Texas Windstorm Insurance Association

Statutory Financial Statements and Supplemental Information

Years Ended December 31, 2012 and 2011

Calhoun, Thomson + Matza, LLP
Certified Public Accountants

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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, 2012 and 2011, and have issued our report thereon dated June 25, 2013. 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 40 years and 8 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 2012, 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 2012, 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.

Calhoun, Thomson & Matza, LLP

June 25, 2013

ctm Calhoun, Thomson+Matza, LLP
Certified Public Accountants

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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, 2012 and 2011 and the related statutory statements of income and changes in surplus and other funds, and cash flows for the years then ended, and the related notes to the statutory financial statements.

Management's Responsibility for the Statutory Financial Statements

Management is responsible for the preparation and fair presentation of these statutory financial statements in accordance with accounting practices prescribed or permitted by the Texas Department of Insurance; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the statutory 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 statutory 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 statutory financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statutory financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the statutory 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 statutory 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 statutory financial statements.

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

Basis of Accounting

As described more fully in the Summary of Significant Accounting Policies, 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.

Because of the departures from accounting principles generally accepted in the United States of America identified above, as of December 31, 2012 and 2011 deferred acquisition costs was understated by $35.8

million and $33.8 million, the provision for reinsurance was overstated by $11.0 million and $15.1 million, and other assets were understated by $13.8 million and $7.0 million, respectively. The departures identified above reduced total net position as of December 31, 2012 and 2011 by $60.6 million and $55.9 million, respectively. The effects on net income for the years ended December 31, 2012 and 2011 were immaterial.

Opinion

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Texas Windstorm Insurance Association as of December 31, 2012 and 2011, or the results of its operations or its cash flows for the years then ended.

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, 2012 and 2011, 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".

Emphasis of Matters

As of December 31, 2012, the Association had approximately $81.5 billion of insurance exposure in certain designated counties located in the gulf coast region of the State of Texas. By state statute, the Association may not maintain a surplus greater than zero; any excess surplus must be paid to the Catastrophe Reserve Trust Fund ("Trust Fund"). As of the December 31, 2012, the balance in the Trust Fund was approximately $178.9 million. In addition, the Association had negative surplus (deficit) of $183.0 million as of December 31, 2012. If a major claim event occurs in the future, it could have a severe impact on the financial condition of the Association.

In accordance with House Bill 4409 passed by the Texas Legislature, the Association is authorized to place $2.5 billion in public securities. The Association does not have taxing authority. In addition, the public securities, if issued, will not be guaranteed by any state or federal agency. Consequently, the ability of the Association to place these public securities and the sufficiency of that amount to cover future losses is unknown.

Ultimate loss projections for Hurricane Ike were estimated to be $2.72 billion by the Association's actuary as of December 31, 2012. If the ultimate loss projection changes in the future it could have a severe impact on the financial condition of the Association.

On February 28, 2011, the Association was placed in Administrative Oversight by order of the Insurance Commissioner of the state of Texas. Administrative Oversight is one of the regulatory tools authorized by Chapter 441 of the Texas Insurance Code. It is a form of intervention through which the Texas Department of Insurance increases its involvement in the day to day operations of an insurer. The duration of Administrative Oversight is unknown.

Supplemental Information

Our audits of the statutory financial statements were conducted for the purpose of forming an opinion on those statements as a whole. The accompanying supplementary information is presented to comply with the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and Texas state law. 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 statutory financial statements. The information has been subjected to the auditing procedures applied in the audit of the statutory financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the statutory financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the statutory financial statements as a whole.

Calhoun, Thompson & Matza, LLP

June 25, 2013

Texas Windstorm Insurance Association

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

(Amounts in Thousands)

December 31,		**2012**		2011
Admitted Assets				
Cash and short-term investments	**$**	**427,855**	$	474,693
Amounts recoverable from reinsurers		**291**		16,121
Other		**491**		630
	$	**428,637**	$	491,444
Liabilities, Surplus and Other Funds				
Liabilities:				
Loss and loss adjustment expenses	**$**	**378,717**	$	248,336
Underwriting expenses payable		**4,732**		4,215
Commissions payable		**4,595**		-
Unearned premiums		**173,461**		159,588
Ceded reinsurance premiums payable, net of ceding commissions		**25,449**		26,883
Provision for reinsurance		**11,018**		15,055
Statutory fund payable		**-**		24,666
Other liabilities		**13,644**		12,701
Total liabilities		**611,616**		491,444
Commitments and contingencies (Notes 7, 8, 9, 13, 14, 15 and 16)				
Surplus and other funds:				
Unassigned deficit		**(182,979)**		-
	$	**428,637**	$	491,444

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

Texas Windstorm Insurance Association

Statutory Statements of Income

(Amounts in Thousands)

Years ended December 31,		**2012**		2011
Underwriting income:				
Premiums earned	**$**	**429,594**	$	385,000
Premiums ceded		**(108,472)**		(63,219)
Net premiums earned		**321,122**		321,781
Deductions:				
Losses and loss expenses incurred		**401,873**		202,539
Underwriting expenses incurred		**93,583**		81,665
Total underwriting deductions		**495,456**		284,204
Net underwriting (loss) gain		**(174,334)**		37,577
Investment income:				
Net investment (loss) income earned		**(4,101)**		291
Net realized capital loss on bond anticipation note defeasance		**(1,496)**		-
Net investment (loss) gain		**(5,597)**		291
Other income (loss):				
Other (loss) income		**(160)**		173
Net (loss) income before statutory fund cost and federal income tax expense		**(180,091)**		38,041
Statutory fund cost		-		20,587
Net (loss) income before federal income tax expense		**(180,091)**		17,454
Federal income tax expense		-		25
Net (loss) income	**$**	**(180,091)**	$	17,429

