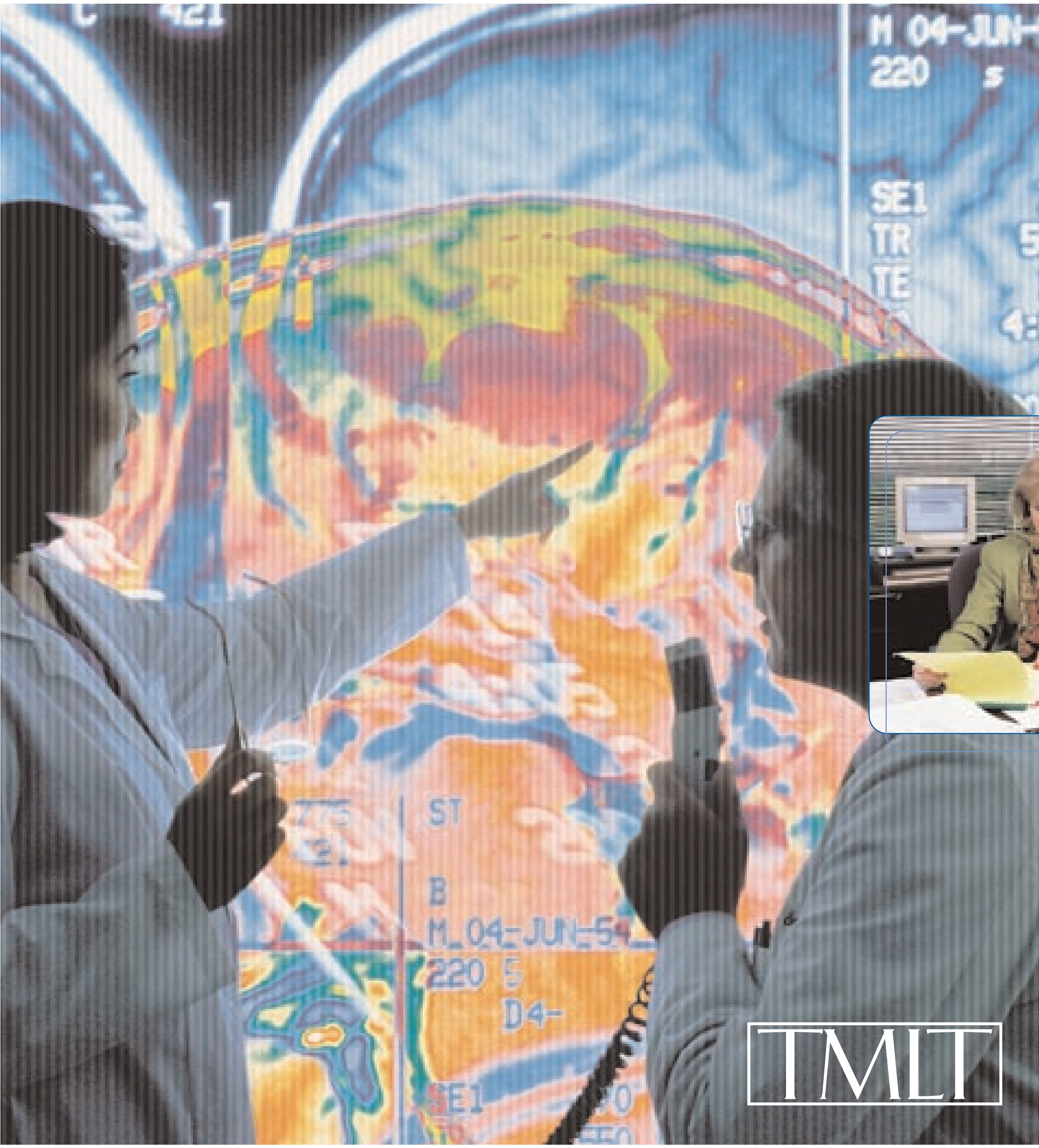
annual report

Texas Medical Liability Trust

Proactive Foundation - Interactive Future

TMLT

annual report



Texas Medical Liability Trust

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.

Past Service and Future Promise

TODAY, THE TEXAS MEDICAL LIABILITY TRUST insures more Texas physicians than any other carrier. I believe that says a lot about how well we have served the needs of physicians over the years, and how we have continually worked to improve the coverage and service we provide. As we have grown – and this organization has seen extraordinary growth – we have not lost sight of our foundation, service to Texas physicians. Every member of the staff at TMLT is dedicated to safeguarding the professional reputations of those practicing medicine in this state.

In 1998, we combined the experience and expertise of twenty years with new technology and new services, improving upon an already outstanding organization. We continued to grow, to improve, and to increase the value of our coverage. The rating received from A.M. Best is one indication of that value, especially significant in that the firm rarely rates a liability trust. Of course, TMLT is not just any liability trust.

One of the most important aspects of our organization is the critical nature of claims management to our insureds. Claims management is the bedrock of any liability claims carrier. At TMLT, we have an experienced and dedicated claims staff and sound policies guiding that staff. The TMLT claims professionals communicate with their physicians. They carefully analyze the legal issues and merits of each claim, advise the insured, and are personally involved in claims that go to mediation or trial. Each year, this service and dedication results in more than 80 percent of claims closed without payment of indemnity.

Claims service formed the basis for TMLT's successes in 1998, but there is more to the story. We improved on our core services, and added new ones. For example, the risk management staff made presentations around the state, teaching physicians better risk management practices and allowing them to earn CME credits, as well as premium discounts. As a physician, I know the value of such education and information. And, in fact, physicians from a wide variety of specialties all over the state took advantage of these presentations.

