

# **Texas Windstorm Insurance Association**

**Statutory Financial Statements**  
Years Ended December 31, 2009 and 2008



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# Texas Windstorm Insurance Association

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## Accountants' Letter of Qualifications

Board of Directors  
Texas Windstorm Insurance Association

We have audited, in accordance with auditing standards generally accepted in the United States of America, the statutory financial statements of Texas Windstorm Insurance Association (the "Association") for the years ended December 31, 2009 and 2008, and have issued our report thereon dated June 9, 2010. In connection therewith, we advise you as follows:

- a. We are independent certified public accountants with respect to the Association and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants, and the Rules of Professional Conduct of the Texas Board of Public Accountancy.
- b. The engagement partner and engagement manager, who are certified public accountants, have 12 years and 5 years, respectively, of experience in public accounting and are experienced in auditing insurance enterprises. Members of the engagement team, most of whom have had experience in auditing insurance enterprises and most of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.
- c. We understand that the Association intends to file its audited statutory financial statements and our report thereon with the Texas Department of Insurance and that the Insurance Commissioner of that state will be relying on that information in monitoring and regulating the statutory financial condition of the Association.

While we understand that an objective of issuing a report on the statutory financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of insurance regulators. In this context, the Association and Insurance Commissioner should understand that the objective of an audit of statutory financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the statutory financial statements present fairly, in all material respects, the admitted assets, liabilities, surplus and other funds, results of operations and cash flows in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the statutory financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, particularly those involving concealment and falsified documentation (including forgery), a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility

that material misstatements resulting from fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Insurance Commissioner.

It is the responsibility of the management of the Association to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control structure that will, among other things, provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the statutory financial position of insurers and should not rely solely upon the independent auditor's report.

- d. We will retain the workpapers prepared in the conduct of our audit until the Texas Department of Insurance has filed a Report of Examination covering 2009, but not longer than seven years. After notification to the Association, we will make the workpapers available for review by the Texas Department of Insurance at the offices of the insurer, at our offices, at the Insurance Department or at any other reasonable place designated by the Insurance Commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Texas Department of Insurance, photocopies of pertinent audit working papers may be made (under the control of the accountant) and such copies may be retained by the Texas Department of Insurance.
- e. The engagement partner has served in that capacity with respect to the Association since 2009, is licensed by the Texas Board of Public Accountancy, and is a member in good standing of the American Institute of Certified Public Accountants.
- f. To the best of our knowledge and belief, we are in compliance with the requirements of section 7 of the NAIC's Model Rule (Regulation) Requiring Annual Audited Financial Reports regarding qualifications of independent certified public accountants.

This letter is intended solely for the information and use of the Texas Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.

June 9, 2010

## Independent Auditors' Report

Board of Directors  
Texas Windstorm Insurance Association  
Austin, Texas

We have audited the accompanying statutory statements of admitted assets, liabilities, surplus and other funds of Texas Windstorm Insurance Association (the "Association") as of December 31, 2009 and 2008 and the related statutory statements of income and changes in surplus and other funds, 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 material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in the Summary of Significant Accounting Policies – “Basis of Accounting”, these financial statements were prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

On September 13, 2008, Hurricane Ike struck the gulf coast of Texas. Claims attributable to this hurricane contributed greatly to the Association's \$190.6 million net loss for 2008. The Association has authority to assess certain property and casualty insurers underwriting business in the state of Texas under Texas Insurance Code Section 21.49 for losses incurred during 2008. However, if another major claim event occurs in the future, it could have a severe impact on the financial condition of the Association.

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, surplus and other funds of the Texas Windstorm Insurance Association at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in the Summary of Significant Accounting Policies – “Basis of Accounting”.

This report is intended solely for the information and use by the Board of Directors and the management of Texas Windstorm Insurance Association and for filing with the Texas Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

June 9, 2010

# Texas Windstorm Insurance Association

## Statutory Statements of Admitted Assets, Liabilities, Surplus and Other Funds

| <i>December 31,</i>   | <b>2009</b>           | <b>2008</b>           |
|---|-----------------------|-----------------------|
| <b>Admitted Assets</b>  |                       |                       |
| Cash and short-term investments                                     | \$ 352,013,162        | \$ 831,456,183        |
| Receivable from Texas FAIR Plan Association                         | 595,329               | 485,334               |
| Premiums receivable   | 267,950               | 292,178               |
| Furniture and equipment, net  | 1,339,868             | 1,530,373             |
| Federal income tax recoverable                                      | -                     | 4,671,812             |
| Member assessments receivable                                       | 1,807,770             | 3,242,804             |
| Amounts recoverable from reinsurers                                 | 93,168,209            | -                     |
|   | <b>\$ 449,192,288</b> | <b>\$ 841,678,684</b> |
| <b>Liabilities, Surplus and Other Funds</b>                         |                       |                       |
| <b>Liabilities:</b>   |                       |                       |
| Loss and loss adjustment expenses                                   | \$ 31,686,974         | \$ 395,196,680        |
| Other expenses payable  | 2,874,342             | 891,316               |
| Other taxes, licenses and fees                                      | 1,774,886             | 1,058,346             |
| Current federal income taxes  | 38,880,652            | -                     |
| Unearned premiums, net of ceded unearned premiums                   | 183,870,362           | (7,058,946)           |
| Advanced premiums   | 8,607,382             | 10,063,456            |
| Ceded reinsurance premiums payable, net of ceding commissions       | 41,058,472            | 91,506,250            |
| Funds held under reinsurance treaties                               | -                     | 540,542,325           |
| Amounts withheld or retained for account of others                  | 100,230               | 90,438                |
| Provision for reinsurance   | 69,239,449            | -                     |
| Deferred pension liability  | 362,902               | -                     |
| Additional minimum pension liability                                | 1,183,067             | -                     |
| Statutory fund payable  | 69,553,570            | -                     |
| Total liabilities   | 449,192,288           | 1,032,289,865         |
| <b>Commitments and contingencies</b> (Notes 7, 8, 9, 13, 14 and 15) |                       |                       |
| <b>Surplus and other funds:</b>                                     |                       |                       |
| Unassigned surplus (deficit)  | -                     | (190,611,181)         |
|   | <b>\$ 449,192,288</b> | <b>\$ 841,678,684</b> |

*See accompanying summary of significant accounting policies and notes to statutory financial statements.*

