

**TEXAS PROPERTY AND CASUALTY
INSURANCE GUARANTY ASSOCIATION**

ANNUAL FINANCIAL REPORT

DECEMBER 31, 2008

West, Davis & Company

a limited liability partnership

INDEPENDENT AUDITORS' REPORT

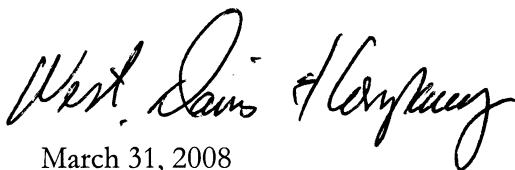
Board of Directors
Texas Property and Casualty Insurance Guaranty Association
Austin, Texas

We have audited the accompanying statements of net assets of Texas Property and Casualty Insurance Guaranty Association (the Association) as of December 31, 2008, and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. 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 of financial misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2008 and 2007, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this supplemental information. However, we did not audit the information and express no opinion on it.



March 31, 2008

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Texas Property and Casualty Insurance Guaranty Association (the Association), Annual Financial Report presents management's discussion and analyzes the Association's financial performance for the fiscal year ended December 31, 2008. This section of the report should be read in conjunction with the independent auditors' report on page 1, and the Association's financial statements, which begin on page 6.

FINANCIAL HIGHLIGHTS

- The Association's deficit of net assets of \$85.8 million decreased by \$50.0 million as a result of this year's operations.
- During the year, the Association had operating expenses that were \$330,000 more than last year. Claims payments decreased by \$14.8 million over last year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Association is considered a governmental organization for accounting, financial reporting, and auditing purposes. Organizations other than public corporations and bodies corporate and politic are classified as governmental organizations if they have one or more of the following characteristics:

- Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments;
- The potential for unilateral dissolution by a government with the net assets reverting to a government; or
- The power to enact and enforce a tax levy.

The Association's governing body is comprised of five insurance industry members and four public members. Insurance industry members of the Board are elected by the Association member companies and approved by the Commissioner of Insurance for the State of Texas. Public members are appointed by the Commissioner. Therefore, the Association exhibits one of the characteristics and is considered to be a governmental organization for accounting, financial reporting, and auditing purposes.

As a special purpose governmental organization engaged in business type activities, the basic financial statements of the Association are presented similarly to an enterprise fund as defined by the Governmental Accounting Standards Board. Enterprise funds are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. Accordingly, revenues are recognized when earned, and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow.

This report consists of three parts – *management's discussion and analysis* (this section), *independent auditor's opinion*, and *accrual basis financial statements*.

The basic financial statements include:

- Statement of Net Assets includes all of the Association's assets and liabilities. The difference between the Association's assets and liabilities is its net assets. Net assets are presented in two components – unrestricted and restricted.
- Statement of Revenues, Expenses and Changes in Net Assets report all of the Association's revenues and expenses. The statement measures the results of the Association's operations.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008

- The Statement of Cash Flows supplements the Statement of Net Assets and Statements of Revenues, Expenses and Changes in Net Assets by providing relevant information about cash receipts and payments of the Association.
- The Notes to the Financial Statements present information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements. The notes are an integral part of the basic financial statements.

FINANCIAL ANALYSIS OF THE ASSOCIATION

The Association's deficit net assets went from \$85.8 million in 2007 to \$35.8 million in 2008.

Table I
Texas Property and Casualty Insurance Guaranty Association

NET ASSETS		
in thousands		
	2008	2007
Current and other assets	406,403	372,057
Capital assets	1,440	1,500
Total assets	407,843	373,557
Long-term liabilities	406,800	412,958
Other liabilities	36,847	46,418
Total liabilities	443,647	459,376
Total net assets (deficit)	(35,804)	(85,819)

Table II
Texas Property and Casualty Insurance Guaranty Association

CHANGES IN NET ASSETS		
in thousands		
	2008	2007
Revenues	77,841	54,558
Claims Activities	(20,405)	15,534
Refunds	-	(18,906)
Operating Expenses	(7,417)	(7,087)
Increase (Decrease) in net assets	50,019	44,099
Gain (Loss) on Sale of Property and Equipment	(4)	0
Net assets (Deficit) Beginning	(85,819)	(129,918)
Net assets (Deficit) Ending	(35,804)	(85,819)

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
 December 31, 2008

The Association experienced a decrease in claim payments of \$14.8 million in 2008 compared to total payments of \$51.4 million in 2007. Total payments for 2008 and 2007 by line of business and claims administrative expenses (ALAE) and operating expenses are reflected in Figure 1.

