

Texas Windstorm Insurance Association

Statutory Financial Statements and Supplemental Information

Years Ended December 31, 2017 and 2016



**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, 2017 and 2016, and have issued our report thereon dated April 27, 2018. 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 State Board of Public Accountancy.
- b. The engagement director, who is a certified public accountant, has 13 years of experience in public accounting and is 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 2017, 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 director has served in that capacity with respect to the Association since 2013, is licensed by the Texas State 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.

Cohn, Therman & Matza, LLP

April 27, 2018

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, 2017 and 2016 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.

Auditors' 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 differences between statutory accounting principles and accounting principles generally accepted in the United States of America identified above, as of December 31, 2017 and 2016 cash, cash

equivalents, and short-term investments were lower by \$0 and \$59.2 million, respectively, and other assets were lower by approximately \$18.4 million and \$9.0 million, respectively. The differences identified above reduced total net position as of December 31, 2017 and 2016 by approximately \$21.2 million and \$69.9 million, respectively. The effects on change in net position for the years ended December 31, 2017 and 2016 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, 2017 and 2016, 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, 2017 and 2016, 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, 2017, the Association had approximately \$72 billion of insurance exposure in certain designated counties located in the gulf coast region of the State of Texas. By state statute, the Association is prohibited from maintaining a surplus by virtue of its funding obligations to the Catastrophe Reserve Trust Fund (“CRTF”); any net gain from operations must be paid to the CRTF. As of the December 31, 2017, the balance in the CRTF was \$1.2 million. 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 Senate Bill 900 (“SB 900”) passed by the Texas Legislature during 2015, the Association is authorized to place \$1.0 billion in public securities and assess member insurance companies \$1.0 billion to fund catastrophic losses. 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 all these public securities and the sufficiency of that amount to cover future losses will depend upon market conditions and the financial and operating results of the Association.

Ultimate loss projections for Hurricane Harvey were estimated to be \$1.4 billion by the Association’s appointed actuary as of December 31, 2017. If the ultimate loss projection changes in the future it could have a material adverse effect on the financial condition of the Association.

The Association was removed from Administrative Oversight as of April 8, 2016. The Texas Department of Insurance will continue to monitor and receive periodic reporting for matters relating to contracts, litigation, depopulation, public security covenants and reinsurance.

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.

Cahn, Therman & Matza, LLP

April 27, 2018

Texas Windstorm Insurance Association

Statutory Statements of Admitted Assets, Liabilities, Surplus and Other Funds (Amounts in Thousands)

<i>December 31,</i>	2017	2016
Admitted Assets		
Cash, cash equivalents, and short-term investments	\$ 646,074	\$ 970,530
Other assets	1,880	2,178
	\$ 647,954	\$ 972,708
Liabilities, Surplus and Other Funds		
Liabilities:		
Loss and loss adjustment expenses	\$ 414,734	\$ 53,459
Borrowed money – bonds and interest payable	431,702	476,652
Underwriting expenses payable	15,278	10,281
Unearned premiums	209,453	237,725
Ceded reinsurance premiums payable, net of ceding commissions	20,603	27,497
Funds held by company under reinsurance treaties	369	1,819
Statutory fund payable	-	147,015
Other liabilities	17,205	18,260
Total liabilities	1,109,344	972,708
Commitments and contingencies (Notes 8, 9, 10, 13, 15 and 16)		
Surplus and other funds:		
Unassigned deficit	(461,390)	-
	\$ 647,954	\$ 972,708

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

Texas Windstorm Insurance Association

Statutory Statements of Income (Amounts in Thousands)

<i>Years ended December 31,</i>	2017	2016
Underwriting income:		
Premiums earned	\$ 451,347	\$ 496,457
Premiums ceded	(103,993)	(126,053)
Net premiums earned	347,354	370,404
Deductions:		
Losses and loss expenses incurred	1,475,302	38,625
Underwriting expenses incurred	97,876	109,756
Total underwriting deductions	1,573,178	148,381
Net underwriting (loss) gain	(1,225,824)	222,023
Investment loss:		
Net investment loss	(28,886)	(34,620)
Other income:		
Statutory fund income	743,213	-
Other income	55	67
Total other income	743,268	67
Net (loss) income before statutory fund cost and federal income tax expense	(511,442)	187,470
Statutory fund cost	-	147,015
Net (loss) income before federal income tax expense	(511,442)	40,455
Federal income taxes incurred	-	-
Net (loss) income	\$ (511,442)	\$ 40,455

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
Balance at January 1, 2016	\$	-
Net income		40,455
Change in nonadmitted assets		(40,375)
Other		(80)
Balance at December 31, 2016		-
Net loss		(511,442)
Change in nonadmitted assets		50,760
Other		(708)
Balance at December 31, 2017	\$	(461,390)

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)

<i>Years ended December 31,</i>	2017	2016
Cash from operations:		
Premiums collected, net of reinsurance	\$ 301,710	\$ 362,588
Net investment loss	(29,510)	(36,440)
Miscellaneous income	743,268	67
Benefit and loss related payments	(951,292)	(36,787)
Commissions, expenses paid and aggregate write-ins for deductions	(402,819)	(226,493)
Net cash from operations	(338,643)	62,935
Cash from financing and miscellaneous sources:		
Borrowed funds	(44,950)	(42,692)
Other cash provided (applied)	59,137	(41,330)
Net cash from financing and miscellaneous sources	14,187	(84,022)
Net change in cash, cash equivalents, and short-term investments	(324,456)	(21,087)
Cash, cash equivalents, and short-term investments, beginning of year	970,530	991,617
Cash, cash equivalents, and short-term investments, end of year	\$ 646,074	\$ 970,530

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

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

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 established in 1971 by the Texas Legislature to provide wind and hail coverage to applicants unable to obtain insurance in the Texas seacoast territory from the private market. The Legislature's action was a response to market constrictions along the Texas coast after several hurricanes. The Association is governed by Chapter 2210 of the Texas Insurance Code (Chapter 2210); however, it is not a state agency and does not receive funds from the general revenue.