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

(Amounts in Thousands)

		Unassigned (Deficit) Surplus
Balance at January 1, 2011	$	-
Net income		17,429
Change in deferred income taxes		21,204
Change in nonadmitted assets		(24,870)
Change in provision for reinsurance		(13,788)
Other		25
Balance at December 31, 2011		-
Net loss		(180,091)
Change in deferred income taxes		(266,040)
Change in nonadmitted assets		259,436
Change in provision for reinsurance		4,037
Other		(321)
Balance at December 31, 2012	$	(182,979)

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

Texas Windstorm Insurance Association

Statutory Statements of Cash Flows
(Amounts in Thousands)

Years ended December 31,		**2012**		2011
Cash from operations:				
Premiums collected, net of reinsurance	**$**	**336,929**	$	296,965
Net investment (loss) income		**(5,593)**		276
Miscellaneous (loss) income		**(159)**		210
Benefit and loss related payments		**(228,417)**		(157,294)
Commissions, expenses paid and aggregate write-ins for deductions		**(140,383)**		(164,944)
Federal income taxes paid		**-**		(25)
Net cash from operations		**(37,623)**		(24,812)
Cash from financing and miscellaneous sources:				
Other cash applied		**(9,215)**		(5,352)
Net cash from financing and miscellaneous sources		**(9,215)**		(5,352)
Net change in cash and short-term investments		**(46,838)**		(30,164)
Cash and short-term investments, beginning of year		**474,693**		504,857
Cash and short-term investments, end of year	**$**	**427,855**	$	474,693

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

Nature of Business
Based upon its statutory purpose under Chapter 2210, Tex. Ins. Code (the “Act”), the Texas Windstorm Insurance Association (the "Association") is an entity created by the Texas legislature with its primary statutory purpose being the provision of an adequate market for windstorm and hail insurance in the seacoast territory of Texas (“seacoast territory”). Chapter 2210 provides a method by which adequate windstorm and hail insurance may be obtained in certain designated portions of the seacoast territory.

The Association is intended to serve as a residual insurer of last resort for windstorm and hail insurance in the seacoast territory. The Association shall function in such a manner as to not be a direct competitor in the private market and to provide windstorm and hail insurance coverage to those who are unable to obtain that coverage in the private market.

Organization
The Association was created by the Texas legislature in 1971. The statutory authority of the Association is currently found in Chapter 2210, Texas Insurance Code. The primary purpose of the Association is to provide an adequate market for windstorm and hail insurance in the seacoast territory**.**

The Association is intended to serve as a residual insurer of last resort for windstorm and hail insurance in the seacoast territory. The Association shall not be a direct competitor in the private market but provide windstorm and hail insurance coverage to those who are unable to obtain that coverage from the private market. The membership of the Association includes every property insurer authorized to write property insurance in Texas, except companies that are excluded by law from writing coverage available through the Association on a statewide basis.

In 1993, the Texas legislature created the Association’s Catastrophe Reserve Trust Fund (“CRTF”) to be held by the Texas Comptroller of Public Accounts, outside the state treasury on behalf of, and with legal title in, the Texas Department of Insurance (“TDI”). In 1999, the Texas legislature enacted legislation to allow the Association to pay the net equity of the Association on an annual basis into the CRTF or purchase reinsurance as approved by the Commissioner.

In 2008, various amendments to the Association’s plan of operation (governing rules) changed the participation formula, and the source, type, and adjustment of premium data used. These changes authorized the Association to prepare financial information on a calendar year basis only rather than on both a calendar year and syndicate year basis, to calculate assessments for members on a calendar year basis rather than a syndicate year basis, and to eliminate a minimum cap and a maximum cap on a member company’s assessment percentage.

In 2009, House Bill 4409 was enacted to address the funding of Association losses and operating expenses in excess of premium and other revenue including allowing for certain financing arrangements, issuance of public securities, use of public security proceeds and payment of public security obligations.

Legislative changes and amendments to the plan of operation established the procedures and requirements for determining and collecting member assessments and premium surcharges for the payment of class 2 public security obligations and class 3 public security obligations under Insurance Code Sections 2210.613 and 2210.6135. The procedures for member assessments are established in Title 28 Texas Administrative Code, Sections 5.4161 to 5.4167, and the procedures for premium surcharges on insurance policies are established in Title 28 Texas Administrative Code, Sections 5.4171, 5.4172, 5.4173, and 5.4181 to 5.4192. Assessments may not include an insurer that became a member of the Association after September 1, 2009, and had not previously been a member of the Association, until after the second anniversary of the date on which the insurer first becomes a member of the Association.

The sequence for funding catastrophe losses in excess of premium and other revenue include funding:

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). The Association must repay the proceeds 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 policyholders who reside or have operations in or whose property is located in the Association's catastrophe area. The surcharge shall be assessed on each Texas windstorm and hail insurance policy and each property and casualty insurance policy, including an automobile insurance policy, issued for automobiles and other property located in the catastrophe area. The surcharge applies to all policies written under the following lines of insurance: fire and allied lines; farm and ranch owners; residential property insurance; private passenger automobile liability and physical damage insurance; and commercial automobile liability and physical damage insurance. The surcharge also includes the property insurance portion of a commercial multiple peril insurance policy.

