TEXAS MEDICAL LIABILITY TRUST

Annual Report 2000

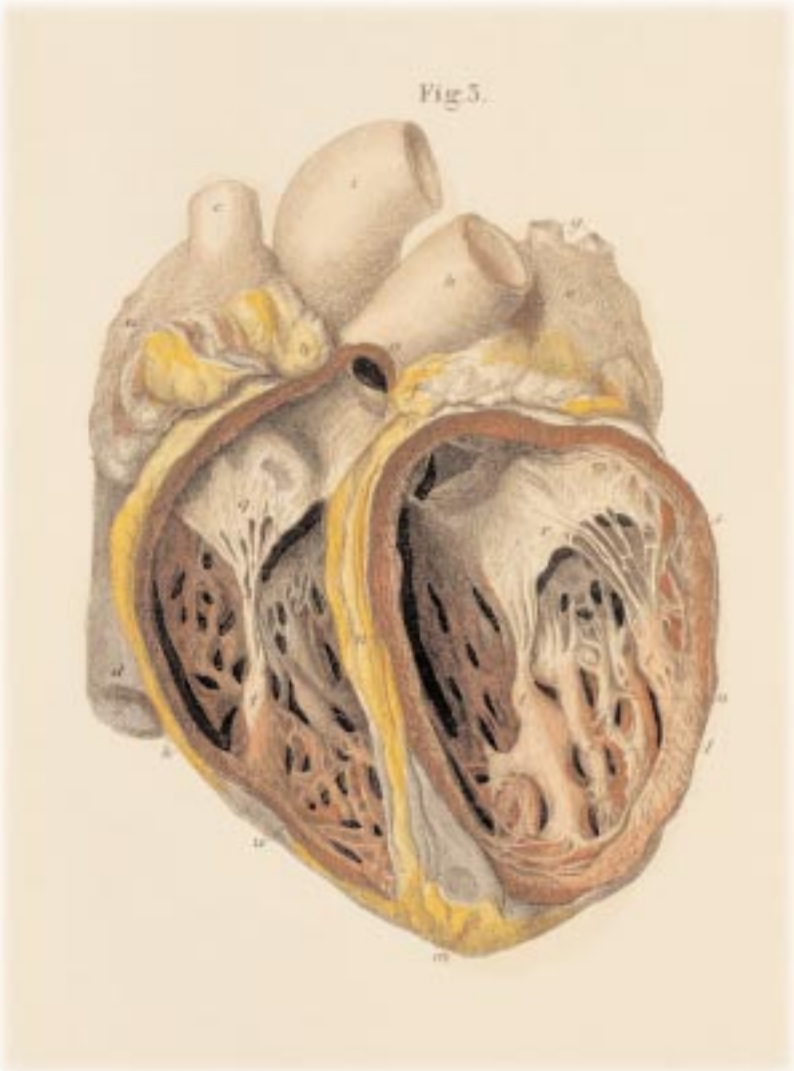
Discovering Solutions

TMLT

Texas Medical Liability Trust

is a unique not-for-profit health care liability claim trust owned by physician policyholders and governed by a physician board. TMLT was created in 1978 by Texas Medical Association to provide a stable, reliable source of medical malpractice coverage solely for Texas physicians. Physician participation and guidance in all areas of operation are TMLT trademarks, as is our history of financial stability and unmatched service to physicians in all specialties and practice settings.

Discovering Solutions



TMLT is an organization that sprang to life in the midst of a nationwide medical liability crisis. In our 21-year history, we've shown that challenges inspire us rather than drive us to defeat. Operating in our state's highly charged legal environment — with claims frequency and severity at record levels — would require our creativity, our leadership, and our staunch resolve to serve and protect the physicians of Texas through an uncertain and unpredictable period. We entered the year 2000 trusting in our people, and in our abilities and past experience, but with no guarantee of a favorable outcome.

As the year progressed, we kept our promise to inform Texas physicians about important issues. Through escalating lawsuit abuse, high damage awards, re-underwriting and increasing premiums, TMLT remained focused. We actively worked with TMA and organized medicine sharing ideas on long-term solutions to serious problems with our civil justice system. Our efforts have only just begun. Immediate medical liability reform is uncertain. TMLT policyholders can be assured that, in 2001, TMLT will be in the front line for reform, serving as your advocate.

TEXAS MEDICAL LIABILITY TRUST

2000 Annual Report

2000 Board of Governors

Front row, left to right: Dennis J. Factor, M.D.; Howard R. Marcus, M.D.,Vice Chairman; Nancy Byrd, M.D.; Robert G. Thumwood, M.D.;
Back row, left to right: W. Thomas Cotten, President and C.E.O.; Martin F. Scheid, M.D., Chairman; Richard C. Geis, M.D.; Daniel A. Chester, M.D.; M. Dwain McDonald, M.D.; Samuel C. Waters, M.D., Secretary-Treasurer.

Commitment through Crisis

CHAIRMAN'S MESSAGE

Having observed the birth of TMLT in 1979 through the eyes of my associate, Dr. M. E. Durham, (who was then president of TMA) and subsequently assuming various assignments in the Trust over the past 21 years, looking back on the development of TMLT is truly amazing. I am gratified to have played a part in TMLT's evolution into the leading medical liability carrier in the state.

With all of our progress, our goals have never changed from the initial commitment of the founders; specifically, to provide a source for the best liability products and services available in Texas to our policyholders. These cornerstones have been further enhanced by the growth of an extensive communication and education system which seeks to help physicians recognize the causes and avoid the occurrence of liability claims.

These educational efforts are coupled with excellence in claim management guided by exceptional communication between our physician advisers and a knowledgeable, understanding claims management staff. A stable of qualified defense counselors-at-law has been selected and retained to serve our physician policyholders should the need arise.

The philosophy of insurance is to share expenses among all policyholders and thus spread the risk and decrease the burden. Through the cooperative efforts of an experienced underwriting staff and our physician advisors and by employing strict underwriting guidelines, we endeavor to shield our policyholders from those few physicians in our midst who repeatedly practice reckless or unfortunate medicine or who incur multiple and expensive claims or judgements. Additionally, a conservative fiscal policy in a not-for-profit setting has enabled the Trust to remain strong through two decades of often turbulent liability storms in our state.

Over a period of 21 years, TMLT has observed a number of other medical liability insurance carriers enter the Texas environment, only to retreat because a vicious plaintiff's bar and the permissive liability laws that have existed in our state made it a very inhospitable place to do insurance business. Under these circumstances, Texas physicians have suffered with limited access to protection and high insurance premiums. Current efforts to correct and modify this environment must include the education and support of all Texas physicians and all Texas citizens. The playing field is not level, and Texas physicians are being forced to bear an unjust and inequitable burden while caring for the citizens of this state.

