

Texas FAIR Plan Association

Statutory Financial Statements and Supplemental Information Years Ended December 31, 2012 and 2011



Texas FAIR Plan Association

Statutory Financial Statements and Supplemental Information

Years Ended December 31, 2012 and 2011

Texas FAIR Plan Association

Contents

Accountants' letter of qualifications	3-4
Independent auditors' report	5-6
Statutory financial statements	
Statutory statements of admitted assets, liabilities, surplus and other funds	7
Statutory statements of income	8
Statutory statements of changes in surplus and other funds	9
Statutory statements of cash flows	10
Summary of significant accounting policies	11-14
Notes to statutory financial statements	15-20
Supplemental information	
Summary investment schedule	21-22
Supplemental investment risk interrogatories	23
Reinsurance interrogatories	24-26

Accountants' Letter of Qualifications

Governing Committee
Texas FAIR Plan Association
Austin, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America, the statutory financial statements of Texas FAIR Plan 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 State 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, and 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 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.

Catharine, Thomson & Matza, LLP
June 25, 2013

Independent Auditors' Report

Governing Committee
Texas FAIR Plan Association
Austin, Texas

We have audited the accompanying statutory statements of admitted assets, liabilities, surplus and other funds of Texas FAIR Plan 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.

Opinion

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 Texas FAIR Plan Association as of 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 \$18 billion of insurance exposure in the State of Texas. The Association has authority to assess certain property and casualty insurers underwriting business in the state of Texas under Texas Insurance Code Chapter 2211. However, if another major claim event occurs in the future, it could have a severe impact on the financial condition of the Association.

As of December 31, 2012, ultimate loss projections for Hurricane Ike are estimated to be \$320 million by the Association's actuary. If the ultimate loss projection changes in the future it could have a significant impact on the financial condition of the Association.

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.

Restriction on Use

This report is intended solely for the information and use by the Governing Committee and the management of Texas FAIR Plan Association and for filing with the Texas Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.

Calhan, Thomson & Matza, LLP

June 25, 2013

Texas FAIR Plan Association

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

<i>December 31,</i>	2012	2011
Admitted Assets		
Cash and short-term investments	\$ 41,689	\$ 35,322
Uncollected premiums and agents' balances in the course of collection	52	60
Deferred premiums, agents' balances and installments booked but deferred	14,967	11,446
Amounts recoverable from reinsurers	-	375
Total admitted assets	\$ 56,708	\$ 47,203
Liabilities, Surplus and Other Funds		
Liabilities		
Loss and loss adjustment expenses	\$ 25,293	\$ 35,374
Underwriting expenses payable	2,362	1,500
Unearned premiums, net of ceded unearned premiums	34,583	25,278
Ceded reinsurance premiums payable	17,853	16,110
Provision for reinsurance	178	1,009
Other liabilities	2,161	1,792
Total liabilities	82,430	81,063
Commitments and contingencies (Notes 8, 9 and 10)		
Surplus and other funds		
Unassigned deficit	(25,722)	(33,860)
Total liabilities and surplus and other funds	\$ 56,708	\$ 47,203

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

Texas FAIR Plan Association

Statutory Statements of Income (In Thousands)

<i>Years ended December 31,</i>	2012	2011
Net premiums earned	\$ 56,880	\$ 47,063
Deductions:		
Losses and loss expenses incurred	28,453	53,010
Other underwriting expenses incurred	20,346	16,118
Total underwriting deductions	48,799	69,128
Net underwriting gain (loss)	8,081	(22,065)
Investment income (loss):		
Net investment loss	(137)	(18)
Other income (loss):		
Other loss	(590)	(200)
Net income (loss)	\$ 7,354	\$ (22,283)

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

Texas FAIR Plan Association

Statutory Statements of Changes in Surplus and Other Funds (In Thousands)

	Unassigned Deficit
Balance, January 1, 2011	\$ (17,449)
Net loss	(22,283)
Change in nonadmitted assets	135
Change in provision for reinsurance	5,737
Balance, December 31, 2011	(33,860)
Net income	7,354
Change in nonadmitted assets	(47)
Change in provision for reinsurance	831
Balance, December 31, 2012	\$ (25,722)

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

Texas FAIR Plan Association

Statutory Statements of Cash Flows (In Thousands)

<i>Years ended December 31,</i>	2012	2011
Cash from operations:		
Premiums collected, net of reinsurance	\$ 64,687	\$ 52,276
Net investment income	(137)	(18)
Miscellaneous income	(645)	(199)
Benefit and loss related payments	(30,811)	(31,270)
Commissions, expenses paid and aggregate write-ins for deductions	(26,469)	(23,452)
Net cash from operations	6,625	(2,663)
Cash from financing and miscellaneous sources:		
Other cash (applied) provided	(258)	616
Net cash from financing and miscellaneous sources	(258)	616
Net change in cash and short-term investments	6,367	(2,047)
Cash and short-term investments, beginning of year	35,322	37,369
Cash and short-term investments, end of year	\$ 41,689	\$ 35,322

