TMLT

Texas Medical Liability Trust and Subsidiary

# CONSOLIDATED FINANCIAL STATEMENTS

Years Ended December 31, 2001 and 2000

**Contents**

CALHOUN & CO., LLP
Accountants & Consultants

BDO SEIDMAN ALLIANCE

Board of Directors
Texas Medical Liability Trust and Subsidiary

**Independent Auditor's Report**

We have audited the accompanying consolidated balance sheet of Texas Medical Liability Trust and subsidiary as of December 31, 2001, and the related consolidated statements of operations, changes in policyholders' surplus and cash flows for the year then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Texas Medical Liability Trust and subsidiary as of December 31, 2000, were audited by other auditors whose report dated March 28, 2001, expressed an unqualified opinion on those statements.

We conducted our audit 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2001 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Texas Medical Liability Trust and Subsidiary at December 31, 2001 and the consolidated results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Calhoun & Co., LLP

Certified Public Accountants
November 8, 2002

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## CONSOLIDATED FINANCIAL STATEMENTS

| | December 31, 2001 | December 31, 2000 |
|---|---|---|
| | (In Thousands) | |
| **Assets** | | |
| Securities, Available-for-Sale, at Fair Value: | | |
| Fixed-Maturity Securities | **$ 181,580** | $ 184,444 |
| Common Stocks | **19,414** | 21,482 |
| Cash and Cash Equivalents | **11,961** | 12,472 |
| Premiums Receivable | **43,436** | 32,501 |
| Accrued Interest Receivable | **2,305** | 2,505 |
| Reinsurance Recoverables: | | |
| On Paid Losses | **4,890** | 2,864 |
| On Unpaid Losses and Loss Adjustment Expenses | **40,742** | 26,202 |
| Prepaid Reinsurance Premiums | **8,726** | 5,935 |
| Deferred Tax Asset | **10,619** | 10,294 |
| Cash Surrender Value of Key Man Life Insurance | **2,588** | 2,588 |
| Other | **7,644** | 6,244 |
| Total Assets | **$ 333,905** | $ 307,531 |

## LIABILITIES AND POLICYHOLDERS' SURPLUS

| | 2001 | 2000 |
|---|---|---|
| **Liabilities** | | |
| Reserves: | | |
| Unpaid Losses and Loss Adjustment Expenses | **$ 217,675** | $ 170,510 |
| Unearned Premiums | **62,837** | 48,211 |
| | **280,512** | 218,721 |
| Revolving Line of Credit | **10,500** | – |
| Premiums received in advance | **3,953** | 2,934 |
| Accounts Payable and Accrued Expenses | **5,034** | 5,296 |
| Reinsurance Premiums Payable | **11,000** | 14,921 |
| Total Liabilities | **310,999** | 241,872 |
| **Policyholders' Surplus** | | |
| Contributed Surplus | **11,221** | 10,538 |
| Surplus Contributes Receivable | **(488)** | 1 |
| | **10,733** | 10,539 |
| Accumulated Other Comprehensive Loss | **(985)** | (353) |
| Unassigned surplus | **13,158** | 55,473 |
| Total Policyholders' Surplus | **22,906** | 65,659 |
| Total Liabilities and Policyholders' Surplus | **$ 333,905** | $ 307,531 |

*See notes to consolidated financial statements*

TMLT

Texas Medical
Liability Trust
and Subsidiary

AUDITED
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STATEMENTS

Year Ended
December 31, 2001

## CONSOLIDATED STATEMENTS OF OPERATIONS

| | Year Ended December 31, | |
|---|---|---|
| | **2001** | **2000** |
| | **(In Thousands)** | |
| Premiums Earned, Net of Reinsurance | **$ 98,876** | $ 77,327 |
| Investment Income, Net of Investment Expenses of $299 in 2001 and $392 in 2000. | **12,762** | 13,461 |
| Net Realized Gains (Losses) on securities available for sale | **(2,292)** | 1,528 |
| Other Revenue | **1,980** | 1,513 |
| Total Revenues | **111,326** | 93,829 |
| Losses and Expenses: | | |
| Losses and Loss Adjustment Expenses | **137,235** | 89,081 |
| Other Underwriting Expenses | **16,406** | 15,030 |
| Total Operating Expenses | **153,641** | 104,111 |
| Loss Before Income Taxes | **(42,315)** | (10,282) |
| Income Tax Expense (Benefit) | **–** | (2,883) |
| Net Loss | **$ (42,315)** | $ (7,399) |

*See notes to consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CHANGES IN POLICYHOLDERS' SURPLUS

