Texas Property and Casualty Insurance Guaranty Association

Financial Report
with Additional Information
December 31, 2018

Contents

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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, 2018 and 2017 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, 2018 and 2017 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 26, 2019

Texas Property and Casualty Insurance Guaranty Association

Balance Sheet

December 31, 2018 and 2017

	2018	2017
Assets		
Investments in debt securities	$ 409,718,541	$ 419,811,651
Cash and cash equivalents	6,270,468	9,623,713
Accounts receivable - Other	62,263	9,454
Accrued interest income	2,393,580	2,491,240
Loans receivable - Net of allowance for uncollectible loans of $328,599,079 and $313,527,203 in 2018 and 2017, respectively	-	-
Property and equipment - Net	317,061	300,602
Collateral from securities lending	10,637,242	15,585,058
Total assets	**$ 429,399,155**	**$ 447,821,718**
Liabilities and Equity		
Liabilities		
Accounts payable and accrued expenses	$ 1,065,753	$ 1,201,629
Obligations under securities lending	10,637,242	15,585,058
Unpaid claims and claims adjustment expenses	361,043,218	394,568,570
Early access distributions	18,720,731	20,080,360
Payable for securities	873,440	-
Total liabilities	392,340,384	431,435,617
Equity	37,058,771	16,386,101
Total liabilities and equity	**$ 429,399,155**	**$ 447,821,718**

See notes to financial statements.

Statement of Income and Comprehensive Income

Years Ended December 31, 2018 and 2017

	2018	2017
Revenue		
Distributions	$ 15,732,666	$ 15,638,619
Net investment income	9,612,020	8,506,295
Realized capital losses - Net	(2,643,158)	(16,240)
Gain on disposal of asset	500	250
Total revenue	22,702,028	24,128,924
Expenses		
Claims (recovered) incurred - Net	(3,271,600)	10,058,709
Subrogation and salvage recoveries	(2,561,050)	(3,927,206)
Operating expenses	6,110,589	6,264,692
Total expenses	277,939	12,396,195
Net Income	22,424,089	11,732,729
Other Comprehensive (Loss) Income		
Unrealized holding losses on securities arising during the year	(4,394,577)	(627,084)
Reclassification adjustment for losses included in net income	2,643,158	16,240
Total other comprehensive loss	(1,751,419)	(610,844)
Comprehensive Income	**$ 20,672,670**	**$ 11,121,885**

See notes to financial statements.

Statement of Equity

Years Ended December 31, 2018 and 2017

	Unassigned Funds	Accumulated Other Comprehensive Loss	Equity
Balance - January 1, 2017	$ 6,847,016	$ (1,582,800)	$ 5,264,216
Net income	11,732,729	-	11,732,729
Other comprehensive loss	-	(610,844)	(610,844)
Balance - December 31, 2017	18,579,745	(2,193,644)	16,386,101
Net income	22,424,089	-	22,424,089
Other comprehensive loss	-	(1,751,419)	(1,751,419)
Balance - December 31, 2018	**$ 41,003,834**	**$ (3,945,063)**	**$ 37,058,771**

See notes to financial statements.

