Texas Property and Casualty Insurance Guaranty Association

Financial Report with Additional Information

December 31, 2013

Texas Property and Casualty Insurance Guaranty Association

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, 2013 and 2012, and the related statements of income and comprehensive income, (deficit) 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 audit 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.

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

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, 2013 and 2012 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.

Emphasis of Matter

During 2013, the Association discovered an error in its financial reporting for collateral from securities lending arrangements. Previously, the Association netted assets and liabilities for collateral from securities lending arrangements. The Association corrected its accounting policy to recognize an asset and liability on its balance sheet for collateral from securities lending arrangements. Accordingly, as further described in Note 1, the Association restated its balance sheet as of December 31, 2012 to reflect these arrangements. There was no impact to net income or equity as a result of the restatement.

Plante & Moran, PLLC

April 30, 2014

Texas Property and Casualty Insurance Guaranty Association

Balance Sheet

	December 31, 2013	December 31, 2012
Assets		
Assets		
Cash and cash equivalents	$ 47,290,122	$ 48,877,068
Investments in debt securities	413,524,599	450,957,572
Accounts receivable - Other	397	3,403
Collateral from securities lending	156,133,246	98,235,336
Accrued interest income	2,168,336	1,998,289
Loans Receivable - Net of allowance for uncollectible loans of $245,064,425 and $230,831,989 in 2013 and 2012, respectively	-	-
Property and Equipment - Net	500,360	585,550
Total assets	**$ 619,617,060**	**$ 600,657,218**
Liabilities and (Deficit) Equity		
Liabilities		
Accounts payable and accrued expenses	$ 1,476,199	$ 1,009,560
Obligations under securities lending	156,133,246	98,235,336
Unpaid claims and claims adjustment expenses	502,584,490	402,385,953
Early access distributions	25,184,797	27,210,935
Payable for securities	-	13,307,723
Total liabilities	685,378,732	542,149,507
(Deficit) Equity	(65,761,672)	58,507,711
Total liabilities and (deficit) equity	**$ 619,617,060**	**$ 600,657,218**

Texas Property and Casualty Insurance Guaranty Association

Statement of Income and Comprehensive Income

	Year Ended	
	December 31, 2013	December 31, 2012
Revenue		
Distributions	$ 18,306,882	$ 17,264,036
Net investment income	7,844,676	8,281,082
Realized capital gains - Net	1,459,999	6,355,588
Other income	-	4,080,095
Total revenue	27,611,557	35,980,801
Expenses		
Claims incurred	133,815,429	24,890,593
Subrogation and salvage recoveries	(2,826,144)	(4,036,718)
Operating expenses	6,051,460	6,551,461
Loss on disposal of asset	4,626	-
Total operating expenses	137,045,371	27,405,336
Net (Loss) Income	(109,433,814)	8,575,465
Other Comprehensive (Loss) Income		
Unrealized holding (losses) gains on securities arising during the period	(13,375,570)	3,145,103
Reclassification adjustment for gains included in net income	(1,459,999)	(6,355,588)
Total other comprehensive loss	(14,835,569)	(3,210,485)
Comprehensive (Loss) Income	**$ (124,269,383)**	**$ 5,364,980**

See Notes to Financial Statements.

Texas Property and Casualty Insurance Guaranty Association

Statement of Equity (Deficit)

	Unassigned Funds	Accumulated Other Comprehensive Income	(Deficit) Equity
Balance - January 1, 2012	$ 34,923,358	$ 18,219,372	$ 53,142,730
Net income	8,575,465	-	8,575,465
Other comprehensive income	-	(3,210,484)	(3,210,484)
Balance - December 31, 2012	43,498,823	15,008,888	58,507,711
Net loss	(109,433,814)	-	(109,433,814)
Other comprehensive loss	-	(14,835,569)	(14,835,569)
Balance - December 31, 2013	**$ (65,934,991)**	**$ 173,319**	**$ (65,761,672)**

See Notes to Financial Statements.