From proceeds of Class 3 public securities not to exceed $500 million per year to be repaid through non-recoupable assessments to the member companies.

House Bill 4409 also changed the member composition of the Board of Directors and increased the size of the Board of Directors to a ten-member board. These changes include the Commissioner of Insurance appointing all members of the Board, a reduction of the number of industry members from 5 to 4, changing two public and two agent members to four members being from the first tier coastal counties with at least one member who is an agent (other than a captive agent), adding a member from a county other than a seacoast county and adding a non-voting member that is an engineer from a first tier coastal county. All Board members serve staggered three-year terms.

In 2011, House Bill 3 was enacted, 82nd Legislature, 1st called Special Session. Key changes allow the Association to:

issue pre-event public securities under Class 1 public securities;

allow issuance of Class 2 public securities in the event the total of Class 1 public securities cannot be issued;

require a declination every three years to maintain coverage in the Association;

reduce the minimum retained premium from 180 to 90 days;

develop a new claims resolution process with different deadlines than industry standards;

require appraisal for certain claim payment amounts;

require alternative dispute resolution before allowing the Association to be sued on disputed claims;

establish an alternative certification program to maintain coverage with the Association for non-compliant structures;

allow increased oversight by the Texas Department of Insurance and State Auditor;

increase reporting requirements to the legislature, regulator, and board of directors; and

issue new policies consistent with the legislative changes.

(Amounts in Thousands)

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.

Reconciliations of net income and policyholders' surplus between the amounts reported in the accompanying financial statements (TX basis) and NAIC SAP follow:

Years ended December 31,		**2012**		2011
Net income, Texas basis	**$**	**(180,091)**	$	17,429
Effect of Texas permitted practices		**(24,679)**		(20,490)
Net income, NAIC SAP basis	**$**	**(204,770)**	$	(3,061)

December 31,		**2012**		2011
Statutory surplus, Texas basis	**$**	**(182,979)**	$	-
Effect of Texas permitted practices		**(34,209)**		(7,382)
Policyholders' surplus, NAIC SAP basis	**$**	**(217,188)**	$	(7,382)

TDI has approved the permitted practice to allow the Association to recognize the reinsurance premium associated with its catastrophe reinsurance agreement June 1, 2012 and June 1, 2011 over a 12-month period. The duration of the June 1, 2012 permitted practice is for one year only, ending May 31, 2013 and will not be extended to any future reinsurance agreements.

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.

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 Governmental Money Market Mutual funds.

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. Amounts have been non-admitted.

Income Taxes
In 2010, the Association applied for and received a Private Letter Ruling ("PLR") from the Internal Revenue Service ("IRS"). The PLR requested acknowledgement that the Association's income is derived from an essential governmental function which accrues to a state or political subdivision and is therefore excluded from gross income under Section 115(1) of the Internal Revenue Code ("IRC"). On August 17, 2010, the IRS ruled that the Association performs an essential government function and that income from that function is excluded from gross income under IRC Section 115(1).

The Association has been filing form 1120-PC tax returns with the IRS as a property and casualty insurance company. Under the IRC the statute of limitations to be assessed additional taxes or to file amended tax returns is 3 years from the later of the due date of the return (including extensions) or the filing date of the return. For the Association, open years are 2007, 2008, 2009, 2010 and 2011.

For 2007 and 2008, the Association has extended the statute of limitations until July 31, 2013 and for 2009 and 2010 until September 15, 2014.

The Association filed amended returns with the IRS for these open years based upon the PLR excluding from gross income the income derived from an essential governmental function. The amount of the tax recoverable for these open years as a result of excluding gross income resulting from performing an essential government function is approximately $60 million. This recoverable has been reported as a federal income tax recoverable in the statutory statements of admitted assets, liabilities and surplus and has been non-admitted.

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. Premiums are generally recognized as revenue on a pro-rata basis over the policy term once the policy is effective. Unearned premiums, net of deductions for reinsurance, are computed on a pro-rata basis over the term of the policies.

Those premiums received for policies issued but not effective as of year-end are included in advanced premiums within the Association's statutory statement of admitted assets, liabilities, surplus and other funds.

Those premiums received for policies which are not effective and not issued as of year-end are included in remittances and items not allocated within the Association's statutory statement of admitted assets, liabilities, surplus and other funds.

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.

Fair Value Measurements
Statement of Statutory Accounting Principles ("SSAP") No. 100, Fair Value Measurements, requires disclosures of the aggregate fair value of all financial instruments, summarized by type of financial instrument, for which it is practicable to estimate fair value. SSAP No. 100 excludes obligations for pension benefits, substantively extinguished debt, insurance contracts, lease contracts, warranty obligations and rights, investments accounted for under the equity method and equity instruments issued by the entity. Accordingly, the aggregate fair value amounts presented herein do not necessarily represent the underlying value of the Association; similarly, care should be exercised in deriving conclusions about the Association's business or financial condition based on the fair value information presented herein.

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 fair value.