Statement of Cash Flows

Years Ended December 31, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
Net income	$ 22,424,089	$ 11,732,729
Adjustments to reconcile net income to net cash and cash equivalents from operating activities:		
Depreciation and amortization	69,596	80,593
Gain on disposal of asset	(500)	(250)
Net amortization of premiums and discounts on debt securities	569,708	1,119,085
Realized capital losses - Net	2,643,158	16,240
Changes in operating assets and liabilities that (used) provided cash and cash equivalents:		
Accounts receivable - Other	(52,809)	7,158
Accrued interest income	97,660	(81,899)
Unpaid claims and claims adjustment expenses	(33,525,352)	(28,064,349)
Accounts payable and accrued expenses	(135,876)	(735,932)
Early access distributions	(1,359,629)	99,704
Net cash and cash equivalents used in operating activities	(9,269,955)	(15,826,921)
Cash Flows from Investing Activities		
Purchase of property and equipment	(86,055)	(38,588)
Proceeds from sale of assets	500	250
Purchases of investments	(202,639,003)	(160,425,889)
Proceeds from sales and maturities of investments in available-for-sale securities	208,641,268	169,880,676
Net cash and cash equivalents provided by investing activities	5,916,710	9,416,449
Net Decrease in Cash and Cash Equivalents	(3,353,245)	(6,410,472)
Cash and Cash Equivalents - Beginning of year	9,623,713	16,034,185
Cash and Cash Equivalents - End of year	**$ 6,270,468**	**$ 9,623,713**
Significant Noncash Transactions - Payable for securities	$ 873,440	$ -

See notes to financial statements.

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 and U.S. Treasury debt securities 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.

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 change 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. 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 collateral received and the corresponding liability to return the collateral. Cash received for collateral is reinvested in a fund managed by Northern Trust that consists of various short-term investments (primarily certificates of deposit and commercial paper). Noncash collateral consists of various U.S. Treasury securities and Federal National Mortgage Association mortgage-backed securities.

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, 2018 and 2017. 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." 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).

Note 2 - Significant Accounting Policies (Continued)

- 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).
- 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. No assessments were issued in 2018 or 2017.

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, 2018 and 2017. 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 Income (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. The Association does not believe this new standard will have a significant impact, as the Association does not invest in equity securities.

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 either the beginning of the earliest period presented or the beginning of the year of adoption. The effect of applying the new lease guidance on the financial statements is expected to increase long-term assets and long-term liabilities on the balance sheet. The changes in equity are not expected to be significant, as recognition and measurement of expenses and cash flows for leases will be substantially the same under the new standard.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*. The ASU includes changes to the accounting and measurement of financial assets, including the Association's accounts receivable and held-to-maturity debt securities by requiring the Association to recognize an allowance for all expected losses over the life of the financial asset at origination. This is different from the current practice where an allowance is not recognized until the losses are considered probable. The ASU also changes the way credit losses are recognized for available-for-sale debt securities. Credit losses are recognized through the recording of an allowance rather than as a write-down of the carrying value. The new guidance will be effective for the Association's year ending December 31, 2021. Upon adoption, the ASU will be applied using a modified retrospective transition method to the beginning of the earliest period presented. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. Early adoption for all institutions is permitted for fiscal years beginning after December 15, 2018.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20)*. The ASU shortens the amortization period for certain purchased callable debt securities held at a premium to the earliest call date rather than maturity. The standard is effective for fiscal years beginning after December 15, 2019 and must be adopted on a modified retrospective basis. The Association is still evaluating the impact the new standard will have on its financial statements.

Subsequent Events

The financial statements and related disclosures include evaluation of events up through and including April 26, 2019, 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, 2018 and 2017:

	2018	2017
Investment income:		
Debt securities	$ 9,943,467	$ 8,977,795
Cash and cash equivalents	86,871	35,172
Gross investment income	10,030,338	9,012,967
Investment expenses	(418,318)	(506,672)
Net investment income	$ 9,612,020	$ 8,506,295

Note 4 - Investments

Investments in securities classified as available for sale mature as follows:

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Treasury	$ 162,315,076	$ 785,990	$ (1,510,276)	$ 161,590,790
U.S. government agencies	39,258,302	97,594	(711,157)	38,644,739
Corporate	95,541,049	102,099	(2,010,606)	93,632,542
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	50,952,472	155,907	(949,124)	50,159,255
Municipal	65,596,731	556,059	(461,575)	65,691,215
Total	$ 413,663,630	$ 1,697,649	$ (5,642,738)	$ 409,718,541