The Association is a residual insurer of last resort and as such is not a direct competitor in the private market. The Association's primary purpose is to provide an adequate market for windstorm and hail insurance in certain designated portions of the seacoast territory of Texas. The seacoast territory includes 14 first tier and 14 second tier coastal counties. The designated catastrophe area is that portion of the seacoast territory where the Commissioner of Insurance has found that windstorm and hail insurance is not reasonably available. It currently includes the entire first tier counties and a portion of Harris County (second tier). The specific designated catastrophe areas are: Aransas, Brazoria, Calhoun, Cameron, Chambers, Galveston, Jefferson, Kenedy, Kleberg, Matagorda, Nueces, Refugio, San Patricio and Willacy, inside the city limits and east of Highway 146, and the following portions of Harris County: La Porte, Morgan's Point, Pasadena, Seabrook, and Shore Acres.

The Association operates as an insurance company by issuing policies, collecting premiums, and paying losses. The Association is required by law to use the net gain from operations each year to make payments to the CRTF, procure reinsurance or use alternative risk mechanisms. The CRTF is an account maintained by the Texas Comptroller dedicated to funding the payment of Association catastrophe losses.

Association policies provide residential and commercial property coverage for losses resulting from windstorm or hail. No other perils are covered by Association policies. Applications for coverage, accompanied by the full annual premium, may be submitted to the Association through a property and casualty agent properly licensed through the Texas Department of Insurance ("TDI"). In order to be eligible for an Association policy, applicants and properties must meet certain criteria defined by the Texas Legislature:

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

- Applicants must have been denied coverage by at least one insurer in the private market.
- Properties must be located in the designated catastrophe area.
- Properties must be certified by TDI as having been built to applicable building codes, with limited exceptions.
- Properties located in specified flood zones that were constructed, altered, remodeled, or enlarged after September 1, 2009 and that can obtain flood insurance through the National Flood Insurance Program must provide proof of flood insurance coverage.
- Properties must be in an insurable condition as specified by the Association in the Plan of Operation.

Texas Insurance Code Sections 2210.251 and 2210.258 - 2210.259 and the Association's Plan of Operation (28 TAC 5.4001 et seq.) outline the building code and inspection requirements for eligibility in the Association and provide for limited exceptions. In accordance with these sections, the Association requires a WPI-8 certificate of compliance on all structures constructed, altered, remodeled, enlarged, repaired, or to which additions have been made on or after January 1, 1988. To obtain a WPI-8, TDI inspectors or TDI-approved licensed professional engineers must inspect the property and certify that it is fully compliant with the windstorm building code.

Properties must be in an insurable condition to be eligible for Association coverage, i.e. in good repair with no unrepaired damage or hazardous conditions. The Association regularly inspects properties as part of its underwriting process to verify insurability. Properties may be inspected on-site by a vendor or remotely via high-quality aerial imagery. Inspections are used to determine the accuracy of rating information, discover any unrepaired damage, and identify any other conditions that affect the insurability of the property.

Approximately \$4,900,000 in funding was secured for the 2017 hurricane season. SB 900, passed by the 84th Texas Legislature, took effect during 2015, and changed the Association's funding structure. \$4,900,000 is sufficient to fund claims associated with 99% of all modeled hurricane seasons.

The Association's funding structure for the 2017 hurricane season is, in order;

- Approximately \$800,000 in premiums and amounts in the CRTF
- \$500,000 in pre-event Class 1 public securities
- \$500,000 in Class 1 company assessments
- \$250,000 in Class 2 public securities
- \$250,000 in Class 2 company assessments
- \$250,000 in Class 3 public securities
- \$250,000 in Class 3 company assessments
- \$2,100,000 in total reinsurance, including both traditional reinsurance and catastrophe bonds

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

Class 1, 2, and 3 public securities will be repaid by Association premiums and surcharges on Association policies. Class 2 and 3 public securities, after a finding by the Commissioner of Insurance, may also be repaid by surcharges on coastal policyholders, if necessary.

Depopulation measures were introduced in the 84th Texas Legislature in 2015 authorizing assumption reinsurance agreements between the Association and the private market to facilitate depopulation. This allows private insurance companies interested in writing on the Texas coast to assume portions of the Association's book of business as of a point in time. Policyholders have the chance to opt-out of the assumption process.

The Association implemented the Assumption Reinsurance Depopulation Program ("Assumption Program") in 2016 and continued the Assumption Program in 2017. The Assumption Program requires participating insurers to work through agents to identify the policies that will receive assumption offers. A total of 3,091 and 18,074 policies were identified for assumption during 2017 and 2016, respectfully. Policyholders have until May 31, 2018 of the subsequent year to opt out of the 2017 Assumption Program.