The Association is required to categorize its assets and liabilities that are measured at fair value into the three-level fair value hierarchy. The three-level fair value hierarchy is based on the degree of subjectivity inherent in the valuation method by which fair value was determined. The three levels are defined as follows:

- Level 1 – Fair values are based on quoted prices in active markets for identical assets or liabilities that the Association has the ability to access as of the measurement date.
- Level 2 – Fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that can otherwise be corroborated by observable market data.
- Level 3 – Fair values are based on inputs that are considered unobservable where there is little, if any, market activity for the asset or liability as of the measurement date. In this circumstance, the Association has to rely on values derived by independent brokers or internally-developed assumptions. Unobservable inputs are developed based on the best information available to the Association which may include the Association's own data.

The Association has no assets or liabilities that are measured and reported at fair value in the statutory statement of admitted assets, liabilities, surplus and other funds.

(Amounts in Thousands)

1. Cash and Short-Term Investments

Cash and short-term investments are as follows:

December 31,		**2012**		2011
Cash	**$**	**427,855**	$	374,629
Short-term investments		**-**		100,064
	$	**427,855**	$	474,693

2. Furniture and Equipment

Furniture and equipment consist of the following:

December 31,		**2012**		2011
Furniture and equipment	**$**	**918**	$	1,200
Electronic data processing equipment and software		**11,862**		7,930
Leasehold improvements		**1,858**		-
		14,638		9,130
Less: accumulated depreciation		**(4,041)**		(4,515)
		10,597		4,615
Less: non-admitted furniture and equipment		**(10,597)**		(4,615)
	$	**-**	$	-

Depreciation expense was approximately $1,027 and $675 for the years ended December 31, 2012 and 2011, respectively.

3. Reinsurance

During 2012 and 2011, the Association entered into reinsurance agreements. These agreements reduce 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, 2012, the reinsurance contract is to indemnify the Association in respect of the liability that may accrue to the Association as a result of loss or losses under Policies classified by the Association as Property business, including, but not limited to Residential, Commercial and Inland Marine business, in force at the inception of this Contract, or written or renewed during the term of this Contract by or on behalf of the Association. The reinsurer shall be liable in respect of each Loss Occurrence for 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of $2.3 billion, subject to a limit of liability to the Reinsurer of $850 million for each Loss Occurrence. Furthermore, the Reinsurer’s liability for all Loss Occurrences commencing during the term of this Contract shall not exceed $1.5 billion.

(Amounts in Thousands)

Effective June 1, 2011, the reinsurance contract is to indemnify the Association in respect of the liability that may accrue to the Association as a result of loss or losses under Policies classified by the Association as Property business, including, but not limited to Residential, Commercial and Inland Marine business, in force at the inception of this Contract, or written or renewed during the term of this Contract by or on behalf of the Association. The reinsurer shall be liable in respect of each Loss Occurrence for 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of $1.6 billion, subject to a limit of liability to the Reinsurer of $636 million for each Loss Occurrence. Furthermore, the Reinsurer's liability for all Loss Occurrences commencing during the term of this Contract shall not exceed $1.272 billion.

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 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, 2012 and 2011:

	Name of reinsurer	**2012**	2011
AA-3190339	Renaissance Reinsurance Ltd	**$ 1,567**	$ 1,880
AA-3194139	Axis Capital Holdings Limited	**1,155**	1,410
AA-3194122	DaVinci Reins. thru Underwriters Managers	**1,054**	1,253
AA-3190829	Alterra Bermuda Ltd	**898**	1,098
AA-1128001	Lloyd's Underwriter Syndicate No. 2001 AML	**814**	940
22-2005057	Everest Reinsurance Company	**800**	783
AA-1464104	Allianz Risk Transfer AG	**772**	705
AA-3190686	Partner Reinsurance Company Ltd	**772**	2,597
AA-3190770	Ace Tempest Reinsurance Limited	**745**	909
AA-3190875	Hiscox Insurance Company	**745**	862
AA-1126033	Lloyd's Underwriter Syndicate No. 0033	**714**	877
AA-1127414	Lloyd's Underwriter Syndicate No. 1414	**714**	877
AA-1120083	Lloyd's Underwriter Syndicate No. 1910	**576**	-
47-0698507	Odyssey America Reinsurance Corporation	**565**	689
AA-3194129	Montpellier Reinsurance Ltd.	**488**	549
AA-1460006	Flagstone Reassurance Suisse SA	**385**	470
AA-3190757	XL Re Ltd	**385**	470
AA-1460019	Amin AG	**381**	470
AA-3194161	Catlin Insurance Company Ltd	**282**	313
AA-3190870	Validus Holdings Limited	**282**	313
AA-1128003	Lloyd's Underwriter Syndicate No. 2003	**257**	313

(Amounts in Thousands)