Texas Property and Casualty Insurance Guaranty Association

Statement of Cash Flows

	Year Ended December 31, 2013	Year Ended December 31, 2012
Cash Flows from Operating Activities		
Net (loss) income	$ (109,433,814)	$ 8,575,465
Adjustments to reconcile net (loss) income to net cash from operating activities:		
Depreciation and amortization	184,103	250,843
Loss on disposal of property and equipment	4,626	-
Net amortization of premiums and discounts on debt securities	1,417,998	1,036,532
Realized capital gains - Net	(1,459,999)	(6,349,224)
Changes in operating assets and liabilities which (used) provided cash:		
Accounts receivable - Other	3,006	(2,714)
Accrued interest income	(170,047)	360,537
Unpaid claims and claims adjustment expenses	100,198,537	(1,377,912)
Accounts payable and accrued expenses	466,639	592,562
Early access distributions	(2,026,138)	(1,407,228)
Net cash (used in) provided by operating activities	(10,815,089)	1,678,861
Cash Flows from Investing Activities		
Purchase of property and equipment	(103,539)	-
Purchases of investments	(692,567,198)	(591,157,521)
Proceeds from sales and maturities of investments in available-for-sale securities	701,898,880	601,761,653
Net cash provided by investing activities	9,228,143	10,604,132
Net (Decrease) Increase in Cash and Cash Equivalents	(1,586,946)	12,282,993
Cash and Cash Equivalents - Beginning of year	48,877,068	36,594,075
Cash and Cash Equivalents - End of year	**$ 47,290,122**	**$ 48,877,068**

See Notes to Financial Statements.

Note 1 - Nature of Business and Significant Accounting Policies

The 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.

Basis of Presentation - The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America.

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.

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 losses reported in other comprehensive income.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

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.

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.

Other-than-temporary Impairment - 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 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 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.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

During 2013, the Association discovered an error in its financial reporting for collateral from securities lending arrangements. Previously, the Association netted assets and liabilities for collateral from securities lending arrangements. The Association corrected its accounting policy to recognize an asset and liability on its balance sheet for collateral from securities lending arrangements. Accordingly, the Association restated its balance sheet as of December 31, 2012 to record an asset and liability in the amount of $98,235,336 to reflect these arrangements. There was no impact to net income or equity as a result of the restatement.

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 and unreported claims incurred through December 31, 2013. 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 claims 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.

Revenue Recognition - Revenue is recognized when it is realized or realizable and earned. The Association considers assessment revenue realized or realizable when assessed to the members of the Association. There were no such assessments in 2013 and 2012. 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).

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Loans Receivables/Allowance for Uncollectible Loans - Loans receivable represent claims and claims 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, 2013 and 2012. 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) Income - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. However, certain changes in assets and liabilities, including unrealized gains and losses on available-for-sale securities, are reported as a direct adjustment to the (deficit) equity section of the balance sheet. These items, along with net (loss) income, are considered components of comprehensive income.

Subsequent Events - The financial statements and related disclosures include evaluation of events up through and including April 25, 2014, which is the date the financial statements were available to be issued.

Note 2 - Investment Income

Investment income is composed of the following for the years ended December 31, 2013 and 2012:

	2013	2012
Investment income:		
Debt securities	$ 8,367,801	$ 8,785,613
Cash and cash equivalents	4,313	4,368
Gross investment income	8,372,114	8,789,981
Investment expenses	(527,438)	(508,899)
Net investment income	$ 7,844,676	$ 8,281,082

Note 3 - Investments in Debt Securities

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

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Treasury	$ 181,415,408	$ 1,530,521	$ (1,667,309)	$ 181,278,620
U.S. government agencies	33,057,183	1,107,494	(1,447)	34,163,230
FDIC guaranteed	56,909,733	315,711	(790,761)	56,434,683
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	71,389,448	1,042,742	(590,779)	71,841,411
Municipal	66,933,425	723,128	(1,442,106)	66,214,447
Treasury inflation protected securities	3,648,958	-	(56,750)	3,592,208
Total	$ 413,354,155	$ 4,719,596	$ (4,549,152)	$ 413,524,599

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Treasury	$ 217,766,330	$ 8,953,801	$ -	$ 226,720,131
U.S. government agencies	69,770,995	1,999,536	(15,813)	71,754,718
FDIC guaranteed	182,408	-	(5,719)	176,689
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	82,029,949	2,446,973	(21,512)	84,455,410
Municipal	59,133,407	1,593,659	(62,834)	60,664,232
Guaranteed fixed income	7,065,595	120,797	-	7,186,392
Total	$ 435,948,684	$ 15,114,766	$ (105,878)	$ 450,957,572