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 (loss) and policyholders' surplus between the amounts reported in the accompanying financial statements (Texas basis) and NAIC statutory accounting practices ("SAP") follow:

<i>Years ended December 31,</i>	2017	2016
Net (loss) income, Texas basis	\$ (511,442)	\$ 40,455
Effect of Texas prescribed practices	-	-
Effect of Texas permitted practices	-	-
Net (loss) income, NAIC SAP basis	\$ (511,442)	\$ 40,455

<i>December 31,</i>	2017	2016
Statutory deficit, Texas basis	\$ (461,390)	\$ -
Effect of Texas prescribed practices	-	-
Effect of Texas permitted practices	(279,711)	(476,642)
Policyholders' deficit, NAIC SAP basis	\$ (741,101)	\$ (476,642)

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

TDI has approved the permitted practice to allow the Association to admit the following restricted assets associated with the issuance of Series 2014 Pre-Event Class 1 Revenue Bonds (the "Bonds") as of December 31, 2017 and 2016, respectively:

- \$188,637 and \$445,390 held in the program fund to pay catastrophic losses
- \$91,074 and \$90,412 held in the obligation revenue fund for repayment of the Bonds.
- \$0 and \$(59,160) related to the amounts of assets in excess of bond liabilities.

The restrictions are primarily due to debt service reserves and use of proceeds only when a large hurricane event occurs. The permitted practice will last the life of the Bonds or until rescinded by TDI at an earlier date.

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) Unearned premiums and loss and loss adjustment expense ("LAE") reserves are presented net of related reinsurance rather than on a gross basis as required under GAAP.
- c) The statements of cash flows represent cash balances and cash equivalents with initial maturities of one year or less rather than cash and cash equivalents with initial maturities of three months or less.

Use of Significant Estimates

The preparation of financial statements in accordance with statutory accounting practices prescribed or permitted by the Texas Department of Insurance 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.

Reverse Repurchase Agreements

Reverse repurchase agreements are recorded in cash equivalents as the repurchase date is less than 90 days. Reverse repurchase agreements represent the purchase of a security with an agreement to resell.

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.

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

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 had 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. There are existing net operating loss carryforwards in the open tax years that are not anticipated to be realized. As of December 31, 2017, the statute of limitations remains open for the 2011 to 2017 tax years. No further federal income tax impact is expected in the future.

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 other liabilities within the Association's statutory statements 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 other liabilities within the Association’s statutory statements of admitted assets, liabilities, surplus and other funds.

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

Loss and Loss Adjustment Expense Reserves

Loss and LAE 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. Depopulation ceded premiums are recognized as the ceded policies' premiums are earned.

Fair Value Measurements

Statement of Statutory Accounting Principles ("SSAP") No. 100, Fair Value, 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, cash equivalents, 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.

Texas Windstorm Insurance Association

Summary of Significant Accounting Policies (Amounts in Thousands)

- 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.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

1. Cash, Cash Equivalents and Short-Term Investments

Cash, cash equivalents and short-term investments are as follows:

<i>December 31,</i>	2017		2016	
Cash	\$	179,687	\$	467,792
Cash equivalents		466,387		476,642
Short-term investments		-		26,096
	\$	646,074	\$	970,530

Reverse Repurchase Agreements

The Association invests in overnight reverse repurchase agreements with the Texas Treasury Safekeeping Trust Company ("TTSTC"). These invested funds were received from the issuance of bonds during 2014 and include debt service payments. The funds are held at the TTSTC to be used for debt service and for use when a catastrophic event occurs (See Note 13). The TTSTC's minimum collateral required for overnight reverse repurchase investments is at least 100% for Treasuries; 101% for Agencies and U.S. Instrumentalities and 102% for mortgage-backed securities. The fair value of reverse repurchase agreements was approximately \$279,711 and \$535,802 as of December 31, 2017 and 2016, respectively. The admitted value of reverse repurchase agreements was approximately \$279,711 and \$476,642 as of December 31, 2017 and 2016, respectively, and is included in cash equivalents in the statutory statements of admitted assets, liabilities, surplus and other funds.

The Association has not pledged any of its assets as collateral as of December 31, 2017 and 2016.

Repurchase agreements were Tri-Party during the year ended 2017.

Original (flow) & residual maturity

	Fourth Quarter 2017			
	Minimum	Maximum	Average Daily Balance	Ending Balance
Overnight	\$ 259,194	\$ 539,465	\$ 409,885	\$ 279,711

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

Securities acquired under repurchase agreements - sale

Fourth Quarter 2017					
	Minimum	Maximum	Average Daily Balance	Ending Balance	
BACV	\$ -	\$ -	\$ -	\$ -	\$ 279,711
Nonadmitted – subset of BACV	-	-	-	-	-
Fair value	\$ 259,194	\$ 539,465	\$ 409,885	\$	\$ 279,711

Securities acquired under repurchase agreements – sale by NAIC designation

December 31, 2017	None	NAIC 1	NAIC 2	NAIC 3	NAIC 4	NAIC 5	NAIC 6	Nonadmitted
Other invested assets – BACV	\$ -	\$ 279,711	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other invested assets – FV	-	279,711	-	-	-	-	-	-
Total assets – BACV	-	279,711	-	-	-	-	-	-
Total assets - FV	\$ -	\$ 279,711	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Proceeds Provided - Sale

Fourth Quarter 2017					
	Minimum	Maximum	Average Daily Balance	Ending Balance	
Cash	\$ 259,194	\$ 539,465	\$ 409,885	\$	\$ 279,111
Securities (FV)	-	-	-	-	-
Securities (BACV)	-	-	-	-	-
Nonadmitted subset	\$ -	\$ -	\$ -	\$ -	\$ -

Recognized forward resale commitment

Fourth Quarter 2017					
	Minimum	Maximum	Average Daily Balance	Ending Balance	
Recognized forward resale commitment	\$ 259,194	\$ 539,465	\$ 409,885	\$	\$ 279,711

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

2. Restricted Assets

Restricted assets summarized by restricted asset category. Certain assets below included in the subject to reverse repurchase category are held by the TTSTC and are restricted for use for debt service reserves and for when a catastrophic event occurs (See Note 13). These assets are invested in overnight reverse repurchase agreements. The other restricted assets category consists of minimum maturity time deposit investments.