AA-1128791	Lloyd's Underwriter Syndicate No. 2791	**257**	313
AA-3190838	Tokio Millennium Reinsurance Ltd	**257**	313
13-1675535	Swiss Re Underwriters Agency, Inc.	**250**	313
AA-3194168	Aspen Bermuda Limited	**230**	282
AA-1320031	SCOR Global P&C S.E.	**213**	-
13-5616275	Transatlantic Reinsurance Company	**192**	235
AA-1440076	Sirius International Insurance Company	**129**	157
AA-3194126	Arch Reinsurance Ltd	**104**	125
AA-1120102	Lloyd's Underwriter Syndicate No. 1458	**77**	94
23-1641984	QBE Reinsurance Company	**76**	94
AA-1120084	Lloyd's Underwriter Syndicate No. 1955	**69**	-
AA-1340125	Hannover Ruckversicherung AG	**64**	79
AA-1126626	Lloyd's Underwriter Syndicate No. 0626	**64**	79
AA-1127084	Lloyd's Underwriter Syndicate No. 1084	**64**	79
AA-1120116	Lloyd's Underwriter Syndicate No. 3902	**64**	79
AA-1120075	Lloyd's Underwriter Syndicate No. 4020	**64**	79
AA-5420050	Korean Reinsurance Company	**64**	79
AA-1120085	Lloyd's Underwriter Syndicate No. 1274	**52**	63
AA-1120071	Lloyd's Underwriter Syndicate No. 2007	**52**	63
AA-1128623	Lloyd's Underwriter Syndicate No. 2623	**52**	64
AA-3194174	Platinum Underwriters Bermuda Ltd	**52**	-
AA-1128987	Lloyd's Underwriter Syndicate No. 2987	**40**	-
AA-1126566	Lloyd's Underwriter Syndicate No. 0566	**39**	-
35-6021485	Paladin Catastrophe Management	**20**	23
AA-1126609	Lloyd's Underwriter Syndicate No. 0609	**13**	-
AA-1127225	Lloyd's Underwriter Syndicate No. 1225	**13**	15
AA-1126623	Lloyd's Underwriter Syndicate No. 0623	**12**	15
AA-3190873	Ariel Reinsurance Company Ltd	-	705
AA-1464100	Marsh (Scor)	-	267
AA-3190972	Torus Insurance Ltd	-	89
AA-1126727	Lloyd's Underwriter Syndicate No. 0727 SAM	-	79
AA-1126570	Lloyd's Underwriter Syndicate No. 0570 ATR	-	15
AA-1126807	Lloyd's Underwriter Syndicate No. 0807SDM	-	13
Total		**$ 16,934**	$ 21,589

(Amounts in Thousands)

The effect of reinsurance on premiums written and earned for the years ended December 31, 2012 and 2011 is as follows:

	2012		2011	
	Written	**Earned**	Written	Earned
Direct	**$ 443,480**	**$ 429,594**	$ 403,748	$ 385,000
Ceded	**(108,485)**	**(108,472)**	(108,375)	(63,219)
Net	**$ 334,995**	**$ 321,122**	$ 295,373	$ 321,781

During 2012 and 2011, the Association recovered approximately $0 and $228 million, respectively, of paid losses and loss adjustment expenses relating to reinsurance contracts.

4. Ceded Reinsurance Premiums Payable

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

December 31,	**2012**	2011
Ceded reinsurance premiums payable	**$ 27,366**	$ 29,142
Reinsurance ceding commissions receivable	**(1,917)**	(2,259)
	$ 25,449	$ 26,883

5. Unearned Premiums

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

December 31,	**2012**	2011
Gross unearned premiums	**$ 218,630**	$ 204,744
Ceded unearned premiums	**(45,169)**	(45,156)
	$ 173,461	$ 159,588

(Amounts in Thousands)

6. Loss and Loss Adjustment Expenses

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

		2012		2011
Beginning balance (net of reinsurance receivable of $0 and $228,634)	**$**	**248,336**	$	240,939
Incurred related to:				
Current loss year		**77,021**		107,743
Prior loss years		**324,852**		94,796
Losses and loss adjustment expense incurred		**401,873**		202,539
Paid related to:				
Current loss year		**(58,249)**		(88,265)
Prior loss years		**(213,243)**		(106,877)
Paid losses and loss adjustment expense		**(271,492)**		(195,142)
Ending balance	**$**	**378,717**	$	248,336

The December 31, 2012 direct loss and LAE reserves increased approximately $130.4 million from 2011. This increase in reserves was the result of continued settlement of prior year claims from 2008 storm activity offset by an increase in prior year ultimate losses and LAE of approximately $325 million with the concentration of the loss attributed to accident year 2008. During 2012, some claims were reopened or presented to the Association for the first time due to continued lawsuit activity. The Association feels that the loss and LAE reserves as of December 31, 2012 make a reasonable provision for the Association's claim liabilities considering the increased lawsuit activity during 2012.

The December 31, 2011 loss and loss adjustment expense reserves increased approximately $ 7.4 million from 2010. This increase in reserves was the result of settlement of prior year claims from 2008 storm activity offset by an increase in prior year ultimate losses and LAE of approximately $94 million. This increase was due to the 2008 accident year.

7. Statutory Fund

In 1993, the Texas legislature created the Catastrophe Reserve Trust Fund ("Trust Fund"). At the end of each year and pursuant to administrative rules, the Association shall deposit the net gain from operations of the Association in excess of incurred losses, operating expenses, public security obligations, and public security administrative expenses into the Trust Fund and/or purchase reinsurance. Pursuant to Tex. Ins. Code §2210.259, a surcharge is charged on non-compliant structures insured by the Association, and these surcharges are deposited monthly into the Trust Fund.

When an occurrence or series of occurrences in a catastrophe area, the association shall pay losses in excess of premium and other revenue of the association from available reserves of the association and available amounts in the Trust Fund. Administrative rules adopted by the commissioner of insurance establish the procedures relating to the disbursement of money from the Trust Fund.

The Texas Comptroller of Public Accounts ("comptroller") administers the catastrophe reserve trust fund in accordance with Tex. Ins. Code, Chapter 2210. All money, including investment income, deposited in the catastrophe reserve trust fund, are state funds to be held by the comptroller outside the state treasury on behalf of, and with legal title in, the Texas Department of Insurance ("TDI") until disbursed as provided by the Tex. Ins. Code, Chapter 2210 and administrative rules adopted by the TDI under the Association's Plan of Operation.

