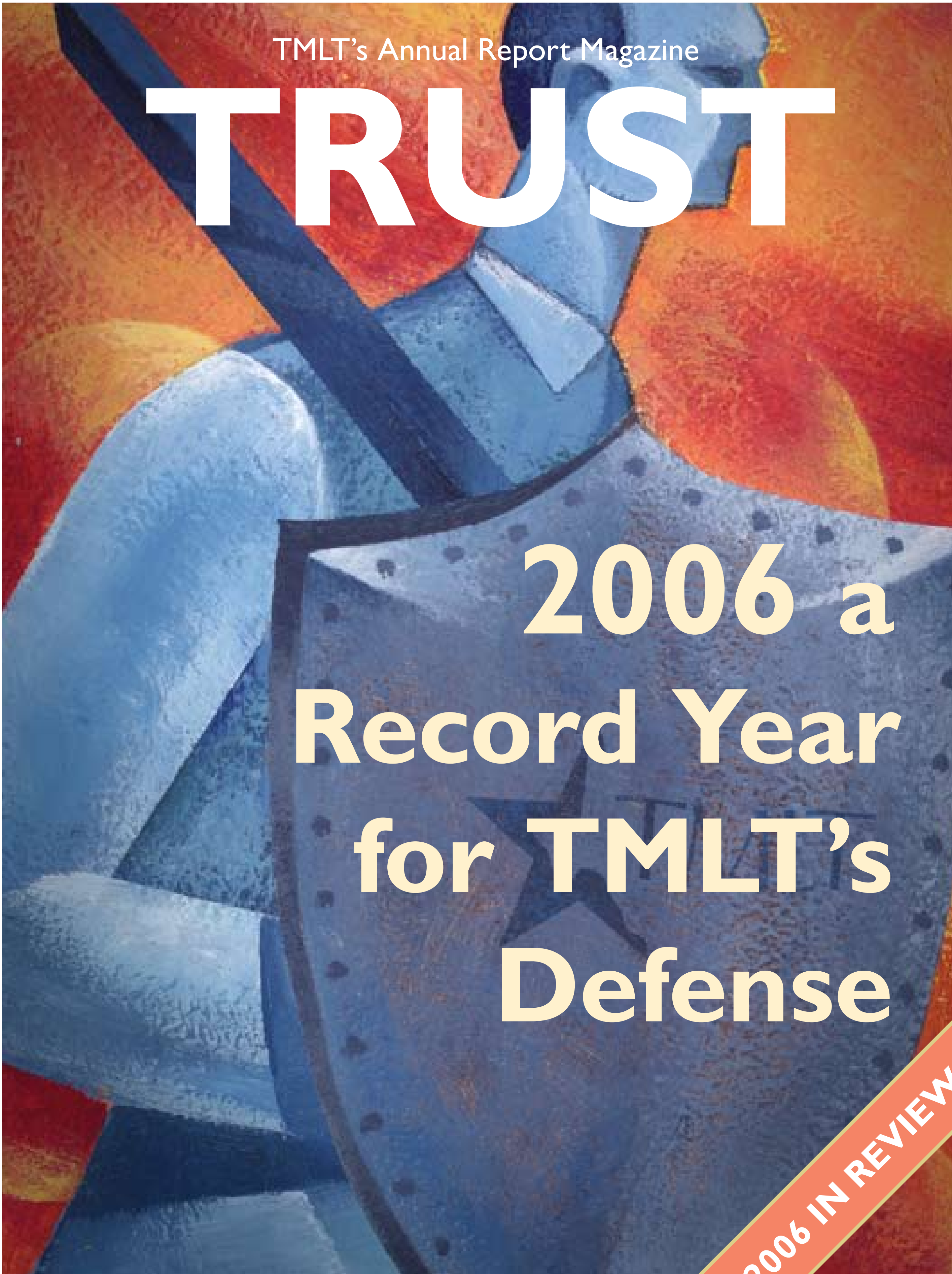
TMLT's Annual Report Magazine

TRUST



2006 a Record Year for TMLT's Defense

2006 IN REVIEW

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

Endorsed by:
Bexar County Medical Society
Dallas County Medical Society
Harris County Medical Society
Lubbock-Crosby-Garza County Medical Society
Tarrant County Medical Society
Travis County Medical Society
The Texas Academy of Family Physicians
The Texas Orthopaedic Association

TMLT is a Gold Corporate Affiliate of the Texas Medical Group Management Association

Welcome to *TRUST*, the 2006 annual report magazine of Texas Medical Liability Trust. This publication will provide you with information on the financial condition of TMLT, as well as a "year in review" of Trust operations.

TMLT's financial strength allows us to provide our policyholders with the support and service they deserve and have come to expect over our 27-year history. The information, facts and figures on the pages that follow speak for themselves and illustrate why TMLT is the premier medical liability carrier in Texas.