MARTIN F. SCHEID, M.D.
Chairman, Board of Governors

The next few years will be critical for Texas physicians who expect excellent liability defense at a reasonable cost. Claims frequency and severity continue to plague us. The cost of litigation continues to rise. Modification of our legal system is an immediate necessity. It is time for Texas physicians to make their voices heard and provide substantial support in an effort to bring equity to our legal system. This being said, I am confident that, with the loyal, physician-friendly staff of TMLT, our physician officers, and the support of proactive, educated policyholders, our Trust will be able to maintain the financially strong, physician-centered commitment of the past 21 years.

Martin F. Scheid, M.D.
Chairman, Board of Governors

Seeking Effective Solutions

PRESIDENT'S MESSAGE

The year 2000 arrived free from the media-hyped crash of computer systems worldwide. Our telephones rang and our electronic files remained intact. Y2K planning at TMLT positioned us among those businesses well prepared in case of a catastrophic systems event; however, Y2K was not the only challenge TMLT faced as the new year began.

Claim frequency and severity across the state and across specialties continued a violent upswing for a second year. Incredible jury awards against Texas physicians made regular headlines and the cost of defending an unprecedented number of claims skyrocketed. TMLT took in a record number of claims in 2000 and a record number of cases went to trial. Our average cost to defend a claim in 2000 was $20,102 up from $19,232 in 1999. Thanks to our expertise in claims management and our commitment to defend physicians and not settle frivolous claims, we closed 87% of claims with no indemnity payment. However, though a claim may not result in an indemnity payment, it always results in legal expenses. In 2000, high levels of claims frequency and severity continued to push the medical liability industry to its knees in Texas. To determine the scope of this problem and to look for solutions, we participated, along with Medical Protective and API, in a TMA Medical Professional Liability Data Study in Spring 2000. Armed with the information obtained from the study, we researched the changes we knew we must make to keep the Trust strong and prepared to go forward.

Leadership during times of turmoil is difficult. The financial losses we endured in 1999 prompted serious re-evaluation of the Trust in 2000. We found that, in order to ensure long-term survival of the Trust, we would need to tighten our underwriting guidelines even further and raise premium rates. For too long, the predatory pricing behavior of insurance carriers in our industry forced premium rates below what was reasonable in our state. Now that Texas has developed into a litigation nightmare, these same carriers are raising rates, limiting the geographic areas in which they will write coverage for physicians, or pulling out of Texas altogether.

At TMLT, we are not limiting our coverage offerings by specialty or by geographic area. We are not pulling out of Texas; this is our home. We are raising premium rates to cover our expenses and remain financially sound — not to make a profit; we are reviewing policyholder accounts that show excessive claims or lawsuits because we must continue to serve the interests of all our policyholders; we are maintaining our high level of service in both risk management and claim management, just as we promised.

W. THOMAS COTTEN
President & Chief Executive Officer

In spite of the challenges we faced in 2000, indeed perhaps because of those challenges, TMLT accomplished many of our goals and objectives for the year. Remarkably, in the face of two premium rate increases, our retention rate was 91.1%! This is a real testament to the loyalty of our policyholders and to the success of our efforts to educate physicians on the issues. For those of you who have stuck with us through the rate increases, our heartfelt thanks. No one is happy about

increasing rates but it was a necessary step. The impact of these rate increases can be somewhat offset through good loss experience credits and risk management discounts.

In November 2000, TMLT continued its education and awareness campaign to help inform physicians, organized medicine and the press about the increasing claim frequency and severity issue, the need for medical liability tort reform, and how to help effect change in the system. Our county medical societies and specialty societies were very supportive and helped distribute information to their memberships. But we must do more.

Our financial results, though more positive than last year, are still not where we would like them to be. Increased premium as the result of rate increases partially offset increased claim losses; however, there is much more to accomplish. Substantive medical liability reform did not appear on the agenda of the 2001 Legislature so we must look further down the road to 2003 for hope of legislative relief. In the interim, we must focus our anger and our energies in the right direction. We are battling a formidable plaintiff's bar. Anger at the insurance companies who are in the business of providing medical liability protection is understandable if you've been nonrenewed, your rates have risen dramatically, or your company has left the area leaving you to seek new coverage. We must uncover the source of the problem and repair it rather than treat the symptom.

Our Governing Board, along with the Texas Medical Association, has agreed to form a coalition of interested parties in an effort to mount an all-out assault to achieve medical liability reform in 2003. We must bring together interested parties at the grassroots level. Both the county and specialty medical societies will be key players as the battle lines are drawn. The system is broken and it must be repaired; currently, it neither protects physicians nor their patients.

Our judicial system needs an overhaul and our tort laws need reforming. If no action is taken at the legislative level, we will continue to face unbridled lawsuit abuse and premiums will continue to rise. Medical liability carriers will disappear from the landscape so that choice is limited, physicians may be driven to retirement or to other professions, and where does that leave us? That dynamic and secure future we looked toward in last year's annual report is not yet within view.

As your not-for-profit carrier, TMLT will continue to work for you as your advocate. We will continue to provide cost-effective, value-added services to Texas physicians as efficiently as possible. We remain undaunted in our commitment to our policyholders despite the current state of the Texas medical malpractice environment. For now, we must rely on the trusting relationship we have shared for 21 years. For the future, we must find ways to work together to discover new solutions.

W. Thomas Cotten
President & Chief Executive Officer

Leading the Industry Challenge

Despite higher premium prices, the TMLT marketing department was successful in 2000, meeting both premium and policy count goals. A total of 1,300 new policyholders joined TMLT in 2000, bringing our policyholder count to 10,017. Marketing campaigns were successful with first year physicians, moonlighting physicians, individuals and networks. Quoting activity was up, providing further evidence of a hardening malpractice insurance market. About 18 percent of new issues for 2000 came through outside agents and brokers; the remaining 82 percent were the result of efforts by TMLT's sales staff.

"The success we had in meeting the production goals was phenomenal considering increased premium prices and tighter underwriting," said Don Chow, vice president, marketing. "There is turmoil in the industry. Several companies have pulled out of Texas all together, others have been downgraded by the financial rating services. The competition is raising rates and buyers are shopping and comparing. The market is hardening and there aren't as many choices for physicians. Without exception, every company is suffering. They are losing market share, declining in premium base and altering marketing strategies," said Chow. "Some competing companies are not writing primary care. Some are not writing physicians in certain geographic areas."

" This chaos in the malpractice industry is leading many physicians back to TMLT. They may have originally left us due to price only to go with a company that is now leaving the state, raising rates, or decreasing services. We've seen physicians who are disillusioned with the lack of commitment to Texas that some other carriers are showing. Unfortunately, they have had a bitter taste of 'you get what you pay for,'" said Chow.