On-site risk management reviews were also in high demand throughout 1998. TMLT created a web site to provide information to physicians on medical developments, regulatory activities and news of the organization. Through the web site, physicians can take credit courses and home study courses as well. These are only a few examples of the types of services we provide and the innovations we have become known for.

One of the hallmarks of this organization has always been that a policyholder gets much more than insurance coverage. In 1998, we continued to make every effort to go the extra mile with our policyholders, to provide additional service and value. For example, every policyholder now receives Medefense, additional coverage at no extra cost for legal assistance against charges of fraud or abuse, or in cases of disciplinary proceedings. Also, the organization continues to work closely with the Texas Medical Association to address relentless increases in medical litigation and the need for additional tort reform.

During the past year, the Board and TMLT put new technology in place to prepare to better meet the needs of physicians today and tomorrow. This report details many of the uses of that technology, including expanded use of computers for claims management and policy renewal, an e-mail system for efficient and convenient communication, and increased Internet access. Many physicians have seen the value of these technological tools in their own practices, and in their dealings with TMLT.

In a profession where every fourth physician will be subject to a malpractice claim in any given year, it matters where your protection comes from. TMLT is a not-for-profit Trust founded and governed by Texas physicians. We work for you. In 1998, as for the past twenty years, that work meant greater success for both of us.

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

1998 Board of Governors

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

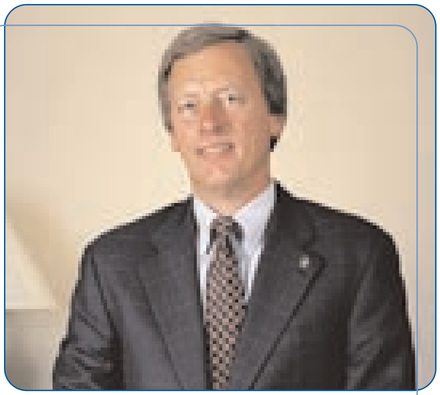
president's message

Building on a Firm Foundation

DURING THE PAST TWENTY YEARS, the medical professional liability landscape has been continually reshaped by the challenges facing the Texas medical community. In this dynamic medical liability environment, Texas Medical Liability Trust has remained true to the objectives established when TMLT was formed in 1979. They have served as our blueprint for successful growth and change as an organization.

TMLT's founding fathers resolved to establish a company that would provide a stable source of medical professional liability protection for all medical specialties in all geographical territories in Texas. They were determined to offer Texas physicians insurance at the most reasonable premium level possible, while operating a sound insurance organization offering the highest quality professional insurance services, competent management of policyholders' assets, and a sound balance of vigorously resisting defensible claims with fair resolution of meritorious claims. These ambitious goals continue to be met at TMLT year after year.

During 1998, we were exceptionally proud to have achieved our goal of receiving an initial rating from A.M. Best Company. Our rating of A- excellent is a first for a Texas domiciled medical malpractice company, and reflects our continued profitability, excellent level of capitalization and adequate loss reserves. In awarding the rating, Best also cited TMLT's strong membership loyalty, sound operating strategies and position of market leadership. The favorable rating comes at a time of continued turmoil and change in the health care market, uncertainty in the tort environment, and increasing competition.



The soft market created by predatory pricing continues to be problematic, coming at a time when losses are trending upward in spite of efforts at tort reform. The search for the lowest price has threatened to turn the purchase of medical malpractice insurance into a commodity-based transaction rather than one that is service-based. We think this business approach is not beneficial for our physicians. There are other important aspects of the insurance purchase to consider.

In 1998, our ability to continue TMLT's tradition of quality service was greatly enhanced as we expanded our use of technology to communicate with and serve our policyholders. Embracing new ways to communicate with physicians and staff and finding ways to make doing business quicker and easier have helped us meet or exceed every established goal for the year. While "value added" is a term that has been somewhat overused, it certainly describes the type of services our policyholders receive from TMLT.

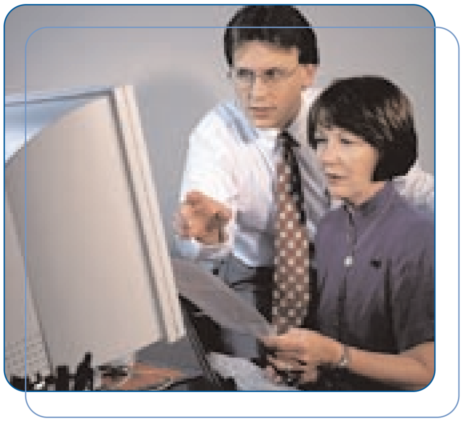
TMLT's subsidiary, Texas Medical Insurance Company, wrote its first Directors & Officers and Errors & Omissions policies in 1998, expanding the range of protection that we are able to offer physicians. We also purchased an equity position in a physician-owned and managed health insurance company, helping return decisions on patient care to the physician.

As we recognize and celebrate twenty years of serving Texas physicians, we appreciate the support we have received from our physician policyholders. Together, we have grown a company that is recognized as the most respected provider of medical professional liability in Texas. During the past two decades, your Trust has written policies for almost 18,000 physicians and paid out over $726 million on 21,589 claims that have been closed or are in the process of adjudication. We are convinced that you can find no better value than TMLT.