Note 3 - Investment in Debt Securities (Continued)

The amortized cost and fair value of the Association's investments in debt securities as of December 31, 2013 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	$ 51,768,907	$ 52,339,991
Due after one year through five years	212,698,113	213,164,757
Due after five years through 10 years	74,938,927	73,582,877
Due after 10 years	2,558,760	2,595,563
U.S. government RMBS	71,389,448	71,841,411
Total	$ 413,354,155	$ 413,524,599

During December 31, 2013 and 2012, respectively, sales proceeds and gross realized gains and loss on debt securities were as follows:

	2013	2012
Sales proceeds	$ 672,084,880	$ 564,003,639
Gross realized gains	2,230,577	6,605,642
Gross realized losses	(770,578)	(250,054)
Net realized gain	$ 1,459,999	$ 6,355,588

As of December 31, 2013 and 2012, the portfolio included 287 and 16 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, FDIC guaranteed, 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 2013 and 2012.

Note 3 - Investment in Debt Securities (Continued)

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 twelve months or greater and those in a continuous loss position for less than twelve months as of December 31, 2013 and December 31, 2012.

	2013					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Treasury	$ 81,280,732	$ (1,667,309)	$ -	$ -	$ 81,280,732	$ (1,667,309)
U.S. government agencies	-	-	286,335	(1,447)	286,335	(1,447)
FDIC guaranteed	73,932,336	(790,761)	-	-	73,932,336	(790,761)
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	88,228,138	(564,194)	404,611	(26,585)	88,632,749	(590,779)
Municipal	61,927,369	(964,072)	7,869,319	(478,034)	69,796,688	(1,442,106)
Treasury inflation protected securities	4,504,861	(56,750)	-	-	4,504,861	(56,750)
Total	$ 309,873,436	$ (4,043,086)	$ 8,560,265	$ (506,066)	$ 318,433,701	$ (4,549,152)

	2012					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. government agencies	$ 15,300,726	$ (8,840)	$ 976,562	$ (6,973)	$ 16,277,288	$ (15,813)
FDIC guaranteed	-	-	133,636	(5,719)	133,636	(5,719)
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	2,847,754	(21,512)	-	-	2,847,754	(21,512)
Municipal	13,584,703	(62,834)	-	-	13,584,703	(62,834)
Total	$ 31,733,183	$ (93,186)	$ 1,110,198	$ (12,692)	$ 32,843,381	$ (105,878)

Note 4 - 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 or liabilities 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 and liabilities 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.

The following tables present information about the Association's assets measured at fair value on a recurring basis at December 31, 2013 and 2012 and the valuation techniques used by the Association to determine those fair values.

Note 4 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2013

	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, 2013
Debt securities:				
U.S. Treasury	$ -	$ 181,278,620	$ -	$ 181,278,620
U.S. government agencies	-	31,561,848	2,601,382	34,163,230
FDIC guaranteed	-	56,434,683	-	56,434,683
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	71,408,387	433,024	71,841,411
Municipal	-	66,214,447	-	66,214,447
Treasury inflation protected securities	-	3,592,208	-	3,592,208
Total debt securities	-	410,490,193	3,034,406	413,524,599
Securities lending collateral - Short-term investments	-	156,133,246	-	156,133,246
Cash equivalents - Money market funds	35,783,188	-	-	35,783,188
Total assets	$ 35,783,188	$ 566,623,439	$ 3,034,406	$ 605,441,033

Note 4 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2012

	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, 2012
Debt securities:				
U.S. Treasury	$ -	$ 226,720,131	$ -	$ 226,720,131
U.S. government agencies	-	67,753,421	4,001,297	71,754,718
Guaranteed fixed income	-	7,186,392	-	7,186,392
FDIC guaranteed	-	-	176,689	176,689
Mortgage-backed U.S. government RMBS (primarily FHLMC and FNMA pools)	-	82,209,991	2,245,419	84,455,410
Municipal	-	60,664,232	-	60,664,232
Total debt securities	-	444,534,167	6,423,405	450,957,572
Securities lending collateral - Short-term investments	-	98,235,336	-	98,235,336
Cash equivalents - Money market funds	26,833,552	-	-	26,833,552
Total assets	$ 26,833,552	$ 542,769,503	$ 6,423,405	$ 576,026,460

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 results 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 asset and liabilities measured at fair value on a recurring basis:

Note 4 - Fair Value Measurements (Continued)

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 agency, guaranteed fixed income, FDIC guaranteed 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 and FDIC guaranteed* - 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.