TMLT remains committed to Texas, and will continue to write all specialties in all areas of the state. "We will continue to position ourselves. We are still the market leader, still the number one writer of medical malpractice insurance in the state," said Chow.

Another reason for the marketing department's success in 2000 has been TMLT's relationship with organized medicine. "We continued to cultivate our relationships with the county medical societies and specialty societies in order to adapt to the needs of their physicians," said Chow. "By showing our support for these organizations, we are reinforcing our commitment to Texas physicians."

In 2000, activity at Texas Medical Insurance Company, TMLT's wholly owned subsidiary, continued at a steady pace. Policyholders were given the opportunity to purchase other types of coverage through the TMIC/Hartford program, including workers' compensation, general liability, commercial automobile and other types of insurance. "The Hartford program was implemented to offer physicians more choice for other lines of coverage. In previous years, physicians had requested these types of coverage from TMLT so they could consolidate with one company. This is now available," says Jim Goreham, vice president of business development.

Over the next year, the marketing department expects further hardening of the medical malpractice insurance market. "Reinsurers are dictating that companies get tough on pricing and underwriting," said Chow. "The number of competing companies will shrink, but, with the support of our policyholders, TMLT will maintain its position."

DISCOVERING SOLUTIONS

Before a solution can be found to a problem, the problem must be clearly identified. In 1999 and in 2000, claim frequency and severity at TMLT were escalating dramatically. How widespread was this trend? The TMA launched a data study in Spring 2000 with the 3 largest Texas medical liability carriers participating. The results of the data study confirmed that increasing claims frequency and severity was an alarming problem for all 3 carriers writing coverage in Texas. With this knowledge, we could begin developing possible solutions to the problem.

SALES AND MARKETING

TMLT remains committed to Texas, and will continue to write all specialties in all areas of the state. "We will continue to position ourselves. We are still the market leader, still the number one writer of medical malpractice insurance in the state."

DONALD J. CHOW
Vice President, Marketing

A SOLUTION DISCOVERED

James Lind and Scurvy

James Lind, an unassuming naval surgeon, pioneered clinical studies in the treatment of disease. After years of observation and documentation at sea, Lind theorized about the cause and treatment of scurvy and conducted the first scientific, controlled trial in the recorded history of clinical medicine.

Accounts of scurvy have been recorded as far back as 1700 BC. Historically, it occurred in armies during sieges, but it became the "calamity of sailors" with the introduction of long voyages in 1492. Between 1500 and 1800, more seamen died of scurvy than of all other causes combined, including battle, shipwreck, accident and other diseases.

James Lind was born on October 4, 1716, in Edinburgh, and became apprenticed to a physician at age 15. At 23 he joined the British Navy as a ship's surgeon. In 1747, after nine years at sea, he drew upon personal experience to reason that scurvy was mainly caused by a "want of fresh vegetables and greens and ripe fruits." In May and June 1747, while serving as surgeon aboard the HMS *Salisbury*, he conducted his experiment on 12 sailors afflicted with scurvy. All 12 received the same Naval diet, but two sailors received a quart of apple cider a day; two received oil of vitriol; two had vinegar; two drank seawater; two were given doses of nutmeg, garlic, barley water and tamarind (a common remedy for scurvy at the time); two were given one lemon and two oranges daily. The two sailors given the oranges and lemons recovered in six days while the others made no improvement. Lind concluded that the addition of citrus fruits to the rations of every sailor could combat scurvy, "the plague of the seas."

Despite Lind's conclusive results, the British admiralty was unconvinced. Years went by with no action. Lind left the Navy in 1748, and returned to Edinburgh where he earned his medical degree. He published his "A Treatise of the Scurvy," in 1753. In this classic text, Lind gives a detailed description of scurvy, describes his experiments and the causes of the disease, and offers ways to treat and prevent scurvy.

In 1758, Lind was appointed physician to the Royal Navy Hospital at Haslar, Portsmouth, and for 25 years he served as medical chief. During his tenure, he gained the admiration of a small group of naval professional colleagues, but received no honors or public recognition from the Admiralty.

Lind's recommendations were virtually ignored until 1794, when Sir Gilbert Blane, one of Lind's students, arranged for a small group of ships headed for the East Indies to be adequately supplied with lemon juice.

Lind died on July 17, 1794, just as his recommendations were being put into effect in the Royal Navy

Within two years of the general issue of lemon juice to the Navy in 1795, scurvy had virtually disappeared from the British Navy.

Delivering a Difficult Message

In 2000, the underwriting department was charged with two difficult but vital tasks — informing the policyholders about the premium rate increases and re-underwriting all policies at renewal. Both factors would play a part in determining the department's success in 2000.

"We were concerned at the beginning of the year that the rate increases and the underwriting actions would affect the retention rate. The retention rate was affected, but not to the extent that we thought it would be," said Jim Hilscher, vice president, underwriting services.

For 2000, the retention rate, not including those policyholders who left for price reasons, was 91.1 percent. When the retention rate was adjusted to include price and underwriting actions, it was 85.5 percent. Policyholder retention rate has long been a key measure of success at TMLT.

"The 85.5 percent is another indication of the loyalty of our policyholders. They did not like the rate increase, but wanted to stay with TMLT," said John Alexander, assistant vice president, underwriting services.

DISCOVERING SOLUTIONS

The financial impact of increasing claims frequency and severity in 2000 was sobering for many companies. Our short term solution — raising premium rates — would help keep the company financially sound and allow us to continue providing a full range of services, including unmatched claim service, to our policyholders. To help ease the news and explain the problem, TMLT launched an information campaign, TMLT 2000, informing renewing policyholders why the rate increase was necessary, providing important background information, and suggesting steps physicians could take to help solve the claims frequency and severity problem.

Delivering the message of increasing premiums proved challenging for the underwriting staff.

"We had a bitter pill to deliver, but we found that most of our physicians had come to terms with the rate increase. They did not like it, but they understood the reasons behind it," said Alexander.

The re-underwriting process begun in 1999 continued in 2000. This process increased the underwriting department's workload significantly."Everyone followed more rigid standards. We all had more files to review and more reports to read," said Hilscher.

Underwriting actions resulted in the loss of 369 policyholders, or 4 percent of the total policyholder base."These physicians were either non-renewed/cancelled or didn't accept our offer of lower limits of liability or other conditions," says Hilscher.

Throughout the re-underwriting process, underwriting staff worked closely with the Underwriting Review Committee (URC) to determine what actions would be taken. "In the beginning, it was difficult for our staff to apply tighter underwriting standards and seemingly even more difficult for the physicians on the committee," said Hilscher. "However, throughout the year the URC was supportive of the underwriting actions that were taken."