The trust fund may be terminated only by law. On termination of the trust fund, all assets of the trust fund revert to the state of Texas to provide funding for the mitigation and preparedness plan established under Tex. Ins. Code, §2210.454.

For the years ending December 31, 2012 and 2011, statutory fund costs were $0 and approximately $20.6 million, respectively. There was no statutory fund cost for December 31, 2012 due to heavy adverse development to loss and LAE related to the 2008 hurricane event.

(Amounts in Thousands)

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.

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:

December 31,		**2012**		2011
Change in Projected Benefit Obligations for Vested Participants:				
Benefit obligation at beginning of year	**$**	**9,041**	$	8,061
Service cost		**494**		711
Interest cost		**464**		416
Actuarial(gain) loss		**850**		(55)
Benefits paid		**(148)**		(92)
Projected benefit obligation at end of year		**10,701**		9,041
Change in Plan Assets				
Fair value of plan assets at beginning of year		**6,048**		4,853
Actual return on plan assets		**873**		149
Employer contributions		**1,152**		1,138
Benefits paid		**(148)**		(92)
Fair value of plan assets at end of year		**7,925**		6,048
Funded Status				
Unrecognized net loss		**(2,913)**		(2,678)
Accrued benefit obligation for vested employees	**$**	**137**	$	(315)
Accumulated Benefit Obligation for Vested Participants	**$**	**9,686**	$	7,488
Benefit Obligation for Non-Vested Employees				
Projected benefit obligation	**$**	**1,060**	$	614

(Amounts in Thousands)

Years ended December 31,	**2012**	2011
Components of Net Periodic Benefit Costs		
Service costs	**$ 494**	$ 711
Interest costs	**464**	415
Expected return on plan assets	**(424)**	(425)
Amount of loss recognized	**166**	111
Total net periodic benefit cost	**$ 700**	$ 812

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, 2012 and 2011, additional minimum liability of $1,761 and $1,440 was required, respectively.

Pension Assumptions

December 31,	**2012**	2011
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	**5.25%**	5.75%
Rate of compensation increase	**4.00%**	4.00%
Expected long-term rate of return of plan assets	**6.50%**	8.00%
Weighted-average assumptions used to determine projected benefit obligations:		
Weighted-average discount rate	**4.25%**	5.25%
Rate of compensation increase	**2.50%**	4.00%

Measurement Date

A measurement date of December 31, 2012 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:

December 31,	**2012**	2011
Equity securities	**51.4%**	50.8%
Debt securities	**45.4%**	46.7%
Real estate	**0.0%**	0.0%
Other	**3.2%**	2.5%
	100.0%	100.0%

(Amounts in Thousands)

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.

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:

Years ending December 31,	Amount
2013	$ 249
2014	288
2015	372
2016	422
2017	476
2018 and thereafter	3,252

Planned Contributions
The Association expects to make contributions of $1,034 during the year ending December 31, 2013.

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 $447 and $319 for the years ended December 31, 2012 and 2011, respectively.

(Amounts in Thousands)

9. Lease Commitments

The Association leases office space under a non-cancellable operating lease agreement which expires in 2022. Future minimum lease payments, by year and in the aggregate, under a non-cancellable operating lease with initial or remaining terms of one year or more consisted of the following at December 31, 2012:

Years ending December 31,		Amount
2013	$	866
2014		756
2015		778
2016		800
2017 and thereafter		6,325
	$	9,525

Rental expense under the non-cancelable operating lease was approximately $999 and $952 for the years ended December 31, 2012 and 2011, respectively.

10. Federal Income Taxes

The Association adopted SSAP No. 101 as of January 1, 2012 and it did not result in a change in amount or composition of admitted deferred tax assets. The adoption of this statement did not result in a change to surplus.

The components of the net deferred tax assets at December 31 are as follows:

December 31, 2012		Ordinary		Capital		Total
Gross deferred tax assets	**$**	**218,320**	**$**	**-**	**$**	**218,320**
Statutory valuation allowance adjustment		**(218,320)**		**-**		**(218,320)**
Adjusted gross deferred tax assets		-		-		-
Deferred tax liabilities		-		-		-
Net deferred tax asset		-		-		-
Deferred tax assets nonadmitted		-		-		-
Net admitted deferred tax assets	$	-	$	-	$	-

December 31, 2011		Ordinary		Capital		Total
Gross deferred tax assets	$	266,040	$	-	$	266,040
Statutory valuation allowance adjustment		-		-		-
Adjusted gross deferred tax assets		266,040		-		266,040
Deferred tax liabilities		-		-		-
Net deferred tax asset		266,040		-		266,040
Deferred tax assets nonadmitted		(266,040)		-		(266,040)
Net admitted deferred tax assets	$	-	$	-	$	-

Change		Ordinary		Capital		Total
Gross deferred tax assets	$	(47,720)	$	-	$	(47,720)
Statutory valuation allowance adjustment		(218,320)		-		(218,320)
Adjusted gross deferred tax assets		(266,040)		-		(266,040)
Deferred tax liabilities		-		-		-
Net deferred tax asset		(266,040)		-		(266,040)
Deferred tax assets nonadmitted		266,040		-		266,040
Net admitted deferred tax assets	$	-	$	-	$	-