Restricted Asset Category	Gross (Admitted & Nonadmitted) Restricted							Current Year			
	Current Year							Percentage			
	1	2	3	4	5	6	7	8	9	10	11
	Total General Account (G/A)	G/A Supporting S/A Restricted Assets (a)	Total Separate Account (S/A) Restricted Assets	S/A Assets Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase / (Decrease) (5 minus 6)	Total Non-admitted Restricted	Total Admitted Restricted (5 minus 8)	Gross (Admitted & Non-Admitted) Restricted to Total Assets (c)	Admitted Restricted to Total Admitted Assets (d)
Subject to reverse repurchase	\$ 279,711	\$ -	\$ -	\$ -	\$ 279,711	\$ 535,802	\$ (256,091)	\$ -	\$ 279,711	42.29%	43.17%
Other restricted assets	933	-	-	-	933	90,425	(89,492)	-	933	0.14%	0.14%
Total restricted assets	\$ 280,644	\$ -	\$ -	\$ -	\$ 280,644	\$ 626,227	\$ (345,583)	\$ -	\$ 280,644	42.43%	43.31%

Restricted Asset Category	Gross (Admitted & Nonadmitted) Restricted							Percentage		
	Current Year							Percentage		
	1	2	3	4	5	6	7	8	9	10
	Total General Account (G/A)	G/A Supporting Protected Cell Account Activity (a)	Total Protected Cell Account Restricted Assets	Protected Cell Account Supporting G/A Activity (b)	Total (1 plus 3)	Total From Prior Year	Increase / (Decrease) (5 minus 6)	Total Current Year Admitted Restricted	Gross (Admitted & Non-Admitted) Restricted to Total Assets	Admitted Restricted to Total Admitted Assets
Minimum Maturity Time Deposits	\$ 933	\$ -	\$ -	\$ -	\$ 933	\$ 90,425	\$ (89,492)	\$ 933	0.14%	0.14%
Total other restricted assets	\$ 933	\$ -	\$ -	\$ -	\$ 933	\$ 90,425	\$ (89,492)	\$ 933	0.14%	0.14%

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

3. Furniture and Equipment

Furniture and equipment consist of the following:

<i>December 31,</i>	2017	2016
Furniture and equipment	\$ 400	\$ 642
Electronic data processing equipment and software	10,466	10,869
Leasehold improvements	1,858	1,858
	<u>12,724</u>	<u>13,369</u>
Less: accumulated depreciation	(10,950)	(8,713)
	1,774	4,656
Less: non-admitted furniture and equipment	(1,774)	(4,656)
	<u>\$ -</u>	<u>\$ -</u>

Depreciation expense was approximately \$2,883 and \$2,907 for the years ended December 31, 2017 and 2016, respectively.

4. Reinsurance

During 2017 and 2016, 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 aggregate excess of loss reinsurance agreement (“aggregate excess of loss”).

Aggregate Excess of Loss

Effective June 1, 2017, the reinsurance program 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 the aggregate in respect of losses occurring during the term of this contract of 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$2,800,000, subject to a limit of liability to the Reinsurer of \$2,100,000. The Association also purchased a second season cover for \$800,000 in excess of \$2,000,000 of which 50% was placed. This cover was purchased to ensure that if an event occurred in 2017 and the CRTF was depleted, additional reinsurance coverage would be available for the 2018 storm season. Due to the impact of Hurricane Harvey in 2017, the coverage will become effective June 1, 2018. Reinsurance premiums related to the second season cover of \$9,054 have been recorded as prepaid reinsurance and non-admitted as of December 31, 2017.

Effective June 1, 2016, the reinsurance program 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

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

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 the aggregate in respect of losses occurring during the term of this contract of 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$2,700,000, subject to a limit of liability to the Reinsurer of \$2,200,000. The Association also purchased a second season cover for \$700,000 in excess of \$2,000,000 of which 50% was placed. This cover was purchased to ensure that if an event occurred in 2016 and the CRTF was depleted, adequate reinsurance coverage was secured for the 2017 storm season. As there was no event in 2016, the coverage became null in 2017. Reinsurance premiums related to the second season cover of 12,056 were 100% earned as of December 31, 2016 and included in premiums ceded in the statutory statements of income.

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 entered into quota share reinsurance agreements in relation to the Assumption Program (See Note 14)

The Association has unsecured reinsurance recoverables which exceed 3% of the Association's surplus as of December 31, 2017 as a result of the Assumption Program. The Association had no unsecured reinsurance recoverables which exceed 3% of the Association's surplus as of December 31, 2016.

Name of reinsurer	2017	2016
Maison Insurance Company	\$ 26	\$ -
Woodlands Insurance Company	50	-
United Property & Casualty Insurance Company	33	-
Weston Insurance Company	64	-
Total	\$ 173	\$ -

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

The effect of reinsurance on premiums written and earned for the years ended December 31, 2017 and 2016 is as follows:

	2017		2016	
	Written	Earned	Written	Earned
Direct written premium	\$ 423,074	\$ 451,347	\$ 487,354	\$ 496,457
Excess of loss ceded premium	(94,909)	(94,909)	(123,658)	(123,658)
Depopulation ceded premium	(9,084)	(9,084)	(2,395)	(2,395)
Net	\$ 319,081	\$ 347,354	\$ 361,301	\$ 370,404

Ceded premiums include premiums ceded to companies that assume policies pursuant to the Assumption Program (see Note 14).