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

Texas FAIR Plan Association

Summary of Significant Accounting Policies (In Thousands)

Nature of Business

Texas FAIR Plan Association (the "Association") was created by the Texas Legislature and activated by the Commissioner of Insurance pursuant to Chapter 2211 of the Texas Insurance Code (the "Act"). The purpose of the Act is to provide a method of delivering residential property insurance to qualified citizens of Texas in areas determined by the Commissioner of Insurance of the Texas Department of Insurance to be underserved areas. The membership of the Association includes every property insurer authorized to write residential property insurance in the State of Texas, except companies that are excluded by law. The Act provides that members will share in the Association's losses on a calendar year basis to the extent of their percentage of participation during the calendar year involved, as determined under the provisions of the Act and the Association's Plan of Operation.

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.

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 unassigned surplus, rather than capitalized and charged to income as used under GAAP. These include certain fixed assets, prepaid expenses and premium receivables.
- (b) Policy acquisition costs are charged against income as incurred, whereas under GAAP, such costs are deferred and amortized over the term of the coverage. Such costs include commissions, direct underwriting costs, policy issue costs and premium taxes.
- (c) The statements 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.
- (d) Unearned premiums and loss and loss adjustment expense reserves are presented net of related reinsurance rather than on a gross basis as required under GAAP.

Texas FAIR Plan Association

Summary of Significant Accounting Policies (In Thousands)

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.

Short-Term Investments

Short-term investments are recorded at cost which approximates market value. These short-term investments are comprised solely of United States Government securities and Governmental Money Market Mutual Funds.

Electronic Data Processing Equipment and Software

Electronic data processing equipment and operating system software are stated at cost, net of accumulated depreciation. Depreciation is calculated using the straight-line method over an estimated useful life of three years. Expenditures for non-operating system software are expensed as incurred. Amounts have been non-admitted.

Income Taxes

As of June 18, 2005, the Association is a tax exempt organization whose gross income is excludable under Internal Revenue Code (IRC) Section 115 and is no longer required to file tax returns.

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.

Texas FAIR Plan Association

Summary of Significant Accounting Policies (In Thousands)

Loss and Loss Adjustment Expenses

Insurance losses and related adjustment expenses are charged to operations as incurred. The reserves for unpaid losses and loss adjustment expenses are determined based upon case-basis evaluations and actuarial projections, and include a provision for incurred but not reported losses. The actuarial projections of ultimate losses on reported claims are based on the Association's experience and expected development assumptions from industry data. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the actual cost of settling all remaining claims may be more or less than the reserve for unpaid losses and loss adjustment expenses. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and any adjustments are reflected in earnings currently.

Salvage and subrogation recoverables are not recognized until received.

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. Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsured policies. The Association evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize exposure to significant gains or losses from reinsurer insolvencies.

Fair Value Measurements

Statements 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:

Texas FAIR Plan Association

Summary of Significant Accounting Policies (In Thousands)

- 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.

Texas FAIR Plan Association

Notes to Statutory Financial Statements (In Thousands)

1. Cash and Short-Term Investments

Cash and short-term investments are as follows:

<i>December 31,</i>	2012		2011
Cash	\$ 41,689	\$	26,629
Short-term investments	-		8,693
	\$ 41,689	\$	35,322

2. Electronic Data Processing Equipment and Software

Electronic data processing equipment and software consists of the following:

<i>December 31,</i>	2012		2011
Electronic data processing equipment and software	\$ 110	\$	810
Less: accumulated depreciation	(110)		(797)
	-		13
Less: non-admitted electronic data processing equipment and software	-		(13)
	\$ -	\$	-

Depreciation expense was approximately \$12 and \$74 for the years ended December 31, 2012 and 2011, respectively.

3. Reinsurance

During 2012 and 2011, the Association entered into a reinsurance agreement. The agreement limits the amount of losses that can arise from claims under a general reinsurance contract known as a property catastrophe excess of loss reinsurance program ("excess of loss").

Excess of Loss. Effective July 1, 2012, the excess of loss reinsurance agreement provides the Association with two layers of coverage. The first layer provides 100% participation of \$85 million in excess of \$40 million of each and every loss occurrence. The second layer provides 100% participation of \$175 million in excess of \$125 million of each and every loss occurrence. The agreement covers losses incurred on all in-force, new and renewal policies. Any additional liability would be funded by member assessments in the event that available funds are not sufficient to meet the obligations of the Association. This agreement expires on June 30, 2013.

