


Part III

Liquidator's and Conservator's Report



This section of the *129th Annual Report* presents statistical information on companies placed in supervision, conservatorship and receivership. It also contains financial information on the state's three guaranty associations: the Texas Property and Casualty Insurance Guaranty Association, Texas Life, Accident, Health and Hospital Service Insurance Guaranty Association and the Texas Title Insurance Guaranty Association.

issued by the **Texas Department of Insurance**

Summary of Supervisions
September 1, 2003–August 31, 2004

	EXISTING	NEW	FY2004 YEAR-END BALANCES
Domestic			
Stock Life	0	0	
Stipulated Premium	0	3	1
Local Mutual Aid	0	0	
Fraternal	0	0	
Fire and/or Casualty	0	1	1
Lloyds	0	0	
Reciprocal Exchanges	0	0	
Surplus Lines Insurers	0	0	
Managing General Agents	1	0	
Local Recording Agents	1	0	
Agencies	0	0	
Premium Finance Company	0	0	
Title	0	0	
Title Agents	0	0	
Health Maintenance Organization	0	1	0
Third Party Administrators	0	0	
Utilization Review Agents	0	0	
Employee Group Benefit Plan	0	0	
Unauthorized Insurers	0	0	
Foreign	0	1	1
Totals	2	6	3

Summary of Conservatorships
September 1, 2003–August 31, 2004

	EXISTING	NEW	FY2004 YEAR-END BALANCES
Domestic			
Stock Life	0	1	1
Stipulated Premium	0	0	
Local Mutual Aid	0	0	
Fraternal	0	0	
Fire and/or Casualty	1	0	
Lloyds	0	0	
Reciprocal Exchanges	0	0	
Surplus Lines Insurers	0	0	
Managing General Agents	0	0	
Local Recording Agents	0	0	
Agencies	0	0	
Premium Finance Company	0	0	
Title	0	0	
Title Agents	0	0	
Health Maintenance Organization	0	0	
Third Party Administrators	0	0	
Utilization Review Agents	0	0	
Employee Group Benefit Plan	0	0	
Unauthorized Insurers	0	0	
Foreign	0	0	
Totals	1	1	1

Summary of Insurers under Special Administrative Action

September 1, 2003–August 31, 2004

	EXISTING	NEW	FY2004 YEAR-END BALANCES
Domestic			
Stock Life	7	2	8
Stipulated Premium	4		3
Local Mutual Aid	1	0	
Fraternal	0	0	
Fire and/or Casualty	3	3	2
Lloyds	1		1
Reciprocal Exchanges	0	0	
Surplus Lines Insurers	0	0	
Managing General Agents	1		1
Local Recording Agents	1		1
Agencies	0	0	
Premium Finance Company	1		1
Title	0	0	
Title Agents	0	1	1
Health Maintenance Organizations	2		1
Third Party Administrators	1	1	2
Utilization Review Agents	0	0	
Employee Group Benefit Plan	1	0	1
Unauthorized Insurers	0	0	
Foreign	0	0	
Totals	23	7	22

Insurance Companies in Supervision, Conservatorship or under Special Administrative Action by Fiscal Year

FY	NUMBER AT 1ST OF YEAR	NUMBER RECEIVED DURING YEAR	REINSURED DISSOLVED	CEASED BUSINESS DISSOLVED	IN RECEIVERSHIP	RELEASED TO MANAGEMENT	OTHER CHANGES	YEAR-END BALANCES
1996	42	26	1	5	1	9	11	41
1997	41	36	1	7	4	14	14	37
1998	37	31	2	3	5	7	16	35
1999	35	30	2	8	4	8	8	35
2000	35	28	3	8	2	7	11	32
2001	32	30	1	5	1	9	8	38
2002	38	39	1	3	2	9	21	41
2003	41	24	0	6	8	13	12	26
2004	26	14	1	0	3	5	5	26

Note: FY2004/Other Changes: 1 Entity moved from Supervision to Conservatorship; 1 moved from Supervision to Article 1.32; 1 moved from Conservatorship to Article 1.32; 1 moved from Article 1.32 to Court Order; 1 moved from Administrative Oversight to Supervision.

Companies in Supervision at Beginning of Fiscal Year 2004

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
02-0350	04/08/02	Aberdeen Insurance Services
03-0495	06/16/03	Reliant American General Agency

Companies in Conservatorship at Beginning of Fiscal Year 2004

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
03-0127	02/26/03	Confidential*

** Confidential pursuant to Texas Statute*

**Art. 1.32/Insurers under Special Administrative Action
at Beginning of Fiscal Year 2004**

ACTION	DATED	COMPANY NAME
Art.1.32 #98-0518	05/07/98	American Insurance Company of Texas
Letter	04/20/01	American Professionals Insurance Company
Letter	06/16/03	Capitol Security Life Insurance Company
Art.1.32 #02-1130	05/13/02	Commercial Indemnity Insurance Company
Art.1.32 #03-0141	03/03/03	Coordinated Care Solutions of Texas
Letter	01/13/02	Dallas General Life Insurance Company
Art.1.32 #01-0385	04/30/01	Frontier Insurance Company
Letter	04/22/02	HHS Texas Management, L.P.
Art.1.32 #02-0878	08/20/02	Highlands Insurance Company
Letter	06/16/03	International American Life Insurance Company
Art.1.32 #01-0122	02/09/01	Jefferson Life Insurance Company
Letter	03/22/99	Mack Hannah Life Insurance Company
Art.1.32 #98-0520	05/07/98	National Financial Insurance Company
Letter	08/11/03	Peoples Funeral Services Insurance Company
Art.1.32 #92-0903	09/16/92	Provident American Insurance Company
Letter	06/16/03	Regal Life of America Insurance Company
Letter	11/28/01	SelectCare of Texas, L.L.C.
Letter	06/16/03	Southwest Service Life Insurance Company
Letter	05/17/02	Texas Builders Insurance Company
Art.1.32 #03-0543	06/27/03	Texas Propane Gas Association Employees' Beneficiary Trust
Art.1.32 #02-0498	05/14/02	Thomas G. Corless
Letter	06/16/03	United Assurance Life Insurance Company
Art.1.32 #02-1066	10/11/02	Universal Insurance Exchange

**Companies Placed in Supervision
between September 1, 2003 and August 31, 2004**

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
03-0842	09/08/03	Confidential*
04-0425	05/03/04	Confidential*
04-0496	05/18/04	Central United Life Insurance Company
04-0582	06/10/04	MetroWest Health Plan, Inc.
04-0731	07/23/04	Confidential*
04-0789	08/31/04	Confidential*

* Confidential pursuant to Texas Statute

**Companies Placed in Conservatorship
between September 1, 2003 and August 31, 2004**

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
04-0215	03/08/04	Confidential*

* Confidential pursuant to Texas Statute

**Insurers under Court Directed/Special Administrative Action
between September 1, 2003 and August 31, 2004**

ACTION	DATED	COMPANY NAME
Letter	09/22/03	Texas Fidelity Title, L.L.C.
Letter	10/02/03	Intercultural Physicians Network
Court Order #GV 304-537	11/06/03	Highlands Insurance Company
Letter	12/17/03	Dallas Fire Insurance Company
Letter	01/12/04	Christian Fidelity Life Insurance Company
Art.1.32 #04-0540	05/28/04	Central United Life Insurance Company
Art.1.32 #04-0502	05/19/04	Reliant American Insurance Company

**Companies Released from Supervision
between September 1, 2003 and August 31, 2004**

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
03-1021	10/15/02	Aberdeen Insurance Company
03-1275	12/18/03	Reliant American General Agency
04-0215	03/08/04	Confidential*
04-0539	05/28/04	Central United Life Insurance Company
04-0837	08/31/04	MetroWest Health Plan, Inc.