Figure 1: Total Payments (In Millions)

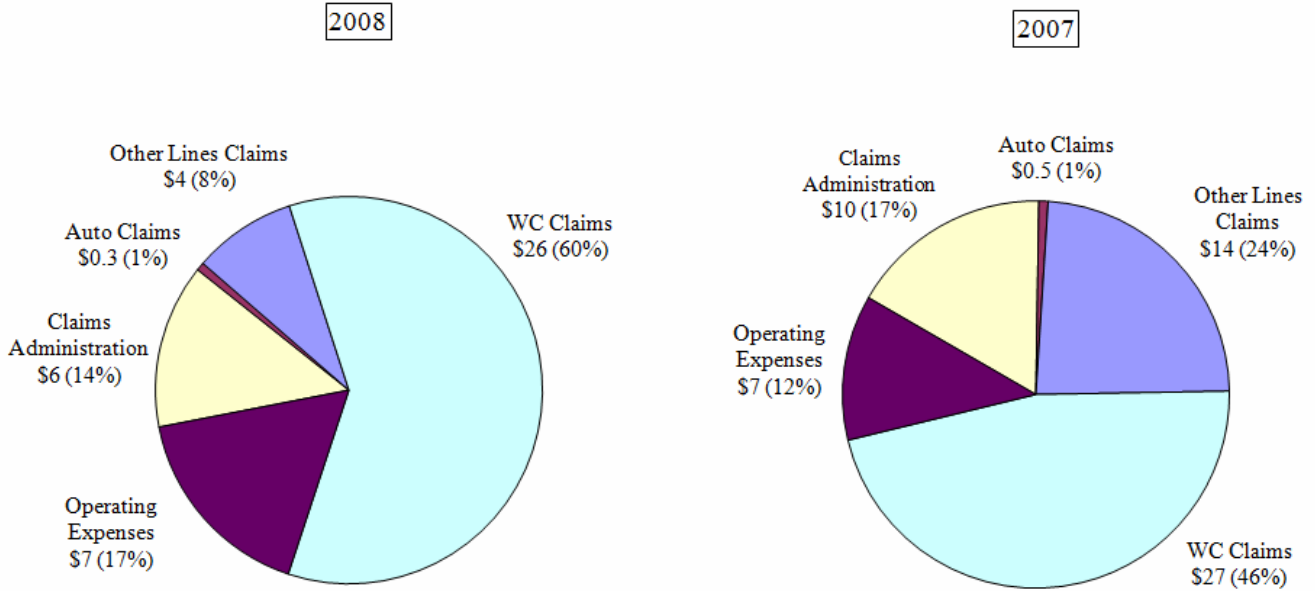
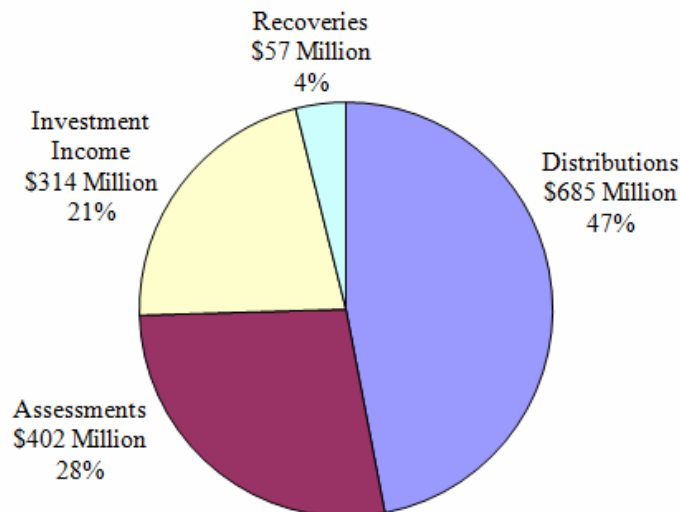


Figure 2 Sources of Funds 1993-2008 illustrates the Association's sources of revenue over fifteen years of history. Distributions from receivership estates are the most significant category at \$685 million representing 47% of total revenues. Assessments paid by member companies represent \$402 million or 28% of revenues with Investment Income representing \$314 million or 21% of total revenues. Recoveries from subrogation, net worth, etc. total \$57 million or 4%. Distributions received by the Association during the early portion of the estate process benefit the Association, member companies and the public as these assets can be invested earlier with the corresponding investment income available for payment of covered claims as the estate progresses.