As of December 31, 2017 and 2016, the Association had reinsurance recoverables of \$17 and \$1, respectively, of paid losses and LAE as a result of the Assumption Program and is included in other assets in the statutory statements of admitted assets, liabilities, surplus and other funds.

5. Ceded Reinsurance Premiums Payable

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

<i>December 31,</i>	2017	2016
Ceded reinsurance premiums payable	\$ 21,426	\$ 29,038
Reinsurance ceding commissions receivable	(823)	(1,541)
	\$ 20,603	\$ 27,497

6. Unearned Premiums

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

<i>December 31,</i>	2017	2016
Gross unearned premiums	\$ 209,453	\$ 237,725
Ceded unearned premiums	-	-
	\$ 209,453	\$ 237,725

The amount of return commission that would have been due to reinsurers if they or the Association had cancelled the Association's excess of loss reinsurance agreement would have been \$0 as of December 31, 2017 and 2016.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

7. Loss and Loss Adjustment Expenses

Activity in the liability for unpaid losses and LAE is summarized as follows:

<i>December 31,</i>	2017	2016
Beginning balance	\$ 53,502	\$ 75,053
Reinsurance recoverable	43	-
Beginning net balance	53,459	75,053
Incurred related to:		
Current loss year	1,484,926	46,220
Prior loss years	(9,624)	(7,595)
Losses and loss adjustment expense incurred	1,475,302	38,625
Paid related to:		
Current loss year	(1,102,892)	(37,597)
Prior loss years	(11,135)	(22,622)
Paid losses and loss adjustment expense	(1,114,027)	(60,219)
Ending net balance	414,734	53,459
Reinsurance recoverable	479	43
Ending balance	\$ 415,213	\$ 53,502

Current year changes in estimates of the cost of prior year losses and LAE affect the current year statutory statements of income. Increases in those estimates increase current year expense and are referred to as unfavorable development or prior year reserve shortages. Decreases in those estimates decrease current year expense and are referred to as favorable development or prior year reserve redundancies. Current year losses and LAE reflected on the statutory statements of income of approximately \$1,475,302 reflect approximately \$9,624 favorable development of prior year estimates, primarily due to favorable development of Hurricane Ike ultimate loss and LAE in accident year 2008. Increases or decreases of this nature occur as the result of claim settlements and receipt and evaluation or additional information regarding unpaid claims. Recent development trends are also taken into account in evaluating the overall adequacy of reserves. During August 2017, the Association was impacted by Hurricane Harvey. Ultimate loss and LAE from Hurricane Harvey are estimated to be approximately \$1,446,000. The appointed actuary for the Association has opined that the loss and LAE reserves as of December 31, 2017 and 2016 make a reasonable provision for the Association's claim liabilities.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

8. Statutory Fund

In 1993, the Texas legislature created the CRTF. 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 CRTF 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 CRTF.

When an occurrence or series of occurrences in a catastrophe area occurs, 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 CRTF. Administrative rules adopted by the commissioner of insurance establish the procedures relating to the disbursement of money from the CRTF.

The Texas Comptroller of Public Accounts (“comptroller”) administers the CRTF in accordance with Tex. Ins. Code, Chapter 2210. All money, including investment income, deposited in the CRTF, are state funds to be held by the comptroller outside the state treasury on behalf of, and with legal title in, the 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 CRTF may be terminated only by law. On termination of the CRTF, all assets of the CRTF 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, 2017 and 2016, statutory fund costs were approximately \$0 and \$147,015, respectively.

For the years ending December 31, 2017 and 2016, the CRTF held \$1,220 and \$587,860, respectively.

In August 2017, Hurricane Harvey impacted the Texas coast and impacted the Association. Ultimate loss and LAE from Hurricane Harvey are estimated to be approximately \$1,446,000. As of December 31, 2017, the deficit of the Association is \$461,390. During 2017, the Association received \$743,213 from the CRTF for use in paying Hurricane Harvey claims. Funds were made available to the Association upon approval by the TDI Commissioner.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

9. Employee Benefit Plans

Defined Benefit Plan. The Association has a defined pension benefit plan (the "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. As of December 31, 2017 and 2016, the Association accrued in accordance with actuarially determined amounts with an offset to the pension cost accrual for the incremental asset amortization.

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>	2017	2016
<u>Change in Projected Benefit Obligations (PBO) (Underfunded):</u>		
Benefit obligation at beginning of year	\$ 19,618	\$ 17,464
Service cost	1,496	1,417
Interest cost	830	778
Actuarial loss	2,019	470
Benefits paid	(506)	(511)
Projected benefit obligation at end of year	23,457	19,618
<u>Change in Plan Assets:</u>		
Fair value of plan assets at beginning of year	12,711	11,403
Actual return on plan assets	1,799	795
Employer contributions	1,594	1,024
Benefits paid	(506)	(511)
Fair value of plan assets at end of year	15,598	12,711
Funded status	\$ (7,859)	\$ (6,907)