* Confidential pursuant to Texas Statute

**Companies Released from Conservatorship
between September 1, 2003 and August 31, 2004**

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
04-0502	05/19/04	Reliant American Insurance Company

**Insurers Released from Special Administrative Action
between September 1, 2003 and August 31, 2004**

COMMISSIONER'S ORDER NUMBER	DATED	COMPANY NAME
Art. 1.32 #03-1114	11/12/03	Commercial Indemnity Insurance Company
Letter	02/18/04	People's Funeral Service Insurance Company
Letter	04/05/04	SelectCare of Texas L.L.C.
Letter	06/02/04	Christian Fidelity Life Insurance Company
Art. 1.32 #04-0720	07/21/04	Highlands Insurance Company
Art. 1.32 #04-0720	07/21/04	American Professionals Insurance Company
Letter	07/23/04	Mack Hannah Life

**Insurance Companies and Affiliates in Receivership
as of August 31, 2004**

NO	DISTRICT RECEIVERSHIP NAME	CAUSE NO	COURT
375	First Service Life Insurance Company	454,774	53rd
442	Commodore Life Insurance Company (Reopened)	490,005	201st
450	Texas Employers Insurance Association	91-1681	201st
461	Sir Lloyd's Insurance Company	91-12765	200th
487	Employers Casualty Company	92-02133	353rd
490	Employers National Insurance Company	94-00950	53rd
495	United Republic Insurance Company	97-07775	126th
496	American Eagle Insurance Company	97-13405	201st
500	Comprehensive Health Services of Texas Inc	99-01313	353rd
501	Legal Security Life Insurance Company	99-03277	98th
503	The Statesman National Life Insurance Company	99-02772	250th
504	Unistar Insurance Company	GV000639	390th
507	Benefit Life Insurance Company	GV002510	353rd
508	American Benefit Plans, et al	GV200903	53rd
509	Amcorp Insurance Company	GV202944	261st
510	Colonial Casualty Insurance Company, et al	GV202935	201st
511	Legion Insurance Company & Villanova Insurance Company	GV203880	200th
512	AmCare Health Plans of Texas, Inc	GV204523	200th
513	Empire Lloyds Insurance Company Lloyds Insurance Holding Company, Inc	GV204662	201st
514	Millers Insurance Company	GV3-00620	345th
515	Guaranty Insurance and Annuities Company	GV-300294	353rd
516	Western Indemnity Insurance Company	GV302024	261st
517	Good Samaritan Life Insurance Company	GV3-02700	345th
518	Commercial Indemnity Insurance Company	GV304173	98th
519	Highlands Insurance Compay	GV3-04537	53rd
520	MetroWest Health Plan, Inc	GV402336	201st

Receiverships by Fiscal Year
New Receiverships/Receiverships Closed

FISCAL YEAR	BALANCE RECEIVERSHIPS BEGINNING	NEW RECEIVERSHIPS	RECEIVERSHIPS CLOSED
1980	52	1	4
1981	49	8	7
1982	50	11	19
1983	42	13	0
1984	55	3	3
1985	55	20	1
1986	74	19	2
1987	91	18	1
1988	108	25	2
1989	131	40	14
1990	157	33	28
1991	162	18	26
1992	154	15	36
1993	133	9	40
1994	102	7	25
1995	84	1	32
1996	53	1	17
1997	37	3	8
1998	32	6	6
1999	32	3	5
2000	30	3	9
2001	24	1	1
2002	24	3	5
2003	*22	†7	6
2004	*23	3	5

* These numbers reflect one receivership that had previously closed, Commodore Life Insurance Company, which was reopened, and one ancillary receivership. Both closed this fiscal year.

Consolidated Receiverships
Balance Sheet

	08/31/2004	08/31/2003
Cash Assets		
Operating Account	\$4,851,277	\$4,015,648
Texas Treasury Account	94,161,519	120,466,186
Court Approved Deposits	25,000	25,000
Early Access/Texas GA	113,039,281	111,052,459
Early Access/Other Gas	111,644,412	98,484,039
Assets/for recovery		
Funds Restricted	10,211,696	9,827,923
Premiums	11,965,861	13,408,227
Agent Balances	466,172	984,118
Reinsurance	39,404,194	50,316,203
Subrogation	1,171,559	4,267,588
Other	82,733,273	34,607,365
Allowance for Recovery	(113,020,187)	(54,799,612)
Stocks/Bonds	11,402,105	13,815,737
Real Estate	0	0
Mortgages/Notes	59,361	491,105
Other	17,015,749	31,261,290
Allowance for Recovery	(16,311,650)	(30,478,593)
Furniture & Fixtures	247,110	57,202
Computers/Software	3,289	300
Home Office Building	3,000,000	3,000,000
Allowance for Recovery	(200,040)	(3,000)
Total Assets	371,869,982	410,799,184

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Consolidated Receiverships
Balance Sheet (continued)

	08/31/2004	08/31/2003
Company Liabilities		
Class I Reserves-G/A	1,419,106	5,608,993
Class II Claims Reserves-G/A	173,723,657	188,161,274
Class II Claims Reserves-Non-G/A	172,773,935	114,159,681
Other Liabilities	47,761,115	54,250,071
Class I Creditors		
SDR Fees	410,862	444,075
SDR Sub-Contractors	427,939	310,784
Receivers Allocation	1,333	40,787
GA-Claims Expense	57,043,225	56,891,967
Other Class I	4,083,306	8,862,829
Class II Creditors		
Policyholder Claims	54,857,023	48,295,115
GA-Policyholder Claims Paid	407,253,022	405,405,029
Other Class II	1,073,980	2,806,533
Class III Creditors		
IRS Payable	432,255	432,255
Other Class III Payable	77,710,161	68,513,023
Class IV Payable		
General Creditors	3,839,680	2,828,167
Reinsurance Payable	26,619,667	41,477,968
Other Class IV	185,032	185,032
Class V Creditors		
Surplus Debentures	0	0
Ownership Interests	0	939,117
Other Class V	0	0
<i>Total Company Liabilities</i>	<i>1,029,615,296</i>	<i>999,612,700</i>
Accumulated (Loss) Equity	(657,745,314)	(581,393,053)
Unrealized Recovery	0	(7,420,464)
Total Liabilities and Equity	371,869,982	410,799,182

Consolidated Receiverships
Statement of Receipts and Expenditures

	08/31/2004	08/31/2003
Funds Held		
Funds Held for Others	21,394	(5,215,901)
Funds Held for Others Expense	(510)	(1,942,138)
Premium		
Collections	1,353,206	2,333,455
Collection Expense	(266,454)	(265,222)
Litigation Expense	0	(11,408)
Receivable		
Agents Balance Receipts	176,293	331,219
Agents Balance Expense	(4,392)	(15,500)
Reinsurance Recovery	9,702,085	7,370,502
Reinsurance Expense	(847,646)	(945,825)
Subrogation Recovery	734,492	242,542
Subrogation Expense	(223,363)	(171,766)
Intercompany Receivable Receipts	0	0
Intercompany Receivable Expenses	(3,576)	0
Other Receivable Receipts	2,064,580	8,977,837
Other Receivable Expenses	(834,546)	(658,949)