Figure 2: Sources of Funds - 1993-2008



TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2008

ECONOMIC FACTORS AND NEXT YEAR'S ACTIVITIES

Current cash flow projections indicate the Association has adequate investment assets to meet current claim obligations. Claim payments during the first three months of 2009 total \$10.1 million compared to \$10.2 million for the same period in 2008. We anticipate 2009 total claim payments will continue along this pattern. However, the Association anticipates new insolvency activity is probable during the balance of this year. Accordingly, we will continue to review and report to our Board on insolvency activity and cash flow, and make assessment recommendations for their review and approval as the needs of the Association require.

CONTACTING THE ASSOCIATION'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Association's finances and to show the Association's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Association's business office at Texas Property and Casualty Insurance Guaranty Association, 9120 Burnet Road, Austin, Texas 78758.

FINANCIAL STATEMENTS

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

STATEMENT OF NET ASSETS

December 31

	2008	2007
<u>ASSETS</u>		
Current Assets:		
Cash and Cash Equivalents (Notes 1 and 2)	\$ 9,326,233	\$ 4,633,489
Investments, at Fair Value (Note 3)	396,893,133	367,421,958
Accounts Receivable - Other	184,281	2,060
Total Current Assets	406,403,647	372,057,507
Noncurrent Assets:		
Loans Receivable (Note 5):		
Administrative	\$ 10,712,411	\$ 17,460,857
Auto	126,605,307	126,545,867
Other Lines	222,307,730	222,301,068
Workers' Compensation	342,484,447	331,269,352
Total Loans Receivable	702,109,895	697,577,144
Allowance for Doubtful Accounts (Notes 1 and 5)	(702,109,895)	(697,577,144)
Net Loans Receivable	-	-
Property and Equipment (Note 1):		
Furniture and Equipment	867,305	845,806
Computer Systems	1,444,662	1,303,989
Telephone Systems	89,196	89,196
Company Vehicles	62,643	58,277
Leasehold Improvements	294,545	299,156
Accumulated Depreciation	(1,318,608)	(1,096,636)
Net Property and Equipment	1,439,743	1,499,788
Total Noncurrent Assets	1,439,743	1,499,788
TOTAL ASSETS	\$ 407,843,390	\$ 373,557,295

The accompanying notes are an integral part of these financial statements.

	<u>2008</u>	<u>2007</u>
<u>LIABILITIES</u>		
Current Liabilities:		
Accounts Payable and Accrued Liabilities	\$ 1,496,754	\$ 1,193,063
Outstanding Checks	5,350,641	5,225,279
Current Portion of Claims Payable (Note 6)	30,000,000	40,000,000
Total Current Liabilities	<u>36,847,395</u>	<u>46,418,342</u>
Long Term Liabilities:		
Claim Liabilities (Note 6):		
Loss Adjustment Expense	14,533,424	14,860,157
Auto	1,476,684	1,663,984
Other Lines	8,048,930	15,363,353
Workers' Compensation	353,231,060	359,363,803
Total Long Term Claim Liabilities	<u>377,290,098</u>	<u>391,251,297</u>
Other Long Term Liabilities:		
Early Access Distributions (Note 6)	29,509,912	21,706,735
Total Other Long Term Liabilities	<u>29,509,912</u>	<u>21,706,735</u>
Total Long Term Liabilities	<u>406,800,010</u>	<u>412,958,032</u>
TOTAL LIABILITIES	<u>\$ 443,647,405</u>	<u>\$ 459,376,374</u>
Net Assets, Invested in Capital Assets	1,439,743	1,499,788
Net Assets (Deficit), Unrestricted (Note 7)	(37,243,758)	(87,318,867)
Total Net Assets	<u>(35,804,015)</u>	<u>(85,819,079)</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 407,843,390</u>	<u>\$ 373,557,295</u>