Texas FAIR Plan Association

Notes to Statutory Financial Statements (In Thousands)

Effective July 1, 2011, the excess of loss reinsurance agreement provided the Association with three layers of coverage. The first layer provided 100% participation of \$50 million in excess of \$40 million of each and every loss occurrence. The second layer provided 100% participation of \$60 million in excess of \$90 million of each and every loss occurrence. The third layer provided 100% participation of \$150 million in excess of \$150 million of each and every loss occurrence. The agreement covered losses incurred on all in-force, new and renewal policies. Any additional liability would be funded by member assessments in the event that available funds are not sufficient to meet the obligations of the Association. This agreement expired on June 30, 2012.

Ceded reinsurance is treated as the risk and liability of the assuming companies; however, the reinsurance contract does 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
Transatlantic Reinsurance Company	\$ 6	\$ 30
Lloyd's Underwriter Syndicate No. 0727 SAM	-	2
Lloyd's Underwriter Syndicate No. 1183 TAL	3	9
Lloyd's Underwriter Syndicate No. 1414 ASC	12	48
Lloyd's Underwriter Syndicate No. 1458 RNR	2	9
Lloyd's Underwriter Syndicate No. 1910 ARW	11	-
Lloyd's Underwriter Syndicate No. 2001 AML	10	32
Lloyd's Underwriter Syndicate No. 2010 MMX	2	10
Lloyd's Underwriter Syndicate No. 2011 MMX	-	-
Lloyd's Underwriter Syndicate No. 2791 MAP	8	31
Lloyd's Underwriter Syndicate No. 3902 NOA	-	6
Lloyd's Underwriter Syndicate No. 4020 ARK	2	4
Lloyd's Underwriter Syndicate No. 3000 MKL	-	-
Lloyd's Underwriter Syndicate No. 4444 CNP	-	-
Lloyd's Underwriter Syndicate No. 0033 HIS	3	11
Ace Tempest Reinsurance Ltd.	19	67
Allianz Risk Transfer Ltd.	6	-
Alterra Bermuda Ltd.	6	24
Amlin Bermuda Ltd.	-	37
Ariel Reinsurance Company Ltd.	-	44
Amlin AG	11	-
Aspen Insurance Limited	8	39
Axis Specialty Limited	21	93
DaVinci Reinsurance Ltd.	7	26
Everest Reinsurance Company	1	5

Texas FAIR Plan Association

Notes to Statutory Financial Statements

(In Thousands)

Odyssey Reinsurance Company	8	31
Endurance Specialty Insurance Limited	10	36
Flagstone Reinsurance Suisse SA	11	43
Glacier Reinsurance AG	-	357
Hiscox Insurance Company (Bermuda) Ltd.	22	72
Montpelier Reinsurance Ltd.	13	74
Partner Reinsurance Company Ltd.	11	52
Platinum Underwriters Bermuda Ltd.	10	34
Renaissance Reinsurance Ltd.	10	40
SCOR Global P&C S.E.	10	33
Validus Reinsurance Ltd.	3	12
Total	\$ 246	\$ 1,311

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	\$ 102,383	\$ 92,026	\$ 83,066	\$ 78,866
Ceded	(36,198)	(35,146)	(35,283)	(31,803)
Net	\$ 66,185	\$ 56,880	\$ 47,783	\$ 47,063

4. Unearned Premiums

Unearned premiums net of ceded unearned premiums are as follows:

<i>December 31,</i>	2012	2011
Gross unearned premiums	\$ 52,682	\$ 42,325
Ceded unearned premiums	(18,099)	(17,047)
	\$ 34,583	\$ 25,278

The amount of return commission that would have been due the reinsurers if they or the Association had cancelled the Association's excess of loss reinsurance agreement would have been approximately \$1,810 and \$1,705 as of December 31, 2012 and 2011, respectively.

Texas FAIR Plan Association

Notes to Statutory Financial Statements (In Thousands)

5. 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 \$37,753)	\$ 35,374	\$ 24,152
Net incurred related to:		
Current loss year	43,263	32,851
Prior loss years	(14,810)	20,159
Net losses and loss adjustment expense incurred	28,453	53,010
Net paid related to:		
Current loss year	(27,444)	(21,459)
Prior loss years	(11,090)	(20,329)
Net paid losses and loss adjustment expense	(38,534)	(41,788)
Ending balance	\$ 25,293	\$ 35,374

The estimated cost of loss and loss adjustment expense (LAE) attributable to insured events of prior years decreased by approximately \$15 million during 2012 and increased by approximately \$20 million during 2011. Increases and decreases of this nature occur as the result of claim settlements during the current year, and as additional information is received regarding individual claims, causing changes from the original estimates of the cost of these claims. The Association feels that the loss and LAE reserves as of December 31, 2012 make a reasonable provision for Texas FAIR Plan Association's claims liabilities.