Consolidated Receiverships
Statement of Receipts and Expenditures

	08/31/2004	08/31/2003
Litigation Receivable		
D & O Litigation Recovery	0	2,193,559
D & O Litigation Expense	(77,777)	(1,135,835)
Judgment/Settlement Collections	0	1,040,718
Judgment/Settlement Expense	0	(18,333)
Investment Account Receipts	0	427,935
Investment Account Expense	0	(4,942)
Other Litigation Receipts	11,058	800,000
Other Litigation Expense	(587,108)	(91,157)
Sale/Conversion of Investment Assets		
Securities/Bonds Sales Receipts	5,260,343	7,654,089
Securities/Bonds Sales Expense	(22,957)	(15,918)
Statutory Deposit Receipts	2,999,387	10,351,774
Statutory Deposit Expense	(7,044)	(117,404)
Real Estate Sales Receipts	687,992	319,789
Real Estate Sales Expense	(155,659)	(47,503)
Mortgage Note Expense	23,907	(47,490)
Subsidiary Affiliate Receipts	2,364,429	0
Subsidiary Affiliate Expense	(10,672)	(11,125)
Other Assets Receipts	16,470	169,723
Other Assets Sales Expense	(36,211)	(489,106)
Sale of Company Fixed Assets		
Charter Sales Receipts	15,000	0
Charter Sales Expense	(10,329)	(2,954)
Furniture, Fixtures & Equipment Receipts	83,585	183,493
Furniture, Fixtures & Equipment Expense	(14,164)	(51,134)
Company Real Estate Receipts	361,041	471,493
Company Real Estate Expense	(290,451)	(323,616)
Other Fixed Asset Receipts	13,515	5,513
Other Fixed Asset Expense	(3,587)	(672)
<i>Net Income from Assets/Receivable</i>	<i>22,492,331</i>	<i>38,447,783</i>
Passive Income		
Investments Interest/Dividends	294,809	643,294
Cash Deposit Interest Income	1,130,192	1,882,437
Early Access Imputed Interest Income	2,488,305	3,759,177
<i>Net Income/Including Passive</i>	<i>26,405,637</i>	<i>44,732,690</i>
Claims Expenses		
Covered Claims Expense		
G/A Expense	(3,005,686)	(3,374,100)
SDR Fees	(217,385)	(346,034)
SDR Subcontractor Fees	(107,650)	(67,452)
Other Covered Claims	0	(8,187)
Non Covered Claims Expenses		
SDR Fees	(2,047,947)	(1,580,354)
SDR Subcontractor Fees	(825,992)	(535,981)
Other Non Covered Claims	(217,149)	(52,335)
Claims Paid/Distribution		
Covered Claims Funded-G/A	8,117,015	12,863,970
Covered Claims Paid-G/A	(8,688,021)	(13,143,852)
Early Access-G/A	(15,719,174)	188,130,470
Non-Covered Claims Paid/Receivership Distribution	(7,659,409)	(197,491,792)
<i>Total Claims Expenses</i>	<i>(30,371,398)</i>	<i>(15,605,647)</i>
Class I General Administration Expenses		
Conservation/Misc. Takeover Expense	0	(119,565)
Bank/Miscellaneous Charges	(43,629)	(26,736)
Building/Utilities	(205,750)	(275,555)
Contract/Employee	(56,763)	(434,606)
Equipment/Lease/Maintenance	(228,214)	(365,430)
Employee-Payroll, PRTax, Benefits	(2,581)	(68,302)
Equipment Lease/Inventory/Storage/Moving	(372,230)	(202,753)

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Consolidated Receiverships
Statement of Receipts and Expenditures (continued)

	08/31/2004	08/31/2003
Class I General Administration Expenses (continued)		
Mailing/Printing/Postage/Publication	(64,837)	(112,958)
Office Supplies/Miscellaneous	(27,464)	(48,882)
Telephone	(24,936)	(72,795)
Receivership Allocation	(354,265)	(347,298)
<i>Total Class I General Administration Expenses</i>	<i>(1,380,668)</i>	<i>(2,074,880)</i>
Class I Subcontractor Administration Expenses		
Accounting/Auditing/Federal Income Tax Service	(129,402)	(154,257)
Consulting Fees/Services	(199,178)	(210,975)
Legal Fees/Services	(227,940)	(461,651)
Class I SDR Administrative Expenses		
SDR Administration	(1,117,903)	(1,177,657)
SDR Accounting	(428,527)	(556,563)
SDR Special Services	(172,863)	(322,979)
SDR Legal Services	(38,180)	(121,383)
<i>Total Receivership Administrative Expenses</i>	<i>(3,694,661)</i>	<i>5,080,345</i>
Net Increase (Decrease) to Receivership Cash	(7,660,422)	24,026,604
FY 2004 Reconciliation Adjustments	(2,461,750)	(13,700,377)
Cash Available as of 8/31/04	99,037,797	126,230,553

Texas Property and Casualty Insurance Guaranty Association
Audited Financial Statements, December 31, 2003

Disclaimer: The state's three insurance guaranty associations now report receivership activity on a calendar year basis. The latest data available is for Calendar Year 2003. As a result, the data provided by the guaranty associations no longer correspond directly to data in the receivership report prepared by TDI's Liquidation Oversight. TDI's report is for the state's Fiscal Year 2004 that runs from September 1, 2003 through August 31, 2004.

Statement of Financial Position, December 31, 2003

	Assets	2003
	Current Assets	
Cash and Cash Equivalents (Notes 1 and 2)	\$48,778,279	\$48,778,279
Investments, at Fair Value (Note 3)	365,601,851	365,601,851
Assessments Receivable	30,274,649	30,274,649
Accounts Receivable-Other	343	343
<i>Total Current Assets</i>	<i>444,655,122</i>	<i>444,655,122</i>
	Noncurrent Assets	
Loans Receivable (Note 5)		
Administrative	\$21,115,742	\$21,115,742
Auto	126,965,690	126,965,690
Other Lines	120,034,004	120,034,004
Workers' Compensation	279,117,764	279,117,764
Total Loans Receivable	547,233,200	547,233,200
Allowance for Doubtful Accounts (Notes 1 and 5)	(547,233,200)	(547,233,200)
<i>Net Loans Receivable</i>	<i>—</i>	<i>—</i>
Property and Equipment (Note 1)		
Furniture and Equipment	786,093	786,093
Computer Systems	1,117,202	1,117,202
Telephone Systems	170,791	170,791
Company Vehicles	14,237	14,237
Leasehold Improvements	86,427	86,427
Accumulated Depreciation	(1,684,015)	(1,684,015)
<i>Net Property and Equipment</i>	<i>490,735</i>	<i>490,735</i>
<i>Total Noncurrent Assets</i>	<i>490,735</i>	<i>490,735</i>
Total Assets	\$445,145,857	\$445,145,857

Texas Property and Casualty Insurance Guaranty Association
Statement of Financial Position, December 31, 2003

Liabilities	
Current Liabilities	
Accounts Payable and Accrued Liabilities	\$ 1,933,061
Outstanding Checks	5,602,428
Current Portion of Claims Payable (Note 6)	130,000,000
<i>Total Current Liabilities</i>	<i>137,535,489</i>
Long Term Liabilities	
Claim Liabilities (Note 6)	
Loss Adjustment Expense	25,820,388
Auto	9,640,497
Other Lines	47,075,368
Workers' Compensation	374,251,913
<i>Total Long Term Claim Liabilities</i>	<i>456,788,166</i>
Other Long Term Liabilities	
Early Access Distributions (Note 6)	29,560,268
<i>Total Other Long Term Liabilities</i>	<i>29,560,268</i>
<i>Total Long Term Liabilities</i>	<i>486,348,434</i>
Total Liabilities	\$623,883,923
Net Assets (Deficit), Unrestricted (Note 7)	(178,738,066)
Total Liabilities and Net Assets	\$445,145,857

Statement of Activities and Changes in Net Assets for the Year ended December 31, 2003

Revenues	
Distributions	\$69,841,760
Assessments	28,787,821
Investment Income, Net (Note 10)	9,177,500
Interest on Accounts	94,165
Subrogation and Salvage Recoveries	2,656,127
Miscellaneous Income	1,647
<i>Total Revenues</i>	<i>110,559,020</i>
Claims Activity	
Claims Payments	
Claims Administration	28,166,715
Auto	11,603,140
Other Lines	44,807,161
Workers' Compensation	60,293,090
Total Claims Payments	144,870,106
Change in Claims Liabilities	(45,372,566)
<i>Total Claims Activity</i>	<i>99,497,540</i>
Excess (Deficiency) of Revenues over Claims Activity and Refunds	11,061,480
Operating Expenses	
Employment Expenses	\$3,943,600
Employee Relations	9,949
Education and Staff Development	82,515
Contract Labor	61,676
Legal Fees	24,615
Audit Fees	14,500
Consulting	61,899
Leasehold Improvements	9,707
Office Rent and Overhead	581,954
Insurance	104,673
Furniture and Equipment	22,449
Equipment Rental	76,474
Computer Systems	759,949
Telephone	60,221
Office Supplies	118,218
Postage and Delivery	221,606
Printing	18,353

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Texas Property and Casualty Insurance Guaranty Association**Statement of Activities and Changes in Net Assets for the Year ended December 31, 2003 (continued)**

Operating Expenses	
Advertising—Employee Procurement	81
Travel	75,780
Professional Meetings	41,029
Reference Materials	15,784
Subscriptions and Professional Dues	75,066
Property Taxes	9,063
Bank Charges	59,024
Depreciation Expense	161,162
<i>Total Operating Expenses</i>	<i>6,609,347</i>
Increase (Decrease) in Net Assets	4,452,133
Gain (Loss) on Sale of Property and Equipment	3,865
Beginning Net Assets (Deficit) at January 1	(183,194,064)
Net Assets (Deficit) at December 31	\$(178,738,066)