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the Years Ended December 31

	2008	2007
Revenues:		
Distributions	\$ 38,904,655	\$ 14,416,842
Assessments	-	-
Investment Income, Net (Note 10)	34,067,307	27,051,694
Interest on Accounts	80,957	273,796
Subrogation and Salvage Recoveries	4,763,271	12,815,402
Miscellaneous Income	24,892	1
Total Revenues	77,841,082	54,557,735
Claims Activity:		
Claims Payments:		
Claims Administration	6,047,898	9,885,236
Auto	301,755	449,457
Other Lines	3,795,599	13,862,537
Workers' Compensation	26,417,432	27,178,304
Total Claims Payments	36,562,684	51,375,534
Change in Claims Liabilities	(16,158,021)	(66,909,780)
Total Claims Activity	20,404,663	(15,534,246)
Refund of Prior Year Distributions and Interest	-	18,906,002
Excess (Deficiency) of Revenues over Claims Activity and Refunds	57,436,419	51,185,979

The accompanying notes are an integral part of these financial statements.

	<u>2008</u>	<u>2007</u>
Operating Expenses:		
Employment Expenses	\$ 5,090,002	\$ 4,747,665
Employee Relations	13,982	25,128
Education and Staff Development	99,842	98,070
Contract Labor	17,988	8,330
Legal Fees	10,979	28,576
Audit Fees	9,500	14,500
Consulting	41,689	81,350
Leasehold Improvements	7,097	2,948
Office Rent and Overhead	442,087	413,594
Insurance	59,542	59,692
Furniture and Equipment	12,992	30,203
Equipment Rental	1,415	1,512
Computer Systems	810,713	748,824
Telephone	34,785	41,230
Office Supplies	36,403	43,750
Postage and Delivery	109,468	160,908
Printing	7,838	11,183
Advertising-Employee Procurement	-	1,494
Travel	66,287	85,452
Professional Meetings	28,594	34,172
Reference Materials	20,131	18,682
Subscriptions and Professional Dues	122,655	97,996
Property Taxes	11,431	13,592
Bank Charges	55,693	71,423
Depreciation Expense	306,097	246,680
Total Operating Expenses	<u>7,417,210</u>	<u>7,086,954</u>
Increase (Decrease) in Net Assets	50,019,209	44,099,025
Gain (Loss) on Sale of Property and Equipment	(4,145)	-
Beginning Net Assets (Deficit) at January 1	<u>(85,819,079)</u>	<u>(129,918,104)</u>
Net Assets (Deficit) at December 31	<u><u>\$ (35,804,015)</u></u>	<u><u>\$ (85,819,079)</u></u>

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

STATEMENT OF CASH FLOWS

For the Years Ended December 31

	2008	2007
Cash Flows from Operating Activities:		
Decrease in Net Assets	\$ 50,019,209	\$ 44,099,025
Adjustments to Reconcile Decrease in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation Expense	306,097	246,680
Unrealized Gains (Losses) on Investments	(12,963,299)	(7,702,037)
Change in Assets and Liabilities:		
(Increase) Decrease in Assessments Receivable	-	-
(Increase) Decrease in Other Assets	(182,221)	153,381
Increase (Decrease) in Claims Liabilities	(16,158,022)	(66,909,780)
Increase (Decrease) in Other Liabilities	429,052	(10,426,350)
Total Adjustments	(28,568,393)	(84,638,106)
Net Cash (Used) Provided by Operating Activities	21,450,816	(40,539,081)
Cash Flows from Investing Activities:		
Capital Expenditures	(258,697)	(966,409)
Sale of Property and Equipment	12,644	-
Gain (Loss) on Sale of Property and Equip.	(4,144)	-
Purchase of Investments	(324,457,729)	(314,302,388)
Proceeds from Sales and Maturities of Investments	307,949,854	350,148,756
Net Cash (Used) Provided by Investing Activities	(16,758,072)	34,879,959
Net Increase (Decrease) in Cash and Cash Equivalents	4,692,744	(5,659,122)
Cash and Cash Equivalents at January 1	4,633,489	10,292,611
Cash and Cash Equivalents at December 31 (Note 2)	\$ 9,326,233	\$ 4,633,489

The accompanying notes are an integral part of these financial statements.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2008

1. Summary of Significant Accounting Policies

Organization - 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) to protect holders of covered claims, contracts of reinsurance, assumption of liabilities or otherwise.