	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Treasury	$ 168,637,489	$ 122,812	$ (1,840,875)	$ 166,919,426
U.S. government agencies	36,940,573	26,956	(706,065)	36,261,464
Corporate	93,675,311	476,122	(376,757)	93,774,676
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	56,321,321	291,011	(656,614)	55,955,718
Municipal	66,430,601	799,994	(330,228)	66,900,367
Total	$ 422,005,295	$ 1,716,895	$ (3,910,539)	$ 419,811,651

The amortized cost and fair value of the Association's investments in debt securities as of December 31, 2018 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	$ 18,425,399	$ 18,351,956
Due after one year through five years	246,417,026	244,035,622
Due after five years through ten years	97,003,733	96,101,995
Due after ten years	865,000	1,069,713
U.S. government RMBS	50,952,472	50,159,255
Total	$ 413,663,630	$ 409,718,541

Note 4 - Investments (Continued)

During the years ended December 31, 2018 and 2017, sales proceeds, gross realized gains, and gross realized losses on securities classified as available for sale were as follows:

	2018	2017
Sales proceeds	$ 159,721,055	$ 156,672,201
Gross realized gains	31,463	325,266
Gross realized losses	(2,674,621)	(341,506)
Net realized loss	$ (2,643,158)	$ (16,240)

As of December 31, 2018 and 2017, the portfolio included 281 and 195 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 2018 and 2017.

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, 2018 and 2017.

	2018					
	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	$ (59,228)	$ 15,656,645	$ (1,451,048)	$ 77,669,489	$ (1,510,276)	$ 93,326,134
U.S. government agencies	(5,885)	3,898,756	(705,272)	23,807,803	(711,157)	27,706,559
Corporate	(875,137)	50,765,483	(1,135,469)	30,500,122	(2,010,606)	81,265,605
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	(19,877)	4,965,893	(929,247)	32,687,967	(949,124)	37,653,860
Municipal	(87,563)	18,410,030	(374,012)	27,578,187	(461,575)	45,988,217
Total	$ (1,047,690)	$ 93,696,807	$ (4,595,048)	$192,243,568	$ (5,642,738)	$ 285,940,375

	2017					
	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	$ (896,765)	$105,153,846	$ (944,110)	$ 45,173,396	$ (1,840,875)	$ 150,327,242
U.S. government agencies	(14,246)	2,309,767	(691,819)	28,431,188	(706,065)	30,740,955
Corporate	(126,737)	20,976,572	(250,020)	22,335,204	(376,757)	43,311,776
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	(98,999)	18,976,847	(557,615)	24,745,786	(656,614)	43,722,633
Municipal	(78,217)	15,241,528	(252,011)	18,428,348	(330,228)	33,669,876
Total	$ (1,214,964)	$162,658,560	$ (2,695,575)	$139,113,922	$ (3,910,539)	$ 301,772,482

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.

The following tables present information about the Association's assets measured at fair value on a recurring basis at December 31, 2018 and 2017 and the valuation techniques used by the Association to determine those fair values.

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.

Note 5 - Fair Value Measurements (Continued)

Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy below.

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2018			
	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, 2018
Debt securities:				
U.S. Treasury	$ -	$ 161,590,790	$ -	$ 161,590,790
U.S. government agencies	-	38,560,033	84,706	38,644,739
Corporate	-	93,632,542	-	93,632,542
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	50,159,255	-	50,159,255
Municipal	-	65,691,215	-	65,691,215
Securities lending collateral - U.S. Treasury	-	5,598,183	-	5,598,183
Securities lending collateral - Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	4,334,778	-	4,334,778
Total debt securities	-	419,566,796	84,706	419,651,502
Securities lending collateral fund at NAV				704,281
Cash equivalents:				
Money market funds	3,699,803	-	-	3,699,803
U.S. Treasury	-	799,700	-	799,700
Total cash equivalents	3,699,803	799,700	-	4,499,503
Total assets	$ 3,699,803	$ 420,366,496	$ 84,706	$ 424,855,286