The amount of each result or component of the calculation, by tax character, of paragraphs 11a, 11b, and 11c:

December 31, 2012		Ordinary		Capital		Total
Recovered through loss carrybacks (11a)	$	-	$	-	$	-
Expected to be recognized after application of the threshold limitation (11b)		-		-		-
Adjusted gross DTAs offset against existing DTLs (11c)		-		-		-
Total	$	-	$	-	$	-

Total adjusted capital used to determine recovery period and threshold limitation above	$	-
Authorized control level	$	-
ExDTA ACL RBC ratio		-

(Amounts in Thousands)

December 31, 2011		Ordinary		Capital		Total
Recovered through loss carrybacks (11a)	**$**	-	$	-	$	-
Expected to be recognized after application of the threshold limitation (11b)		-		-		-
Adjusted gross DTAs offset against existing DTLs (11c)		-		-		-
Total	**$**	-	$	-	$	-
Total adjusted capital					$	-
Authorized control level					$	-
ExDTA ACL RBC ratio						-

There was no impact of tax planning strategies on adjusted gross DTA’s and net admitted DTA’s.

Current income taxes incurred consist of the following major components:

Years ended December 31,		**2012**		2011		Change
Federal	**$**	-	$	25	$	(25)
Foreign		-		-		-
Realized capital gains		-		-		-
Federal and foreign income taxes incurred	**$**	-	$	25	$	(25)

(Amounts in Thousands)

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

December 31,	**2012**	2011	Change
Deferred tax assets:			
Ordinary:			
Discount on unpaid losses and LAE	**$ 2,665**	$ 3,082	$ (417)
Pension accrual	**-**	489	(489)
Net operating loss carry-forward	**215,655**	262,469	(46,814)
Total ordinary deferred tax assets	**218,320**	266,040	(47,720)
Statutory valuation allowance adjustment	**(218,320)**	-	(218,320)
Nonadmitted deferred tax assets	**-**	266,040	266,040
Total deferred tax assets	**-**	-	-
Deferred tax liabilities:			
Ordinary:	**-**	-	-
Other	**-**	-	-
Total deferred tax liabilities	**-**	-	-
Net admitted deferred tax assets	**$ -**	$ -	$ -

The significant items causing a difference between the statutory federal income tax rate and the Association's effective income tax rate are as follows:

Years ended December 31,	**2012**	2011
Provision computed at statutory rate	**$ -**	$ 5,934
Section 115(1) income	**-**	(109,563)
Accrual adjustments – prior year Section 115(1) income	**-**	82,809
Other	**-**	(359)
Total statutory income taxes	**$ -**	$ (21,179)

Years ended December 31,	**2012**	2011
Federal and foreign income taxes incurred	**$ -**	$ 25
Realized capital gains tax	**-**	-
Change in net deferred income taxes	**-**	(21,204)
Total statutory income taxes	**$ -**	$ (21,179)

(Amounts in Thousands)

At December 31, 2012, the Association has the following unused operating loss carryforwards available to offset against future taxable income:

Year		Amount
2012	$	317,892
2011		91,573
2010		230,342
2009		-
2008	$	63,949

The Association did not have any income tax expense that is available for recoupment in the event of future net losses.

The Association did not have any protective tax deposits under Section 6603 of the Internal Revenue Code.

11. Related Parties

Pursuant to the Association's Plan of Operation, the Board of Directors consists of nine voting members and one non-voting member appointed by the Commissioner of the Texas Department of Insurance. Four members must be representatives of the insurance industry. Four members must reside in the first tier coastal counties. At least one member appointed must be a property and casualty agent who is licensed.

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. During 2012 and 2011 the Association paid expenses for the Texas Fair Plan Association under its management contract and was reimbursed $6,262 and $6,187 respectively for each year. As of December 31, 2012 and 2011, the Association incurred or paid expenses for which it has not been reimbursed of $365 and $2, respectively, on behalf of the Plan. These amounts are recognized in the statements of net assets as a receivable from TFPA.

13. Debt

In 2012, the Texas Public Finance Authority (the “Authority” or the “Issuer”) issued the Texas Public Finance Authority Class 1 Revenue Notes (Texas Windstorm Insurance Association Program), Taxable Series 2012 (the “Notes”) on behalf of the Association for the purpose of financing future costs in the amount of $500 million. The Notes were issued pursuant to a master resolution adopted by the Board of Directors of the Authority (the “Board”) on July 9, 2012 (the “Master Resolution”), and a first supplemental resolution adopted by the Board on July 9, 2012 (the

"First Supplemental Resolution", and together with the Master Resolution, the "Resolutions"). The Notes constitute the initial series of Class 1 Public Securities of the Authority secured and payable from Class 1 Pledged Revenues irrevocably pledged under the Resolutions. The Association pledged the Class 1 Pledged Revenues to the Authority pursuant to a Financing and Pledge Agreement dated as of July 1, 2012 between the Authority and the Association.

The Notes bore interest initially at the per annum rate of 1.00% from the Delivery Date through and including the 60th day following the Delivery Date. On the 61st day after the Delivery Date the Notes bore interest at the per annum rate of 2.5% as the Notes did not (i) receive long-term ratings equivalent to the "A" category or better by two nationally recognized rating agencies (each, a "Rating Agency") and did not (ii) receive the highest short-term ratings by two Rating Agencies. The effective interest rate from the Delivery Date to the Tender Date is 2.01%.