Statement of Cash Flows for the Year ended December 31, 2003

Cash Flows from Operating Activities	
Decrease in Net Assets	\$4,452,133
Adjustments to Reconcile Decrease in Net Assets to Net Cash Provided by Operating Activities	
Depreciation Expense	161,162
Unrealized Gains (Losses) on Investments	11,400,660
Change in Assets and Liabilities	
(Increase) Decrease in Assessments Receivable	29,820,732
(Increase) Decrease in Other Assets	4,108
Increase (Decrease) in Claims Liabilities	(45,372,566)
Increase (Decrease) in Other Liabilities	2,309,437
<i>Total Adjustments</i>	<i>(1,676,467)</i>
Net Cash (Used) Provided by Operating Activities	2,775,666
Cash Flows from Investing Activities	
Capital Expenditures	(33,894)
Sale of Property and Equipment	5,285
Gain (Loss) on Sale of Property and Equipment	3,865
Purchase of Investments	(451,928,253)
Proceeds from Sales and Maturities of Investments	488,939,126
Net Cash (Used) Provided by Investing Activities	36,986,129
Net Increase (Decrease) in Cash and Cash Equivalents	39,761,795
Cash and Cash Equivalents at January 1	9,016,484
Cash and Cash Equivalents at December 31 (Note 2)	\$48,778,279

Notes to Financial Statements, December 31, 2003**1 Summary of Significant Accounting Policies**

Organization—Texas Property and Casualty Insurance Guaranty Association (the Association) is a nonprofit organization formed under the Texas Property and Casualty Insurance Guaranty Act (the Act) to protect holders of covered claims, contracts of reinsurance, assumption of liabilities or otherwise.

The Association is considered a governmental not-for-profit organization and is a component unit of the State of Texas for financial reporting purposes. The accompanying financial statements comply with the reporting requirements of a governmental not-for-profit organization.

Membership in the Association is mandatory for any insurance company authorized in Texas to transact any kind of insurance business to which the Act applies. Membership assessments are made by the Board of Directors of the Association based on estimates of amounts necessary to provide funds to carry out the purposes of the Act with respect to impaired insurers. Any amount in excess of guaranty obligations and continuing expenses

of the Association may be refunded by an equitable method at the discretion of the Board of Directors.

Basis of Accounting—The financial statements are presented on the accrual basis of accounting; consequently, revenue is recognized when earned, and expenses are recognized when the obligations are incurred. Assessment revenue is recognized when billed. Claims liability is recognized using estimates of claims outstanding for each impaired insurer at the date of impairment.

Tax Exempt Status—The Association is exempt from federal income tax under Section 501(c)(6) of the *Internal Revenue Code*. The Association is also exempt from payment of all fees and taxes levied by the State of Texas or any of its subdivisions, except taxes levied on real and personal property.

Cash Equivalents—For purposes of the statement of cash flows, the Association considers all highly liquid investments to be cash equivalents. This includes checking account balances and mutual fund investments.

Investments—Investments are carried at fair value.

Derivatives—Mortgage-backed Pass-through Securities are used to enhance the Association's investment rate of return and are recorded at market value. The Association's involvement in derivatives is limited with the level of investment not to exceed 20% of the portfolio. The balance of derivatives at December 31, 2003 represented 4.0% of the portfolio's fair value.

Furniture, Equipment and Leasehold Improvements—Fixed assets are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the individual assets, ranging from five to ten years.

Allowances for Uncollectible Loans—The Association fully reserves for all such loans; therefore, loan repayments are recorded as revenue when received in cash.

2 Cash and Cash Equivalents

Cash and cash equivalents at December 31, consisted of the following:

	2003
Cash in Bank	\$1,657,985
Cash on Hand	300
Mutual Funds	47,119,994
	\$48,778,279

The Association's mutual fund investments are not insured by the Federal Deposit Insurance Corporation nor are they a deposit or other obligation of, or guaranteed by a bank or other depository institution. Mutual fund investing is subject to investment risks, including possible loss of the principal amount invested.

At December 31, 2003 the Association maintained demand accounts with bank balances in excess of federally insured limits of \$1,592,317. The carrying value of these demand accounts, resulting from uncollected items and outstanding checks, was \$1,657,985 in 2003.

3 Investments

The Association's investment policy sets guidelines and parameters through which investment managers have full discretion. Securities must have maturity dates within ten years of the date of purchase, with the exception of Mortgage-backed Pass-through Securities. The following securities and investment transactions are acceptable for investment if they meet the restrictions set forth in the Investment Policy:

- A** Direct security repurchase agreements (underlying security must be U.S. Treasury securities);
- B** Reverse security repurchase agreements (underlying security must be U.S. Treasury securities);
- C** Direct obligations of or obligations where the principal and interest of which are guaranteed by the United States;
- D** Direct obligations of or obligations guaranteed by agencies or instrumentalities of the United States government;
- E** Bankers' acceptances that:
 - are eligible for purchase by the Federal Reserve System;
 - do not exceed 270 days to maturity; and
 - are issued by a bank that has received the highest short term credit rating by a nationally recognized investment rating firm;
- F** Commercial paper that:
 - does not exceed 270 days to maturity; and
 - has received the highest short term credit rating by a nationally recognized investment rating firm;
- G** Direct obligations of or obligations guaranteed by the Inter-American Development Bank, the International Bank for Reconstruction and Development (the World Bank), the African Development Bank, the Asian Development Bank, and the International Finance Corporation that have received the highest credit rating by a nationally recognized investment rating firm;
- H** Direct obligations of a state or an agency, county, city, or other political subdivision of a state (the municipal securities shall be rated A or better on long term debt and A-1 or SP-1 for short-term maturity assets or the equivalent by a nationally recognized rating service). Investments shall be limited to no more than 1% investment in any one single issuer's debt.
- I** Mutual funds which invest only in direct obligations of a state or an agency, county, city or other political subdivision of a state (no M.U.D.s allowed);
- J** Bank certificates of deposit: must be purchased from domestic and foreign banking institutions with U.S. branches ("Yankee CDs") that have ratings similar to those used for purchasing commercial paper and bankers' acceptances. Investments shall be limited to no greater than 10% of an individual bank's total capital, surplus and undivided profits.
- K** Mutual funds which invest only in investments described in some or all of the items (A) through (J) above.
- L** Mortgage-backed Pass-through Securities must be AAA rated by Standard & Poor's or Moody's and have prepayment assumptions of ten years or less if they have price liquidity characteristics documentably similar to ten year or shorter investments. The total aggregate of Mortgage-backed Pass-through Securities cannot exceed 20% of the manager's total portfolio. Inverse floaters are not allowed. Investments are limited to GNMA, FNMA or FHLMC obligations, although investments in FHLMC obligations are limited to the lesser of \$5 million or 5% of the total portfolio of the Association.
- M** Security lending is authorized through the investment custodian, but the collateral accepted must meet the following guidelines: **a)** collateral is maintained at a minimum level of 102% of market value or greater; **b)** the collateral is valued daily to assure the required collateral level; **c)** the collateral is held by the Association or its third party custodian; and **d)** collateral is always cash, U.S. government securities or U.S. government agency or instrumentality securities. Securities lending activities must be governed by a Master Agreement.

Texas Property and Casualty Insurance Guaranty Association
Notes to Financial Statements, December 31, 2003

Investments at December 31, 2003 were as follows

	2003	FAIR VALUE	% OF FAIR VALUE
U.S. Treasury Issues		\$183,048,122	50.0%
Federal Agency Issues		161,525,860	44.2%
Mortgage-backed Pass-through Securities (Derivatives)		14,518,244	4.0%
Cash Equivalents		3,607,787	1.0%
Accrued Interest		2,901,838	0.8%
Total at December 31, 2003		\$365,601,851	100.0%

The following methods and assumptions were used to estimate the fair value of each class of investment:

Short Term Promissory Notes, Outside Managed Treasury Mutual Funds and Accrued Interest: The cost of these investments approximates fair value because of the short maturity of those instruments.

U.S. Treasury Bills, Notes, Government Agency Bonds, U.S. Government Agency Discount Notes, Government National Mortgage Association, African Development Bank and Asian Development Bank: The fair values of debt securities are based on quoted market prices at the reporting date for those investments.

Mortgage-backed Pass-through Securities (Derivatives): The fair value of these investments is estimated by obtaining quotes from brokers.