In addition to the rate increases and re-underwriting process, the department also had to contend with competitive issues. "Early in the year, there were still companies whose underwriting practices were not as strict as ours who would write at a lower price," said Hilscher. "We had to keep our underwriting standards high. We remained firmly committed to our objective, even if it meant losing accounts or failing to secure desirable new accounts."

The underwriting department excelled in another important area in 2000 — customer service. The department processed more than 94 percent of new business within 10 working days and 92 percent of existing policies at least 30 days prior to renewal.

"These results represent a major achievement, especially this year, due to the extra time and effort devoted to the re-underwriting process," said Hilscher.

Next year, the department will continue the re-underwriting process, applying the same criteria used in 2000. Policyholder retention and customer service will remain a top priority.

UNDERWRITING SERVICES

Delivering the message of increasing premiums proved challenging for the underwriting staff. "We had a bitter pill to deliver, but we discovered that most of our physicians had come to terms with the rate increase. They did not like it, but they understood the reasons behind it."

JIM HILSCHER
Vice President, Underwriting Services

A SOLUTION DISCOVERED

Sir James Young Simpson and Anesthesiology

When James Young Simpson, one of Scotland's leading surgeons and obstetricians, began using ether as an analgesic to relieve labor pains, and later introduced chloroform as an anesthetic agent, he helped to revolutionize the practice of both obstetrics and anesthesia.

James Young Simpson was born in Bathgate, Scotland, on June 7, 1811. He obtained his MD from the University of Edinburgh in 1832, and went on to specialize in obstetrics. He was appointed Professor of Midwifery in Edinburgh at the age of 30. Simpson made enormous contributions to his specialty, publishing an impressive number of articles covering the entire field of obstetrics. Simpson was a popular lecturer and maintained a growing private practice that included many members of the aristocracy.

Excited by the use of ether for surgical anesthesia, Simpson began using it in his own practice in December 1846. Initially, he used it as an anesthetic for surgical interventions during delivery, but later as an analgesic during normal labor. However, Simpson quickly became dissatisfied with ether because of its long induction time and flammability, and he began the search for a better anesthetic agent. Simpson experimented with many substances, including acetone, benzene, and benzoin, either inhaling them himself or observing their effects on colleagues and students. Eventually, a Liverpool chemist, David Waldie, suggested that Simpson try chloroform. On November 4, 1847, Simpson, his assistants, Dr. Matthews Duncan and Dr. George Keith, and his niece, Miss Petrie, chloroformed themselves at the dining room table.

Six days later, Simpson presented a paper to the Medico-Chirurgical Society of Scotland, reporting his discovery and introducing chloroform into clinical practice. On November 15th he administered chloroform successfully in three operations at the Royal Infirmary of Edinburgh. Within a few weeks, Simpson had used chloroform in more than 50 cases of labor. Through the use of pamphlets and reports in medical journals, Simpson obtained tremendous publicity for the use of chloroform.

Chloroform soon became the most popular anesthetic agent in the United Kingdom, but many physicians, members of the clergy and moralists attacked Simpson for his use of chloroform to relieve pain in childbirth. They argued that removing the pain of labor went against divine law, basing their beliefs on Genesis chapter 3 verse 16; "Unto the woman, he said, I will greatly multiply that sorrow and thy conception, in sorrow thou shalt bring forth children."

Simpson answered his critics on theological grounds. He studied Hebrew texts and concluded that the word translated as "sorrow" was really the word for labor or toil rather than pain. Simpson further argued that God established anesthesia when he caused a deep sleep to fall on Adam before removing his rib. Simpson won the battle of words with his opponents, and the humanitarian argument for anesthesia eventually prevailed. When Dr. John Snow administered chloroform to Queen Victoria in 1853 during the birth of her eighth child, the issue was settled.

As a result of his contributions, Simpson received many honors. He was knighted, appointed Physician in Scotland to the Queen, and awarded an honorary doctorate from Oxford University. When he died in 1870, academic and commercial activities in Scotland were suspended to accommodate one of the largest funerals ever for a Scottish physician.

Our Steadfast Commitment to the Best Defense

Record increases in claim frequency, claim severity and trial activity continued to plague the claim department in 2000. The department closed 3,090 claims, but took in 3,022 new claims. The average paid claim remained at $180,000 after running from $140,000-160,000 from '91-'98. Claims closed without indemnity remained high at 86.6 percent.

Also in 2000, the claim department took more cases to trial than in any year in TMLT history, ending the year with 77 trial victories and 20 losses.

"Our biggest challenge in 2000 was the deteriorating claim environment. We saw continued high frequency and escalating severity. We dealt with cases with significant exposure every day," said Bob Fields, executive vice president of claim operations.

"For further evidence of the problem, look at the total claim payout over the last few years," said Fields. "In 1998, the total claim payout was $78 million. In 1999, it was $90 million. In 2000, it was $100 million. In 2001, we predict it will be between $110-120 million."

Increased activity in the area of mass litigation served as another warning sign of a worsening claim environment. "We have closed about 800 Fen-phen lawsuits, which is about half of the total number filed. Of the 1,550 breast implant cases, we have closed 1,400," said Fields. "However, new cases from Propulsid and Rezulin are on the way. Mass litigation continues to be a serious problem."

DISCOVERING SOLUTIONS

Rampant lawsuit abuse has branded Texas as one of the most litigious states in the nation. Since 1990, over 80% of TMLT cases taken to trial have been judged nonmeritorious. We urge physicians and others in the medical community to become involved in organizations like Citizens Against Lawsuit Abuse (CALA). These organizations are working to inform the public about the injustices in the civil justice system and the consequences of abuse.

Claim staff attributes the declining claim environment in part to negative media attention on physicians, hospitals and nursing homes, and public dissatisfaction with managed care.

"The public is bombarded with negative information about physicians on TV, in the movies, and in newspapers. The media are biased against hospitals and doctors and this is leading to more lawsuits and higher damage awards," said Jill McLain, assistant vice president of claim operations.

"Managed care also fosters problems in communication and follow-up by disrupting the doctor-patient relationship," said Sue Mills, assistant vice president of claim operations. "There is evidence of public dissatisfaction with the system, and juries come to the jury box with this mindset."

In addition to the deteriorating claim environment, claim staff continued to see specific problems in the cases filed.

"Medical records continue to be a problem because of inadequate charting, failure to follow up, and failure to communicate," said McLain. "Another problem we see is physicians testifying against one other and unreasonably expanding the standard of care. These are all recipes for trouble."