W. THOMAS COTTEN
President and Chief Executive Officer

IN 1998, COMPETITION in the medical malpractice industry continued to increase as other insurance companies entered the Texas market and pursued market share with heavily discounted premiums. The medical profession continued to experience changes as well, requiring creativity and thoughtful decision-making by those who serve the business needs of Texas physicians. In spite of these challenges, Texas Medical Liability Trust enjoyed unprecedented growth for the year. To keep pace with the increased numbers of policyholders and maintain high service levels, TMLT employed new technologies companywide. State-of-the-art equipment and software helped the organization serve policyholders faster and better, and also set the stage for additional growth and more sophisticated service in the future. The year's results, covered in the following pages, demonstrate how TMLT successfully combined the traditional with the technological.

By approaching the market creatively, TMLT was able to tailor programs to specific clients, from the individual specialist to the large, multi-specialty practice, while maintaining its commitment to the organization's stability.



Vice President of MIS Treg Russell and Director of Business Systems Janie Turner review TMLT's web site.

sales and marketing

Improve the Old, Bring in the New

Don Chow, vice president of marketing and Michele Reid, executive assistant, study marketing survey results.

THE NUMBER OF COMPETITORS TMLT faced reached an all-time high in 1998. The Sales and Marketing Department's primary goal was to increase market share without compromising underwriting and pricing standards. At the close of 1998, TMLT was leading the industry in Texas, adding 1,592 new physicians to its policyholder base and $5.69 million in new written premium.

"We adapted and responded to the challenge of a very tough market," says Vice President of Marketing Don Chow. "We expanded and diversified by making innovative changes." By approaching the market creatively, TMLT was able to tailor programs to specific clients, from the individual specialist to the large, multi-specialty practice, while maintaining its commitment to the organization's stability.

Recognizing the need to evaluate ways to develop new business in an increasingly competitive environment, TMLT took a small but important step away from its tradition as a direct writer of medical liability coverage. "We have a good distribution system, but we recognized the need to look at new methods of writing in order to expand our market," states Chow. In 1998, TMLT appointed two agents and brokered new accounts through a third, resulting in the addition of new physicians to the policyholder base and nearly $2 million in premium. "Many agents and brokers have established valuable, long-term relationships with physicians. The agent or broker thus becomes an important part of the decision-making process when it's time to choose a carrier. Combining those relationships with the tremendous credibility of TMLT works very well," says Chow.

Aggressive marketing strategies were devised to target major markets in 1998 and were implemented successfully by TMLT's sales force and outside agents. A joint venture with Texas Medical Association's Management Services Organization further demonstrates TMLT's commitment to organized medicine. Along with helping to support management services provided to TMA membership, TMLT's participation in this effort also provided opportunities to market TMLT services to IPAs and group accounts. Additionally, dedicated sales staff was hired to focus on marketing insurance products offered by TMLT's subsidiary, Texas Medical Insurance Company (TMIC).

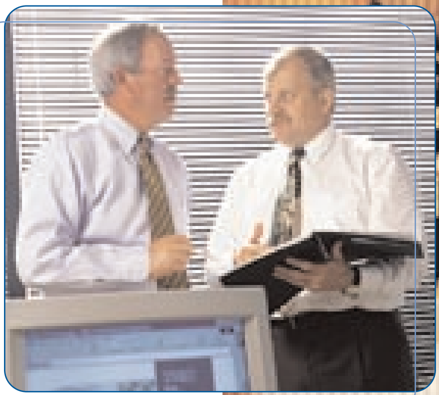
An important achievement this year was the greater integration of Texas Medical Insurance Company with overall TMLT operations. TMIC achieved 94 percent of production projected in the 1998 business plan. TMIC production is projected to move forward in 1999 with the addition of other competitive products to serve physicians and their staffs.

The expanded use of technology is meant to enhance, not take the place of, the personal service so valued by TMLT policyholders. In 1999, TMLT's marketing and sales staff will work closely with Management Information Systems to fine tune use of technology to better service new and existing policyholders, handle large accounts more efficiently, and increase retention. "Rather than playing the price game, as much of our competition is doing, we will emphasize the value-added benefits of TMLT," says Don Chow. "Those benefits, from outstanding risk management education to claim service and legislative participation, are second to none."

The expanded use of technology is meant to enhance, not take the place of, the personal service so valued by TMLT policyholders.

Dana Leidig, Robbie Michael and Laura Hale, of the Communications and Advertising Department, prepare the TMLT exhibit.

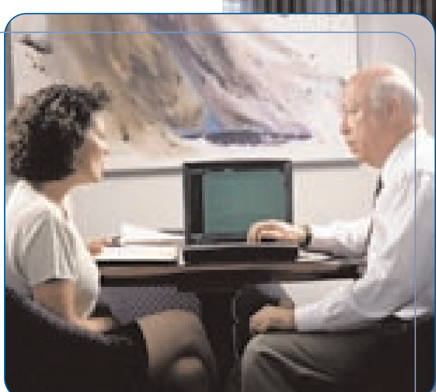
Innovative Changes, Unwavering Service



Business Development staff Jim Goreham, vice president, and Theo van Eeten, consultant, discuss TMLT coverage options.

risk management

More Service for Physicians



Risk Manager Rosslyn Wolfe and Scott Berglund, vice president, analyze an online CME program.

TMLT'S RISK MANAGEMENT DEPARTMENT HAS THREE PRIMARY GOALS: to help physicians practice safe medicine, to assist them in working more effectively with their teams, and to make sure our physicians are as defensible as possible," says Scott Berglund, vice president, risk management. "Or, in other words, to provide the best offense and the best defense. We measure all our activities and goals against that."

Helping people change behaviors and improve processes, though, takes more than good ideas. It requires showing the beneficial effects of your suggestions, maximizing the client's understanding, and then helping them implement those ideas. "This," says Berglund, "is where most risk management efforts fail." TMLT's risk management efforts are the exception.