Note 4 - Fair Value Measurements (Continued)

- *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.

Changes in Level 3 assets measured at fair value on a recurring basis for the years ended December 31, 2013 and 2012 are as follows:

	U.S. Government Agencies	FDIC Guaranteed	U.S. Government RMBS
Balance at December 31, 2012	$ 4,003,387	$ 176,484	$ 2,247,049
Purchases, issuances, sales, and settlements:			
Sales and maturities	(1,376,744)	(176,484)	(1,814,025)
Amortization	(23,814)	-	-
Total unrealized losses	(1,447)	-	-
Balance at December 31, 2013	$ 2,601,382	$ -	$ 433,024

	U.S. Government Agencies	FDIC Guaranteed	U.S. Government RMBS
Balance at January 1, 2012	$ 6,950,724	$ 197,517	$ 2,280,566
Purchases, issuances, sales, and settlements:	-	-	-
Sales and maturities	(2,442,593)	-	-
Amortization	(472,766)	(21,033)	(33,517)
Total unrealized gains losses	(31,978)	-	-
Balance at December 31, 2012	$ 4,003,387	$ 176,484	$ 2,247,049

Realized and unrealized gains and losses of $1,459,999 and $6,355,588 for the years ended December 31, 2013 and 2012, respectively, are reported in the revenue section in the statement of operations.

Note 4 - Fair Value Measurements (Continued)

Fair value of 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.

Note 5 - Property and Equipment

Property and equipment are summarized as follows:

	2013	2012	Depreciable Life - Years
Telephone systems	$ 78,817	$ 76,904	10
Furniture and equipment	858,069	870,678	10
Computer software and equipment	1,774,568	1,683,285	5
Leasehold improvements	306,593	306,593	Life of Lease
Total cost	3,018,047	2,937,460	
Accumulated depreciation	2,517,687	2,351,910	
Net property and equipment	$ 500,360	$ 585,550	

Depreciation and amortization expense was $184,103 and $250,843 in 2013 and 2012, respectively

Note 6 - 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 2012 premium information available from the Texas Department of Insurance and the Texas Comptroller's Office:

	Premium Base	Assessment Capability
Line of Business:		
Automobile	$ 16,192,742,435	$ 323,854,849
Other lines	15,901,592,474	318,031,849
Workers' compensation	3,538,752,788	70,775,056
Total	$ 35,633,087,697	$ 712,661,754

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 2013 and 2012 was $0.

Note 7 - 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.

Note 7 - Unpaid Claims and Unpaid Claims Adjustment Expense (Continued)

Activity in the liability for unpaid claims and claim adjustment expenses is summarized as follows:

	2013	2012
Balance as of January 1	$ 402,385,953	$ 403,763,865
Incurred related to:		
Current year	149,146,570	-
Prior year	(15,331,141)	24,890,592
Total incurred	133,815,429	24,890,593
Paid related to:		
Current year	7,044,671	-
Prior year	26,572,221	26,268,505
Total paid	33,616,892	26,268,505
Balance as of December 31	$ 502,584,490	$ 402,385,953

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. Losses incurred related to the current year increased by approximately $149 million as a result of eight new member insurer insolvencies designated as impaired by the Commissioner of Insurance during 2013. 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.

Losses incurred related to prior years decreased by approximately $15 million in 2013 as a result of favorable development. Losses incurred related to prior years increased by approximately $25 million in 2012 as a result of the Association re-estimating the expected losses related to these claims based on the most current information available to management.