**(In Thousands)**

| | Contributed Surplus | Unassigned Surplus | Accumulated Other Comprehensive Income (Loss) | Total Policyholders' Surplus | Comprehensive Income |
|---|---|---|---|---|---|
| Balances at January 1, 2000 | $ 10,518 | $ 62,872 | $ (104) | $ 73,286 | $ – |
| Other Comprehensive Income | – | – | (249) | (249) | (249) |
| Net Loss | – | (7,399) | – | (7,399) | (7,399) |
| Contributed Surplus, Net | 21 | – | – | 21 | – |
| Balances at December 31, 2000 | 10,539 | 55,473 | (353) | 65,659 | $ (7,648) |
| Other Comprehensive Income | – | – | (632) | (632) | (632) |
| Net Loss | – | (42,315) | – | (42,315) | (42,315) |
| Contributed Surplus, Net | 194 | – | – | 194 | – |
| Balances at December 31, 2001 | $ 10,733 | $ 13,158 | $ (985) | $ 22,906 | $ (42,947) |

*See notes to consolidated financial statements*

## CONSOLIDATED STATEMENTS OF CASH FLOW

| | Year Ended December 31, 2001 | 2000 |
|---|---|---|
| | (In Thousands) | |
| **Operating Activities:** | | |
| Net Loss | **$ (42,315)** | $ (7,399) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | **487** | 511 |
| Net (accretion) amortization on securities | **(198)** | (150) |
| Deferred Income Taxes | **(325)** | (3,244) |
| Net Realized Gains | **2,292** | (1,528) |
| Change in Operating Assets and Liabilities: | | |
| Premiums Receivable | **(10,935)** | (7,582) |
| Reinsurance Recoverables | **(16,566)** | 792 |
| Reserves | **47,165** | (1,782) |
| Reinsurance Premium Balances | **(3,921)** | (945) |
| Refundable Income Taxes | **–** | 2,750 |
| Other | **11,509** | 9,606 |
| Net Cash used in Operating Activities | **(12,807)** | (8,971) |
| **Investing Activities:** | | |
| Purchases of securities | **(50,139)** | (51,938) |
| Proceeds from Disposals and Maturities of Securities | **52,019** | 63,223 |
| Purchases of Furniture and Equipment | **(278)** | (292) |
| Increase in Key Man Life Insurance | **–** | 1,786 |
| Net Cash Provided by Investing Activities | **1,602** | 12,779 |
| **Financing Activity:** | | |
| Net borrowings under line of credit | **10,500** | – |
| Net Surplus Contributions | **194** | 21 |
| Cash Provided by Financing Activity | **10,694** | 21 |
| Change in Cash and Cash Equivalents | **(511)** | 3,829 |
| Cash and Cash Equivalents at Beginning of Year | **12,472** | 8,643 |
| Cash and Cash Equivalents at End of Year | **$ 11,961** | $ 12,472 |

*See notes to consolidated financial statements*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

### A. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Texas Medical Liability Trust (Trust) was formed in June 1978 to provide professional liability and office premises liability insurance coverage to eligible physicians who are members of the Texas Medical Association and who practice primarily in Texas. The Trust was organized under Article 21.49 – 4 of the Texas Insurance Code under the name "Texas Medical Association Health Care Liability Claim Trust" and began operations in 1979.

The Trust provides professional liability coverage to the ancillary staff of the Trust's policyholders through its wholly-owned subsidiary, Texas Medical Insurance Company (TMIC), which was formed in 1995 as a state-regulated property/casualty insurance company.

**Basis of Presentation**

The consolidated financial statements include the accounts of the Trust and TMIC after elimination of all significant intercompany accounts.

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

**Premiums**

Policies written are generally for a one-year term and premiums are recorded as earned on a pro rata basis over the life of the policy. Policies are written on both an occurrence and claims-made basis. Unearned premiums represent the portion of premiums written which are applicable to the unexpired terms of the policies in force.

Billings for calendar year premiums are rendered in advance of the premium year. Also, surplus deposits are received from physicians applying for coverage in advance of approval of their applications. Premiums and deposits collected in advance of the period covered are classified as premiums received in advance.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## A. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – Continued

### Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses represent the estimated liability for claims reported through year end (case-basis) plus the estimated losses and loss adjustment expenses relating to incidents incurred but not yet reported. These amounts have been estimated by management and the Company's consulting actuaries based on available industry data and the Trust's actual experience and represent estimates of the ultimate cost of all losses incurred, but unpaid, through year end. However, the ultimate cost of settling claims may vary significantly from the estimated liability. The estimates are continually reviewed and adjusted as necessary; such adjustments are included in current operations and are accounted for as changes in estimates.