# Texas Windstorm Insurance Association

## Statutory Statements of Income

| <i>Years ended December 31,</i>   | <b>2009</b>           | <b>2008</b>      |
|---|-----------------------|------------------|
| <b>Underwriting income:</b>   |                       |                  |
| Premiums earned   | \$ 357,906,150        | \$ 321,936,632   |
| Premiums ceded  | (167,443,257)         | (253,130,140)    |
| Net premiums earned   | <b>190,462,893</b>    | 68,806,492       |
| <b>Deductions:</b>  |                       |                  |
| Losses and loss expenses incurred   | (290,313,489)         | 1,215,124,201    |
| Other underwriting expenses incurred:   |                       |                  |
| Commissions   | 61,148,941            | 32,821,433       |
| General expenses  | 19,714,562            | 14,742,468       |
| Premium and maintenance taxes   | 7,035,201             | 6,195,001        |
| Total underwriting deductions   | <b>(202,414,785)</b>  | 1,268,883,103    |
| Net underwriting gain (loss)  | <b>392,877,678</b>    | (1,200,076,611)  |
| <b>Investment income:</b>   |                       |                  |
| Net investment income earned  | <b>707,687</b>        | 6,009,349        |
| <b>Other income:</b>  |                       |                  |
| Assessment income   | 905,946               | 530,000,000      |
| Statutory fund income   | -                     | 469,281,450      |
| Other   | 2,888                 | (2,284)          |
| Total other income  | <b>908,834</b>        | 999,279,166      |
| Net income (loss) before statutory fund cost and federal income tax expense (benefit) | <b>394,494,199</b>    | (194,788,096)    |
| Statutory fund cost   | <b>69,553,570</b>     | -                |
| Net income (loss) before federal income tax expense (benefit)                         | <b>324,940,629</b>    | (194,788,096)    |
| Federal income tax expense (benefit)  | <b>57,000,000</b>     | (4,141,812)      |
| Net income (loss)   | <b>\$ 267,940,629</b> | \$ (190,646,284) |

*See accompanying summary of significant accounting policies and notes to statutory financial statements.*

# Texas Windstorm Insurance Association

## Statutory Statements of Changes In Surplus and Other Funds

|                                      |    | Unassigned<br>Surplus (Deficit) |
|--------------------------------------|----|---------------------------------|
| Balance at January 1, 2008           | \$ | (86,032)                        |
| Net loss                             |    | (190,646,284)                   |
| Change in deferred income taxes      |    | 62,063,302                      |
| Change in nonadmitted assets         |    | (61,945,055)                    |
| Other                                |    | 2,888                           |
| Balance at December 31, 2008         |    | (190,611,181)                   |
| Net income                           |    | 267,940,629                     |
| Change in deferred income taxes      |    | (54,418,012)                    |
| Change in nonadmitted assets         |    | 47,108,841                      |
| Change in provision for reinsurance  |    | (69,239,449)                    |
| Additional minimum pension liability |    | (780,824)                       |
| Other                                |    | (4)                             |
| Balance at December 31, 2009         | \$ | -                               |

# Texas Windstorm Insurance Association

## Statutory Statements of Cash Flows

| <i>Years ended December 31,</i>                                   | <b>2009</b>           | <b>2008</b>    |
|---|-----------------------|----------------|
| <b>Cash from operations:</b>                                      |                       |                |
| Premiums collected, net of reinsurance                            | \$ 329,505,218        | \$ 35,374,591  |
| Net investment income   | 707,687               | 6,009,349      |
| Miscellaneous income  | 908,797               | 999,282,054    |
| Benefit and loss related payments                                 | (128,802,454)         | (739,995,536)  |
| Commissions, expenses paid and aggregate write-ins for deductions | (122,794,273)         | (144,883,952)  |
| Federal income taxes paid   | (13,447,536)          | -              |
| Net cash from operations  | <b>66,077,439</b>     | 155,786,506    |
| <b>Cash from financing and miscellaneous sources:</b>             |                       |                |
| Other cash (applied) provided                                     | (545,520,460)         | 461,468,113    |
| Net cash from financing and miscellaneous sources                 | <b>(545,520,460)</b>  | 461,468,113    |
| Net change in cash and short-term investments                     | <b>(479,443,021)</b>  | 617,254,619    |
| Cash and short-term investments, beginning of year                | <b>831,456,183</b>    | 214,201,564    |
| Cash and short-term investments, end of year                      | <b>\$ 352,013,162</b> | \$ 831,456,183 |

*See accompanying summary of significant accounting policies and notes to statutory financial statements.*

# Texas Windstorm Insurance Association

## Summary of Significant Accounting Policies

### Nature of Business

Texas Windstorm Insurance Association (the "Association") was created by the Texas Legislature when it enacted Article 21.49 (the "Act"), as amended, of the Texas Insurance Code, currently codified as chapter 2210. The purpose of the Act is to provide a method whereby adequate windstorm, hail and fire insurance may be obtained in certain designated counties located in the gulf coast region of the State of Texas. Presently, only windstorm and hail coverage is provided by the Association. The membership of the Association includes every property insurer authorized to write property insurance in the State of Texas, except companies that are excluded by law. The Act provides that members will share in the Association's losses on a policy year basis to the extent of their percentage of participation during the policy year involved, as determined under the provisions of the Act and the Association's Plan of Operations. In the event of a net loss for any policy years prior to January 1, 2009, members participating in that policy year may be assessed for their share of the loss based upon their respective participation percentages.

On June 1, 2009, the Texas Legislature passed House Bill 4409 in which the funding mechanism for the Association was amended. A section of the bill provides that the Association shall pay for losses in excess of premium and other revenue as follows:

- From available reserves and the Catastrophe Reserve Trust Fund;
- From proceeds of Class 1 public securities not to exceed \$1 billion per year or other financing arrangements (including commercial paper). These proceeds must be repaid by the Association from its premiums and other revenue;
- From proceeds of Class 2 public securities not to exceed \$1 billion per year to be repaid as follows: 30% of the cost shall be paid through non-recoupable assessments to member companies; 70% of the cost shall be paid by a nonrefundable surcharge collected by every insurer and assessed on all policyholder who reside or have operations in or whose property is located in the TWIA catastrophe area. The surcharge applies to all policies that provide coverage on any premises, locations operation or property located in the catastrophe area for all property and casualty lines of insurance except federal flood insurance, workers' compensation, accident and health and medical malpractice;
- From proceeds of Class 3 public securities not to exceed \$500M per year to be repaid through non-recoupable assessments to the member companies.

# Texas Windstorm Insurance Association

## Summary of Significant Accounting Policies

### Basis of Accounting

The accompanying financial statements have been prepared on a statutory basis in accordance with accounting practices prescribed or permitted by the Texas Department of Insurance. Prescribed statutory accounting practices include state laws, regulations and general administrative rules applicable to all insurance companies domiciled in the State of Texas and the National Association of Insurance Commissioners' ("NAIC") Accounting Practices and Procedures Manual. Permitted statutory practices include practices not prescribed but allowed by the Texas Department of Insurance.

