Fair Value Measurements (Continued)

The following tables present information about the Association's assets measured at fair value on a recurring basis at December 31, 2016 and 2015 and the valuation techniques used by the Association to determine those fair values.

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2016
Debt securities:				
U.S. Treasury	\$ -	\$ 146,103,755	\$ -	\$ 146,103,755
U.S. government agencies	-	49,165,577	1,191,574	50,357,151
Corporate	-	106,636,127	-	106,636,127
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	61,094,547	-	61,094,547
Municipal	-	67,917,167	-	67,917,167
Total debt securities	-	430,917,173	1,191,574	432,108,747
Securities lending collateral - Short-term investments	-	34,281,109	-	34,281,109
Cash equivalents - Money market funds	8,367,372	-	-	8,367,372
Total assets	\$ 8,367,372	\$ 465,198,282	\$ 1,191,574	\$ 474,757,228

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2015			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2015
Debt securities:				
U.S. Treasury	\$ -	\$ 153,734,455	\$ -	\$ 153,734,455
U.S. government agencies	-	52,570,930	1,588,164	54,159,094
Corporate	-	94,853,423	-	94,853,423
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	64,076,556	112,182	64,188,738
Municipal	-	66,536,434	-	66,536,434
Total debt securities	-	431,771,798	1,700,346	433,472,144
Securities lending collateral - Short-term investments	-	41,926,447	-	41,926,447
Cash equivalents - Money market funds	10,952,729	-	-	10,952,729
Total assets	\$ 10,952,729	\$ 473,698,245	\$ 1,700,346	\$ 486,351,320

December 31, 2016 and 2015

Note 5 - Fair Value Measurements (Continued)

Fair values of debt securities are generally determined by a third-party valuation source. The Association performs periodic valuations of the fair value sourced from the independent pricing services. Such validation principally includes sourcing security prices from quoted market prices and other independent pricing services. The validation process provides the Association with information as to whether the volume and level of activity for a security has significantly decreased and assists in identifying transactions that are not orderly. Depending on the result of the validation, additional information may be gathered from other market participants to support the fair value measurements. A determination is made as to whether adjustments to the observable inputs are necessary as a result of investigation and inquiries about the reasonableness of the inputs used and the methodologies employed by the independent pricing services.

The following summarizes the valuation methodology used in determining fair value measurements of the significant classes of the Association's assets and liabilities measured at fair value on a recurring basis:

Level 1 Measurements

Money market funds - The fair value of these funds is based on unadjusted prices for the identical security in active markets that the Association can access.

Level 2 Measurements

U.S. Treasury, U.S. government agencies, corporate, and Treasury inflation-protected securities - The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, and credit spreads.

U.S. government RMBS (primarily FHLMC and FNMA pools) - The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, prepayment speeds, collateral performance, and credit spreads.

Municipal - The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active. Other characteristics used in this process include section/subsector of issuance, credit quality, and structural elements (coupon, maturity, redemption provisions, etc.).

Securities lending collateral - The primary inputs to the valuation of securities, which consist of short-term investments, include quoted prices for identical or similar assets in markets that are not active.

Level 3 Measurements

The following summarizes significant Level 3 inputs by security type:

U.S. government agencies - Primary inputs to the valuation are nonbinding broker quotes. Opinions of market participants, when available, are also used as inputs to pricing models. This is different from two-sided market data (noted above) in that dealer quotes are just bid quotes whereas two-sided markets provide bid and ask quotes. Other information about markets, sectors, and individual issuers (i.e., credit events, benchmark curves, etc.) that is received through media sources may also be used as a factor in the determination of prices. For example, credit events that could affect an issue or issuer are considered in the price of a security.

U.S. government RMBS (primarily FHLMC and FNMA pools) - Primary inputs to the valuation are nonbinding broker quotes and quotes from pricing vendors for identifiable securities or similar securities in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements. Other information about markets, sectors, and individual issuers (i.e., credit events, benchmark curves, etc.) that is received through media sources may also be used as a factor in the determination of prices. For example, credit events that could affect an issue or issuer are considered in the price of a security.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 5 - Fair Value Measurements (Continued)

Changes in Level 3 assets measured at fair value on a recurring basis for the years ended December 31, 2016 and 2015 are as follows:

	U.S. Government Agencies	U.S. Government RMBS
Balance at December 31, 2015	\$ 1,588,164	\$ 112,182
Purchases, issuances, sales, and settlements:		
Sales and maturities	(396,778)	(112,182)
Amortization	(3,225)	-
Total unrealized gains	<u>3,413</u>	<u>-</u>
Balance at December 31, 2016	<u>\$ 1,191,574</u>	<u>\$ -</u>
	U.S. Government Agencies	U.S. Government RMBS
Balance at January 1, 2015	\$ 2,414,192	\$ 113,615
Purchases, issuances, sales, and settlements:		
Purchases	36,377	-
Sales and maturities	(862,773)	(1,433)
Amortization	(3,224)	-
Total unrealized gains	<u>3,592</u>	<u>-</u>
Balance at December 31, 2015	<u>\$ 1,588,164</u>	<u>\$ 112,182</u>

Realized and unrealized gains and losses of \$1,817,410 and \$859,148 for the years ended December 31, 2016 and 2015, respectively, are reported in the revenue section in the statement of income and comprehensive income.

Fair value of Level 3 debt securities are generally determined by a third-party valuation source. The Association performs periodic validations of the fair value sourced from the independent pricing services. Such validation principally includes sourcing security prices from other independent pricing services or broker quotes. The validation process provides the Association with information as to whether the volume and level of activity for a security has significantly decreased and assists in identifying transactions that are not orderly. Depending on the results of the validation, additional information may be gathered from other market participants to support the fair value measurements. A determination will be made as to whether adjustments to the observable inputs are necessary as a result of investigations and inquiries about the reasonableness of the inputs used and the methodologies employed by the independent pricing services.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets and liabilities. As a result, the unrealized gains and losses for these assets and liabilities presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 6 - Property and Equipment

Property and equipment are summarized as follows:

	2016	2015	Depreciable Life - Years
Telephone systems	\$ 78,817	\$ 78,817	10
Furniture and equipment	974,364	958,230	10
Computer software and equipment	1,803,049	1,791,541	5
Leasehold improvements	310,558	310,558	Life of lease
Total cost	3,166,788	3,139,146	
Accumulated depreciation	2,834,214	2,763,883	
Net property and equipment	<u>\$ 332,574</u>	<u>\$ 375,263</u>	

Depreciation and amortization expense for 2016 and 2015 was \$86,571 and \$114,967, respectively.

Note 7 - Membership Assessments

The Association is authorized by the Texas Insurance Code, Chapter 462, Subchapter D, to assess member insurers in amounts necessary to pay both claims and administrative expenses of the Association. The current annual assessment ability is estimated below using the applicable 2015 premium information available from the Texas Department of Insurance and the Texas Comptroller's Office:

	Premium Base	Assessment Capability
Line of business:		
Automobile	\$ 20,144,655,119	\$ 402,893,102
Other lines	18,038,957,033	360,779,141
Workers' compensation	3,478,102,059	69,562,041
Total	<u>\$ 41,661,714,211</u>	<u>\$ 833,234,284</u>

In the event of a natural disaster or other catastrophic event, the Association may apply to the governor of Texas for authority to assess each member insurer that writes insurance coverage, other than motor vehicle or workers' compensation coverage, an additional amount not to exceed 2 percent of the insurer's net direct written premium for the preceding calendar year.

In the event that management believes the liabilities related to previous assessments have been successfully rundown, refunds of prior member assessments will be redistributed back to members based upon the percentage of the member's original assessment. The refund assessment redistributed to members during 2016 and 2015 was \$0.

Note 8 - Unpaid Claims and Unpaid Claims Adjustment Expense

The Association established liabilities for unpaid claims and claim adjustment expenses on reported and unreported claims of insured losses. These liabilities are based on management's estimates of the ultimate cost to settle all claims incurred. The establishment of appropriate liabilities is an inherently uncertain process. Changes in prior year liability estimates, which may be material, are reflected in the results of operations in the period such changes are determined to be needed.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 8 - Unpaid Claims and Unpaid Claims Adjustment Expense (Continued)

The following summarizes activity in the liability for unpaid claims and claim adjustment expenses as of December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Balance as of January 1	\$ 422,995,417	\$ 495,137,785
Included related to:		
Current year	52,491,450	57,677
Prior years	<u>(10,563,116)</u>	<u>(23,755,572)</u>
Total incurred (recovered)	41,928,334	(23,697,895)
Paid related to:		
Current year	6,886,188	175
Prior years	<u>35,404,644</u>	<u>48,444,298</u>
Total paid	<u>42,290,832</u>	<u>48,444,473</u>
Balance as of December 31	<u>\$ 422,632,919</u>	<u>\$ 422,995,417</u>

The liability for unpaid claims and claims adjustment expenses consists of estimates to settle claims of insolvent insurers. Once a member insurer becomes insolvent and is designated as impaired by the Commissioner of Insurance, the Association becomes responsible for processing its "covered claims." Claim files from the insolvent company are forwarded to the Association for claim handling and adjusting. The increase in 2016 incurred losses is a result of two new member insurer insolvencies designated as impaired by the Commissioner of Insurance during 2016. Losses incurred related to prior years decreased by approximately \$11 million and \$24 million in 2016 and 2015, respectively, as a result of favorable development. The Association believes it has, or has access to through its assessment authority, sufficient resources to fulfill its responsibilities with respect to member insurer insolvencies.