"In 1998, evaluations from the physicians receiving our risk management services were the highest they have ever been," Berglund says. At the same time, the department increased the number of physicians it served. In other words, the staff reached more physicians and provided a higher quality of service than ever before. The number of physicians receiving practice reviews nearly doubled in 1998. Requests for risk management consultations by phone also grew, from 1,500 in 1997 to more than 1,800 in 1998.

These achievements in productivity and efficiency were possible in part due to the department's greater use of technological tools. For example, staff continued to work with TMLT's Management Information Systems Department to develop proprietary software for risk management evaluations. The World Wide Web was employed to offer risk management education online. The use of online technology allows physicians to participate in risk management education at their convenience and without the time and expense of traveling. Additionally, policyholders receive CME credit for completion of TMLT's risk management seminars.

The Risk Management Department also served TMLT policyholders as an information resource. Publications on topics such as informed consent, health information release and practice management were made available to physicians upon request.

The Reporter, TMLT's risk management newsletter, was published six times in 1998. The newsletter featured articles on the latest trends in medical liability, and was sent to all TMLT policyholders.

In 1999, the Risk Management Department will continue working to ensure that clients receive worthwhile risk management benefits. More "Risk Alerts" will be issued to provide physicians with critical information about drug interactions, regulatory developments and other medical news. Greater and more effective use of technology will continue to be explored and efforts to address Y2K issues will culminate at the end of the calendar year. The department will offer a greater variety of CME courses on TMLT's web site, as well as additional offerings of specialized seminars. "We've been a leader in risk management nationwide," Berglund points out, "and we don't intend to relinquish that position."

"We've been a leader in risk management nationwide, and we don't intend to relinquish that position."

Shanna Homann, Lesley Lopez and Jane Mueller discuss the details of an upcoming risk management event.

Old-Fashioned Service with Brand New Technology

Executive Vice President Bob Fields and Assistant Vice President Jill McLain review a claim.

RISING CLAIM INTAKE AND CLAIM INVENTORY created a major challenge for the Claim Department in 1998, and yet the year was one of TMLT's most successful in terms of indemnity control. TMLT won 72 of 82 trials taken to verdict, and total judgements in the other ten cases added up to $2.25 million. The department closed 85.8 percent of its claims with no indemnity payments. This exceeded its goal of 83.75 percent or higher.

"The reduction in claim settlements during 1998, from $44.7 million to $39.2 million, is the most significant we've accomplished in our twenty years," says Bob Fields, executive vice president of claim operations. This accomplishment becomes even more remarkable when one considers that, in 1998, TMLT also faced one of the largest ever increases in claim intake.

TMLT's increased use of technology helped the claims staff ensure continued first class service to its policyholders in 1998. Personal computers and access to email enables staff members to communicate more efficiently with defense attorneys, and provides them with the capability to electronically track claim status. Using technology to accomplish more is an important factor in light of a claim frequency trending back up toward pre-tort reform levels.

"Texas continues to be a very dangerous place to take cases to trial, but a strong defense is absolutely necessary. We appreciate the courage and willingness of our defendant policyholders to fight these cases in the courtroom and to work with the TMLT team toward their successful defense," states Fields. "We believe that acquiescing to the demands of plaintiff attorneys on nonmeritorious cases will only stimulate higher claim frequency."

Legal expenses continue to rise, due in part to the continuing defense of breast implant, Norplant, and Fen-Phen mass litigation, which is affecting most Texas insurance carriers. Thus far, TMLT has been successful in avoiding indemnity payments on mass litigation, but legal costs have and will continue to be a concern. The company will not, however, sacrifice a strong defense of its policyholders to save on legal expenses.

The department employs a strong team ethic, and the most thorough claims workup in the country. As a Texas-based organization headquartered in Austin, TMLT also offers its clients solid experience with the venue, should a claim become a lawsuit. TMLT is distinctive in that its claim professionals attend the bulk of each insured's trial, offering an experienced perspective, fresh ideas, feedback, and moral support to the physician.

In 1999, as claim intake and claim frequency continue their upward trends, TMLT's Claim Department will strive to keep its trial victory percentage high, maintain current closed-without-indemnity percentages, and ensure that its legal expenses are reasonable. Maintaining the quality of defense provided to TMLT's physicians will remain paramount. Increased use of technology, added to the experience and dedication of TMLT employees and attorneys, will allow the company to provide a quality of claim service unmatched in today's market.

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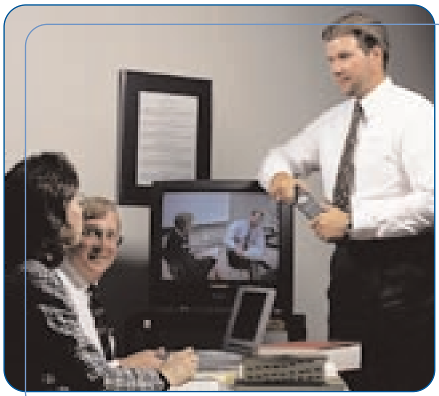


Claims staff members Ginny Markham, Dave Peabody and Randy Pollock at a training seminar.

Supporting Change and Growth

Accounting's Maryann Baca, Mary Gonzales and Laura Hunter talk about new accounting procedures.

Gail Nichols, director of human resources and administrative services, meets with Kristie Wainwright and Sherry Montez to address the employee handbook.

Accounting

As December 31, 1999 began to loom larger on the horizon, TMLT's computerized accounting and investment systems were examined and upgraded to versions that are Y2K compliant. The accounting staff received training on filing requirements and regulatory accounting procedures for Texas Medical Insurance Company in preparation for the first Texas Department of Insurance audit of TMIC. The audit was successfully completed. Cross-training of personnel created a department better able to efficiently respond to an increasing workload. Accounting staff provided critical support to TMLT's successful effort to obtain an A.M. Best rating.