The Notes were subject to mandatory tender on the Tender Date. The Notes were also subject to defeasance in December if a catastrophe did not occur by December 15, 2012. No catastrophe occurred and as such, the Notes were terminated by in-substance defeasance on December 17, 2012.

The Notes had an original maturity of February 1, 2013, but were defeased on December 17, 2012.

There are no future maturities remaining on the Notes and no future payments.

Note issuance costs amounted to $1,226 at December 31, 2012. Note issuance costs are expensed as incurred.

Interest expense for the year ending December 31, 2012 totaled $3,507 and calculated through December 17, 2012. A loss on defeasance totaled $1,496.

14. Line of Credit

The Association had a $200 million line of credit with a bank. There were no balances outstanding as of December 31, 2012 and 2011 or drawn against the line of credit for the years ended December 31, 2012 and 2011. This agreement was cancelled on May 18, 2012.

15. 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.

(Amounts in Thousands)

16. 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 14 counties along the Texas coast in which it has approximately $82 billion, and $74 billion of insurance exposure as of December 31, 2012 and 2011, respectively.

17. Nonadmitted Assets

Nonadmitted assets consisted of the following:

December 31,		**2012**		2011
Prepaid expenses and receivables	**$**	**741**	$	120
Federal income tax recoverable		**60,169**		60,169
Deferred tax asset		**-**		266,039
Furniture and equipment		**10,597**		4,615
Total nonadmitted assets	**$**	**71,507**	$	330,943

18. Fair Value Measurements

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

	2012				2011			
December 31,		**Carrying Amount**		**Fair Value**		Carrying Amount		Fair Value
Cash and short-term investments	**$**	**427,855**	**$**	**427,855**	$	474,693	$	474,693

19. Reconciliation with Annual Statement

There were no differences between the 2012 annual statement and 2011 restated annual statement as filed with the Texas Department of Insurance and the 2012 and 2011 audited statutory financial statements.

20. Correction of an Error

During 2011, the Association determined that a liability for Advance Date premiums was not properly recorded at December 31, 2010 and prior years. The impact of the restatements on the 2011 financial statements was a reduction of $4 million to the written and earned premium of the Association. The impact on net income for 2011 before taxes was zero due to the nature of recording the statutory fund expense, and related liability. The Association has taken measurements to ensure proper controls of recording of these transactions as of December 31, 2011 and into the future.

21. Subsequent Events

The Association has evaluated subsequent events occurring after December 31, 2012, the date of the most recent balance sheet date, through June 25, 2013, the date the financial statements were issued. The Association does not believe any subsequent events have occurred that would require further disclosure or adjustment to the statutory financial statements.

Texas Windstorm Insurance Association

Summary Investment Schedule
December 31, 2012
(Amounts in Thousands)

Investment categories	Gross Investment Holdings * Amount	%	Admitted Assets as Reported in the Annual Statement ** 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	-	-	-	-
Non-U.S. 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 or guaranteed 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 and hybrid securities)	-	-	-	-
Unaffiliated non-U.S. securities (including Canada)	-	-	-	-
Affiliated securities	-	-	-	-

See accompanying independent auditors' report on supplemental material.

Texas Windstorm Insurance Association

Summary Investment Schedule
December 31, 2012
(Amounts in Thousands)

Investment categories	Gross Investment Holdings * Amount	%	Admitted Assets as Reported in the Annual Statement ** 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	427,855	100.00	427,855	100.00
Other invested assets	-	-	-	-
Total invested assets	$ 427,855	100.00	$ 427,855	100.00

**Gross investment holdings as valued in compliance with the NAIC Accounting Procedures Manual.*
*** The Association has no securities lending reinvested collateral at December 31, 2012.*

See accompanying independent auditors' report on supplemental material.

Texas Windstorm Insurance Association

Supplemental Investment Risk Interrogatories
December 31, 2012
(Amounts in Thousands)

1)	Reporting entity's total admitted assets as reported in the accompanying financial statements.	$ 428,637

Questions 2 through 23 are not applicable.

See accompanying independent auditors' report on supplemental material.

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]

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;

(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[X] NO [ ]

See accompanying independent auditors' report on supplemental material.

(Amounts in Thousands)

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[X] 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.

Financial Impact – Section A	As Reported	Interrogatory 9 Reinsurance Effect	Restated Without Interrogatory 9 Reinsurance
Assets – Line 1			
Assets	$ 428,637	$ (291)	$ 428,346
Liabilities	611,616	8,702	620,318
Surplus as regards to policyholders	(182,979)	(8,993)	(191,972)
Income before taxes	(180,091)	100,247	(79,844)

See accompanying independent auditors' report on supplemental material.

(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

Effective June 1, 2012, the reinsurance contract is to indemnify the Association in respect of the liability that may accrue to the Association as a result of loss or losses under Policies classified by the Association as Property business, including, but not limited to Residential, Commercial and Inland Marine business, in force at the inception of this Contract, or written or renewed during the term of this Contract by or on behalf of the Association. The reinsurer shall be liable in respect of each Loss Occurrence for 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of $2.3 billion, subject to a limit of liability to the Reinsurer of $850 million for each Loss Occurrence. Furthermore, the Reinsurer's liability for all Loss Occurrences commencing during the term of this Contract shall not exceed $1.5 billion.

The contract is being reported pursuant to Interrogatory 9.1.

(c) A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

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 companies.

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

See accompanying independent auditors' report on supplemental material.