The Association is considered a governmental not-for-profit organization and is a component unit of the State of Texas for financial reporting purposes. The accompanying financial statements comply with the reporting requirements of a governmental not-for-profit organization.

Membership in the Association is mandatory for any insurance company authorized in 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 purposes 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.

Basis of Accounting - The financial statements are presented on the accrual basis of accounting; consequently, revenue is recognized when earned, and expenses are recognized when the obligations are incurred. Assessment revenue is recognized when billed. Claims liability is recognized using estimates of claims outstanding for each impaired insurer at the date of impairment.

Tax Exempt Status - 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.

Cash Equivalents - For purposes of the statement of cash flows, the Association considers all highly liquid investments to be cash equivalents. This includes checking account balances and mutual fund investments.

Investments - Investments are carried at fair value.

Derivatives - Mortgage-backed Pass-through Securities are used to enhance the Association's investment rate of return and are recorded at market value. The Association's involvement in derivatives is limited with the level of investment not to exceed 30% of the portfolio. The balance of derivatives at December 31, 2008, and 2007, represented 24% and 30.5%, respectively of the portfolio's fair value.

Furniture, Equipment and Leasehold Improvements - Fixed assets are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the individual assets, ranging from five to ten years.

Allowances for Uncollectible Loans - The Association fully reserves for all such loans; therefore, loan repayments are recorded as revenue when received in cash.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

(continued)

2. Cash and Cash Equivalents

Cash and cash equivalents at December 31, consisted of the following:

	2008	2007
Cash in Bank	\$ 22,210	\$ 57,424
Cash on Hand	300	300
Mutual Funds	9,303,723	4,575,765
	<u>\$ 9,326,233</u>	<u>\$ 4,633,489</u>

The Association's mutual fund investments are not insured by the Federal Deposit Insurance Corporation nor are they a deposit or other obligation of, or guaranteed by a bank or other depository institution. Mutual fund investing is subject to investment risks, including possible loss of the principal amount invested.

At December 31, 2008 the Association maintained demand accounts with bank balances within federally insured limits. The carrying value of these demand accounts, resulting from uncollected items and outstanding checks, was \$22,210 in 2008 and \$57,424 in 2007.

3. Investments

The Association's investment policy sets guidelines and parameters through which investment managers have full discretion. Securities must have maturity dates within ten years of the date of purchase, with the exception of Mortgage-backed Pass-through Securities. The following securities and investment transactions are acceptable for investment if they meet the restrictions set forth in the Investment Policy:

- A. Direct security repurchase agreements (underlying security must be U.S. Treasury securities);
- B. Reverse security repurchase agreements (underlying security must be U.S. Treasury securities);
- C. Direct obligations of or obligations where the principal and interest of which are guaranteed by the United States;
- D. Direct obligations of or obligations guaranteed by agencies or instrumentalities of the United States government;
- E. Bankers' acceptances that:
 - are eligible for purchase by the Federal Reserve System;
 - do not exceed 270 days to maturity; and
 - are issued by a bank that has received the highest short term credit rating by a nationally recognized investment rating firm;
- F. Commercial paper that:
 - does not exceed 270 days to maturity; and
 - has received the highest short term credit rating by a nationally recognized investment rating firm;

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

(continued)