Investments held by the Association at December 31, 2003 were considered Category 2 investments as defined by Governmental Accounting Standards Board Statement No. 3, uninsured and unregistered, with securities held by the counterparty's trust department or agent in the government's name.

4 Membership Assessments

The Association is authorized by the *Texas Insurance Code*, Annotated Article 21.28-C, Section 18 to assess member insurers in amounts necessary to pay both claims and administrative expenses of the Association.

Annual assessment ability is estimated below using the most recent premium information available (2002):

LINE-OF-BUSINESS	PREMIUM BASE	ASSESSMENT CAPABILITY
Automobile	\$12,360,158,684	\$247,203,174
Other Lines	10,535,218,341	210,704,367
Workers' Compensation	4,426,780,819	88,535,616
	\$27,322,157,844	\$546,443,157

In the event of a natural disaster or other catastrophic event, the Association may apply to the Governor for authority to assess each member insurer that writes insurance coverage other than motor vehicle coverage or workers' compensation coverage, an additional amount not to exceed 2% of the insurer's net direct written premium for the preceding calendar year.

5 Loans Receivable

Loans receivable consist of advances to and claims payments made and expenses paid on behalf of impaired insurers. An allowance is made for these loans in total; therefore, these loans are expensed when made. Any repayments of the loans are recorded as revenue when received in cash.

6 Claims Liability

The liability for claims payable is an estimated amount for all impaired companies. No provision is made for repayments or recoveries; such recoveries are recognized when received in cash. Early access distributions are recorded as long term liabilities until those estates are closed.

7 Net Assets

The Association has the authority to assess members as necessary in subsequent years to meet its responsibility to pay claims of these impaired companies. Assessment ability and recorded claims liability at December 31, 2003, are as follows:

LINE-OF-BUSINESS	CLAIMS PAYABLE	ANNUAL ASSESSMENT CAPABILITY
Automobile	\$9,640,497	\$247,203,174
Other Lines	47,075,368	210,704,367
Workers' Compensation	374,251,913	88,535,616
Loss Adjustment Expenses	25,820,388	No Limit
Total	456,788,166	
Current	130,000,000	
Long Term	\$586,788,166	

As mentioned in Note 4, the Association, in the event of a natural disaster or other catastrophic event, may have additional assessment capability.

Assessments are made annually based on annual cash flow needs to meet claims liabilities as paid in cash. No provision has been made for recoveries from company assets to meet these obligations.

8 Commitments and Contingencies

The Association leases certain office space. This lease expires in November, 2004. The Association is obligated for the following minimum lease payments:

MINIMUM LEASE PAYMENT 2004 = \$488,458

The Association, by its nature, is subject to various ongoing claims by insurance companies, policyholders, receiverships and creditors of the receiverships. Some of these claims are in the form of litigation against the Association.

9 Significant Group Concentrations of Risk

Most of the Association's business activity, assessment revenue and advances are with concerns in the insurance industry in the state of Texas. At year end, all of the Association's advances receivable are from companies that are operating or have operated in Texas.

The Association, as described in Note 2, has a significant concentration of credit risk arising from cash deposits in excess of federally insured limits.

10 Investment Income

Investment income is reported net of realized losses on investment sales, custodian fees and investments manager's fees realized throughout the year. Gross earnings for 2003 were \$22,259,948 (including \$9,034,913 in realized gains and security lending income of \$339,739), net of realized losses of \$1,270,821, unrealized losses of \$11,400,660, custodian fees of \$23,232, and investment manager's fees of \$387,735, resulting in net investment income of \$9,177,500. Gross earnings for 2002 were \$44,179,985 (including \$6,855,117 in unrealized gains, \$18,886,441 in realized gains and security lending income of \$568,315), net of realized losses of \$2,114,505, custodian fees of \$25,412, and investment manager's fees of \$402,381, resulting in net investment income of \$41,637,687.

11 Deferred Compensation Plan

The Association has established a defined contribution retirement plan (the plan) (a “profit sharing” plan under IRS Section 401(a) Plan). The plan is open to all employees. The employer made a discretionary contribution of 3% of all employees’ compensation for the plan year. The employer will make a “matching contribution” to the plan on behalf of the employees in the amount of 100% of the employees’ elective deferral, up to 3% of total compensation for the plan year. The employee may make discretionary before tax contribution to the plan not to exceed Internal Revenue Service limitations. The Association’s contribution for the years ended December 31, 2003, and 2002, were \$170,419 and \$135,246, respectively. The employees contributed \$177,906 and \$166,265, for 2003 and 2002 respectively. The employees are fully vested in their own contributions to the plan and become vested in the employer contributions to the plan as follows based on years of service: 1 year–20%; 2 years–40%; 3 years–60%; 4 years–80%; and 5 years–100%.

12 Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

13 Risk Management

The Association is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees and natural disasters. During 2003, the Association contracted with insurance carriers for property and general liability insurance.

Property coverage and computer system coverage both carry a \$1,000 deductible. Comprehensive general liability carries no deductible while excess liability coverage has a retained limit of \$5,000. Auto physical damage has deductibles of \$100 for comprehensive coverage and \$250 for collision. No insurance settlements exceeded coverage in the past three years relating to Association activities.

Life, Accident, Health and Hospital Service Insurance Guaranty Association
Audited Financial Statements, December 31, 2003

Disclaimer: The state’s three insurance guaranty associations now report receivership activity on a calendar year basis. The latest data available is for Calendar Year 2003. As a result, the data provided by the guaranty associations no longer corresponds directly to data in the receivership report prepared by TDI’s Liquidation Oversight. TDI’s report is for the state’s Fiscal Year 2004 that runs from September 1, 2003 through August 31, 2004.

Statement of Net Assets, December 31, 2003

Assets	2003
Current assets	
Cash and cash equivalents	\$87,983,127
Investments	21,000
Receivables	
Billed assessments, net of allowance of \$723,363	70,407
Other receivables	6,996
Proofs of claim, net of allowance of \$327,982,567	3,110,874
<i>Total current assets</i>	<i>91,192,404</i>
Noncurrent assets	
Unbilled assessments	64,211,979
Capital assets, net	60,267
	64,272,246
Total assets	\$155,464,650

Life, Accident, Health and Hospital Service Insurance Guaranty Association
Statement of Net Assets, December 31, 2003 (continued)

Liabilities and Net Assets	
Current liabilities	
Accounts payable	574,416
Accrued expenses	42,480
Refunds payable	12,766,957
Current portion of insurance contractual obligations	6,908,270
<i>Total current liabilities</i>	<i>20,292,123</i>
Noncurrent liabilities	
Insurance contractual obligations, net of current portion	113,346,396
<i>Total noncurrent liabilities</i>	<i>113,346,396</i>
Total liabilities	133,638,519
Net assets	
Invested in capital assets	60,267
Unrestricted	21,765,864
<i>Total net assets</i>	<i>21,826,131</i>
Total liabilities and net assets (see accompanying notes to financial statements)	\$155,464,650

Statement of Revenues, Expenses and Changes in Net Assets
for the Year ended December 31, 2003

Operating revenues	
Membership assessments	
Billed assessments	\$1,726,797
Change in unbilled assessments	(552,851)
Estate recoveries	5,310,009
Change in proofs of claim, net of allowance	(3,908,905)
Premiums	431,734
<i>Total operating revenues</i>	<i>3,006,784</i>
Operating expenses	
Claims	
Change in insurance contractual obligations	(5,845,279)
Refund of prior year's assessments	10,143,091
Claims paid	1,356,047
Assumption reinsurance agreements	5,847,111
Third-party administrators	66,889
National task forces	959,155
	<i>12,527,014</i>
Administrative costs	
Legal and professional	180,208
Salaries and benefit costs	593,306
Building and equipment lease costs	144,584
Depreciation	11,445
National organization dues and meetings	64,275
Other	116,879
	<i>1,110,697</i>
<i>Total operating expenses</i>	<i>13,637,711</i>
<i>Operating loss</i>	<i>(10,630,927)</i>
Nonoperating revenues	
Interest income	838,597
Net nonoperating revenues	838,597
Decrease in net assets	(9,792,330)
Net assets, beginning of year	31,618,461
Net assets, end of year (see accompanying notes to financial statements)	\$21,826,131

Life, Accident, Health and Hospital Service Insurance Guaranty Association
Statement of Cash Flows for the Years ended December 31, 2003