A difference between Texas prescribed practices and NAIC statutory accounting practices, as they relate to the Association, is that furniture, labor-saving devices, machines, and all other office equipment may be an admitted asset depreciated in full not to exceed 5 years. NAIC statutory accounting practice classifies these assets as non-admitted. The effect of admitting these assets is as follows:

| <i>December 31,</i>                   | <b>2009</b>         | <b>2008</b>             |
|---------------------------------------|---------------------|-------------------------|
| Unassigned deficit, as reported       | \$ -                | \$ (190,611,181)        |
| Effect of Texas prescribed practices: |                     |                         |
| Admitted furniture and equipment      | <b>(758,988)</b>    | (405,614)               |
| Unassigned deficit, NAIC SAP basis    | <b>\$ (758,988)</b> | <b>\$ (191,016,795)</b> |

In the preparation of the accompanying financial statements, Texas Department of Insurance has permitted companies domiciled in the state of Texas to delay the adoption of certain substantive amendments (SSAP 10R) to the 2009 Accounting Practices and Procedures Manual.

Significant differences between statutory accounting practices and accounting principles generally accepted in the United States of America ("GAAP"), as they relate to the Association include the following:

- a) Certain assets designated as "non-admitted assets" are charged directly against surplus rather than capitalized and charged to income as used. These include certain fixed assets, prepaid expenses and other assets.
- b) Loss and loss adjustment expense reserves are presented net of related reinsurance rather than on a gross basis.
- c) Commissions and other acquisition costs relating to issuance of new policies are expensed as incurred rather than deferred and amortized over the period covered by the policies.
- d) Defined pension liability excludes non-vested employees' rather than including vested and non-vested employee obligations.

# Texas Windstorm Insurance Association

## Summary of Significant Accounting Policies

- e) The statement of cash flows represent cash balances, cash equivalents and short-term investments with initial maturities of one year or less rather than cash and cash equivalents with initial maturities of three months or less.
- f) Deferred income taxes are limited by an admissibility formula as opposed to using the “more likely than not” standard. Also, changes in the net deferred income taxes are reflected in the statutory statements of changes in surplus and other funds rather than reflected in the statement of income.

### **Use of Significant Estimates**

The preparation of financial statements in accordance with statutory accounting practices 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Short-Term Investments**

Short-term investments are recorded at cost which approximates market value. These short-term investments are comprised solely of United States government securities.

### **Furniture, Equipment and Depreciation**

Furniture and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of 3-5 years.

### **Income Taxes**

The provision for federal income taxes is computed in accordance with Subchapter L of the Internal Revenue Code.

The Association utilizes the balance sheet approach in computing its provision for deferred income taxes. Accordingly, deferred income taxes arise from the temporary differences in the valuation of certain assets and liabilities as determined for financial reporting purposes, and the benefits expected to be realized from the use of capital loss carry forwards. Such temporary differences relate primarily to the discounting of loss and loss adjustment expense reserves, the recognition of unearned premiums and capital losses in excess of gains. The admissibility of deferred tax assets is limited by an admissibility formula developed by the NAIC.

### **Premiums**

All policies issued by the Association have a maximum term of one year from date of issuance. Premiums earned are taken into income over the periods covered by the policies whereas the related acquisition costs are expensed when incurred. Unearned premiums, net of deductions for reinsurance, are computed on a pro-rata basis over the term of the policies.

# Texas Windstorm Insurance Association

## Summary of Significant Accounting Policies

### **Loss and Loss Adjustment Expense Reserves**

Loss and loss adjustment expense reserves are based upon claim estimates for (1) losses for cases reported prior to the close of the accounting period, (2) losses incurred but unreported prior to the close of the accounting period, and (3) expenses for investigating and adjusting claims. Such liabilities are necessarily based on assumptions and estimates and while management believes the amounts are adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed and any adjustments are reflected in the period determined.

### **Reinsurance**

In the normal course of business, the Association seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

### **Advanced Premiums**

Premiums are generally recognized as revenue on a pro-rata basis over the policy term after the policy is issued. Those premiums received for policies not yet issued are included in advanced premiums within the Association's statutory statement of admitted assets, liabilities, surplus and other funds.

### **Assessments to Member Companies**

Prior to the enactment of HB 4409 in 2009, member companies were assessed to the extent that the Association's Board of Directors determined that available funds were not sufficient to satisfy the obligations of the Association. During 2009 and 2008, the Association assessed its members approximately \$905,000 and \$530 million, respectively.

### **Fair Value of Financial Instruments**

The following methods and assumptions were used by the Association to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

*Cash and short-term investments:* The carrying values approximate estimated value.

### **Reclassifications**

Certain prior year balances have been reclassified to conform to current year presentation.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### 1. Cash and Short-Term Investments

Cash and short-term investments are as follows:

| <i>December 31,</i>    | <b>2009</b>           | 2008           |
|------------------------|-----------------------|----------------|
| Cash                   | \$ 107,086,496        | \$ 447,027,639 |
| Short-term investments | 244,926,666           | 384,428,544    |
|                        | <b>\$ 352,013,162</b> | \$ 831,456,183 |

### 2. Furniture and Equipment

Furniture and equipment consist of the following:

| <i>December 31,</i>                               | <b>2009</b>         | 2008         |
|---|---------------------|--------------|
| Furniture, fixtures and equipment                 | \$ 1,106,414        | \$ 1,172,897 |
| Electronic data processing equipment and software | 3,319,040           | 2,600,342    |
|   | <b>4,425,454</b>    | 3,773,239    |
| Less: accumulated depreciation                    | (3,085,586)         | (2,242,866)  |
|   | <b>\$ 1,339,868</b> | \$ 1,530,373 |

Depreciation expense was approximately \$803,000 and \$480,000 for the years ended December 31, 2009 and 2008, respectively.

### 3. Reinsurance

During 2008, the Association entered into a reinsurance agreement. This agreement reduces the amount of losses that can arise from claims under a general reinsurance contract known as a catastrophe excess of loss reinsurance agreement ("excess of loss").

Effective June 1, 2008, the catastrophe excess of loss reinsurance agreement provided the Association with three layers of coverage. The first layer provided 100% participation of \$500 million in excess of \$600 million. The second layer provided 100% participation of \$500 million in excess of \$1.1 billion. The third layer provided 100% participation of \$500 million in excess of \$1.6 billion. This agreement expired on May 31, 2009. The Association has decided to not renew this reinsurance contract.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

In accordance with the terms of the reinsurance agreement, the Association paid the reinsurers net premiums of approximately \$58,700,000 and \$241,400,000 during 2009 and 2008, respectively.