3. Investments, continued

- G. Direct obligations of or obligations guaranteed by the Inter-American Development Bank, the International Bank for Reconstruction and Development (the World Bank), the African Development Bank, the Asian Development Bank, and the International Finance Corporation that have received the highest credit rating by a nationally recognized investment rating firm;
- H. Direct obligations of a state or an agency, county, city, or other political subdivision of a state (the municipal securities shall be rated A or better on long term debt and A-1 or SP-1 for short-term maturity assets or the equivalent by a nationally recognized rating service). Investments shall be limited to no more than 1% investment in any one single issuer's debt.
- I. Mutual funds which invest only in direct obligations of a state or an agency, county, city or other political subdivision of a state (no M.U.D.s allowed);
- J. Bank certificates of deposit; must be purchased from domestic and foreign banking institutions with U.S. branches ("Yankee CDs") that have ratings similar to those used for purchasing commercial paper and bankers' acceptances. Investments shall be limited to no greater than 10% of an individual bank's total capital, surplus and undivided profits.
- K. Mutual funds which invest only in investments described in some or all of the items (A) through (J) above.
- L. Mortgage-backed Pass-through Securities must be AAA rated by Standard & Poor's or Moody's and have prepayment assumptions of ten years or less if they have price liquidity characteristics documentably similar to ten year or shorter investments. The total aggregate of Mortgage-backed Pass-through Securities cannot exceed 30% of the manager's total portfolio. Inverse floaters are not allowed. Investments are limited to GNMA, FNMA or FHLMC obligations.
- M. Security lending is authorized through the investment custodian, but the collateral accepted must meet the following guidelines: a) collateral is maintained at a minimum level of 102% of market value or greater; b) the collateral is valued daily to assure the required collateral level; c) the collateral is held by the Association or its third party custodian; and d) collateral is always cash, U.S. government securities or U.S. government agency or instrumentality securities. Securities lending activities must be governed by a Master Agreement.

Investments at December 31, were as follows:

2008	Maturity	Ratings	Fair Value	% of Fair Value
U.S. Treasury Issues	2010 –2038	TSY	\$120,440,063	30.3%
Federal Agency Issues	2010 –2037	AGY	117,229,169	29.5%
Municipal/Provincial Bonds	2009 –2018	A / AAA	46,414,202	11.7%
Mortgage-backed Pass-through Securities (Derivatives)	2009 - 2039	AGY	95,097,075	24.0%
Cash Equivalents	--	--	13,866,170	3.5%
Accrued Interest	--	--	3,846,454	1.0%
Total at December 31, 2008			<u>\$ 396,893,133</u>	<u>100.0%</u>

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
December 31, 2008
(continued)

3. Investments, continued

2007	Maturity	Ratings	Fair Value	% of Fair Value
U.S. Treasury Issues	2010 –2017	TSY	\$ 98,846,757	26.9%
Federal Agency Issues	2008 –2032	AGY	108,036,709	29.4%
Municipal/Provincial Bonds	2008 –2017	A / AAA	41,893,983	11.4%
Mortgage-backed Pass-through Securities (Derivatives)	2008 - 2037	AGY	112,011,699	30.5%
Cash Equivalents	--	--	2,923,369	0.8%
Accrued Interest	--	--	3,709,441	1.0%
Total at December 31, 2007			<u>\$ 367,421,958</u>	<u>100.0%</u>

The following methods and assumptions were used to estimate the fair value of each class of investment:

Short Term Promissory Notes, Outside Managed Treasury Mutual Funds and Accrued Interest:

The cost of these investments approximates fair value because of the short maturity of those instruments.

U.S. Treasury Bills, Notes, Government Agency Bonds, U.S. Government Agency Discount Notes, Government National Mortgage Association, African Development Bank and Asian Development Bank:

The fair values of debt securities are based on quoted market prices at the reporting date for those investments.

Mortgage-backed Pass-through Securities (Derivatives):

The fair value of these investments is estimated by obtaining quotes from brokers.

Analysis of Specific Deposit and Investment Risks:

GASB Statement No. 40 requires a determination as to whether the Association was exposed to the following specific investment risks at year end and if so, the reporting of certain related disclosures:

A. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ratings of securities by nationally recognized rating agencies are designed to give an indication of credit risk. At year end, the Association's investments were rated as noted above.

B. Custodial Credit Risk

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the Association's name.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the Association's name.

At year end, the Association was not exposed to custodial credit risk.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

(continued)

3. Investments, continued

C. Concentration of Credit Risk

This risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. At year end, the Association's investments representing more than 5% of total investments are disclosed above.

D. Interest Rate Risk

This the risk that changes in interest rates will adversely affect the fair value of an investment. At year end, the Association does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

E. Foreign Currency Risk

This is the risk that exchange rates will adversely affect the fair value of an investment. At year end, the Association was not exposed to foreign currency risk.

4. 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.