Cash flows from operating activities	
Receipts from assessments	\$1,861,974
Receipts from estate recoveries	5,310,009
Receipts from premiums	431,734
Payments on assumption reinsurance agreements	(5,847,111)
Payments for direct claims	(1,356,047)
Payments to suppliers for goods and services	(1,757,683)
Payments to employees	(593,306)
Assessment refunds applied	(1,719,956)
Net cash used in operating activities	(3,670,386)
Cash flows from capital and related financing activities	
Purchases of capital assets	(37,511)
Net cash used in capital and related financing activities	(37,511)
Cash flows from investing activities	
Redemption of long-term bond investment	5,000
Receipt of interest on investments	838,597
Net cash provided by investing activities	843,597
Net decrease in cash and cash equivalents	(2,864,300)
Cash and cash equivalents—beginning of year	90,847,427
Cash and cash equivalents—end of year	\$87,983,127
Reconciliation of operating loss to net cash used by operating activities	
Operating loss	\$(10,630,927)
Adjustments to reconcile operating loss to net cash used in operating activities	
Depreciation expense	11,445
Unbilled assessments	552,851
Change in assets and liabilities	
Billed assessments receivable, net of allowance	83,326
Other receivables	51,851
Proofs of claim, net of allowance	3,908,905
Accounts payable	(235,483)
Accrued expenses	9,790
Estate refunds payable	8,423,135
Insurance contractual obligations	(5,845,279)
Net cash used in operating activities	\$(3,670,386)

Notes to Financial Statements, December 31, 2003

1 Nature of Operations and Reporting Entity

The Life, Accident, Health and Hospital Service Insurance Guaranty Association (the Association) was created by the Texas Life, Accident, Health and Hospital Service Insurance Guaranty Act (the Act) and privatized by the Texas Legislature in 1992. The Association was created to protect, subject to certain limitations, persons specified in the Act against failure in the performance of contractual obligations under life, accident and health insurance policies and annuity contracts, because of the impairment or insolvency of the member insurer who issued the policy or contract. To provide this protection, this association of insurers was created to pay benefits and to continue coverage as limited in the Act.

Membership in the Association is mandatory for any insurance company authorized in Texas to transact any kind of insurance business to which the Act applies. Membership assessments are made by the Board of Directors of the Association based on estimates of amounts necessary to provide funds to carry out the purposes of the Act with respect to impaired insurers. Any amount in excess of statutory obligations and continuing expenses of the Association may be refunded by an equitable method at the discretion of the Board of Directors.

Pursuant to the Act, the Association is governed by a nine member Board of Directors appointed by the Commissioner of Insurance. Five members of the Board must be chosen from industry member companies, three from the fifty member companies having the largest total direct premium income and two from other member companies. Four of the

Directors must be representatives of the general public. Board members serve six-year terms and are eligible to succeed themselves in office.

The Association is considered to be a primary government according to the definition in Governmental Accounting Standards Board (GASB) Statement No. 14, The Financial Reporting Entity. The Association is not considered to be a component unit of any other governmental entity, and no component units were identified for which the Association is considered financially accountable under GASB Statement No. 14.

The Association is reported as a special-purpose government engaged in business-type activities. The significant accounting policies followed by the Association in preparing these financial statements basically conform to generally accepted accounting principles applicable to government units. The Association applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) statements and interpretations issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

Effective January 1, 2003, the Association adopted Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, Statement No. 37, Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments: Omnibus, and Statement No. 38, Certain Financial Statement Note Disclosures. These Statements established standards for external reporting for state and local governments as a whole. In prior years, the Association followed guidance provided by the Financial Accounting Standards Board when presenting their financial position. Since the Association is engaged in business-type activities, there are no changes in the basis of accounting of the Association resulting from adopting GASB 34. For the first time the financial statements include a Management’s Discussion and Analysis (MD&A) section providing an analysis of the Association’s overall financial position and results of operations.

Effective January 1, 1998 through December 31, 2002, the Board of Directors contracted with a management company to provide day-to-day management services to the Association. As of January 1, 2003, day-to-day management of the Association was provided under a new organizational structure with the employment of an executive director and chief operating officer to manage the daily operations and meet the responsibilities of the Association.

2 Summary of Significant Accounting Policies

a Basis of Accounting

The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, except for premium income which is recognized when collected due to the immaterial amount of premiums to be earned. Consequently, revenue is recognized when earned and expenses are recognized when the obligations are incurred. Operating revenues and expenses generally result from providing services in connection with the Association’s principal ongoing operations, as described in Note 1. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. Assessment revenue (billed and unbilled) is recognized when insurance contractual obligations are incurred. Claim liabilities are recognized using estimates of contractual obligations for each impaired insurer at the date of impairment or issuance of an order of liquidation based on a finding of insolvency by a court of competent jurisdiction. Projected claim liabilities are reviewed and revised periodically as information related to the obligations of the individual insolvent member companies is obtained.

b Tax Exempt Status

The Association is exempt from federal income taxes under Section 501(c)(6) of the *Internal Revenue Code*. The Association is also exempt from payment of all fees and taxes levied by the state of Texas or any of its subdivisions, except taxes levied on real and personal property.

c Cash Equivalents

For purposes of the statements of cash flows, the Association considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

d Investments

Funds of the Association may be invested in bonds, notes or securities or other evidences of indebtedness of the United States that are supported by the full faith and credit of the United States or that are guaranteed as to principal and interest by the United States. Purchases of investment securities are made with the intent to hold such securities to maturity. Investments are recorded at market value.

e Allowances for Uncollectible Proofs of Claim Receivable

Allowances for uncollectible proofs of claim are estate specific. The allowance for each estate is based on evaluations of estate financial statements and records, reports from estate receivers, and information from other third parties. Uncollected proofs of claim are written off by the Board of Directors only after an estate is closed in both the domestic and ancillary state and there is no reasonable expectation that any additional funds will be recovered from the estate or other third party.

f Furniture and Equipment

Furniture and equipment are stated at cost. The Association capitalizes furniture and equipment with estimated useful lives greater than one year and an acquisition cost greater than \$500. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which is generally five years.

g Net Assets

The net assets reflected in the financial statements of the Association are deemed to be unrestricted. Estate specific net assets may be refunded to member insurers or a reasonable amount may be retained to provide funds for the continuing expenses of the Association.

h Premium Revenue

Premiums received from a policyholder for coverage, after an order of receivership is entered, belong to the Association. Due to the immaterial amount of premiums to be collected, revenue is recognized as the premiums are received by the Association, both for direct bill and premiums collected by third party agents.

i Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

3 Cash and Cash Equivalents

Cash and cash equivalents consist of bank demand deposits and money market investment accounts. The Association's carrying amount of bank demand deposits at December 31, 2003 was \$108,648, and the total bank balances equaled \$156,897. The deposits are insured up to a maximum of \$100,000 by the Federal Deposit Insurance Corporation. Excess

funds are swept into overnight investments which are backed by the full faith and credit of the United States.

Money market investments at December 31, 2003 were \$87,874,479 and \$90,986,762 respectively. These mutual fund portfolios are comprised of U.S. government obligations backed by the full faith and credit of the United States and repurchase agreements backed by such instruments. These mutual fund investments are not insured by the Federal Deposit Insurance Corporation nor are they a deposit of, other obligation of, or guaranteed by a bank or other depository institution. The Association has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk.

4 Membership Assessments

The Association is authorized by the *Texas Insurance Code*, Annotated Article 21.28-D, Section 9 to assess member insurers in amounts necessary to pay both contractual claim obligations and administrative expenses of the Association. There are two classes of assessments: Class A, which may be levied to meet administrative costs; and Class B, which may be levied to meet the contractual obligations associated with specific insolvent or impaired insurers.

The amount of Class A assessments is prorated to individual member insurers, taking into consideration annual premium receipts reflected in the annual statements for the year preceding the assessment year for individual member insurers. A Class A assessment has not been levied since 1992.

The amount of each Class B assessment is allocated to each member insurer based on their line-of-business premiums (life, accident and health, and annuity), in the same proportion that the premiums were received by the insolvent or impaired insurer for all covered policies during the year preceding impairment.

The total of all Class B assessments levied against a member insurer for each line-of-business account may not exceed one percent of the member insurer's premiums on the policies covered by the line-of-business account in any one calendar year, which is defined as the most recent year for which assessable premium data is available.