Administrative Services

Following the relocation of TMLT to the current offices at year end 1997, Administrative Services spent much of 1998 providing assistance to employees as they settled into the new building, and handling facilities-related issues as they arose. As new employees joined the growing organization, the department ensured that the facility needs of those employees were met. "Our primary focus in 1998 was to make sure that existing and new employees had a good work environment," says Gail Nichols, director of human resources and administrative services.

Human Resources

An increase in policyholders and expansion of services required growth in TMLT staff in 1998. Finding top-notch candidates to serve TMLT policyholders presented a challenge for the Human Resources Department in an extremely tight Austin labor market.

In keeping with TMLT's overall emphasis on education and skills development, the department provided employee training in a number of areas. Human Resources Representative Laura Waldo, certified to teach Stephen Covey's *The Seven Habits of Highly Effective People*, held an in-house workshop series teaching these skills to TMLT employees. Other educational offerings included organization and time management, collaborative problem solving, and building effective teamwork, communication and trust. "We are striving to become a learning organization," Nichols says, "and we tried to present employees a variety of opportunities geared toward helping us achieve that goal."

Management Information Systems

In 1998, the MIS Department installed a personal computer on the desk of every individual in the company and provided staff training on use of the new technology.

"We tried to make everyone's job easier by automating more of what they do," says Janie Turner, director of business systems, "Streamlining processes increases productivity. The new technology enhances our ability to provide excellent service."

Treg Russell, vice president of MIS, states, "The technology implemented in 1998 created a core foundation that helps everyone work more effectively, and that will support the organization well into the future. Our claims, sales and risk management professionals can remain out of town serving policyholders more effectively because they can access information available at the office and do much of their paperwork via laptop computer."

Other MIS accomplishments in 1998 include collaborating with the Communications & Advertising Department on the development of a TMLT Internet site. In 1999, the department will continue its quest to help improve TMLT staff efficiency, reduce paperwork and enhance the sharing of information.

Communications and Advertising

While MIS was focused on the technology used to send the message, Communications & Advertising was equally focused on the message itself. Both internal and external communications efforts were audited to determine their effectiveness. Striving to employ every method available to communicate with our policyholders, Communications & Advertising staff helped guide the development of presentations, direct mail marketing campaigns, marketing print materials and risk management program materials and publications. The TMLT Communications & Advertising staff received an award of excellence from the International Association of Business Communicators for TMLT's 1997 Annual Report.

Debra Frost, Kathy Schulz-Behrend, and Michele Luckie share notes from a computer training course.

Tom Borel and Daniel Fallwell from the Management Information Systems Department work on the TMLT computer system.

Underwriting staff Alba Brandon, Diane Sisco and Sandye Hayden review policyholder records.

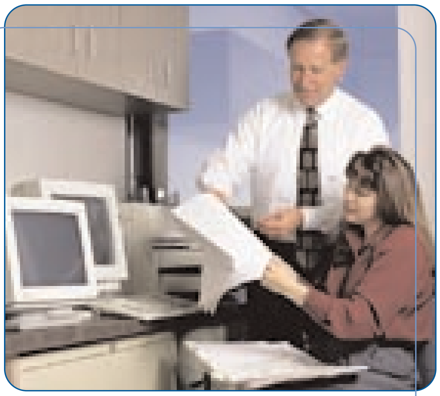
1998 financial review

Maximum Yield, Minimum Risk

TMLT's financial position continued to improve in 1998, as evidenced in the following financial statements. Surplus generated from operations and investment income grew to a total of $94.6 million, an increase of $1.7 million from 1997. This strong financial position played a major role in TMLT receiving an A- from A.M. Best in our first attempt to obtain a rating. The investment portfolio yielded $16.2 million of investment income and capital gains in a market experiencing increasing volatility and decreasing interest rates. Two new investment managers brought on board in 1998 furthered efforts to increase investment yield. A larger commitment to the equity market in 1998 was evidenced in an additional $3.6 million invested in equities, a trend that will continue in 1999.

Twenty years of growth and strength as an organization, coupled with an exceptional level of surplus, allowed TMLT to broaden its investment strategies and take on a calculated measure of additional risk, while adhering to our policies of conservatism, liquidity and quality in investments. Policyholders received surplus refunds of $4 million in 1998, bringing to $23.8 million the total amount of surplus returned to date.

There are many challenges facing TMLT. Increased competition keeps the current market soft, while claims expenses continue to increase. Alternative investment possibilities will need to be explored to increase the yield of the portfolio and enhance cash flow. Maintaining our current status as the preferred provider of medical liability in Texas will require continued efforts of the board and staff, and the support of our policyholders.



Vice President and Chief Financial Officer Ray Demel and Accounting Manager Viola Moreno inspect TMLT financial statements.