Finally, Fields noted that doctors are frequently selecting plaintiff's attorneys to represent them as personal attorneys in their malpractice suits. These personal plaintiff attorneys tend to cooperate more with their fellow plaintiff attorneys instead of the doctor's defense attorneys and hinder TMLT's efforts to defend the physicians. "In many cases, we experience real cooperation problems from these attorneys representing doctors...problems for which the insured physician is responsible," said Fields.

Through all the increases in claim activity for 2000, the department remained committed to TMLT's philosophy of vigorously defending physicians. "We continued and will continue to defend claims. Other companies may tend to settle more when things get tough, but we believe you must be willing to go to trial," said Fields. "This puts more pressure on the decision-making. We have to forecast what juries hundreds of miles away will do. To be successful, we must be able to expect justice in the courtroom."

While remaining committed to policyholder defense, the department is also focused on seeking permanent solutions to the problem of increased malpractice activity. In the coming year, TMLT will work with organized medicine and lawsuit abuse groups to help discover solutions to the problems of increasing claim frequency and severity.

CLAIM OPERATIONS

"Our biggest challenge in 2000 was the deteriorating claim environment. We are seeing continued high frequency and escalating severity. We dealt with cases with significant exposure every day."

BOB FIELDS

Executive Vice President, Claim Operations

A SOLUTION DISCOVERED

Lady Mary Wortley Montagu and Variolation

One of many early inoculation advocates living in the pre-Jennerian era, Lady Mary Wortley Montagu is usually credited with the introduction of variolation into England. The wife of a British ambassador to Turkey, she brought the "heathen custom" of variolation into fashionable practice among the English aristocracy.

Variolation is the process of taking the exudate from the lesion of an infected person and transferring the material to an uninfected person either by ingestion or by scratching the material onto the skin. It has a long and colorful history, dating back to 590 BC. The Chinese practiced variolation by placing bamboo splinters dipped in infectious exudate into the nasal passages of uninfected individuals. The practice was modified in later years by using smallpox scabs. By the 16th and 17th century, variolation was practiced in India, Asia and Africa. In 1718 when Montagu visited Turkey, the practice was widespread.

Montagu was born May 26, 1689, in London, daughter of the 5th Earl of Kingston and Lady Mary Fielding. She had not studied medicine, but was well known for her beauty, wit and poetry. She eloped with Edward Wortley Montague, a Whig member of Parliament, in 1712. The Whigs came to power in 1714, and in 1716, Montagu's husband was appointed ambassador to Turkey.

While in living in Turkey, Montagu became intrigued by the custom of variolation. (She had suffered from smallpox herself in 1714, and had also lost a brother to the disease.) In her letters to friends in England, she described the practice in great detail. To show her faith in the procedure, she had it performed on her 6-year-old son. With the ambassador's physician, Charles Maitland, and embassy surgeon, Emanuel Timoni, present, Edward was variolated by an old woman with a "blundt and rusty needle."

Three years after Montagu returned to England, a smallpox epidemic swept the country. Montagu insisted on having her 4-year-old daughter variolated, and summoned Maitland from his country practice. Maitland agreed to perform the procedure, but only with official medical witnesses present to observe. One of the witnesses, Dr. James Keith, was so impressed, he begged Maitland to inoculate his only surviving son (all the others died of smallpox). Both children did well, and Montagu's daughter was observed not only by physicians, but by the upper-class friends of her mother. Many of these parents had their children variolated without waiting for any further experiment.

As news of variolation spread, so did the controversy. Physicians and clergymen published pamphlets denouncing the practice, and Montagu herself published "A Plain Account of the Inoculating of the Small Pox" in response. Amid the debate, Princess Caroline, who wanted to have her own children variolated, convinced George I to set up a public experiment. Six prisoners in Newgate Prison were offered a full pardon in return for allowing themselves to be variolated. Again, Maitland performed the procedure, this time with government and medical witnesses present. The prisoners had a mild attack of smallpox and then made a full recovery.

Public debate on the issue continued, but variolation spread among the upper classes and the more "scientifically-minded" members of society. Although these early inoculation efforts probably had little impact on the overall incidence of smallpox, variolation helped pave the way for the rapid acceptance of Jenner and the widespread use of vaccination.

Risk Management at Work

The TMLT risk management department worked with more than 4,000 physicians through its programs in 2000. Physicians from all over Texas learned how to reduce their chances of becoming involved in a malpractice claim through CME seminars, online CME courses and practice reviews.

Risk management staff completed 544 practice reviews for 1,196 physicians in 2000. The practice review, which is the most comprehensive risk management tool offered by TMLT, involves an office visit by a TMLT risk management professional to determine a practice's specific risk exposures. In 2000, the most frequent practice review recommendations involved medical records, follow-up, patient procedures, medication administration and informed consent.

In addition to educating physicians, the practice review also serves as an educational tool for TMLT's risk management department. Risk management staff collect information about the types of recommendations made to determine the overall risk management needs of TMLT policyholders. This allows the department to customize programs to meet policyholders' specific needs. As a result of the 2000 data, the risk management department will be working with the claim department in 2001 to develop a medical records tool.

DISCOVERING SOLUTIONS

In a climate of increasing claims frequency and severity, it is more important than ever for physicians to embrace risk management principles. At TMLT, we believe claims and lawsuits arising because of medication errors, poorly documented medical records, inadequate communication with patients, and inadequate communication with other treating physicians may be reduced when good risk management practices are consistently applied in the medical practice. We offer seminars, practice reviews, personal consultations, and publications to help physicians decrease the likelihood of being involved in a claim or lawsuit.

Participation in risk management CME programs also increased in 2000. A total of 3,564 physicians attended risk management CME programs, including 2,813 physicians who attended the TMLT/TMA programs. "Approximately half of the attendees at the joint TMA programs were not policyholders, giving us an excellent opportunity to market our services," said Jane Mueller, director, risk management.

CME programs were also presented for family physicians in 11 locations through a joint program with the Texas Academy of Family Physicians.

Also in 2000, risk management staff developed a new online study course for physicians. "Medical Records Handbook for the Physicians Office" was added to the TMLT web site in the spring. A total of 274 physicians completed online courses in 2000.

In addition to seminars and practice reviews, risk management staff were also available for phone consultations with policyholders. In 2000, 2,614 phone consultations occurred. The department also developed a list of frequently asked risk management questions for use on the TMLT web site to further assist policyholders.

TMLT risk management publications were enhanced and revised in 2000. The department introduced a new publication, the Specialty Reporter. Based on the TMLT newsletter, the Reporter, the Specialty Reporter contains specialty-specific articles, such as closed claim studies and closed claim statistics. In 2000, three editions of the Specialty Reporter were produced and distributed to pediatricians, anesthesiologists and internal medicine physicians. Nine editions of the Specialty Reporter are planned for 2001.