Annual assessment ability is estimated below using the most recent premium information available (2007):

<u>Line-of-Business</u>	<u>Premium Base</u>	<u>Assessment Capability</u>
Automobile	\$ 13,859,435,990	\$ 277,188,720
Other Lines	13,012,816,215	260,256,324
Workers' Compensation	4,258,644,726	85,172,895
	<u>\$ 31,130,896,931</u>	<u>\$ 622,617,939</u>

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

5. Loans Receivable

Loans receivable consist of advances to and claims payments made and expenses paid on behalf of impaired insurers. An allowance is made for these loans in total; therefore, these loans are expensed when made. Any repayments of the loans are recorded as revenue when received in cash.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

(continued)

6. Claims Liability

The liability for claims payable is an estimated amount for all impaired companies. No provision is made for repayments or recoveries; such recoveries are recognized when received in cash. Early access distributions are recorded as long term liabilities until those estates are closed.

7. Net Assets

The Association has the authority to assess members as necessary in subsequent years to meet its responsibility to pay claims of these impaired companies. Assessment ability and recorded claims liability at December 31, 2008, are as follows:

Line-of-Business	Claims Payable	Annual Assessment Capability
Automobile	\$ 1,476,684	\$ 277,188,720
Other Lines	8,048,930	260,256,324
Workers' Compensation	353,231,060	85,172,895
Loss Adjustment Expenses	<u>14,533,424</u>	No Limit
Long Term	377,290,098	
Current	<u>30,000,000</u>	
Total	<u>\$ 407,290,098</u>	

As mentioned in Note 4, the Association, in the event of a natural disaster or other catastrophic event, may have additional assessment capability.

Assessments are made annually based on annual cash flow needs to meet claims liabilities as paid in cash. No provision has been made for recoveries from company assets to meet these obligations.

8. Commitments and Contingencies

The Association leases certain office space. This lease expires in November 2014. The Association is obligated for the following minimum lease payments:

	Minimum Lease Payment
2009	\$ 394,420
2010	394,420
2011	394,420
2012	394,420
2013	394,420
2014	<u>361,552</u>
	<u>\$ 2,333,652</u>

The Association, by its nature, is subject to various ongoing claims by insurance companies, policyholders, receiverships and creditors of the receiverships. Some of these claims are in the form of litigation against the Association.

TEXAS PROPERTY AND CASUALTY INSURANCE GUARANTY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

(continued)

9. Significant Group Concentrations of Risk

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

The Association, as described in Note 2, has a significant concentration of credit risk arising from cash deposits in excess of federally insured limits.

10. Investment Income

Gross earnings for 2008 were \$21,890,976 (including \$5,001,068 in realized gains and security lending income of \$897,592), net of realized losses of \$383,101, unrealized gains of \$12,963,299, custodian fees of \$23,340, and investment manager's fees of \$380,527, resulting in net investment income of \$34,067,307. Gross earnings for 2007 were \$21,758,902 (including \$4,617,807 in realized gains and security lending income of \$280,115), net of realized losses of \$2,019,969, unrealized gains of \$7,702,037, custodian fees of \$25,645, and investment manager's fees of \$363,631, resulting in net investment income of \$27,051,694.

11. Deferred Compensation Plan

The Association has established a defined contribution retirement plan (the plan) (a "profit sharing" plan under IRS Section 401(a) Plan). The plan is open to all employees. The employer made a discretionary contribution of 3% of all employees' compensation for the plan year. The employer will make a "matching contribution" to the plan on behalf of the employees in the amount of 100% of the employees' elective deferral, up to 3% of total compensation for the plan year. The employee may make discretionary before tax contribution to the plan not to exceed Internal Revenue Service limitations. The Association's contribution for the years ended December 31, 2008, and 2007, were \$235,554 and \$217,853, respectively. The employees contributed \$362,297 and \$310,808, for 2008 and 2007 respectively. The employees are fully vested in their own contributions to the plan and become vested in the employer contributions to the plan as follows based on years of service: 1 year - 20%; 2 years - 40%; 3 years - 60%; 4 years - 80%; and 5 years - 100%.

12. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

13. Risk Management

The Association is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees and natural disasters. During 2008, the Association contracted with insurance carriers for property and general liability insurance.

Property coverage and computer system coverage both carry a \$1,000 deductible. Comprehensive general liability carries no deductible while excess liability coverage has a retained limit of \$5,000. Auto physical damage has deductibles of \$100 for comprehensive coverage and \$250 for collision. No insurance settlements exceeded coverage in the past three years relating to Association activities.