As noted in Note 7, the Association has the authority to assess members as necessary in subsequent years to meet its responsibility to pay claims of impaired companies. Assessment ability and recorded claims liability as of December 31, 2016 are as follows:

	<u>Claims Payable</u>	<u>Annual Assessment Capability</u>
Line of business:		
Automobile	\$ 33,689,888	\$ 402,893,102
Other lines	2,560,027	360,779,141
Workers' compensation	365,919,821	69,562,041
Loss adjustment expenses	<u>20,463,183</u>	No limit
Total	<u>\$ 422,632,919</u>	

Note 9 - Employee Benefit Plans

The Association has established a 401(a) defined contribution profit-sharing retirement plan which is open to all employees. The Association matches a portion of the employee's contributions based on a percentage of salary contributed by participants in the plan and may also contribute a discretionary amount for profit sharing. The Association's total contribution for 2016 and 2015 was \$247,458 and \$248,134, respectively.

Texas Property and Casualty Insurance Guaranty Association

Notes to Financial Statements

December 31, 2016 and 2015

Note 10 - Operating Leases

The Association leases office space under an operating lease agreement for the period from December 1, 2014 through November 30, 2024. Rental expense was \$572,721 and \$560,424 for 2016 and 2015, respectively.

Future minimum annual commitments under these operating leases are as follows:

Years Ending December 31	Amount
2017	\$ 553,705
2018	555,601
2019	576,460
2020	578,356
2021	599,215
Thereafter	<u>1,793,220</u>
Total	<u>\$ 4,656,557</u>

Note 11 - Loans Receivable and Early Access Distributions

Loans receivable consist of advances to, claim payments made, and expenses paid on behalf of impaired insurers. Early access distributions consist of distributions from receiverships. An allowance is made for all loans receivable, which makes all loans expensed as claims are paid. Any repayments of loans to the Association are recorded as revenue when received. Loans receivable by line of business as of December 31, 2016 and 2015 are as follows:

	2016	2015
Administrative	\$ 11,886,023	\$ 10,874,248
Automobile	40,223,298	32,819,467
Other lines	100,856,515	100,002,761
Workers' compensation	<u>138,396,421</u>	<u>125,835,338</u>
Total	291,362,257	269,531,814
Less allowance for uncollectible loans	<u>(291,362,257)</u>	<u>(269,531,814)</u>
Net loans receivable	<u>\$ -</u>	<u>\$ -</u>

December 31, 2016 and 2015

Note 11 - Loans Receivable and Early Access Distributions (Continued)

The following table represents collections on the loans receivable over the last 10 years. The variability of collection by year is significant and is affected by the composition of open estates as of the balance sheet date. Accordingly, and recognizing also the difficulty in estimation of collectible amounts in a given year, the Association elected to establish an uncollectible amount equivalent to the loan balance. This allows the Association to recognize revenue accurately per annum as distributions are received from the receivership estates, which is consistent with revenue recognition criteria as required by GAAP.

	Receivable at Start of Year	Distributions/ Recoveries	Percentage
2016	\$ 269,531,814	\$ 22,746,826	8.4 %
2015	254,291,186	35,452,683	13.9 %
2014	245,064,425	40,297,366	16.4 %
2013	230,831,989	21,133,024	9.2 %
2012	406,913,234	21,300,753	5.2 %
2011	618,998,415	30,978,093	5.0 %
2010	677,449,619	93,804,894	13.8 %
2009	702,109,895	65,754,480	9.4 %
2008	697,577,144	43,667,925	6.3 %
2007	672,519,076	27,232,245	4.0 %

Note 12 - Custodial Credit Risk of Bank Deposits

The Association maintains cash balances at various financial institutions. Cash accounts are insured up to \$250,000 per depositor. As of December 31, 2016 and 2015, the Association's cash balances totaled \$7,666,813 and \$5,411,285, respectively. At various times during the year, the Association's cash balances are in excess of FDIC insurance coverage. Management believes the Association's cash balances are held in high-quality institutions, and therefore, the Association's credit risk is at an acceptable level.