Unpaid losses and loss adjustment expenses have been discounted using a 4% factor. The discount amount was approximately $14,000 and $10,000 at December 31, 2001 and 2000 respectively.

The Trust considers anticipated investment income in determining whether a premium deficiency exists on the unexpired terms of the policies in force. No such deficiency exists as of December 31, 2001.

### Reinsurance

Amounts recoverable from reinsurers for unpaid losses and loss adjustment expenses and the amounts payable to reinsurers for reinsurance premiums are estimated in a manner consistent with the related liabilities associated with the reinsured policies. Consistent with the estimate of the unpaid loss and loss adjustment expenses, the reinsurance balances are discounted at a rate of 4%. The effect of this discounting decreased a portion of ceded premiums by approximately $24 and $292 at December 31, 2001 and 2000 respectively. Adjustments to the provisional reinsurance premiums are provided for in the ceded premiums.

Amounts paid to reinsurers under prospective, short-duration reinsurance contracts are recorded as prepaid reinsurance premiums which are recognized as the related premiums are earned.

### Investments

Investments are categorized as available-for-sale. Accordingly, the investment portfolio is carried at fair value. Unrealized holding gains and losses on securities are reported in accumulated other comprehensive income (loss) net of income taxes and are classified as a separate component of policyholders' surplus.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## A. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – Continued

### Investments – Continued

The cost of fixed-maturity securities is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of loan-backed securities, over the estimated life of the security. Such amortization and interest earned are included in investment income. Realized gains and losses are included in net realized gains on investments. The cost of securities sold is based on the specific identification method.

### Income Taxes

The Trust uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

### Acquisition Costs

Acquisition costs are expensed as they are incurred; the financial statement effect of this method does not differ significantly from the effect of using the deferral method.

### Cash Equivalents

Money market funds and commercial paper with initial maturities of less than three months are considered to be cash equivalents.

### Disclosures about Fair Value of Financial Instruments

The fair value of financial instruments, as defined by generally accepted accounting principles, approximates the recorded book value of such instruments.

### Accounting Changes

During 2001, the Trust and TMIC changed their method for recording investment transactions from the settlement date to the trade date. The cumulative effect of changes in accounting principles should be reported as an adjustment to unassigned surplus in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date, if the new accounting principle had been applied retroactively for all prior periods. This cumulative effect as of January 1, 2001, has no material effect on the financial statements.

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Texas Medical Liability Trust and Subsidiary

AUDITED FINANCIAL STATEMENTS

Year Ended December 31, 2001

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

### B. COMPREHENSIVE INCOME

In accordance with SFAS 130, *Reporting Comprehensive Income*, the Trust presents comprehensive income (loss) within the consolidated statements of changes in policyholders' surplus.

Components of other comprehensive income (loss) consist of the following:

| | Year Ended December 31, 2001 | 2000 |
|---|---|---|
| Unrealized losses on available-for-sale securities | $ (957) | $ (3,365) |
| Reclassification adjustment for realized net gains (losses) in net income | – | 2,919 |
| Income tax benefit | 325 | 197 |
| Other comprehensive loss | $ (632) | $ (249) |

Accumulated other comprehensive income shown on the consolidated statements of changes in policyholders' surplus is solely comprised of unrealized gains (losses) from available-for-sale securities, net of tax of $325 and $(182) for the years ended December 31, 2001 and 2000, respectively.

### C. SECURITIES

The amortized cost and fair value of the Trust's investments in fixed-maturity securities are summarized as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| **At December 31, 2001:** | | | | |
| U.S. government and its agencies | $ 11,281 | $ 478 | $ 23 | $ 11,736 |
| Corporations | 80,588 | 2,691 | 2,162 | 81,117 |
| Loan-backed securities and collateralized mortgage obligations | 86,858 | 2,219 | 350 | 88,727 |
| | $ 178,727 | $ 5,388 | $ 2,535 | $ 181,580 |
| **At December 31, 2000:** | | | | |
| U.S. government and its agencies | $ 11,487 | $ 268 | $ 156 | $ 11,598 |
| Corporations | 88,270 | 1,082 | 1,053 | 88,299 |
| Loan-backed securities and collateralized mortgage obligations | 84,007 | 997 | 458 | 84,547 |
| | $ 183,764 | $ 2,347 | $ 1,667 | $ 184,444 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

### C. SECURITIES – Continued

At December 31, the Trust's investment in common stocks had a cost basis of $23,759 and $22,813 in 2001 and 2000, respectively. Gross unrealized gains and gross unrealized losses were $756 and $5,101 respectively in 2001 and, $2,323 and $3,537 respectively in 2000.