Note 7 - Unpaid Claims and Unpaid Claims Adjustment Expense (Continued)

As noted in Note 6, 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, 2013 are as follows:

Line of Business	Claims Payable	Annual Assessment Capability
Automobile	$ 41,705,944	$ 323,854,849
Other lines	2,565,213	318,031,849
Workers' compensation	433,220,258	70,775,056
Loss adjustment expenses	25,092,875	No Limit
Total	$ 502,584,490	

Note 8 - 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 2013 and 2012 was $204,756 and $214,014, respectively.

Note 9 - Operating Leases

The Association leases office space under a noncancelable operating lease agreement that expires in November 2014. Rental expense under this agreement was $394,420 for the years ended December 31, 2013 and 2012. Future minimum annual commitment under this operating lease is $361,552 for 2014. Management is assessing its decision to renew this lease upon expiration.

Note 10 - 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, 2013 and 2012 are as follows:

	2013	2012
Administrative	$ (7,046,410)	$ (9,379,986)
Automobile	20,697,624	18,730,555
Other lines	107,857,569	110,108,235
Workers' compensation	123,555,642	111,373,185
Total	245,064,425	230,831,989
Less allowance for uncollectible loans	(245,064,425)	(230,831,989)
Net loans receivable	$ -	$ -

The following table represents collections on the loans receivable over the last ten 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
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%
2006	601,491,875	55,365,660	9.2%
2005	574,602,388	34,488,393	6.0%
2004	547,233,093	61,812,054	11.3%

Note 11 - Custodial Credit Risk of Bank Deposits

The Association maintains cash balances at various financial institutions. Subsequent to December 31, 2012, cash accounts are insured up to $250,000 per depositor. As of December 31, 2013 and 2012, the Association's cash balances totaled $11,504,822 and $22,043,516, 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 12 - 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 13 - Litigation Settlement

The Association is named a party to a number of lawsuits in the normal course of business. In the opinion of management, the resolution of these lawsuits will not have a material adverse effect on the Association's financial position or results of operations.

During the third quarter of 2012, the Association received its share of a settlement, as did numerous other guaranty fund participants as parties to the settlement agreement, relating to underreporting of worker's compensation premiums by a member insurance company over several years, principally in the 1980s. The underreporting caused this member company's assessment amount to be understated for the years in which assessments were made for the workers' compensation line of business. The settlement amount paid to the Association was $4,072,460 which was recorded as Other Income in the statement of income and comprehensive income. These funds have been made available to pay worker's compensation claims incurred by the Association as reported to the board of directors.

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 is 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.

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, 2013 and 2012, the fair value of securities loaned in the portfolio was $152,826,122 and $96,361,230, respectively. At December 31, 2013 and 2012, collateral held for securities lending was $156,133,246 and $98,235,336, respectively. Collateral received consists of cash. The value of the collateral held and a corresponding liability to return the collateral have been reported on the accompanying balance sheet.

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, 2013 and 2012, and have issued our report thereon dated April 25, 2014, 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 additional information has been subjected to the auditing procedures applied in the audits 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 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 additional information is fairly stated in all material respects in relation to the financial statements as a whole.

Plante & Moran, PLLC

April 30, 2014

Texas Property and Casualty Insurance Guaranty Association

Schedule of Operating Expenses

	Year Ended December 31 2013	2012
Employment expenses	$ 4,471,218	$ 5,156,695
Employee relations	5,725	10,327
Education and staff development	38,030	44,773
Contract labor	11,653	-
Legal fees	57,850	58,909
Audit fees	41,420	53,515
Consulting	50,200	-
Leasehold improvements	5,300	368
Office rent and overhead	448,369	446,872
Insurance - General	49,066	51,938
Furniture and equipment	34,951	24,843
Equipment rental	1,741	2,162
Computer systems	312,022	171,788
Telephone and telecommunications	23,353	23,099
Office supplies	33,015	19,178
Postage	74,618	53,281
Printing	14,162	-
Advertising	-	310
Travel expenses	32,170	24,249
Professional meetings	6,636	2,571
Reference materials	13,368	14,538
Subscriptions and professional dues	131,207	129,069
Taxes - Property	11,283	12,133
Depreciation and amortization expense	184,103	250,843
Total operating expenses	**$ 6,051,460**	**$ 6,551,461**