Class B assessment revenue for 2003 was \$1,726,797. The assessments levied were for four impaired companies in 2003. The Association collected approximately 99% of the total Class B assessment in 2003, through the end of the year.

The Association may refund to member insurers, in proportion to the contribution of each member insurer, the amount by which accumulated assets exceed the amount necessary to meet its obligations with regard to a particular insolvent insurance company. The Association, through a credit applied against each member insurers' Class B assessment for 2003 refunded to the member insurers \$10,143,091.

Billed assessments receivable as of December 31, 2003 (before an allowance) were \$793,770. These unpaid assessments were levied in years 1991 through 2003. An allowance for uncollectible billed assessments in the amount of \$723,363 has been recorded as of December 31, 2003.

Unbilled assessments receivable of \$64,211,979 at December 31, 2003, represent the statutory ability of the Association to assess member insurers as required to meet corresponding insurance contractual obligations. This amount may be billed in future periods as necessary to fund estate liabilities.

5 Proofs of Claim

The Association files proofs of claim against individual receivership estates to recover claims, claims handling costs, and administrative expenses incurred by the Association related to the estate. These proofs of claim may be amended and are updated and filed periodically as additional costs are incurred and paid by the Association. At December 31, 2003, proofs of claim receivable on open estates (before an allowance) were \$331,093,441.

An allowance related to the collectibility of proofs of claim is recorded based on estate specific evaluations of net assets held by the receiver and other potential recoveries. The amounts to be received by the Association in early access distributions or final distributions are often not readily determinable; therefore, recoveries due to the Association are necessarily estimates and subject to change as the estates are closed out. Based on the Association's estate specific review, the allowances for uncollectible proofs of claim as of December 31, 2003 were \$327,982,567.

6 Capital Assets

Capital asset activity for the year ended December 31, 2003 was as follows:

	BALANCE JANUARY 1 2003	ADDITIONS	RETIREMENTS	BALANCE DECEMBER 31 2003
Capital assets, being depreciated				
Furniture and equipment	\$34,201	37,511	—	71,712
Less: accumulated depreciation	—	11,445	—	11,445
	\$34,201	26,066	—	60,267

Depreciation expense for 2003 was \$11,445.

7 Interaccount Loans and Borrowings

The Board of Directors of the Association has adopted a resolution that allows for short-term loans from the account of one estate to another estate. Interest is paid by the borrowing estate to the estate making the short-term loan at a rate which approximates that earned on short-term government securities. For the year ended December 31, 2003, the following transactions occurred, which are not reflected in the financial statements since they relate to activity within the Association:

	2003	BEGINNING OF YEAR	ADDITIONS	REPAYMENTS	END OF YEAR
Interaccount loans		\$6,327,138	555,529	(6,774,210)	108,457
Interaccount borrowings		\$(6,327,138)	(555,529)	6,774,210	(108,457)

Interest of \$3,783 was charged on these loans for the year ended December 31, 2003.

8 Insurance Contractual Obligations

The liability for insurance contractual obligations is an estimated amount of future cash payments for all impaired or court ordered insolvent estates. The amounts are necessarily based on estimates, and the ultimate liability may vary significantly from the estimate. In addition, the liability is based on information supplied principally by third parties such as receivers, third-party administrators and member participation task forces. As of December 31, 2003, activity in the insurance contractual obligations was as follows:

	BALANCE JANUARY 1 2003	ADDITIONS	REDUCTIONS	BALANCE DECEMBER 31 2003	CURRENT PORTION
	\$126,099,945	508,201	6,353,480	120,254,666	6,908,270

One open estate, Executive Life, comprised approximately 98% of the insurance contractual obligations at December 31, 2003. The obligations related to the Executive Life estate are based on estimated cash flow projections to be paid through 2088 to the insurance company which acquired the business. Annually, a calculation of the amount which could

be paid to settle the future funding obligation is performed by the company which acquired the business. This calculation is based on procedures and formulas laid out in an enhancement (purchase) agreement. The calculation resulted in a settlement calculation of approximately \$59,000,000 as of December 31, 2003. The settlement calculation does not include certain guaranteed issue contracts with future cash flows of approximately \$7,600,000 as of December 31, 2003.

Revisions to estimates of the insurance contractual obligations are reflected in the statements of revenues, expenses and changes in net assets as "changes in insurance contractual obligations."

9 Net Assets

As of December 31, 2003, unrestricted net assets reflected in the financial statements of the Association consisted of the following:

Association's Continuing Administrative Expenses	\$13,814,442
Insolvent Estates	7,951,422
	\$21,765,864

10 Operating Leases

The Association leases its office facility under a non-cancelable operating lease that expires in September 2010. The Association also has several noncancelable operating leases for equipment and machinery that expire during the next five years. Lease expense charged to operations for the year ended December 31, 2003 amounted to \$144,584.

Future annual minimum lease payments under noncancelable operating leases for each of the next five years subsequent to December 31, 2003 are as follows: 2004, \$88,364; 2005, \$87,566; 2006, \$86,996; 2007, \$86,996; 2008, \$80,933; and thereafter \$161,392.

11 Employee Benefit Plan

During 2003, the Association began sponsoring a safe harbor defined contribution retirement plan, Tx. L.A.H.H.S.I.G.A. 401(k) Plan (the Plan), covering substantially all of its employees. Employees are generally eligible to participate in the Plan after completing six months of service and attaining the age of 21. Employees may contribute to the Plan through elective deferrals of salary up to an annual maximum as set by law. Further, the Association may make a safe harbor matching contribution equal to 100% of employee elective deferrals of salary that do not exceed 3% of annual compensation, plus 50% of elective salary deferrals between 3% and 5% of annual compensation, in order to maintain safe harbor status. The Association may also make additional employer matching contributions and discretionary profit-sharing contributions as determined annually.

Employees become fully vested in the Plan after completing five years of service. Provisions of the Plan and contribution requirements may be amended at any time by the Plan administrator.

Contributions to the Plan for 2003 by the Association totaled \$17,480 and employee contributions totaled \$48,826.

12 Risk Management

The Association carries commercial insurance as protection from exposure to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. There were no significant reductions in insurance and no insurance claims were filed during 2003.

13 Commitments and Contingencies

A liquidator or special deputy receiver for the estate of an insolvent insurer may, as assets become available, make disbursements out of marshaled assets to a guaranty association(s) having claims against the estate of the insolvent insurer prior to a distribution to other creditors or the closing of the estate. The liquidator or special deputy receiver prior to such disbursement shall also secure from each guaranty association entitled to disbursements an agreement to return to the liquidator upon request and with court approval such assets, together with income on assets previously disbursed as may be required. As of December 31, 2003, the Association has received approximately \$104 million subject to such agreements since its inception.

The Association, by its nature, is subject to various ongoing claims by insurance companies, policyholders, receiverships and creditors of the receiverships. Some of these claims are in the form of litigation against the Association. It is the opinion of management that any losses which may be sustained would not be material to the Association and, in all foreseeable instances, the Association would have the statutory authority to assess member insurance companies for any losses sustained.

Pending a finding of insolvency in the state of domicile and the separate subsequent designation as an impaired insurer by the Commissioner of Insurance for the State of Texas, the Association shall be triggered (activated). Such activation may create an obligation for protection within the limits of the Guaranty Association Act. As of December 31, 2003, an insurer domiciled in a state other than Texas has been placed into rehabilitation by court order in the domiciliary state. The rehabilitator and the National Organization of Life and Health Insurance Guaranty Associations have jointly prepared, distributed and received bid packages for the company's life and annuity business. As a result of this bidding process, a liquidation plan is being developed that includes several options for policyholders. Contingent on the policyholder option elections under the liquidation plan, the Association will incur a funding obligation related to the Texas resident policyholders from the calculated asset shortfall of approximately \$20 million to \$30 million. It is anticipated that the liquidation plan will be completed, approved by the court and implemented in 2004 with the Association being required to fund its portion of the total obligations.

Texas Title Insurance Guaranty Association
Audited Financial Statements, December 31, 2003

Disclaimer: The state's three insurance guaranty associations now report receivership activity on a calendar year basis. The latest data available is for Calendar Year 2003. As a result, the data provided by the guaranty associations no longer corresponds directly to data in the receivership report prepared by TDI's Liquidation Oversight. TDI's report is for the state's Fiscal Year 2004 that runs from September 1, 2003 through August 31, 2004.