As the risk management department continues to expand its products and services to physicians, staying informed about the latest developments in both medicine and law is one of the most difficult aspects of risk management.

"The greatest challenge for the department is trying to stay current on all the medical/legal issues. We must keep up with all the legislative and legal changes, state and federal issues to provide that information to policyholders," said Mueller. "We read journals, publications and conduct research online. We must keep up with all this information in order to better serve physicians."

RISK MANAGEMENT

"The greatest challenge for the department is trying to stay current on all the medical/legal issues. We must keep up with all the legislative and legal changes, state and federal issues to provide that information to our policyholders."

A SOLUTION DISCOVERED

Gerhard Domagk and Sulpha Drugs

When Gerhard Domagk presented his paper entitled "A Contribution to the Chemotherapy of Bacterial Infections" in 1935, he ushered in a new era in the control of bacterial infections.

Born in Lagow, October 30, 1895, Domagk studied medicine at Kiel University. He worked at the University of Griefswald and the Pathological Institute at Munster before becoming research director at a prominent dye manufacturing company, I.G. Farbenindustries.

Inspired by the work of Paul Ehrlich, who discovered chemical remedies for some protozoan and parasitic infections, Domagk spent five years investigated thousands of chemical dyes (his firm's main products were azo dyes used for textiles) to see if they had any negative effect on bacteria. In 1932 he found that a red leather dye cured mice that had been injected with a lethal dose of haemolytic streptococci. The dye, developed by others at his company, was called Prontosil Rubrum. Shortly after his discovery, I.G. Farbenindustries began clinical testing of Prontosil Rubrum, but Domagk delayed publishing the results of his research for three years. During this time, his daughter contracted a streptococcal infection from a needle prick and failed to respond to traditional treatment. Domagk injected her with Prontosil Rubrum and she made a full recovery.

Domagk's report, "A Contribution to the Chemotherapy of Bacterial Infections" was published in 1935, and his work was soon replicated in laboratories across Europe. Researchers at the Pasteur Institute found Prontosil worked when the compound split into two parts in the body. One of the two parts, later called sulphanilamide, was largely responsible for Prontosil's bacteriostatic action.

Since the drug could not be patented (Prontosil was basically sulphonamide, which had been synthesized in 1907), it became widely available. More than 5,000 derivatives were synthesized and tested, but less than 20 clinically useful compounds were found. Over the next several years, sulpha drugs were used to treat puerperal fever, streptococcal infections, meningitis, blood poisoning, and gonorrhea, saving thousands of lives in the late 30s and early 40s.

Domagk was awarded the 1939 Nobel Prize in Physiology or Medicine "for the discovery of the antibacterial effects of Prontosil," but he had to decline the prize in a letter drafted for him by the German authorities. Hitler had forbidden any German to accept a Nobel Prize. He finally received the Nobel medal in 1947.

By the end of the World War II, sulpha drugs were considered obsolete. Several strains of sulpha-resistant streptococci had developed and Domagk warned that the same would follow the use of penicillin unless researchers learned to appreciate the factors that led to the development and spread of resistant strains.

Nevertheless, sulpha drugs represented a major step in the control of bacterial diseases. Alexander Fleming later recalled that neither bacteriologists nor physicians paid any attention to penicillin until the introduction of sulphonamide changed attitudes about the possibilities of chemotherapy for the treatment of bacterial infections.

A Comprehensive Report

RAY DEMEL
Vice President, Chief Financial Officer

The following financial statements detail TMLT's financial position for 2000, and clearly demonstrate the continuing impact of rising claim activity.

Fiscal year 2000 was a very challenging one for TMLT and the entire medical malpractice sector. However, TMLT is pleased with the financial progress made in 2000. Due to TMLT's re-underwriting and premium pricing efforts, written premium increased to $101 million in 2000. This is up from $83 million in 1999. Although written premium increased, TMLT experienced higher claim and legal costs. Liabilities increased by $8 million, total assets remained the same and surplus decreased by $7.63 million. Investment income remained constant at $13 million, while claim expense increased by $4 million. This resulted in a pre-tax net loss of $10.3 million.

Claims expense increased dramatically during the year, and resulted in cash payments in excess of $100 million in indemnity and expense payments (a record high amount for TMLT). These cash expenditures required the liquidation of invested assets. The declining interest rate environment actually caused the market value of TMLT bond investments to increase by $5.8 million. Capital gains of $1.5 million were taken on the sale of equities and the funds from the sale were reinvested in the stock market. However, as a result of the market meltdown at the end of 2000, TMLT ended the year with a $1.2 million unrealized loss in the stock portfolio. Operating expenses remained steady at $14 million.

While we are currently operating in challenging market conditions, TMLT remains financially strong. We are committed to identifying the causes for the increase in claim frequency and severity, and taking corrective action. We are confident that TMLT will grow and prosper in the future. Our employees and Board of Governors are dedicated to the continued success of TMLT.

CONTENTS

CONSOLIDATED BALANCE SHEET

	December 31 2000	1999
	(In Thousands)	
Assets		
Securities, available-for-sale, at fair value:		
Fixed-maturity securities	**$184,444**	$189,563
Common stocks	**21,482**	25,970
Cash and cash equivalents	**12,472**	8,643
Premiums receivable	**32,501**	24,919
Accrued interest receivable	**2,505**	2,380
Reinsurance recoverables:		
On paid losses	**2,864**	3,890
On unpaid losses and loss adjustment expenses	**26,202**	25,968
Prepaid reinsurance premiums	**5,935**	4,865
Refundable federal income taxes	**-**	2,750
Deferred tax asset	**10,294**	7,299
Cash surrender value of key man life insurance	**2,588**	4,374
Other	**6,244**	6,586
Total assets	**$307,531**	$307,207

	December 31 2000	1999
	(In Thousands)	
Liabilities and policyholders' surplus		
Liabilities:		
Reserves:		
Unpaid losses and loss adjustment expenses	**$170,510**	$172,292
Unearned premiums	**48,211**	38,417
	218,721	210,709
Premiums received in advance	**2,934**	2,777
Accounts payable and accrued expenses	**5,296**	4,569
Reinsurance premiums payable	**14,921**	15,866
Total liabilities	**241,872**	233,921
Policyholders' surplus:		
Contributed surplus	**10,538**	10,516
Surplus contributions receivable	**1**	2
	10,539	10,518
Accumulated other comprehensive loss	**(353)**	(104)
Unassigned surplus	**55,473**	62,872
Total policyholders' surplus	**65,659**	73,286
Total liabilities and policyholders' surplus	**$307,531**	$307,207

See accompanying notes.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31	
	2000	**1999**
	(In Thousands)	
Premiums earned, net of reinsurance	**$77,327**	$69,791
Investment income, net of investment expenses of $392 in 2000 and $347 in 1999	**13,461**	13,279
Net realized gains	**1,528**	1,157
Other revenue	**1,513**	1,213
Total revenues	**93,829**	85,440
Losses and expenses:		
Losses and loss adjustment expenses	**89,081**	85,518
Other underwriting expenses	**15,030**	14,130
Total operating expenses	**104,111**	99,648
Loss income before income taxes	**(10,282)**	(14,208)
Income tax benefit	**(2,883)**	(2,690)
Net loss	**$ (7,399)**	$ (11,518)

See accompanying notes.