The fair values generally represent quoted market value prices for securities traded in the public marketplace or analytically determined valued using bid or closing prices for securities not traded in the public marketplace.

The amortized cost and estimated fair value of the fixed-maturity securities at December 31, 2001 are summarized, by stated maturity as follows:

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Years to maturity: | | |
| One or less | $ 6,699 | $6,916 |
| After one through five | 40,021 | 41,878 |
| After five through ten | 33,059 | 33,444 |
| Loan-backed securities and collateralized mortgage obligations and other | 98,948 | 99,342 |
| Total | $ 178,727 | $ 181,580 |

Actual maturities may differ from the contractual maturities in the foregoing table because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Proceeds from the sales of available-for-sale securities were $43,442 in 2001 and $51,021 in 2000. Gross realized gains and gross realized losses on these sales were $529 and $2,869 respectively, during 2001, and $5,221 and $3,693, respectively, during 2000.

### D. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following table provides a reconciliation of the beginning and ending reserve balances for unpaid losses and loss adjustment expenses (LAE), net of reinsurance recoverables, for 2001 and 2000.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## D. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES – Continued

| | Year Ended December 31, 2001 | 2000 |
|---|---|---|
| Reserve for unpaid losses and LAE, net of related reinsurance recoverables at beginning of year | $ 144,308 | $ 146,324 |
| Add provision for claims, net of reinsurance, occurring in: | | |
| Current year | 104,803 | 79,645 |
| Prior years | 32,432 | 9,436 |
| Incurred losses during the current year, net of reinsurance | 137,235 | 89,081 |
| Deduct payments for claims, net of reinsurance, occurring in: | | |
| Current year | 202 | 745 |
| Prior years | 104,099 | 90,352 |
| | 104,301 | 91,097 |
| Reserve for losses and LAE, net of related reinsurance recoverables, at end of year | 177,242 | 144,308 |
| Reinsurance recoverables on unpaid losses and LAE, at end of year | 40,433 | 26,202 |
| Reserve for unpaid losses and LAE, gross of reinsurance recoverables on unpaid losses, at end of year. | $ 217,675 | $ 170,510 |

The foregoing reconciliation shows that the Trust's reserve for unpaid losses and LAE, net of related reinsurance recoverable, at December 31, 2001 and 2000, was increased by $32,432 and $9,436 for claims that had occurred on or prior to 2000 and 1999, respectively. During 2001, the Trust increased reserves due to higher than anticipated loss severity and frequency, which resulted in higher reserves for both current year and prior year reported claims. This change in management's estimate of claims resulted from plaintiff's attorney's response to recent changes in the procedure for filing lawsuits and the time period allowed for discovery in Texas. During 2000, the $9,436 additional provision for claims occurring in prior years, is partially a continuation of the 1999 claim trends, and also reflects the inherent uncertainties in estimating medical malpractice reserves for unpaid losses and LAE.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## D. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES – Continued

Medical malpractice claims have a very long development period. Historically, cases have taken years to be reported and, as a rule, take years to adjust, settle or litigate. With respect to the Trust's estimates of reserves for unpaid losses and LAE, there is additional uncertainty related to the strength of case reserves and the effect of changes in the reinsurance of allocated loss adjustment expense (ALAE). Accordingly, should management's assumptions as to case reserve redundancies or reinsurance recoverables differ from the actual closure of claims, reserves are likely to develop adversely. Loss and loss adjustment reserve estimates are reviewed regularly and adjusted, as appropriate.

## E. REINSURANCE

The trust cedes certain risks to various reinsurers. These reinsurance arrangements allow management to control exposure to potential losses arising from large risks and provide additional capacity for growth. A significant portion of the reinsurance is effected under quota-share reinsurance contracts and, in some cases, stop-loss coverage.

Ceded premiums are charged to operations as a deduction from premiums written. The effects of reinsurance on premiums written and earned are as follows:

| | 2001 Premiums | | 2000 Premiums | |
|---|---|---|---|---|
| | Written | Earned | Written | Earned |
| Direct | $ 130,380 | $ 115,753 | $ 101,051 | $ 91,233 |
| Ceded | 19,668 | 16,877 | 13,930 | 13,906 |
| Net Premiums | $ 110,712 | $ 98,876 | $ 87,121 | $ 77,327 |

The amounts deducted from losses and loss adjustment expenses in the income statements that relate to reinsurance were $27,623 for 2001 and $13,871 for 2000.