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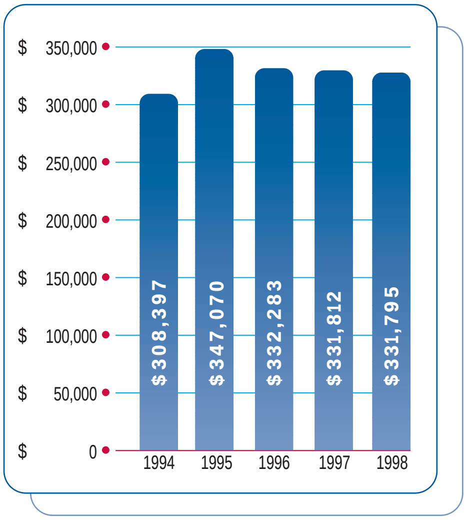
	December 31	
	1998	1997
	(In Thousands)	
Assets		
Securities, available-for-sale, at fair value:		
Fixed-maturity securities	**$227,807**	$234,665
Common stocks	**8,379**	4,693
Cash and cash equivalents	**11,900**	10,312
Premiums receivable	**24,331**	23,270
Accrued interest receivable	**3,239**	3,265
Reinsurance recoverables:		
On paid losses	**979**	3,658
On unpaid losses and loss adjustment expenses	**33,007**	31,452
Prepaid reinsurance premiums	**4,511**	4,774
Refundable federal income taxes	**1,402**	-
Deferred income taxes	**5,397**	6,633
Key man life insurance	**4,244**	4,398
Other	**6,599**	4,692
Total assets	**$331,795**	$331,812

ASSETS
(In Thousands)



	December 31	
	1998	1997
	(In Thousands)	
Liabilities and policyholders' surplus		
Liabilities:		
Reserves:		
Unpaid losses and loss adjustment expenses	**$172,509**	$169,196
Unearned premiums	**36,729**	36,067
	209,238	205,263
Premiums received in advance	**2,367**	2,878
Federal income taxes payable	**-**	426
Accounts payable and accrued expenses	**5,179**	5,331
Reinsurance premiums payable	**20,400**	25,003
Total liabilities	**237,184**	238,901
Policyholders' surplus:		
Contributed surplus	**14,514**	18,627
Less surplus contributions receivable	**-**	2
	14,514	18,625
Accumulated other comprehensive income	**5,707**	4,503
Unassigned surplus	**74,390**	69,783
Total policyholders' surplus	**94,611**	92,911
Total liabilities and policyholders' surplus	**$331,795**	$331,812

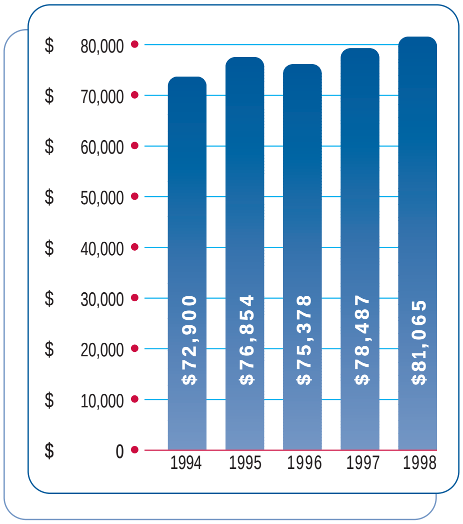
See accompanying notes.

consolidated statements of income

	Year ended December 31	
	1998	**1997**
	(In Thousands)	
Premiums earned, net of reinsurance	**$70,944**	$72,026
Investment income, net of investment expenses of $254 in 1998 and $221 in 1997	**14,870**	15,481
Net realized gains	**1,366**	675
Other revenue	**1,191**	1,452
Total revenues	**88,371**	89,634
Losses and expenses:		
Losses and loss adjustment expenses	**70,966**	65,614
Other underwriting expenses	**12,010**	10,241
Total operating expenses	**82,976**	75,855
Income before income taxes	**5,395**	13,779
Income tax expense	**788**	3,856
Net income	**$ 4,607**	$ 9,923

See accompanying notes.

WRITTEN PREMIUMS
(In Thousands)



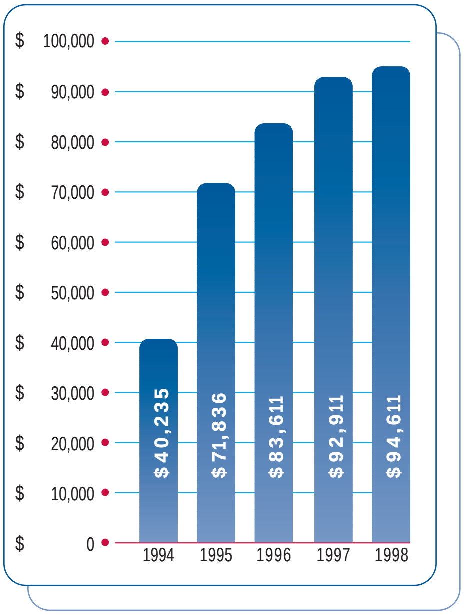
consolidated statements of changes in policyholders' surplus

(In Thousands)

	Contributed Surplus	Unassigned Surplus	Accumulated Other Comprehensive Income	Total Policyholders' Surplus	Comprehensive Income
Balances at January 1, 1997	$22,997	$59,860	$ 754	$83,611	$ -
Other comprehensive income	-	-	3,749	3,749	3,749
Return of contributed surplus, net	(4,372)	-	-	(4,372)	-
Net income	-	9,923	-	9,923	9,923
Balances at December 31, 1997	18,625	69,783	4,503	92,911	$13,672
Other comprehensive income	-	-	**1,204**	**1,204**	**1,204**
Return of contributed surplus, net	**(4,111)**	**-**	**-**	**(4,111)**	**-**
Net income	**-**	**4,607**	**-**	**4,607**	**4,607**
Balances at December 31, 1998	**$14,514**	**$74,390**	**$5,707**	**$94,611**	**$ 5,811**

See accompanying notes.