Statement of Net Assets, December 31, 2003

Assets	
Cash and cash equivalents	\$1,821,402
Investments	—
Accrued income receivable	—
Other assets	19,112
<i>Total assets</i>	<i>\$1,840,514</i>
Liabilities and Net Assets	
Liabilities	
Accrued expenses	\$ 75,657
<i>Total liabilities</i>	<i>75,657</i>

Continued on page 86

Texas Title Insurance Guaranty Association
Statement of Net Assets, December 31, 2003 (continued)

Net assets	
Unrestricted	981,370
Restricted	783,487
<i>Total net assets</i>	<i>1,764,857</i>
Total Liabilities and Net Assets	\$1,840,514

Statement of Revenues, Expenses and Changes in Net Assets for the Year ended December 31, 2003

Operating revenues		2003
Investment income		\$ 16,642
<i>Total operating revenues</i>		<i>16,642</i>
Operating expenses		
Examiners		847,622
Professional services		45,395
Board meeting expenses		3,428
Insurance		1,064
Property taxes		907
Supplies		185
<i>Total operating expenses</i>		<i>898,601</i>
Deficit of revenues over expenses		(881,959)
Net assets at beginning of year		2,646,816
Net assets at end of year		\$1,764,857

Statements of Cash Flows for the Year ended December 31, 2003

Cash from operating activities		
Receipts of investment income		\$19,814
Payments to professionals		(44,036)
Payments to examiners		(848,869)
Payments to board members		(3,428)
Payments to vendors		(2,155)
Net cash used in operating activities		(878,674)
Cash from financing activities		—
Cash from investing activities		—
Cash from operating activities		
Purchase of investments		—
Sale of investments		718,329
Net cash provided by (used in) investing activities		718,329
Net decrease in cash and cash equivalents		(160,345)
Cash and cash equivalents at beginning of year		1,981,747
Cash and cash equivalents at end of year		\$1,821,402
Reconciliation of operating deficit to net cash used in operating activities		
Deficit of revenues over expenses		\$(881,959)
Adjustments to reconcile deficit of revenues over expenses to net cash provided by operating activities		
Net increase in the fair market of investments		—
Changes in assets and liabilities		
Decrease (increase) in accrued income receivable		3,171
Increase (decrease) in accrued expenses		114
Net cash used in operating activities		\$(878,674)

Notes to Financial Statements, December 31, 2003

1 Summary of Significant Accounting Policies

a Reporting Entity

The Texas Title Insurance Guaranty Association (the "Association") is a nonprofit organization formed under the Texas Title Insurance Act (the "Act") to protect holders of covered claims as defined by the Act through payment of claims, contracts of reinsurance, assumption of liabilities or otherwise.

Membership in the Association is mandatory for any insurance company authorized in Texas to transact any kind of insurance business to which the Act applies. Title guaranty fees may be collected based on a fixed fee applied to each title insurance policy written in the State. The fee is to provide funds for title examinations under the supervision of the Commissioner of Insurance and pay covered claims with respect to impaired agents. Guaranty fees were not assessed and collected in the year ended December 31, 2003. Assessments may be levied on the individual insurers to pay covered claims arising from impaired underwriters.

Recoupment fees may be collected by the Association based on a fee set by the Commissioner of Insurance. The recoupment fees are used to reimburse member companies, on a pro rata basis, for a portion of the assessment paid. All assessments have been fully recovered.

b Basis of Accounting

The Association meets the definition of a governmental not-for-profit entity as set forth in the *AICPA Audit and Accounting Guide, Audits of State and Local Governmental Units*. The financial statements of the Association are prepared on the basis of an enterprise fund as defined by the Governmental Accounting Standards Board (GASB). Enterprise funds are used to account for operations **1)** that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or **2)** where the governing body has decided that periodic determination of revenue earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Enterprise funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred. Assessment revenue is recognized when claims liability is incurred. Claims liability is recognized using estimates of claims outstanding for each impaired insurer at the date of impairment. The Authority has elected not to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, which is an alternative allowed by GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting.

Effective January 1, 2002, the Association implemented Government Accounting Standards Board ("GASB") Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, GASB Statement No. 37, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, and GASB Statement No. 38, Certain Financial Statement Disclosures, effective January 1, 2002. The primary effects of adopting these standards on the Association's financial statements are the addition of management's discussion and analysis as required supplemental information, the classification of net asset categories, and certain modifications to footnote disclosures. The adoption of GASB Statement No. 34 had no impact on total net assets.

c Cash and Cash Equivalents

For purposes of the statement of cash flows, the Association considers money market accounts and mutual funds, certificates of deposit, and investments with purchased maturities of three months or less to be cash equivalents.

d Investments

Investments are reported at fair value based upon quoted market prices, with the change in fair value of investments captioned as investment income and interest income reported at the relevant stated interest rate. Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

e Taxes

The Authority is a not-for-profit governmental entity, which is exempt from federal income taxes under the provisions of the *Internal Revenue Code*. As such, no provision for federal income taxes has been provided in the accompanying financial statements. The Association is exempt from payment of all fees and taxes levied by the State of Texas or any of its subdivisions except taxes levied on real property.

f Restricted Assets

Substantially all of the Association's assets are restricted by virtue of the Act. The Association has approximately \$981,370 and \$1,451,558 of unrestricted net assets at December 31, 2003 and 2002, respectively.

g Classification of operating and nonoperating revenue and expenses

The Association defines operating revenues and expenses as those revenues and expenses generated by a specified program offering either a good or service. This definition is consistent with GASB Statement No. 9 which defines operating receipts as cash receipts from customers and other cash receipts that do not result from transactions defined as capital and related financing, non-capital financing or investing activities. Operating revenues include interest on investments, fee assessments and other revenues related to guaranty operations. Operating expenses include contractual services and other expenses (such as examinations, insurance and professional fees). Revenues and expenses not fitting the above definitions are considered nonoperating.

h Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2 Cash, Cash Equivalents and Investments

The Association's bank balances totaled approximately \$61,765 and \$294,566 as of December 31, 2003 and 2002, respectively. The Association's cash management practice includes deposit transfers to and from money market mutual fund accounts with the remainder covered by FDIC insurance. Occasionally, the timing of deposit receipt results in end-of-day bank balances exceeding the FDIC insurance levels. Cash in bank accounts exceeded federally insured limits by \$0 and \$194,566 at December 31, 2003 and 2002, respectively.

Cash and cash equivalents consisted of the following as of December 31, 2003.

	2003
Cash on Deposit	\$869,909
Certificates of Deposit	—
Treasury Funds	303,853
Money Market Mutual Funds	647,640
	\$1,821,402

The Association is authorized to invest funds in mutual funds or direct obligations of or obligations where the principal and interest of which are guaranteed by the U.S. Government; mutual funds or direct obligations of or obligations guaranteed by agencies or instrumentalities of the U.S. Government; as well as, subject to certain restrictions, direct obligations of a state or an agency, county, city or other political subdivision of a state other than a municipal utility district, bankers acceptances, commercial paper, and mutual funds.

The Association's investments are categorized below as an indicator of credit and market risk. Category 1 includes investments that are insured by the Securities Investor Protection Corporation or held by the Association or its agent and listing the Association as owner. Category 2 includes uninsured investments held by the counterparty's agent by listing the Association as owner. Category 3 includes uninsured investments held by the counterparty in their own name.

As of December 31, 2002

INVESTMENTS	1	CATEGORY 2	3	FAIR VALUE
U.S. Treasury Bills	\$718,329	—	—	\$718,329
Total investments				\$718,329

3 Commitments and Contingencies

The Association, by its nature, is subject to various ongoing claims by insurance companies, policyholders, receiverships and creditors of the receiverships. Some of these claims may result in litigation against the Association. At December 31, 2003 and 2002, no such liabilities existed.

4 Significant Group Concentrations of Risk

The majority of the Association's business activity, assessment revenue and advances are with concerns in the title insurance industry in the State of Texas.

5 Subsequent Event

The Association implemented a Guaranty Fee pursuant to Article 9.48, Section 6 a) and b) of the *Texas Insurance Code* effective January 1, 2004. The Guaranty Fee will be in the amount of \$1.00 per owner title policy and mortgagee title policy issued. The Association estimates that these fees will result in revenues in excess of \$1,000,000 in 2004.

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