Ceded reinsurance is treated as the risk and liability of the assuming companies; however, the reinsurance contracts do not relieve the Association from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Association. The Association, together with the Texas Department of Insurance, evaluates the financial conditions of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

The Association has unsecured reinsurance recoverables which exceed 3% of the Association's surplus with the following reinsurers as of December 31, 2009: (in thousands)

| Name of reinsurer                          | 2009      |
|--|-----------|
| Everest Reinsurance Company                | \$ 16,777 |
| Liberty Mutual Insurance Company           | 936       |
| Munich Reinsurance America, Incorporated   | 6,684     |
| Odyssey America Reinsurance Corporation    | 10,069    |
| QBE Reinsurance Company                    | 924       |
| Swiss Re Underwriters Agency, Inc.         | 8,943     |
| Transatlantic Reinsurance Company          | 1,984     |
| Folksamerica Reinsurance Company           | 4,472     |
| Converium Reinsurance                      | 11,553    |
| Lexington Insurance Company, Pembroke      | 2,696     |
| Liberty Syndicate Paris                    | 832       |
| Lloyd's Underwriter Syndicate No. 0033 HIS | 9,019     |
| Lloyd's Underwriter Syndicate No. 0318 MSP | 528       |
| Lloyd's Underwriter Syndicate No. 0382 PWH | 962       |
| Lloyd's Underwriter Syndicate No. 0435 FDY | 6,343     |
| Lloyd's Underwriter Syndicate No. 0566 STN | 7,887     |
| Lloyd's Underwriter Syndicate No. 0570 ATR | 173       |
| Lloyd's Underwriter Syndicate No. 0623 AFB | 200       |
| Lloyd's Underwriter Syndicate No. 0727 SAM | 960       |
| Lloyd's Underwriter Syndicate No. 0780 ADV | 522       |
| Lloyd's Underwriter Syndicate No. 1084 CSL | 626       |
| Lloyd's Underwriter Syndicate No. 1274 AUL | 1,201     |
| Lloyd's Underwriter Syndicate No. 1301 BGT | 105       |
| Lloyd's Underwriter Syndicate No. 1400 DRE | 1,330     |
| Lloyd's Underwriter Syndicate No. 1414 RTH | 8,482     |
| Lloyd's Underwriter Syndicate No. 1910 ARW | 1,810     |
| Lloyd's Underwriter Syndicate No. 2001 AML | 12,235    |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

| Name of reinsurer                          | 2009              |
|--|-------------------|
| Lloyd's Underwriter Syndicate No. 2003 SJC | 4,231             |
| Lloyd's Underwriter Syndicate No. 2007 NVA | 962               |
| Lloyd's Underwriter Syndicate No. 2010 MMX | 734               |
| Lloyd's Underwriter Syndicate No. 2623 AFB | 850               |
| Lloyd's Underwriter Syndicate No. 2791 MAP | 4,231             |
| Lloyd's Underwriter Syndicate No. 3000 MKL | 2,119             |
| Lloyd's Underwriter Syndicate No. 3820 HDU | 803               |
| Lloyd's Underwriter Syndicate No. 4020 ARK | 690               |
| Lloyd's Underwriter Syndicate No. 4444 CNP | 1,780             |
| Mapfe Compania de Reaseguros S.A.          | 2,142             |
| Ace Tempest Reinsurance Limited            | 452               |
| Ariel Reinsurance Company Ltd              | 1,181             |
| Axis Capital Holdings Limited              | 574               |
| Catlin Insurance Company Ltd               | 251               |
| Harbor Point Re Ltd                        | 4,559             |
| Hiscox Ltd                                 | 2,186             |
| New Castle Reinsurance Company Ltd         | 38                |
| PartnerRe Limited                          | 265               |
| Platinum Underwriters Holdings Ltd         | 221               |
| Tokio Millennium Re Ltd                    | 4,028             |
| Validus Holdings Limited                   | 88                |
| Allianz Risk Transfer AG                   | 2,878             |
| Paris Re                                   | 205               |
| Amilin Bermuda Ltd                         | 10,629            |
| <b>Total</b>                               | <b>\$ 164,350</b> |

The effect of reinsurance on premiums written and earned for the years ended December 31, 2009 and 2008 is as follows:

|            | 2009                  |                       | 2008                   |                      |
|------------|-----------------------|-----------------------|------------------------|----------------------|
|            | Written               | Earned                | Written                | Earned               |
| Direct     | \$ 382,342,402        | \$ 357,906,150        | \$ 331,048,817         | \$ 321,936,632       |
| Ceded      | (950,202)             | (167,443,257)         | (350,000,000)          | (253,130,140)        |
| <b>Net</b> | <b>\$ 381,392,200</b> | <b>\$ 190,462,893</b> | <b>\$ (18,951,183)</b> | <b>\$ 68,806,492</b> |

During 2009 and 2008, the Association recovered approximately \$675 million and \$115 million, respectively, of paid losses and loss adjustment expenses relating to reinsurance contracts.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

**4. Ceded Reinsurance Premiums Payable**

Ceded reinsurance premiums payable are reported net of reinsurance ceding commissions receivable as follows:

| <i>December 31,</i>                       | <b>2009</b>          | <b>2008</b>   |
|---|----------------------|---------------|
| Ceded reinsurance premiums payable        | \$ <b>43,111,396</b> | \$ 96,109,375 |
| Reinsurance ceding commissions receivable | <b>(2,052,924)</b>   | (4,603,125)   |
|   | <b>\$ 41,058,472</b> | \$ 91,506,250 |

**5. Unearned Premiums**

Unearned premiums are reported net of ceded unearned premiums as follows:

| <i>December 31,</i>     | <b>2009</b>           | <b>2008</b>    |
|-------------------------|-----------------------|----------------|
| Gross unearned premiums | \$ <b>183,870,362</b> | \$ 159,434,109 |
| Ceded unearned premiums | -                     | (166,493,055)  |
|                         | <b>\$ 183,870,362</b> | \$ (7,058,946) |

**6. Loss and Loss Adjustment Expenses**

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

|   | <b>2009</b>           | <b>2008</b>    |
|---|-----------------------|----------------|
| Beginning balance (net of reinsurance receivable of \$1,257,175,137 and \$0)        | \$ <b>395,196,680</b> | \$ 10,575,903  |
| Incurred related to:  |                       |                |
| Current loss year   | <b>17,744,000</b>     | 1,223,282,709  |
| Prior loss years  | <b>(308,057,489)</b>  | (8,158,508)    |
| Losses and loss adjustment expense incurred   | <b>(290,313,489)</b>  | 1,215,124,201  |
| Paid related to:  |                       |                |
| Current loss year   | <b>(9,656,000)</b>    | (825,177,874)  |
| Prior loss years  | <b>(63,540,217)</b>   | (5,325,550)    |
| Paid losses and loss adjustment expense   | <b>(73,196,217)</b>   | (830,503,424)  |
| Ending balance (net of reinsurance receivable of \$386,127,586 and \$1,257,175,137) | <b>\$ 31,686,974</b>  | \$ 395,196,680 |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### 7. Statutory Fund

During 1993, the Texas Legislature amended Article 21.49 of the Texas Insurance Code authorizing the creation of a Catastrophe Reserve Trust Fund ("Trust Fund") to be held by the Texas Department of Insurance ("TDI") for the purpose of allowing the Association to enter into a program with TDI in lieu of a renewal of the Association's past reinsurance arrangements. Pursuant to the statutory agreement with TDI, the Association terminated its retrospective reinsurance agreement. Consequently, the retrospective premium due from the reinsurers was refunded directly to the Trust Fund, with legal title to such funds reverting to TDI. In accordance with the statutory agreement, the Association shall pay the net equity, including all premiums and other revenue of the Association in excess of incurred losses and operating expenses to the Trust Fund or a reinsurance program approved by TDI. As a result, the Association accrued \$69.5 million of statutory fund costs for the year ended December 31, 2009.