There were approximately \$0 and \$62.7 million in recoveries pertaining to reinsurance contracts that were deducted from losses and loss expenses incurred during 2012 and 2011, respectively.

6. Related Parties

Pursuant to the Association's Plan of Operation, its Governing Committee consists of eleven members. The members are appointed by the Commissioner of the Texas Department of Insurance as follows: five members who represent the interest of insurers, four public members and two members who are licensed agents.

Texas FAIR Plan Association

Notes to Statutory Financial Statements

(In Thousands)

7. Service Contract with Texas Windstorm Insurance Association

The Association entered into a service contract with Texas Windstorm Insurance Association ("TWIA") in which the Association is to reimburse TWIA for all expenditures, professional fees, consulting services, allocated employee time, lost investment income and other costs directly associated with the services provided by TWIA on behalf of the Association. As of December 31, 2012 and 2011, the Association incurred expenses for which it has not reimbursed TWIA in the amount of \$365 and \$2, respectively. These amounts are included in other liabilities in the statutory statements of admitted assets, liabilities, surplus and other funds.

8. Line of Credit

The Association has a \$50 million line of credit with a bank. There were no balances outstanding or drawn against the line of credit as of and for the years ended December 31, 2012 and 2011.

9. 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.

10. 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 underwrites policies for residences located exclusively in the State of Texas.

The Association continues to experience an increase of premiums written in Harris County, Texas. As of December 31, 2012 and 2011 premiums written in Harris County, Texas represented 74% of total premiums.

11. Fair Value Measurements

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

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
December 31,				
Cash and short-term investments	\$ 41,689	\$ 41,689	\$ 35,322	\$ 35,322

Texas FAIR Plan Association

Notes to Statutory Financial Statements (In Thousands)

12. Surplus

The Act does not provide for a minimum surplus requirement. However, members may be assessed to the extent that the Association's Governing Committee determines that available funds are not sufficient to meet the obligations of the Association. There were no assessments as of December 31, 2012 or 2011.

The portion of unassigned surplus at December 31, 2012 and 2011 decreased and increased by non-admitted assets was \$47 and \$135, respectively.

13. Distributions

The Act provides that the profits of the Association shall be used to mitigate losses, including the purchase of reinsurance and the offset of future assessments, and may not be distributed to insurers.

14. Reconciliation with Annual Statement

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

15. 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 FAIR Plan Association

Summary Investment Schedule

December 31, 2012

(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 by FNMA and FHLMC	-	-	-	-
All other	-	-	-	-
CMO's and REMIC's:				
Issued or guaranteed by GNMA, FNMA, FHLMC or VA	-	-	-	-
Issued by non U.S. Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies	-	-	-	-
All other	-	-	-	-
Other debt and other fixed income securities (excluding short-term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	-	-	-	-
Unaffiliated foreign securities	-	-	-	-
Affiliated securities	-	-	-	-

See accompanying independent auditors' report on supplemental information.

Texas FAIR Plan Association

Summary Investment Schedule December 31, 2012 (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	41,689	100%	41,689	100%
Other invested assets	-	-	-	-
Total invested assets	\$ 41,689	100%	\$ 41,689	100%

*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 information.

Texas FAIR Plan Association

Supplemental Investment Risk Interrogatories

December 31, 2012

(In Thousands)

- | | | |
|---|----|--------|
| 1) Reporting entity's total admitted assets as reported in the accompanying financial statements. | \$ | 56,708 |
|---|----|--------|

Questions 2 through 23 are not applicable.

See accompanying independent auditors' report on supplemental information.

Texas FAIR Plan Association

Reinsurance Interrogatories

December 31, 2012

(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 [X]
- 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[] NO [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, according 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 FAIR Plan Association

Reinsurance Interrogatories

December 31, 2012

(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 common 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 affiliate 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 contracts on the balance sheet and statement of income;

Financial Impact – Section A	As Reported	Interrogatory 9 Reinsurance Effect	Restated Without Interrogatory 9 Reinsurance
Assets	\$ 56,708	\$ -	\$ 56,708
Liabilities	82,430	68	82,498
Surplus as regards to policyholders	(25,722)	(68)	(25,790)
Income before taxes	7,354	34,086	41,440

- (b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and

See accompanying independent auditors' report on supplemental information.

Texas FAIR Plan Association

Reinsurance Interrogatories

December 31, 2012

(In Thousands)

Effective July 1, 2012, the excess of loss reinsurance agreement provides the Association with two layers of coverage. The first layer provides 100% participation of \$85 million in excess of \$40 million of each and every loss occurrence. The second layer provides 100% participation of \$175 million in excess of \$125 million of each and every loss occurrence. The agreement covers losses incurred on all in-force, new and renewal policies. Any additional liability would be funded by member assessments in the event that available funds are not sufficient to meet the obligations of the Association. This agreement expires on June 30, 2013.

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 32 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.