Reinsurance ceded contracts do not relieve the Trust from its obligations to policyholders. The Trust remains liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under the reinsurance agreements. To minimize its exposure to significant losses from reinsurer insolvencies, the Trust evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## F. FEDERAL INCOME TAXES

Significant components of the provision for income tax expense (benefit) for the year ended December 31 were as follows:

| | 2001 | 2000 |
|---|---|---|
| Current expense (benefit) | $ – | $ (17) |
| Deferred expense (benefit) | – | (2,866) |
| | $ – | $ (2,883) |

No income tax refunds were received or taxes paid in 2001. The Trust received income tax refunds of $2,795 during 2000.

Significant components of the Trust's deferred tax assets and liabilities were as follows as of December 31:

| | 2001 | 2000 |
|---|---|---|
| Deferred Tax Assets: | | |
| Loss Reserve Discounting | $ 4,779 | $ 3,564 |
| Unearned Premium Discounting | 4,273 | 2,947 |
| Net Operating Losses | 16,662 | 6,983 |
| Other | 783 | 678 |
| Total Deferred Tax Assets | 26,497 | 14,172 |
| Valuation Allowance for Deferred Tax Assets | (15,378) | (3,495) |
| Total Deferred Tax Assets, Net of Allowance | 11,119 | 10,677 |
| Deferred Tax Liabilities: | | |
| Other | (500) | (383) |
| Total Deferred Tax Liabilities | (500) | (383) |
| Net Deferred Tax Asset | $ 10,619 | $ 10,294 |

Under provisions of FASB Statement No. 109, the Trust is required to record a valuation allowance on a deferred tax asset, if it is more likely than not that the benefit will not be realized. At December 31, 2001, the Trust established a $15,378 valuation allowance for the deferred tax asset, an $11,883 increase from December 31, 2000. Management believes that it is more likely than not the net deferred tax asset recorded at December 31, 2001 will be realized from expected future taxable income.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

## F. FEDERAL INCOME TAXES – Continued

At December 31, 2001, the Trust has taxable net operating loss carryforwards of $49,000 which begins to expire in 2019 to offset against future federal taxable income.

The differences between the income tax benefit reported and the income tax benefit that would result from applying domestic federal statutory rates to pretax income in 2001 and 2000 resulted primarily from the effects of tax-exempt interest and changes in the valuation allowance.

## G REVOLVING – LINE OF CREDIT

In January, 2001, the Trust entered into an agreement with a commercial lender which provides the Trust with a revolving credit facility of $15,000 ($10,500 outstanding at December 31, 2001 and no outstanding balance at December 31, 2000). The funds are available under the credit agreement may be used for general corporate purposes. The revolving credit facility expires on January 17, 2002. Under the revolving credit facility, the Trust granted liens with respect to equity interests in certain fixed maturity investments owned by the Trust.

Interest on borrowings under the credit agreement are determined, at the Company's option, based on the prime rate minus 2.35% or the LIBOR rate plus a margin of 0.7%. There is a commitment fee of .08% on the unused balance. At December 31, 2001 the prime rate was 4.75%.

Subsequent to year end, the line of credit was renewed for an additional year at substantially the same terms.

## H. POLICYHOLDERS' SURPLUS

Eligible physicians desiring to purchase insurance through the Trust are required to purchase a Surplus Deposit Certificate. The Surplus Deposit Certificates are offered solely to provide surplus for the Trust and do not bear interest.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

**Year Ended December 31, 2001**

**(Amounts in Thousands)**

### I. COMMITMENTS AND CONTINGENCIES

The Trust leases office facilities and certain equipment through agreements which expire through 2004. As of December 31, 2001, the future minimum lease payments under these agreements for the years ending December 31 are as follows:

| | |
|---|---|
| 2002 | $ 747 |
| 2003 | 747 |
| 2004 | 652 |
| 2005 | – |
| Thereafter | – |
| Total | $ 2,146 |

Total rent expense was $1,222 for 2001 and $1,208 for 2000.

The Trust is named as a defendant in various legal actions principally from claims made under insurance policies. Those actions are considered by the Trust in estimating the loss and loss adjustment expense reserves. The Trust's management believes that the resolution of those actions will not have a material adverse effect on the Trust's financial position or results of operations.

### J. EMPLOYEE BENEFIT PLAN

The Trust sponsors a non-contributory, defined contribution employee benefit plan, which covers all employees who have completed one year of service. The Trust makes contributions to the Plan equal to 10% of participant's salaries. Such contributions are reduced by forfeitures of participants who leave the Plan before they become fully vested. Plan expense was $1,161 for 2001 and $980 for 2000.