Note 5 - Fair Value Measurements (Continued)

	Assets Measured at Fair Value on a Recurring Basis at December 31, 2017			
	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, 2017
Debt securities:				
U.S. Treasury	$ -	$ 166,919,426	$ -	$ 166,919,426
U.S. government agencies	-	35,754,518	506,946	36,261,464
Corporate	-	93,774,676	-	93,774,676
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	55,955,718	-	55,955,718
Municipal	-	66,900,367	-	66,900,367
Total debt securities	-	419,304,705	506,946	419,811,651
Securities lending collateral fund at NAV				15,585,058
Cash equivalents - Money market funds	2,872,312	-	-	2,872,312
Total assets	$ 2,872,312	$ 419,304,705	$ 506,946	$ 438,269,021

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, and Corporate - 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 spread.

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.).

Note 5 - Fair Value Measurements (Continued)

Level 3 Measurements

*U.S. Government Agencie*s - 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.

Changes in Level 3 assets measured at fair value on a recurring basis for the years ended December 31, 2018 and 2017 are as follows:

	U.S. Government Agencies
Balance at January 1, 2018	$ 506,946
Purchases, issuances, sales, and settlements:	
Sales and maturities	(420,285)
Amortization	(4,569)
Total unrealized gains	2,614
Balance at December 31, 2018	$ 84,706

	U.S. Government Agencies
Balance at January 1, 2017	$ 1,191,574
Purchases, issuances, sales, and settlements:	
Sales and maturities	(684,447)
Amortization	(3,186)
Total unrealized gains	3,005
Balance at December 31, 2017	$ 506,946

Fair value of Level 3 debt securities is 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.

Note 5 - Fair Value Measurements (Continued)

Investments in Entities that Calculate Net Asset Value per Share

The Association holds shares or interests in investment companies at year end whereby the fair value of the investment held is estimated based on the net asset value per share (or its equivalent) of the investment company. See Note 14 for further information.

Note 6 - Property and Equipment

Property and equipment are summarized as follows:

	2018	2017	Depreciable Life - Years
Telephone systems	$ 78,817	$ 78,817	10
Furniture and equipment	1,000,087	998,080	10
Computer software and equipment	1,898,620	1,820,308	5
Leasehold improvements	310,558	310,558	Life of lease
Total cost	3,288,082	3,207,763	
Accumulated depreciation	2,971,021	2,907,161	
Net property and equipment	$ 317,061	$ 300,602	

Depreciation and amortization expense for 2018 and 2017 was $69,596 and $80,593, 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 2017 premium information available from the Texas Department of Insurance and the Texas Comptroller's Office:

	Premium Base	Assessment Capability
Line of business:		
Automobile	$ 24,401,715,064	$ 488,034,301
Other lines	20,098,618,652	401,972,373
Workers' compensation	2,850,195,813	57,003,916
Total	$ 47,350,529,529	$ 947,010,590

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 run down, 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 2018 and 2017 was $0.

Note 8 - Unpaid Claims and Claims Adjustment Expenses

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.

The following summarizes activity in the liability for unpaid losses and loss adjustment expenses as of December 31, 2018 and 2017:

	2018	2017
Net balance at January 1	$ 394,568,570	$ 422,632,919
Incurred (recovered) related to:		
Current year	45,733	8,357,284
Prior years	(3,317,333)	1,701,425
Total (recovered) incurred	(3,271,600)	10,058,709
Paid related to:		
Current year	5,900	597,995
Prior years	30,247,852	37,525,063
Total paid	30,253,752	38,123,058
Net unpaid losses and LAE as of December 31	$ 361,043,218	$ 394,568,570

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 decrease in 2018 incurred losses is a result of smaller and fewer new member insurer insolvencies designated as impaired by the commissioner of insurance during 2018. Losses incurred related to prior years decreased approximately $3 million in 2018, as a result of favorable development. Losses incurred related to prior years increased by approximately $2 million in 2017 as a result of unfavorable 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, 2018 are as follows:

	Claims Payable	Annual Assessment Capability
Line of business:		
Automobile	$ 7,433,673	$ 488,034,301
Other lines	312,191	401,972,373
Workers' compensation	338,491,236	57,003,916
Loss adjustment expenses	14,806,118	No limit
Total	$ 361,043,218	

Note 9 - Employee Benefit Plans

The Association sponsors a 401(a) plan which is open to all employees. The plan provides for the Association to match 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 contributions to the plan totaled $246,449 and $250,770 for the years ended December 31, 2018 and 2017, respectively.

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 $608,230 and $628,227 for 2018 and 2017, respectively.

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

Years Ending December 31	Amount
2019	$ 576,460
2020	578,356
2021	599,215
2022	601,111
2023	621,970
Thereafter	570,139
Total	$ 3,547,251

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, 2018 and 2017 are as follows:

	2018	2017
Administrative	$ 14,968,391	$ 17,402,159
Automobile	50,037,538	45,409,094
Other lines	99,824,059	100,660,200
Workers' compensation	163,769,091	150,055,750
Total	328,599,079	313,527,203
Less allowance for uncollectible loans	(328,599,079)	(313,527,203)
Net loans receivable	$ -	$ -

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

The following table represents collections on the loans receivable over the last 10 years. Collections on the loan receivable include distributions and subrogation and salvage recoveries, which are reported separately on the statement of income and comprehensive income. 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
2018	$ 313,527,203	$ 18,293,716	5.8 %
2017	291,362,257	19,565,825	6.7 %
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 %

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, 2018 and 2017, the Association's cash balances totaled $6,929,611 and $11,873,122, respectively. During most of 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, U.S. Treasury securities or Federal National Mortgage Association mortgage-backed 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 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, 2018 and 2017, the fair value of securities loaned in the portfolio was $10,282,060 and $15,259,609, respectively. At December 31, 2018 and 2017, collateral held for securities lending was $10,637,242 and $15,585,058, respectively. Noncash collateral received in the form of U.S. Treasury securities was $5,598,183 and $0 as of December 31, 2018 and 2017, respectively, and noncash collateral in the form of Federal National Mortgage Association mortgage-backed securities was $4,334,778 and $0 as December 31, 2018 and 2017. Cash collateral received was $704,281 and $15,585,058 as of December 31, 2018 and 2017, respectively, which was reinvested in a fund held by Northern Trust. This fund consists of various short-term investments (primarily certificates of deposit and commercial paper). 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, 2018:

	Overnight and Continuous
U.S. government agencies	$ 4,330,451
Corporate	6,306,791
Total	$ 10,637,242

Additional Information

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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, 2018 and 2017 and have issued our report thereon dated April 26, 2019, 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 26, 2019

Schedule of Operating Expenses

Years Ended December 31, 2018 and 2017

	Year ended December 31	
	2018	2017
Employment expenses	$ 4,496,543	$ 4,538,264
Employee relations	9,012	8,923
Education and staff development	59,360	62,014
Contract labor	16,829	28,979
Legal fees	84,338	123,507
Audit fees	52,271	73,689
Leasehold improvements	6,406	3,217
Office rent and overhead	608,230	628,227
Insurance - General	72,688	82,453
Furniture and equipment	28,496	13,180
Equipment rental	2,360	3,853
Computer systems	304,248	303,844
Telephone and telecommunications	22,246	23,660
Office supplies	23,546	32,329
Postage	38,045	44,061
Printing	4,898	4,299
Travel expenses	22,325	26,427
Professional meetings	6,534	6,125
Reference materials	12,843	14,330
Subscriptions and professional dues	162,121	154,498
Property taxes	7,654	8,220
Depreciation and amortization expense	69,596	80,593
Total operating expenses	$ 6,110,589	$ 6,264,692