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 December 31, 1998	$14,514	$74,390	$ 5,707	$94,611	-
Other comprehensive income	-	-	(5,811)	(5,811)	$(5,811)
Return of contributed surplus, net	(3,996)	-	-	(3,996)	-
Net loss	-	(11,518)	-	(11,518)	(11,518)
Balances at December 31, 1999	10,518	62,872	(104)	73,286	(17,329)
Other comprehensive income	-	-	**(249)**	**(249)**	**$(249)**
Contributed surplus, net	**21**	**-**	**-**	**21**	**-**
Net loss	**-**	**(7,399)**	**-**	**(7,399)**	**(7,399)**
Balances at December 31, 2000	**$10,539**	**$55,473**	**$(353)**	**$65,659**	**$(7,648)**

See accompanying notes.

	Year ended December 31	
	2000	**1999**
	(In Thousands)	
Operating activities		
Net loss	**$(7,399)**	$(11,518)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	**511**	930
Net (accretion) amortization on securities	**(150)**	137
Deferred income taxes	**(3,244)**	1,092
Net realized gains	**(1,528)**	(1,157)
Change in operating assets and liabilities:		
Premiums receivable	**(7,582)**	(588)
Reinsurance recoverables	**792**	4,128
Reserves	**(1,782)**	(217)
Reinsurance premium balances	**(945)**	(4,534)
Refundable income taxes	**2,750**	(1,348)
Other	**9,606**	1,201
Net cash used in operating activities	**(8,971)**	(11,874)
Investing activities		
Purchases of securities	**(51,938)**	(199,191)
Proceeds from disposals and maturities of securities	**63,223**	212,057
Purchases of furniture and equipment	**(292)**	(123)
(Increase) decrease in key man life insurance	**1,786**	(130)
Net cash provided by investing activities	**12,779**	12,613
Financing activity		
Net surplus contributions (refunds)	**21**	(3,996)
Cash provided by (used in) financing activity	**21**	(3,996)
Change in cash and cash equivalents	**3,829**	(3,257)
Cash and cash equivalents at beginning of year	**8,643**	11,900
Cash and cash equivalents at end of year	**$12,472**	$8,643

See accompanying notes.

(Amounts In Thousands)

1. Organization and Accounting Policies

Organization

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.

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.

(Amounts In Thousands)

Unpaid losses and loss adjustment expenses have been discounted using a 4% factor. The discount amount was approximately $10,000 and $11,000 at December 31, 2000 and 1999, 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, 2000.

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 $292 and $92 at December 31, 2000 and 1999, 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) and are classified as a separate component of policyholders' surplus.

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.

(Amounts In Thousands)

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.

2. 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	
	2000	**1999**
	(In Thousands)	
Unrealized losses on available-for-sale securities	**$(3,365)**	$(7,161)
Reclassification adjustment for realized gains (losses) in net income	**2,919**	(1,572)
Income tax benefit	**(197)**	2,922
Other comprehensive loss	**$(249)**	$(5,811)

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 $(182) and $(35) for the years ended December 31, 2000 and 1999, respectively.

(Amounts In Thousands)

3. 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, 2000:				
U.S. government and its agencies	**$11,487**	**$268**	**$156**	**$11,598**
States, political subdivisions and countries	**-**	**-**	**-**	**-**
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**
At December 31, 1999:				
U.S. government and its agencies	$ 10,024	$ -	$ 564	$ 9,460
States, political subdivisions and countries	2,997	-	57	2,940
Corporations	81,140	114	2,774	78,480
Loan-backed securities and collateralized mortgage obligations	100,586	235	2,138	98,683
	$194,747	$ 349	$5,533	$189,563

At December 31, the Trust's investment in common stocks had a cost basis of $22,813 and $20,943 in 2000 and 1999, respectively. Gross unrealized gains and gross unrealized losses were $2,323 and $3,537 respectively in 2000 and, $6,131 and $1,104, respectively in 1999.

The fair values generally represent quoted market value prices for securities traded in the public marketplace or analytically determined values 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, 2000 are summarized, by stated maturity, as follows:

	Amortized Cost	Estimated Fair Value
Years to maturity:		
One or less	$995	$994
After one through five	43,175	43,511
After five through ten	50,320	50,139
After ten	5,267	5,253
Loan-backed securities and collateralized mortgage obligations	84,007	84,547
Total	$183,764	$184,444

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 $51,021 in 2000 and $211,603 in 1999. Gross realized gains and gross realized losses on these sales were $5,221 and $3,693, respectively, during 2000, and $2,189 and $972, respectively, during 1999.

(Amounts In Thousands)

4. 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 2000 and 1999:

	Year ended December 31	
	2000	**1999**
Reserve for unpaid losses and LAE, net of related reinsurance recoverables at beginning of year	**$146,324**	$139,502
Add provision for claims, net of reinsurance, occurring in:		
Current year	**79,645**	72,341
Prior years	**6,533**	12,167
Accrection of discount on prior years	**2,903**	1,010
Incurred losses during the current year, net of reinsurance	**89,081**	85,518
Deduct payments for claims, net of reinsurance, occurring in:		
Current year	**745**	374
Prior years	**90,352**	78,322
	91,097	78,696
Reserve for losses and LAE, net of related reinsurance recoverables, at end of year	**144,308**	146,324
Reinsurance recoverables on unpaid losses and LAE, at end of year	**26,202**	25,968
Reserve for unpaid losses and LAE, gross of reinsurance recoverables on unpaid losses, at end of year	**$170,510**	$172,292

The foregoing reconciliation shows that the Trust's reserve for unpaid losses and LAE, net of related reinsurance recoverable, at December 31, 2000 and 1999, was increased by $6,533 and $12,167 for claims that had occurred on or prior to 1999 and 1998, respectively. During 1999, 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 $6,533 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.

(Amounts In Thousands)

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 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.