To administer these funds, TDI entered into a related Funds Management Agreement with the State Comptroller of Public Accounts ("Comptroller") whereby the Comptroller will manage the funds in the Trust Fund.

Under the statutory agreement with the TDI, under the law in effect prior to the enactment of HB 4409 all monies in the Trust Fund were to be used for payment of net losses from windstorm and hail catastrophe losses in excess of \$100 million in any calendar year and/or catastrophe mitigation (see Note 3). During 2008, the Association received a payment of approximately \$469 million from the Trust Fund to meet its estimated obligations.

### 8. Employee Benefit Plans

**Defined Benefit Plan.** The Association has a defined pension benefit plan, which covers employees from their date of hire, if the employee is scheduled to work at least 1,000 hours in a twelve-month period. Pension benefits are based on years of service and the employee's compensation during the five highest consecutive years' earnings from the last ten years of employment. An employee's benefits vest 5 years from date of hire. The Association makes contributions to the plan that complies with the minimum funding provisions of the Employee Retirement Income Security Act. Such contributions are included in general expenses.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

The following sets forth a summary of projected benefit obligations, plan assets, funded status, benefit costs and assumptions of the defined pension benefit plan as follows:

| <i>December 31,</i>   | <b>2009</b>         | 2008         |
|---|---------------------|--------------|
| <u>Change in Projected Benefit Obligations for Vested Participants:</u> |                     |              |
| Benefit obligation at beginning of year                                 | \$ 4,622,990        | \$ 3,618,822 |
| Service cost  | 680,919             | 351,225      |
| Interest cost   | 312,070             | 241,662      |
| Actuarial loss  | 639,496             | 461,939      |
| Benefits paid   | (123,370)           | (50,658)     |
| Projected benefit obligation at end of year                             | <b>6,132,105</b>    | 4,622,990    |
| <u>Change in Plan Assets</u>  |                     |              |
| Fair value of plan assets at beginning of year                          | 2,631,250           | 3,359,615    |
| Actual return on plan assets  | 766,131             | (1,042,255)  |
| Employer contributions  | 335,640             | 364,548      |
| Benefits paid   | (123,370)           | (50,658)     |
| Fair value of plan assets at end of year                                | <b>3,609,651</b>    | 2,631,250    |
| <u>Funded Status</u>  |                     |              |
| Unrecognized net loss   | 2,159,552           | 2,298,879    |
| (Accrued) prepaid benefit obligation for vested employees               | \$ (362,902)        | \$ 307,139   |
| Accumulated Benefit Obligation for Vested Participants                  | <b>\$ 4,792,718</b> | \$ 2,631,250 |
| Benefit Obligation for Non-Vested Employees                             |                     |              |
| Projected benefit obligation  | \$ 462,322          | \$ 538,207   |
| <u>Years ended December 31,</u>   |                     |              |
|   | <b>2009</b>         | 2008         |
| <u>Components of Net Periodic Benefit Costs</u>                         |                     |              |
| Service costs   | \$ 680,919          | \$ 351,225   |
| Interest costs  | 312,070             | 241,662      |
| Expected return on plan assets  | (218,756)           | (279,299)    |
| Amount of loss recognized   | 231,448             | 28,354       |
| Total net periodic benefit cost   | <b>\$ 1,005,681</b> | \$ 341,942   |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### Minimum Pension Liability

Accrual is required when actuarial present value of accumulated benefits exceeds plan assets and accrued pension liabilities. Minimum liability adjustment is reported as an adjustment to unassigned funds. At December 31, 2009 and 2008, additional minimum liability of \$1,183,067 and \$0 was required, respectively.

### Pension Assumptions

| <i>December 31,</i>   | <b>2009</b> | 2008 |
|---|-------------|------|
| Weighted-average assumptions used to determine net periodic benefit cost:     |             |      |
| Discount rate   | <b>6.0%</b> | 6.5% |
| Rate of compensation increase   | <b>4.0%</b> | 4.0% |
| Expected long-term rate of return of plan assets                              | <b>8.0%</b> | 8.0% |
| Weighted-average assumptions used to determine projected benefit obligations: |             |      |
| Weighted-average discount rate  | <b>6.0%</b> | 6.5% |
| Rate of compensation increase   | <b>4.0%</b> | 4.0% |

### Measurement Date

A measurement date of December 31, 2009 was used to determine the above.

### Asset Allocation

The defined benefit pension plan asset allocation as of the measurement date presented as a percentage of total plan assets were as follows:

| <i>December 31,</i> | <b>2009</b>   | 2008   |
|---------------------|---------------|--------|
| Equity securities   | <b>58.1%</b>  | 50.6%  |
| Debt securities     | <b>39.0%</b>  | 45.9%  |
| Real estate         | <b>0.0%</b>   | 0.0%   |
| Other               | <b>2.9%</b>   | 3.5%   |
|                     | <b>100.0%</b> | 100.0% |

The investment policy of the Plan is to maximize the total return of the fund while maintaining a strong emphasis on preservation of capital. The total portfolio is expected to be less volatile than the market the vast majority of the time. The plan assets are invested in a mix of equity and fixed income investments subject to target allocation ranges. The target allocation range for fixed income investments is between 20% and 40%. The target allocation range for international equity investments is between 10% and 20%. Remaining funds not invested in the categories above are to be invested in short-term cash equivalents such as money market funds.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

The long-term rate of return represents the expected average rate of return on the plan assets based on the expected long-term asset allocation of the plan. Several factors are considered, including historical market index returns, expectations of future returns in each asset classes, and the potential to outperform market index returns.

### Future Payments

The following estimated future payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

| <i>Years ending December 31,</i> | Amount     |
|----------------------------------|------------|
| 2010                             | \$ 142,763 |
| 2011                             | 197,853    |
| 2012                             | 223,269    |
| 2013                             | 277,515    |
| 2014                             | 310,653    |
| 2015 - 2019                      | 2,426,757  |

### Planned Contributions

The Association expects to make contributions of \$759,736 during the year ending December 31, 2009.

**Defined Contribution Plan.** The Association has a defined contribution 401(k) plan available to eligible employees after six months of employment. The Association contributed approximately \$258,000 and \$252,000 for the years ended December 31, 2009 and 2008, respectively.