CONTRIBUTED AND UNASSIGNED SURPLUS
(In Thousands)

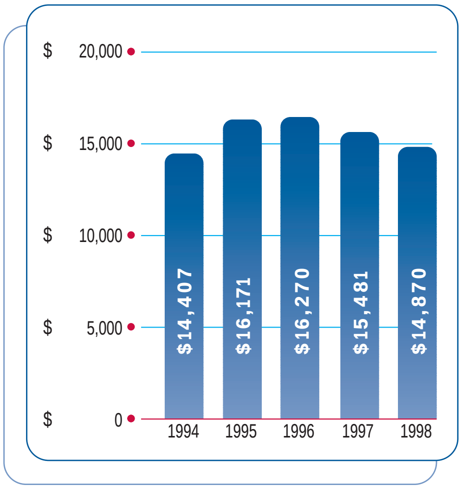


consolidated statements of cash flows

	Year ended December 31	
	1998	**1997**
	(In Thousands)	
Operating activities		
Net income	**$4,607**	$9,923
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	**524**	348
Net amortization on securities	**101**	196
Deferred income taxes	**616**	394
Net realized gains	**(1,366)**	(675)
Change in operating assets and liabilities:		
Premiums receivable	**(1,061)**	(30)
Reinsurance recoverables	**1,124**	(235)
Reserves	**3,975**	(3,123)
Reinsurance premium balances	**(4,340)**	(6,654)
Other	**(4,272)**	(2,175)
Net cash used in operating activities	**(92)**	(2,031)
Investing activities		
Purchases of securities	**(79,707)**	(46,228)
Proceeds from disposals and maturities of securities	**85,969**	59,567
Purchases of furniture and equipment	**(625)**	(1,386)
Decrease (increase) in key man life insurance	**154**	(691)
Net cash provided by investing activities	**5,791**	11,262
Financing activity		
Surplus refunds, net of contributions	**(4,111)**	(4,372)
Cash used in financing activity	**(4,111)**	(4,372)
Change in cash and cash equivalents	**1,588**	4,859
Cash and cash equivalents at beginning of year	**10,312**	5,453
Cash and cash equivalents at end of year	**$11,900**	$10,312

See accompanying notes.

INVESTMENT INCOME
(Excluding Net Realized Capital Gains)
(In Thousands)



1. Organization and Accounting Policies

(Amounts in Thousands)

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 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) *Note 1. Organization and Accounting Policies - Continued*

Unpaid losses and loss adjustment expenses have been discounted using a 4% factor. The discount amount was approximately $10,479 and $8,750 at December 31, 1998 and 1997, respectively.

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 reinsurance premiums payable by approximately $17 and $164 at December 31, 1998 and 1997, 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 classified as available-for-sale are carried, net of tax, 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.

Cash Equivalents

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

Note 1. Organization and Accounting Policies - Continued *(Amounts in Thousands)*

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 June 1997, the Financial Accounting Standards Board (FASB) issued SFAS 130, Reporting Comprehensive Income. The Trust adopted SFAS 130 during the year ended December 31, 1998.

SFAS 130 requires presentation of comprehensive income (net income plus all other changes in net assets from non-owner sources) and its components in the financial statements. The Trust has adopted SFAS 130 and changed the format of its consolidated statements of changes in policyholders' surplus to present comprehensive income.

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

	Year Ended December 31	
	1998	**1997**
Unrealized gains on securities		
Unrealized gains on available-for-sale securities	**$3,222**	$6,385
Less: reclassification adjustment for realized gains in net income	**(1,397)**	(705)
Income tax expense	**(621)**	(1,931)
Other comprehensive income	**$1,204**	$3,749

Accumulated other comprehensive income shown on the consolidated statements of changes in policyholders' surplus is solely comprised of unrealized gains from available-for-sale securities, net of tax of $2,943 and $2,323 for the years ended December 31, 1998 and 1997, 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, 1998:				
U.S. government and its agencies	**$ 12,165**	**$ 101**	**$ 45**	**$ 12,221**
States, political subdivisions and countries	**65,585**	**3,783**	**21**	**69,347**
Corporations	**63,464**	**2,818**	**254**	**66,028**
Loan-backed securities and collateralized mortgage obligations	**79,315**	**1,550**	**654**	**80,211**
	$220,529	**$8,252**	**$974**	**$227,807**
At December 31, 1997:				
U.S. government and its agencies	$ 12,374	$ 11	$ 46	$ 12,339
States, political subdivisions and countries	63,801	2,732	48	66,485
Corporations	75,635	2,492	202	77,925
Loan-backed securities and collateralized mortgage obligations	76,611	1,416	111	77,916
	$228,421	$6,651	$407	$234,665

At December 31, the Trust's investment in common stocks had a cost basis of $7,009 and $4,114 in 1998 and 1997, respectively. Gross unrealized gains were $1,370 and $579 in 1998 and 1997, respectively.

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, 1998 are summarized, by stated maturity, as follows:

	Amortized Cost	Estimated Fair Value
Years to maturity:		
One or less	$ 5,484	$ 5,510
After one through five	38,155	39,287
After five through ten	68,098	71,384
After ten	29,477	31,416
Loan-backed securities and collateralized mortgage obligations	79,315	80,210
Total	$220,529	$227,807

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 $60,911 in 1998 and $42,700 in 1997. Gross realized gains and gross realized losses on these sales were $1,525 and $159, respectively, during 1998, and $884 and $209, respectively, during 1997.