Note 13 - Concentrations

Most of the Association's business activity, assessment revenue, and advances are derived from the insurance industry in the state of Texas. At year end, all of the Association's loans receivable are from companies that are operating or have operated in Texas.

Note 14 - Securities Lending

The Association participates in a securities lending program with Northern Trust, its custodian, primarily for its U.S. Treasury and Agency obligations. These securities are loaned in exchange for collateral, which can be in the form of cash or U.S. Treasury, and U.S. government agency bond securities. Collateral under the securities lending program is maintained at a minimum of 102 percent of the market value of the securities loaned. Both the collateral and the securities loaned are marked-to-market on a daily basis so that all loaned securities are more than fully collateralized at all times. Collateral received is invested in a segregated account managed by Northern Trust. The agreement term is indefinite; however, the Association may terminate a loan at any time, whereby Northern Trust shall deliver equivalent securities to the Association within (a) the customary delivery period for such securities, (b) five business days, or (c) the time negotiated for such delivery by the Association and Northern Trust, whichever period is least, and the Association shall concurrently therewith deliver collateral identical to the collateral provided by Northern Trust.

Note 14 - Securities Lending (Continued)

Although the Association’s securities lending activities are collateralized as described above, and although the terms of the securities lending agreement with Northern Trust require Northern Trust to comply with government rules and regulations related to the lending securities held by the Association, the securities lending program involves both market and credit risk. In this context, market risk refers to the possibility that the borrower of securities will be unable to collateralize its loan upon a sudden material change in the fair value of the loaned securities or the collateral, or that Northern Trust’s investment of collateral received from the borrowers of the Association’s securities may be subject to unfavorable market fluctuations. Credit risk refers to the possibility that counterparties involved in the securities lending program may fail to perform in accordance with the terms of their contracts.

At December 31, 2016 and 2015, the fair value of securities loaned in the portfolio was \$33,435,850 and \$40,884,949, respectively. At December 31, 2016 and 2015, collateral held for securities lending was \$34,281,109 and \$41,926,447, respectively. Collateral received consists of cash, which was reinvested in various short-term investments (primarily certificates of deposit and commercial paper) held by Northern Trust as of December 31, 2016 and 2015. The value of the collateral held and a corresponding liability to return the collateral have been reported on the accompanying balance sheet. The collateral can only be accessed in the event that the institution borrowing the securities is in default under the lending agreement. As a result of these restrictions, we consider our securities lending activities to be noncash investing and financing activities.

The remaining contractual maturities of our securities lending agreements disaggregated by class of collateral pledged are as follows as of December 31, 2016:

	<u>Overnight and Continuous</u>
U.S. Treasury	\$ 12,277,402
U.S. government agencies	5,611,644
Corporate	<u>16,392,063</u>
Total	<u>\$ 34,281,109</u>

Additional Information

Independent Auditor's Report on Additional Information

To the Board of Directors
Texas Property and Casualty
Insurance Guaranty Association

We have audited the financial statements of Texas Property and Casualty Insurance Guaranty Association as of and for the years ended December 31, 2016 and 2015, and have issued our report thereon dated April 24, 2017, which contained an unmodified opinion on those financial statements. Our audits were performed for the purpose of forming an opinion on the financial statements as a whole. The schedule of operating expenses is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Plante & Moran, PLLC

April 24, 2017

Texas Property and Casualty Insurance Guaranty Association

Schedule of Operating Expenses

Years Ended December 31, 2016 and 2015

	Year ended December 31	
	2016	2015
Employment expenses	\$ 4,465,075	\$ 4,540,296
Employee relations	5,746	5,018
Education and staff development	59,443	58,576
Contract labor	33,205	10,140
Legal fees	105,663	100,028
Audit fees	90,110	152,962
Leasehold improvements	3,251	6,762
Office rent and overhead	572,721	560,424
Insurance - General	69,167	59,180
Furniture and equipment	18,674	17,874
Equipment rental	2,189	2,083
Computer systems	300,072	322,390
Telephone and telecommunications	24,404	21,984
Office supplies	30,505	36,553
Postage	52,123	71,869
Printing	10,616	7,905
Travel expenses	22,875	24,615
Professional meetings	5,948	8,651
Reference materials	13,998	15,070
Subscriptions and professional dues	150,502	140,552
Property Taxes	9,054	9,256
Depreciation and amortization expense	86,571	114,967
Total operating expenses	<u>\$ 6,131,912</u>	<u>\$ 6,287,155</u>