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

<i>December 31,</i>	2017	2016
Funded Status:		
Assets (non-admitted):		
Prepaid benefit costs	\$ -	\$ -
Total assets (non-admitted)	-	-
Liabilities recognized:		
Accrued benefit costs	2,808	2,564
Liability for pension benefits	5,051	4,343
Total liabilities recognized	7,859	6,907
Unrecognized liabilities as a component of net periodic benefit cost	-	-
Funded status	\$ (7,859)	\$ (6,907)
Accumulated benefit obligation	\$ 20,968	\$ 17,547
Years ended December 31,		
Components of Net Periodic Benefit Costs:		
Service costs	\$ 1,496	\$ 1,417
Interest costs	830	778
Expected return on plan assets	(728)	(638)
Loss amortization	196	189
Prior service cost or (credit)	44	44
Total net periodic benefit cost	\$ 1,838	\$ 1,790

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

<u>Years ended December 31,</u>	<u>2017</u>	<u>2016</u>
<u>Amounts in unassigned funds (surplus) recognized as components of net periodic benefit cost:</u>		
Items not yet recognized as a component of net periodic cost – prior year	\$ 4,342	\$ 4,263
Net transition asset or obligation recognized	-	-
Net prior service cost or credit arising during the period	-	-
Net prior service cost or credit recognized	(44)	(44)
Net loss arising during the period	949	313
Net gain recognized	(196)	(189)
Items not yet recognized as a component of net periodic cost – current year	\$ 5,051	\$ 4,343

<u>Years ended December 31,</u>	<u>2017</u>	<u>2016</u>
<u>Amounts in unassigned funds (surplus) expected to be recognized in the next fiscal year as components of net periodic benefit cost:</u>		
Net transition asset or obligation	\$ -	\$ -
Net prior service cost or credit	44	44
Net recognized gains and losses	\$ 213	\$ 179

<u>Years ended December 31,</u>	<u>2017</u>	<u>2016</u>
<u>Amounts in unassigned funds (surplus) that have not yet been recognized as components of net periodic benefit cost:</u>		
Net transition asset or obligation	\$ -	\$ -
Net prior service cost	400	444
Net recognized loss	\$ 4,651	\$ 3,898

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

Pension Assumptions:

<i>December 31,</i>	2017	2016
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	4.25%	4.50%
Rate of compensation increase	2.50%	2.50%
Expected long-term rate of return of plan assets	5.50%	5.50%
Weighted-average assumptions used to determine projected benefit obligations:		
Weighted-average discount rate	3.75%	4.25%
Rate of compensation increase	2.50%	2.50%

The amount of accumulated benefit obligation for defined benefit pension plans was approximately \$20,968 and \$17,547 as of December 31, 2017 and 2016, respectively.

Measurement Date

A measurement date of December 31, 2017 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>	2017	2016
Equity securities	37.3%	42.5%
Debt securities	57.0%	57.2%
Real estate	4.9%	0.0%
Other	0.8%	0.3%
	100.0%	100.0%

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (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 is to increase the percentage of fixed income investments depending on market conditions. 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:

<i>Years ending December 31,</i>	<i>Amount</i>
2018	\$ 541
2019	594
2020	654
2021	699
2022	767
2023 and thereafter	5,050

Planned Contributions

The Association expects to make contributions of \$2,180 during 2018.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

Fair value measurements of Plan Assets as of December 31, 2017 and 2016:

	Fair Value Measurements at December 31, 2017			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Cash	\$ -	\$ 76	\$ -	\$ 76
Large cap equity	3,575	-	-	3,575
Small cap equity	562	-	-	562
Mid cap equity	1,170	-	-	1,170
International equity	-	1,591	-	1,591
Realty fund	-	966	-	966
Fixed income	-	7,652	-	7,652
Limited partnerships	-	-	6	6
Total plan assets	\$ 5,307	\$ 10,285	\$ 6	\$ 15,598

	Fair Value Measurements in Level 3 at December 31, 2017			
	January 1, 2017	Sales	Return on Assets Still Held	December 31, 2017
Limited partnerships	\$ 6	\$ -	\$ -	\$ 6
Total plan assets	\$ 6	\$ -	\$ -	\$ 6

	Fair Value Measurements at December 31, 2016			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Cash	\$ -	\$ 61	\$ -	\$ 61
Large cap equity	3,244	-	-	3,244
Small cap equity	609	-	-	609
Mid cap equity	1,075	-	-	1,075
International equity	-	1,497	-	1,497
Fixed income	-	6,219	-	6,219
Limited partnerships	-	-	6	6
Total plan assets	\$ 4,928	\$ 7,777	\$ 6	\$ 12,711

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

Fair Value Measurements in Level 3 at December 31, 2016

	January 1, 2016	Sales	Return on Assets Still Held	December 31, 2016
Limited partnerships	\$ 5	\$ -	\$ 1	\$ 6
Total plan assets	\$ 5	\$ -	\$ 1	\$ 6

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 \$741 and \$673 for the years ended December 31, 2017 and 2016, respectively.

10. 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, 2017:

<i>Years ending December 31,</i>	Amount
2018	\$ 983
2019	1,009
2020	1,036
2021	1,062
2022	1,088
	\$ 5,178

Rental expense under the non-cancelable operating lease was approximately \$1,395 and \$1,413 for the years ended December 31, 2017 and 2016, respectively.