4. Unpaid Losses and Loss Adjustment Expenses *(Amounts in Thousands)*

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 1998 and 1997:

	Year ended December 31	
	1998	**1997**
Reserve for unpaid losses and LAE, net of related reinsurance recoverables at beginning of year	**$137,744**	$142,573
Add provision for claims, net of reinsurance, occurring in:		
Current year	**66,938**	60,057
Prior years	**4,028**	5,557
Incurred losses during the current year, net of reinsurance	**70,966**	65,614
Deduct payments for claims, net of reinsurance, occurring in:		
Current year	**234**	733
Prior years	**68,974**	69,710
	69,208	70,443
Reserve for losses and LAE, net of related reinsurance recoverables, at end of year	**139,502**	137,744
Reinsurance recoverables on unpaid losses and LAE, at end of year	**33,007**	31,452
Reserve for unpaid losses and LAE, gross of reinsurance recoverables on unpaid losses, at end of year	**$172,509**	$169,196

The foregoing reconciliation shows that the Trust's reserve for unpaid losses and LAE, net of related reinsurance recoverable, at December 31, 1998 and 1997, was increased by $4,028 and $5,577 for claims that had occurred on or prior to 1997 and 1996, respectively. This increase in prior years' reserves results principally from changes in management's estimates of the average severity of future claims payments and an increase in allocated LAE estimates.

(Amounts in Thousands)

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:

	1998 Premiums		**1997 Premiums**	
	Written	**Earned**	**Written**	**Earned**
Direct	**$81,065**	**$80,403**	$78,487	$76,687
Ceded	**9,459**	**9,459**	4,661	4,661
Net premiums	**$71,606**	**$70,944**	$73,826	$72,026

The amounts deducted from losses and loss adjustment expenses in the income statements that relate to reinsurance were $9,849 for 1998 and $7,706 for 1997.

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.

6. Federal Income Taxes

(Amounts in Thousands)

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

	1998	1997
Current expense	**$172**	$3,462
Deferred expense	**616**	394
	$788	$3,856

The Trust made income tax payments of $2,000 in 1998 and $4,750 in 1997.

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

	1998	1997
Deferred tax liabilities:		
Net unrealized gain on available-for-sale securities	**$(2,940)**	$(2,320)
Tax over book depreciation	**(187)**	(140)
Unearned revenue	**(161)**	(197)
Amortization of securities' discount	**(162)**	(204)
Total deferred tax liabilities	**(3,450)**	(2,861)
Deferred tax assets:		
Loss reserve discounting	**6,264**	7,184
Unearned premium discounting	**2,423**	2,120
Premiums received in advance discounting	**160**	190
Total deferred tax assets	**8,847**	9,494
Net deferred tax asset	**$ 5,397**	$ 6,633

Under the provisions of FASB Statement No. 109, the Trust is allowed to recognize a deferred tax asset to the extent that management believes it is more likely than not that the Trust will realize a future benefit. At December 31, 1998 and 1997, the Trust recognized the benefit that may be realized from the recovery of previously paid taxes available in the carryback period and the implementation of prudent tax planning strategies.

The difference between the income tax expense reported and the income tax expense that would result from applying domestic federal statutory tax rates to pretax income in 1998 and 1997 resulted primarily from the effects of tax-exempt interest.

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 1998 and 1997, the Board of Governors authorized the return of 15% of policyholders' surplus deposits for those policyholders who met their surplus requirements as of December 31, 1997 and 1996.

(Amounts in Thousands)

8. Commitments and Contingencies

The Trust leases office facilities and certain equipment through agreements which expire through 2004. As of December 31, 1998, the future minimum lease payments under these agreements for the years ending December 31 are as follows:

1999	$ 747
2000	747
2001	747
2002	747
2003	747
Thereafter	652
Total	$ 4,387

Total rent expense was $1,133 for 1998 and $772 for 1997.

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 noncontributory, 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 $785 for 1998 and $610 for 1997.

10. Year 2000 Issue - Unaudited

The Year 2000 Issue is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Trust's computer programs or hardware that have date-sensitive software or embedded chips may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities.

The Trust's plan to resolve the Year 2000 Issue involves the following four phases: assessment, remediation, testing and implementation. To date, the Trust has substantially completed its implementation of all systems that could be significantly affected by the Year 2000. This implementation indicates that the Year 2000 Issue does not present a material exposure to the sale of the Trust's products, subsequent to December 31, 1999. In addition, the Trust has gathered information about the Year 2000 compliance status of its significant subcontractors and continues to monitor their compliance.

report of independent auditors

Board of Governors
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, 1998 and 1997, and the related consolidated statements of income, 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 generally accepted auditing standards. 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, 1998 and 1997, and the consolidated results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst + Young LLP

March 11, 1999
Austin, Texas

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Laura Waldo
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Trina Watson
Wanda Wilson
Rosslyn Wolfe
Marshall Wyatt
Christie Zarria

tmlt

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.

tmlt at twenty

Much has happened in the medical liability arena over the past two decades and Texas Medical Liability Trust has played an active role in writing that history. Formed in 1978, TMLT wrote its first medical liability policy in 1979. The organization grew quickly and reached a policyholder count of 2,900 by 1983. When TMLT celebrated its tenth anniversary, it recorded over 5,000 policyholders! In 1992, the Trust received the full endorsement of Texas Medical Association as well as that of the Texas Academy of Family Physicians. By TMLT's fifteenth anniversary, the policyholder count was posted at 7,500 and TMLT was awarded the endorsements of the Dallas, Tarrant and Travis county medical societies. We reached another big milestone when TMLT's subsidiary, Texas Medical Insurance Company, was formed in 1995. In January of TMLT's twentieth anniversary year, the policyholder count exceeded 9,500 and two new endorsements were added, Harris and Bexar county medical societies. Our phenomenal growth in numbers and endorsements by the Texas medical community is a testament to our ability to provide physicians with quality education, protection and defense.

TMLT 1979 • 1999

20 YEARS SERVING
TEXAS PHYSICIANS

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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

TMLT

TEXAS MEDICAL LIABILITY TRUST