## 9. Lease Commitments

The Association leases office space under a non-cancellable operating lease agreement which expires in 2012. Future minimum lease payments, by year and in the aggregate, under a non-cancelable operating lease with initial or remaining terms of one year or more consisted of the following at December 31, 2009:

| <i>Years ending December 31,</i> | Amount       |
|----------------------------------|--------------|
| 2010                             | \$ 709,268   |
| 2011                             | 730,999      |
| 2012                             | 441,000      |
| 2013                             | -            |
| 2014 and thereafter              | -            |
|                                  | \$ 1,881,267 |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

Rental expense under the non-cancelable operating lease was approximately \$621,000 and \$591,000 for the years ended December 31, 2009 and 2008, respectively.

### 10. Federal Income Taxes

The net deferred tax assets and the increase in nonadmitted deferred tax assets are comprised of the following components:

| <i>December 31,</i>                                    | <b>2009</b>   | 2008            |
|--|---------------|-----------------|
| Total gross deferred tax assets                        | \$ 14,258,983 | \$ 68,182,268   |
| Total gross deferred tax liabilities                   | (92,484)      | -               |
| Net deferred tax asset                                 | 14,166,499    | 68,182,268      |
| Nonadmitted deferred tax assets                        | (14,166,499)  | (68,182,268)    |
| Net admitted deferred tax assets                       | \$ -          | \$ -            |
| Decrease (increase) in nonadmitted deferred tax assets | \$ 54,015,769 | \$ (62,063,302) |

The change in deferred income taxes reported in surplus before consideration of nonadmitted assets is comprised of the following components:

| <i>December 31,</i>                                | <b>2009</b>     | 2008          |
|--|-----------------|---------------|
| Net deferred tax assets                            | \$ 14,166,499   | \$ 68,182,268 |
| Tax-effect of additional minimum pension liability | (402,243)       | -             |
| Net tax effect without unrealized gains and losses | \$ 13,764,256   | \$ 68,182,268 |
| Change in net deferred income tax                  | \$ (54,418,012) | \$ 62,063,302 |

Deferred income tax assets and liabilities consist of the following major components:

| <i>December 31,</i>                  | <b>2009</b>  | 2008         |
|--------------------------------------|--------------|--------------|
| Deferred tax assets:                 |              |              |
| Discount of unpaid losses and LAE    | \$ 371,466   | \$ 4,502,488 |
| 20% of unearned premiums             | 13,473,442   | 204,307      |
| Net operating loss carryforward      | -            | 63,212,220   |
| AMT tax credit                       | -            | 260,423      |
| Additional minimum pension liability | 402,243      | -            |
| Other                                | (80,652)     | 2,830        |
| Total deferred tax assets            | 14,166,499   | 68,182,268   |
| Nonadmitted deferred tax assets      | (14,166,499) | (68,182,268) |
| Net admitted deferred tax assets     | \$ -         | \$ -         |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

The Company's income tax incurred and change in deferred income tax differ from the amount obtained by applying the federal statutory rate to income before federal income taxes as follows:

| <i>Years ended December 31,</i>               | <b>2009</b>           |            | <b>2008</b>            |             |
|---|-----------------------|------------|------------------------|-------------|
| Expected income tax expense at statutory rate | \$ 113,729,220        | 35%        | \$ (66,227,953)        | -34%        |
| Other   | -                     | 0%         | 22,839                 | 0%          |
| <b>Total income tax</b>                       | <b>\$ 113,729,220</b> | <b>35%</b> | <b>\$ (66,205,114)</b> | <b>-34%</b> |
| Federal income taxes incurred                 | \$ 57,000,000         | 17%        | \$ (4,141,812)         | -32%        |
| Change in net deferred income taxes           | 54,418,012            | 17%        | (62,063,302)           | -2%         |
| Accrual adjustment/change in rate             | 2,311,208             | 1%         | -                      | 0%          |
| <b>Total statutory income taxes</b>           | <b>\$ 113,729,220</b> | <b>35%</b> | <b>\$ (66,205,114)</b> | <b>-34%</b> |

At December 31, 2009, the Association utilized approximately \$184 million of the 2008 net operating losses to offset current year taxable income.

The amounts of federal income taxes incurred that are available for recoupment in the event of future net losses are approximately \$57 million for 2009.

### 11. Related Parties

Pursuant to the Association's Plan of Operation, its Board of Directors consists of nine members. Five directors are elected from the membership of the Association, two directors are appointed by the Texas Department of Insurance from the public sector based on nominations by the Office of Public Insurance Counsel and two directors, who are licensed local recording agents, are appointed by the commissioner of the Texas Department of Insurance. Of the five directors elected from the membership, a minimum of three members shall be from companies with multi-state operations and a minimum of one member shall be from a company domiciled in the State of Texas.

### 12. Service Contract with Texas FAIR Plan Association

During 2002, the Association entered into a service contract with the Texas Fair Plan Association (the "Plan") in which the Association is to be fully reimbursed for all expenditures, professional fees, consulting services, allocated employee time, lost investment income and other costs directly associated with the services provided by the Association on behalf of the Plan. As of December 31, 2009 and 2008, the Association incurred or paid expenses for which it has not been reimbursed of \$7,604,974 (of which \$7,009,645 has been non-admitted) and \$485,334, respectively, on behalf of the Plan. These amounts are recognized in the statutory statements of admitted assets, liabilities, surplus and other funds as a receivable from Texas FAIR Plan Association.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### 13. Line of Credit

The Association had a \$150 million line of credit with a bank. There were no balances outstanding as of December 31, 2008 or drawn against the line of credit for the years ended December 31, 2009 and 2008. This agreement expired on July 13, 2009 and was not renewed.

### 14. Commitments and Contingencies

The Association is subject to various investigations, claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its business activities. Management believes that any liability that may ultimately result from the resolution of these matters in excess of the amounts provided will not have a material adverse effect on the financial position of the Association. These matters are subject to various uncertainties, and some of these matters may be resolved unfavorably to the Association.

### 15. Concentration of Credit Risk

The Association maintains deposits of cash in excess of federally insured limits with certain financial institutions. The Association has not experienced any losses in such accounts and believes they are not exposed to any significant credit risk on cash.

The Association writes windstorm and hail coverage primarily in the 13 counties along the Texas coast.

### 16. Nonadmitted Assets

Nonadmitted assets consisted of the following:

| <i>December 31,</i>                         | <b>2009</b>   | <b>2008</b>   |
|---|---------------|---------------|
| Premiums receivable                         | \$ 133,344    | \$ 125,985    |
| Prepaid pension cost                        | -             | 307,139       |
| Deferred tax asset                          | 14,166,499    | 68,182,268    |
| Receivable from Texas FAIR Plan Association | 7,009,645     | -             |
| Furniture and equipment                     | 197,063       | -             |
| Total nonadmitted assets                    | \$ 21,506,551 | \$ 68,615,392 |

### 17. Fair Value of Financial Instruments

The estimated fair values and carrying values of the Association's financial instruments are as follows:

| <i>December 31,</i>             | <b>2009</b>            |                   | <b>2008</b>            |                   |
|---------------------------------|------------------------|-------------------|------------------------|-------------------|
|                                 | <b>Carrying Amount</b> | <b>Fair Value</b> | <b>Carrying Amount</b> | <b>Fair Value</b> |
| Cash and short-term investments | \$ 352,013,162         | \$ 352,013,162    | \$ 831,456,183         | \$ 831,456,183    |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### 18. Reconciliation with Annual Statement

The following schedules set forth the differences in the amounts reported by the Association to Texas Department of Insurance on its December 31, 2009 annual statement and as reported in the accompanying 2009 audited financial statements. The adjustments, excluding minor reclassifications, relate to the following:

Taxes, licenses and fees and current federal income taxes payable – A reclassification adjustment was made to properly classify current federal income taxes payable.