11. Governance

Pursuant to SB 900 signed into law during 2015, the Board of Directors composition changed and now consists of nine members: three industry representatives from companies actively writing and renewing windstorm and hail insurance in the first tier coastal counties, three public members residing in the first tier coastal counties, and three non-coastal representatives who live more than 100 miles from the Texas coast. One of the public members must also be a property and casualty agent who is licensed under this code and is not a captive agent.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

12. Service Contract with Texas Fair Plan Association

During 2002, the Association entered into a service contract with the Texas Fair Plan Association ("TFPA") 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 TFPA. During 2017 and 2016 the Association paid expenses for TFPA under its management contract and was reimbursed \$14,034 and \$10,534, respectively. As of December 31, 2017 and 2016, the Association incurred or paid expenses for which it has not been reimbursed of \$1,427 and \$1,261, respectively, on behalf of TFPA. These amounts are included in other assets in the statutory statements of admitted assets, liabilities, surplus and other funds. This arrangement is subject to a written agreement which requires that balances be settled within 30 days.

13. Borrowed Money – Bonds Payable

The Texas Public Finance Authority (the "Authority" or the "Issuer") has issued the Bonds on behalf of the Association for the purposes of financing future costs in the amount of \$500,000. The Bonds are issued pursuant to a master resolution adopted by the Board of Directors of the Authority on September 24, 2014 (the "Master Resolution"), and a first supplemental resolution adopted by the Board of Directors of the Authority on September 24, 2014 (the "First Supplemental Resolution", and together with the Master Resolution, the "Resolutions"). The Bonds 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 has pledged the Class 1 Pledged Revenues to the Authority pursuant to a Financing and Pledge Agreement dated as of September 1, 2014 between the Authority and the Association.

The Bonds were issued on September 30, 2014 for \$500,000 of which \$414,600 and \$458,400 was outstanding as of December 31, 2017 and 2016, respectively. The bonds mature July 1, 2024 and can be called by the Issuer beginning July 1, 2019. The Bonds bear interest from 5.25% to 8.25% with an effective interest rate of 8.03%. Interest is payable semi-annually on January 1 and July 1 with the first payment made January 1, 2015. The Bonds are secured by the Association's net premium and other revenue which is used to fund the Debt Service and related accounts held by the TTSTC.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

There are various general and special covenants. The primary covenant, which exists as long as there are outstanding Class 1 Public Securities and Administrative Expenses are incurred, states that in the event the Association's Projected Net Coverage Revenues are less than 1.25 times the Obligations due in the next calendar year and 1.25 times the estimated amount of Administrative Expenses due in the next calendar year, the Association will undertake a plan of action or actions necessary to meet the required Projected Net Coverage Revenues. Another covenant, which exists as long as the Bonds are outstanding, states that the Association will maintain the Operating bank account subject to a deposit account control agreement to maintain a perfected security interest in the Net Premiums and Other Revenue held for the benefit of the Bondholders. The deposit account control agreement is activated upon default of certain debt covenants. As of December 31, 2017 and 2016, the Association is not in violation of these or any of the other various covenants.

The Bonds are subject to optional make-whole redemption, in whole or in part, at the option of the Authority, at the request of the Association prior to July 1, 2019 at a redemption price equal to the greater of (i) 100% of the principal amount of the Bonds to be redeemed or (ii) the sum of the present values of the remaining schedule payments of principal and interest on the Bonds to be redeemed (exclusive of interest accrued to the date fixed for redemption) discounted to the date of redemption on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus 100 basis points, plus in each case, accrued and unpaid interest on the Bonds being redeemed to the date fixed for redemption.

The Bonds are also subject to optional redemption prior to maturity on or after July 1, 2019, in whole or in part, at a redemption price equal to the principal amount of Bonds to be redeemed plus accrued interest to the date of redemption.

As of December 31, 2017 and 2016, the Bonds had no unamortized premium or discount. Bond issuance costs are expensed as incurred.

Interest expense incurred is recorded as an investment expense and was approximately \$35,354 and \$37,596 for the years ending December 31, 2017 and 2016, respectively, and is included in net investment loss in the statutory statements of income. Interest expense of \$36,504 and \$38,688 was paid for the years ended December 31, 2017 and 2016, respectively. Interest payable was \$17,102 and \$18,252 as of December 31, 2017 and 2016, respectively, and is included in borrowed money – bonds and interest payable in the statutory statements of admitted assets, liabilities, surplus and other funds.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

Changes in borrowed money - bonds payable for the year ending December 31, 2017 is as follows:

Description	Bonds Outstanding January 1, 2017	Bonds Issued	Bonds Matured	Bonds Outstanding December 31, 2017
Bonds	\$ 458,400	\$ -	\$ 43,800	\$ 414,600

Changes in borrowed money - bonds payable for the year ending December 31, 2016 is as follows:

Description	Bonds Outstanding January 1, 2016	Bonds Issued	Bonds Matured	Bonds Outstanding December 31, 2016
Bonds	\$ 500,000	\$ -	\$ 41,600	\$ 458,400

The aggregate maturities for the next five years and thereafter is as follows:

<i>Years Ended December 31,</i>	Amount
2018	\$ 46,100
2019	49,900
2020	54,000
2021	58,500
2022	63,300
2023 and thereafter	142,800
On Demand	-
	\$ 414,600

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

14. Depopulation

Effective December 1, 2017, pursuant to measures introduced in the 84th Texas Legislature in 2015, the Association implemented year two of the Assumption Program. 3,091 policies were identified and approved by agents for possible transfer from the Association to the participating private market insurers with 2,789 policies remaining as of December 31, 2017. Policies will automatically transfer to participating companies on June 1, 2018. Policyholders may choose to remain with the Association by opting out of the Assumption Program by May 31, 2018. In connection with the Assumption Program, a 100% quota share reinsurance agreement was entered with three private market insurance companies effective December 1, 2017. Funds held by the Association under the Assumption Program as of December 31, 2017 will be settled at the end of the treaty period, June 1, 2018.