5. 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 effect of reinsurance on premiums written and earned are as follows:

	2000 Premiums		**1999 Premiums**	
	Written	**Earned**	**Written**	**Earned**
Direct	**$101,050**	**$90,769**	$83,378	$81,645
Ceded	**13,930**	**13,906**	11,899	11,854
Net premiums	**$87,121**	**$76,862**	$71,479	$69,791

The amounts deducted from losses and loss adjustment expenses in the income statements that relate to reinsurance were $13,871 for 2000 and $16,034 for 1999.

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.

(Amounts In Thousands)

6. Federal Income Taxes

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

	2000	1999
Current expense (benefit)	**$(17)**	$(3,782)
Deferred expense (benefit), including ($4,737) and ($2,246) of benefit from operating loss carryforwards at 2000 and 1999, respectively	**(2,866)**	1,092
	$(2,883)	$(2,690)

The Trust received income tax refunds of $2,795 during 2000. No income tax refunds were received or taxes paid in 1999.

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

	2000	1999
Deferred tax assets:		
Loss reserve discounting	**$3,564**	$5,422
Unearned premium discounting	**2,947**	2,283
Net operating losses	**6,983**	2,246
Other	**678**	538
Total deferred tax assets	**14,172**	10,489
Valuation allowance for deferred tax assets	**(3,495)**	(2,750)
Total deferred tax assets, net of allowance	**10,677**	7,739
Deferred tax liabilities:		
Unearned revenue and other	**(383)**	(440)
Total deferred tax liabilities	**(383)**	(440)
Net deferred tax asset	**$10,294**	$7,299

Under the 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, 2000, the Trust established a $3,495 valuation allowance for the deferred tax asset, a $745 increase from December 31, 1999. Management believes that is is more likely than not that the net deferred tax asset recorded at December 31, 2000 will be realized from expected future taxable income.

At December 31, 2000, the Trust has taxable net operating loss carryforwards of $11.5 million and $9.0 million (which expire in 2019 and 2020, respectively) 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 2000 and 1999 resulted primarily from the effects of tax-exempt interest and changes in the valuation allowance.

(Amounts In Thousands)

7. 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.

During 1999, the Board of Directors authorized the return of 15% of policyholders' surplus deposits for those policyholders who met their surplus requirements as of December 31, 1998. No such return was made in 2000.

8. Commitments and Contingencies

The Trust leases office facilities and certain equipment through agreements which expire through 2004. As of December 31, 2000, the future minimum lease payments under these agreements for the years ending December 31 are as follows:

2001	$747
2002	747
2003	747
2004	652
2005	–
Thereafter	–
Total	$2,893

Total rent expense was $1,208 for 2000 and $1,321 for 1999.

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.

9. 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 participants' salaries. Such contributions are reduced by forfeitures of participants who leave the Plan before they become fully vested. Plan expense was $980 for 2000 and $954 for 1999.

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Texas Medical Liability Trust and Subsidiary

We have audited the accompanying consolidated balance sheets of Texas Medical Liability Trust and subsidiary as of December 31, 2000 and 1999, and the related consolidated statements of operations, changes in policyholders' surplus and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 audits provide a reasonable basis for our opinion.

In our opinion, the 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, 2000 and 1999, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

March 28, 2001

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TMLT is the only health care liability claim trust created and endorsed by Texas Medical Association.

Endorsed by:
The Texas Academy of Family Physicians
Bexar County Medical Society
Dallas County Medical Society
Harris County Medical Society
Tarrant County Medical Society
Travis County Medical Society

Gold Corporate Affiliate of the Texas Medical Group Management Association

Rated A- Excellent by A.M. Best Company

Thank you!

2000 TMLT employees

Alba Brandon
Angela Campbell
Anita Marx
April Galvan
Barbara Chelli
Barbara DeBeaudry
Barbara Rose
Becky Ridings
Becky Stewart
Bob Fields
Brenda Marsh
Brian Dittmar
Brittney Clarkson
Carlos Martinez
Carol Bowser
Carol Nauert
Carol Plassman
Carol Wallace
Cecile Knight
Charlene Janecek
Chris Adams
Chris Nanez
Christene Baker
Christie Zarria
Cindy Elstad
Cindy Garza
Cindy Hixenbaugh
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David Strickland
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Jaime Browning
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Jayel Moreno
Jean Lisenbee
Jennifer Sheppard
Jesse Aguilar
Jignasha Amin
Jill McLain
Jim Goreham
Jim Hilscher
Joan Paone
JoAnne Barton
John Alexander
John Devin
Julie Gibson
Kathy Phillips
Kathy Schulz-Behrend
Kellie Craft
Kerri Prince
Kristal Chester
Kristie Wainwright
Kristina Holt
Kristy Wymore
Kyle Broom
Laura Camacho
Laura Hale
Laurel Schlie
Lesley Lopez
Leslie Harris
Letty Aguirre
Lisa Hanson
Lou Pantermuehl
Lynn Frazier
Lynne Dakers
Madra Mays
Marc Clint
Margaret Lown
Maria Birmingham
Maria Zanella
Marshall Wyatt
Martha Knetsar
Mary Mager
Mary Gonzales
Maryann Esparza
Michael Moya
Michael Murphy
Michele Luckie
Michele Reid
Michelle Alvarez
Michelle Jennings
Misty Villanueva
Mysti Pride
Natalie Gilmore
Nicole Gonzales
Pat Murray
Patty Robledo
Patty Spann
Paula Thomas
Randy Pollok
Ray Demel
Ray Godine
Rebecca Deones
Rhonda Kruise
Rhonda Pastrano
Robbie Michael
Robin Bowles
Robin Logan
Rodney Stephens
Ron Massey
Sabrina Cagle
Sandra Mascorro
Sandye Hayden
Scott Berglund
Scott Grissom
Sean McDaniel
Shanna Homann
Shannon Quinn
Shelly Dominguez
Sherry Montez
Shirley Kuykendall
Stacey Agnew
Steve Hampton
Sue Mills
Sylvia Meier
Teresa Canant-Finch
Terry Garza
Theo van Eeten
Tom Borel
Tom Cotten
Tom Mohler
Treg Russell
Viola Zimmerman
Wanda Wilson
Wendy Sanchez
Yvonne Johnston
Yvonne Taylor

Our Vision

TMLT is the most respected and preferred provider of medical professional liability coverage and related products in Texas. Through the efforts of our team of qualified professionals and physician insureds, we sustain TMLT's premier position in quality of coverage, service, market share and financial integrity.

Our Mission

Our mission is to be on the leading edge of industry change to provide a standard of coverage and service to our policyholders by which all others are compared.

Our Purpose

Our purpose is to make a positive impact on the quality of health care for Texans by educating, protecting and defending physicians. We provide peace of mind to our policyholders and a supportive work environment for our team members.