Receivable from Texas FAIR Plan – An adjustment was made to non-admit certain receivables from Texas FAIR Plan.

Other underwriting expenses incurred and additional minimum pension liability – An adjustment was made to record additional minimum pension liability in accordance with SSAP No. 89.

Statutory fund payable – An adjustment was made to properly reflect the statutory fund cost in accordance with Article 21.49 of the Texas Insurance Code.

Deferred tax assets – An adjustment was made to reflect the tax effect of the above changes.

|  | <i>December 31, 2009</i> |                |                                    |
|--|--------------------------|----------------|------------------------------------|
|  | Annual<br>Statement      | Adjustments    | Audited<br>Financial<br>Statements |
| Statutory statement of admitted assets,<br>liabilities, surplus and other funds: |                          |                |                                    |
| Receivable from Texas FAIR Plan  | \$ 7,604,974             | \$ (7,009,645) | \$ 595,329                         |
| Taxes, licenses and fees   | 40,655,550               | (38,880,664)   | 1,774,886                          |
| Current federal income taxes   | -                        | 38,880,652     | 38,880,652                         |
| Statutory fund payable   | 124,264,347              | (54,710,777)   | 69,553,570                         |
| Unassigned deficit   | (47,701,144)             | 47,701,144     | -                                  |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

|   | <i>December 31, 2009</i> |                 |                                    |
|---|--------------------------|-----------------|------------------------------------|
|   | Annual<br>Statement      | Adjustments     | Audited<br>Financial<br>Statements |
| Statutory statement of income:                                |                          |                 |                                    |
| Statutory fund cost   | \$ 124,264,347           | \$ (54,710,777) | \$ 69,553,570                      |
| Other underwriting expenses incurred                          | 89,081,784               | (1,183,080)     | 87,898,704                         |
| Statutory statement of changes in surplus<br>and other funds: |                          |                 |                                    |
| Net income  | \$ 212,046,772           | \$ 55,893,857   | \$ 267,940,629                     |
| Change in net deferred income tax                             | (54,242,329)             | (175,683)       | (54,418,012)                       |
| Change in non-admitted assets                                 | 54,345,046               | (7,236,205)     | 47,108,841                         |
| Additional minimum pension liability                          | -                        | (780,824)       | (780,824)                          |

The following schedules set forth the differences in the amounts reported by the Association to Texas Department of Insurance on its December 31, 2008 annual statement and as reported in the accompanying 2008 audited financial statements. The adjustments, excluding minor reclassifications, relate to the following:

Cash and short-term investments – An adjustment was made to properly reflect claim payments due to timing differences.

Amounts recoverable from reinsures and provision for reinsurance – An adjustment was made to reclass amounts as a reduction in reserves in accordance with SSAP No. 62

Loss and loss adjustment expense reserves – An adjustment was made to strengthen reserves based on management’s best estimate and also to reduce those reserves for the amounts ceded under reinsurance contracts in accordance with SSAP No. 62.

Funds held under reinsurance treaties – An adjustment was made to reflect funds received in advance for loss payments in accordance with SSAP No. 62.

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

December 31, 2008

|  | Annual<br>Statement | Adjustments      | Audited<br>Financial<br>Statements |
|--|---------------------|------------------|------------------------------------|
| Statutory statement of admitted assets,<br>liabilities, surplus and other funds: |                     |                  |                                    |
| Cash and short-term investments  | \$ 835,306,600      | \$ (3,850,417)   | \$ 831,456,183                     |
| Amounts recoverable from reinsures   | 361,250,000         | (361,250,000)    | -                                  |
| Receivables from affiliate   | 515,846             | (30,512)         | 485,334                            |
| Loss and loss adjustment expense<br>reserves                                     | 1,152,371,816       | (757,175,136)    | 395,196,680                        |
| Other expenses   | 921,829             | (30,513)         | 891,316                            |
| Funds held under reinsurance treaties  | -                   | 540,542,325      | 540,542,325                        |
| Provision for reinsurance  | 22,752,085          | (22,752,085)     | -                                  |
| Statutory statement of income:   |                     |                  |                                    |
| Loss and loss adjustment expense<br>incurred                                     | \$ 1,083,273,783    | \$ 131,850,418   | \$ 1,215,124,201                   |
| Other underwriting expenses incurred   | 49,617,091          | 4,141,811        | 53,758,902                         |
| Federal income taxes incurred  | -                   | (4,141,812)      | (4,141,812)                        |
| Statutory statement of changes in surplus<br>and other funds:                    |                     |                  |                                    |
| Net loss   | \$ (58,792,981)     | \$ (131,853,303) | \$ (190,646,284)                   |
| Change in net deferred income tax  | 17,274,800          | 44,788,502       | 62,063,302                         |
| Change in nonadmitted assets   | (17,156,551)        | (44,788,504)     | (61,945,055)                       |
| Change in provision for reinsurance  | (22,752,085)        | 22,752,085       | -                                  |
| Other  | -                   | 2,888            | 2,888                              |
| Statutory statement of cash flows:   |                     |                  |                                    |
| Benefit and loss related payments  | \$ 213,299,404      | \$ 526,696,132   | \$ 739,995,536                     |
| Commissions, expenses paid and<br>aggregate write-ins for deductions             | 139,632,204         | 5,251,748        | 144,883,952                        |
| Federal income taxes paid (recovered)  | 4,141,812           | (4,141,812)      | -                                  |
| Other cash provided (applied)  | (62,487,536)        | 523,955,649      | 461,468,113                        |
| Net change in cash   | 621,105,037         | (3,850,418)      | 617,254,619                        |

# Texas Windstorm Insurance Association

## Notes to Statutory Financial Statements

### **19. Subsequent Events**

No events have occurred subsequent to December 31, 2009 through the date of the audit report that would have a material impact on the Association's financial statements or that would merit disclosure.