Effective December 1, 2016, pursuant to measures introduced in the 84th Texas Legislature in 2015, the Association implemented year one of the Assumption Program. After the agent review period concluded, 18,074 policies were approved by agents for possible transfer from the Association to four participating private market insurers. Policies automatically transferred to participating companies on June 1, 2017. Policyholders could elect to remain with the Association by opting out of the Assumption Program on May 31, 2017. In connection with the Assumption Program, a 100% quota share reinsurance agreement was entered with the four insurance companies effective December 1, 2016. Funds were settled at the end of the treaty period, and 5,594 policies remained after the opt out period concluded, June 1, 2017.

As of December 31, 2017 and 2016, funds-held by company under reinsurance treaties was \$369 and \$1,819, respectively, and is included in the statutory statements of admitted assets, liabilities, surplus and other funds.

During 2017 and 2016, the Association recognized ceded written premiums of \$9,084 and \$2,395, respectively, as a result of the Assumption Program.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

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.

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 \$72,000,000 and \$81,000,000 of insurance exposure as of December 31, 2017 and 2016, respectively.

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

17. Nonadmitted Assets

Nonadmitted assets consisted of the following:

<i>December 31,</i>	2017		2016	
Cash, cash equivalents, and short-term investments	\$	-	\$	59,160
Prepaid reinsurance		9,054		-
Prepaid expenses and receivables		2,686		458
Furniture and equipment		1,774		4,656
Total nonadmitted assets	\$	13,514	\$	64,274

18. Fair Value Measurements

The following table reflects the fair values and admitted assets and liabilities that are financial instruments. The fair values are also categorized into the three-level fair value hierarchy. Cash, cash equivalents and short-term investments are the only financial instruments held by the Association in which carrying value and fair value are the same.

Fair Value Measurements at December 31, 2017 Using:

	Aggregate Fair Value	Admitted Assets	Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 646,074	\$ 646,074	\$ 646,074	\$ -	\$ -
	\$ 646,074	\$ 646,074	\$ 646,074	\$ -	\$ -

Fair Value Measurements at December 31, 2016 Using:

	Aggregate Fair Value	Admitted Assets	Level 1	Level 2	Level 3
Cash, cash equivalents and short-term investments	\$ 1,029,690	\$ 970,530	\$ 1,029,690	\$ -	\$ -
	\$ 1,029,690	\$ 970,530	\$ 1,029,690	\$ -	\$ -

Texas Windstorm Insurance Association

Notes to Statutory Financial Statements (Amounts in Thousands)

19. Reconciliation with Annual Statement

There were no differences between the 2017 annual statement and 2016 annual statement as filed with the Texas Department of Insurance and the 2017 and 2016 audited statutory financial statements.

20. Subsequent Events

The Association has evaluated subsequent events occurring after December 31, 2017, the date of the most recent statutory statements of admitted assets, liabilities, surplus, and other funds through April 27, 2018, the date the statutory financial statements were issued.

The Association increased the estimate of Hurricane Harvey gross ultimate loss and LAE to \$1,610,000 as of March 31, 2018 as a result of a greater number and severity of supplemental payments and payments on reopened claims in the first quarter of 2018. This revision equated to \$164,000 of adverse development from December 31, 2017.

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, 2017

(Amounts in Thousands)

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	-	-	-	-
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 information.

Texas Windstorm Insurance Association

Summary Investment Schedule

December 31, 2017

(Amounts in Thousands)

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	646,074	100.00	646,074	100.00
Other invested assets	-	-	-	-
Total invested assets	\$ 646,074	100.00	\$ 646,074	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, 2017.

See accompanying independent auditors' report on supplemental information.

Texas Windstorm Insurance Association

Supplemental Investment Risk Interrogatories

December 31, 2017

(Amounts in Thousands)

- 1) Reporting entity's total admitted assets as reported in the accompanying financial statements. \$ 647,954

Questions 2 through 19 are not applicable

- 20) Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At Year-End		At End of Each Quarter		
	Amount	Percentage of Total Admitted Assets	1 st Qtr	2 nd Qtr	3 rd Qtr
Reverse repurchase agreements	\$ 279,711	43.17%	\$ 467,516	\$ 476,636	\$ 423,123

Questions 21 through 23 are not applicable

See accompanying independent auditors' report on supplemental information.

Texas Windstorm Insurance Association

Reinsurance Interrogatories

December 31, 2017

(Amounts in Thousands)

- 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 information.

Texas Windstorm Insurance Association

Reinsurance Interrogatories

December 31, 2017

(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	\$ 647,954	\$ 17	\$ 647,937
Liabilities	1,109,344	20,493	1,088,851
Surplus as regards to policyholders	(461,390)	(20,476)	(440,914)
Income before taxes	\$ (511,442)	\$ (98,179)	\$ (413,263)

See accompanying independent auditors' report on supplemental information.

Texas Windstorm Insurance Association

Reinsurance Interrogatories

December 31, 2017

(Amounts in Thousands)

- (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, 2017, the reinsurance program 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 the aggregate in respect of losses occurring during the term of this contract of 100% of the Ultimate Net Loss over and above an initial Ultimate Net Loss of \$2,700,000, subject to a limit of liability to the Reinsurer of \$2,200,000.

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 condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

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 31 of SSAP No. 62R, 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]

See accompanying independent auditors' report on supplemental information.

Texas Windstorm Insurance Association

Reinsurance Interrogatories

December 31, 2017

(Amounts in Thousands)

- 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 information.