## **Independent Auditors' Report on Supplemental Material**

Our audits of the statutory financial statements included in the preceding section of this report were performed for the purpose of forming an opinion on those statements taken as a whole. The supplemental material presented in the following section of this report is presented to comply with the National Association of Insurance Commissioners Accounting Practices and Procedures Manual and Texas State law. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors and the management of Texas Windstorm Insurance Association and for filing with the Texas Department of Insurance and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Certified Public Accountants

June 9, 2010  
Austin, Texas

# Texas Windstorm Insurance Association

## Summary Investment Schedule December 31, 2009

| Investment categories   | Gross Investment Holdings * |   | Admitted Assets as Reported in the Annual Statement |   |
|---|-----------------------------|---|---|---|
|   | Amount                      | % | Amount  | % |
| Bonds:  |                             |   |   |   |
| U.S. Treasury securities  | \$ -                        | - | \$ -  | - |
| U.S. Government agency obligations (excluding mortgage-backed securities):  |                             |   |   |   |
| Issued by U.S. Government agencies  | -                           | - | -   | - |
| Issued by U.S. Government-sponsored agencies  | -                           | - | -   | - |
| Foreign Government (including Canada, excluding mortgage-backed securities)   | -                           | - | -   | - |
| Securities issued by states, territories and possessions and political subdivisions in the U.S.:                        |                             |   |   |   |
| State, territories and possessions general obligations  | -                           | - | -   | - |
| Political subdivisions of states, territories and possessions political subdivisions general obligations                | -                           | - | -   | - |
| Revenue and assessment obligations  | -                           | - | -   | - |
| Industrial development and similar obligations  | -                           | - | -   | - |
| Mortgage-backed securities (includes residential and commercial MBS):   |                             |   |   |   |
| Pass-through securities:  |                             |   |   |   |
| Issued or guaranteed by GNMA  | -                           | - | -   | - |
| Issued by FNMA and FHLMC  | -                           | - | -   | - |
| All other   | -                           | - | -   | - |
| CMO's and REMIC's:  |                             |   |   |   |
| Issued or guaranteed by GNMA, FNMA, FHLMC or VA   | -                           | - | -   | - |
| Issued by non U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies | -                           | - | -   | - |
| All other   | -                           | - | -   | - |
| Other debt and other fixed income securities (excluding short-term):  |                             |   |   |   |
| Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)  | -                           | - | -   | - |
| Unaffiliated foreign securities   | -                           | - | -   | - |
| Affiliated securities   | -                           | - | -   | - |

See accompanying independent auditors' report on supplemental material.

# Texas Windstorm Insurance Association

## Summary Investment Schedule December 31, 2009

| Investment categories  | Gross Investment Holdings * |                 | Admitted Assets as Reported in the Annual Statement |                 |
|--|-----------------------------|-----------------|---|-----------------|
|  | Amount                      | %               | Amount  | %               |
| Equity interests:  |                             |                 |   |                 |
| Investments in mutual funds  | -                           | -               | -   | -               |
| Preferred stocks:  |                             |                 |   |                 |
| Affiliated   | -                           | -               | -   | -               |
| Unaffiliated   | -                           | -               | -   | -               |
| Publicly trade equity securities (excluding preferred stocks):           |                             |                 |   |                 |
| Affiliated   | -                           | -               | -   | -               |
| Unaffiliated   | -                           | -               | -   | -               |
| Other equity securities:   |                             |                 |   |                 |
| Affiliated   | -                           | -               | -   | -               |
| Unaffiliated   | -                           | -               | -   | -               |
| Other equity interests including tangible personal property under lease: |                             |                 |   |                 |
| Affiliated   | -                           | -               | -   | -               |
| Unaffiliated   | -                           | -               | -   | -               |
| Mortgage loans:  |                             |                 |   |                 |
| Construction and land development  | -                           | -               | -   | -               |
| Agricultural   | -                           | -               | -   | -               |
| Single family residential properties                                     | -                           | -               | -   | -               |
| Multifamily residential properties                                       | -                           | -               | -   | -               |
| Commercial loans   | -                           | -               | -   | -               |
| Mezzanine real estate loans  | -                           | -               | -   | -               |
| Real estate investments:   |                             |                 |   |                 |
| Property occupied by the company   | -                           | -               | -   | -               |
| Property held for production of income                                   | -                           | -               | -   | -               |
| Property held for sale   | -                           | -               | -   | -               |
| Contract loans   | -                           | -               | -   | -               |
| Receivables for securities   | -                           | -               | -   | -               |
| Cash, cash equivalents and short-term investments                        | 352,013,162                 | 100.000%        | 352,013,162   | 100.000%        |
| Other invested assets  | -                           | -               | -   | -               |
| <b>Total invested assets</b>   | <b>\$ 352,013,162</b>       | <b>100.000%</b> | <b>\$ 352,013,162</b>                               | <b>100.000%</b> |

\*Gross investment holdings as valued in compliance with the NAIC Accounting Procedures Manual

See accompanying independent auditors' report on supplemental material.

# Texas Windstorm Insurance Association

## Supplemental Investment Risk Interrogatories

December 31, 2009

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- 1) Reporting entity's total admitted assets as reported in the accompanying financial statements. \$ 449,192,288

Questions 2 through 23 are not applicable.

*See accompanying independent auditors' report on supplemental material.*

# Texas Windstorm Insurance Association

## Reinsurance Interrogatories December 31, 2009

- 7.1 Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? YES[ ] NO [X]
- 7.2 If yes, indicate the number of reinsurance contracts containing such provisions. N/A
- 7.3 If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? YES[ ] N/A [X]
- 8.1 Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured? YES[ ] NO [X]
- 8.2 Is yes, give full information. N/A [X]
- 9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:
- (a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
  - (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity; or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
  - (c) Aggregate stop loss reinsurance coverage;
  - (d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;

*See accompanying independent auditors' report on supplemental material.*

# Texas Windstorm Insurance Association

## Reinsurance Interrogatories December 31, 2009

- (e) A provision permitting reporting of losses, or payment of losses, less frequently than a quarterly basis (unless there is no activity during the period); or
- (f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

YES  NO

9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling by, or under control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:

- (a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- (b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract?

YES  NO

9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for General Interrogatory 9:

- (a) The aggregate financial statement impact gross of all such ceded reinsurance contacts on the balance sheet and statement income.
- (b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and

*See accompanying independent auditors' report on supplemental material.*

# Texas Windstorm Insurance Association

## Reinsurance Interrogatories December 31, 2009

- (c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved. N/A
- 9.4 Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:
- (a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
- (b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? YES [ ] NO [X]
- 9.5 If yes to 9.4, explain in the Reinsurance Summary Supplemental Filing for General Interrogatory 9 (Section D) why the contract(s) is treated differently for GAAP and SAP. N/A
- 9.6 The reporting entity is exempt from the Reinsurance Attestation Supplement under one or more of the following criteria:
- (a) The entity does not utilize reinsurance ; or, YES [ ] NO [X]
- (b) The entity only engages in a 100% quota share contract with an affiliate and the affiliated or lead company has filed an attestation supplement; or, YES [ ] NO [X]
- (c) The entity has no external cessions and only participates in an intercompany pool and the affiliated or lead company has filed an attestation supplement. YES [ ] NO [X]

*See accompanying independent auditors' report on supplemental material.*