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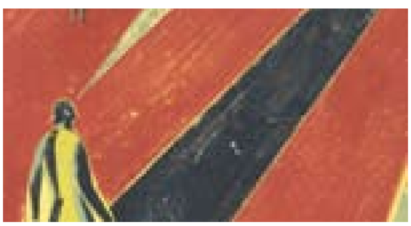
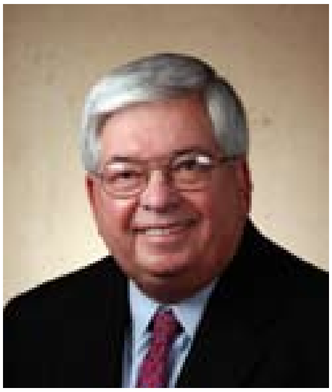


NOW & THEN



Dennis J. Factor, MD
Chairman, Board of Governors

The year was 2002. I was just beginning my fifth year on the TMLT Board of Governors. It was a time when one in four Texas physicians was being sued. It was a time when only four medical liability carriers remained to cover the state's 36,000 physicians. It was a time when the TMLT Board of Governors made tough decisions on rates and surplus that had very serious and very real effects on physicians, but were necessary for the survival of the Trust.

Move forward to 2006. It is my final year to serve on the TMLT Board of Governors and my third year as Chairman. At TMLT, non-meritorious claim intake is down as a result of medical liability reform. There are currently more than 30 medical liability carriers offering coverage to Texas physicians. The TMLT Board of Governors has implemented a strategic plan to give back to policyholders with rate decreases and dividend payments for cumulative savings of more than $180 million.

I am honored to have served the Trust and the physicians of Texas during this remarkable turnaround. TMLT is financially strong and growing stronger. At the end of 2006, TMLT had assets of $654 million and surplus of $227 million. Our promise of financial health is behind each and every policy contract we write.

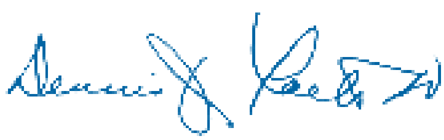
In 2006, the Board approved a 7.5% rate reduction and a 20% dividend for renewing policyholders. This is our fourth year to reduce rates and our second year to offer the dividend. Thanks to the medical liability reforms of 2003, we are in a position to give back to our fellow physicians, and we do so gratefully.

{ …we are in a position to give back to our fellow physicians, and we do so gratefully. }

Competing carriers stepped up their efforts to gain a foothold in the Texas market. While we welcome competition to the state, we believe that TMLT's products are superior to those available from other companies. It is abundantly clear that they cannot compete with our claims service and risk management offerings.

In terms of financial stability, policyholder retention, and growth, 2006 was one of the most successful years in TMLT history. But 2006 was not without challenges. Throughout the year, TMLT staff were in the process of converting to a more powerful, custom-designed computer system intended to improve service capabilities. In addition, the company underwent a change in leadership, with Bob R. Fields, formerly Executive Vice President of Claim Operations, taking the reins of TMLT as acting president and CEO. Bob has served TMLT for more than 20 years and has been a longtime defender of doctors and a leader in our decade-long efforts to achieve tort reform in Texas. Despite these considerable challenges, TMLT staff continued to provide policyholders with customer service unparalleled in the industry.

As my tenure on the TMLT Board of Governors comes to a close, I would like to thank the physicians of Texas who have stood by TMLT through good times and bad. The TMLT Board of Governors has not lost sight of our commitment to Texas physicians. We work for you, and every employee at TMLT is dedicated to safeguarding the professional reputations of those practicing medicine in Texas.



Dennis J. Factor, MD
Chairman, Board of Governors

TMLT 2006 Board of Governors

From left to right: David G. Joseph, MD; Robert I. Parks, MD; Richard C. Geis, MD; Cristie Columbus, MD; Stuart D. McDonald, MD; Dennis J. Factor, MD; Alan C. Baum, MD; Bob R. Fields, Acting President and CEO; Jimmy L. Strong, MD; Dave W. Kittrell, MD

Dennis J. Factor, MD, *Chairman*
OB-GYN, Dallas
Policyholder since 1986

Dave W. Kittrell, MD, *Vice Chairman*
OB-GYN, San Antonio
Policyholder since 1979

Robert I. Parks, MD, *Secretary-Treasurer*
Anesthesiology, Dallas
Policyholder since 1993

Alan C. Baum, MD
Ophthalmology, Houston
Policyholder since 1984

Cristie Columbus, MD
Infectious Diseases, Dallas
Policyholder since 2000

Richard C. Geis, MD
Thoracic/Cardiovascular Surgery, Houston
Policyholder since 1980

David G. Joseph, MD
Family Practice, Austin
Policyholder since 1997

Stuart D. McDonald, MD
Pulmonary & Critical Care, Fort Worth
Policyholder since 1993

Jimmy L. Strong, MD
Pediatrics, Abilene
Policyholder since 1990

President's Message

I assumed the duties of acting president and CEO in August 2006 at the request of the Governing Board. Although new to the global responsibilities a CEO must shoulder, I have been with TMLT since 1986 and have over 33 years experience in the medical liability insurance industry. The Governing Board and knowledgeable, service-oriented TMLT staff made this transition in leadership as smooth as possible and TMLT continued its advance in a highly competitive market.

Bob R. Fields
Acting President and CEO

A YEAR OF ACCOMPLISHMENT

Two thousand six was another remarkable year of accomplishment. I am pleased to present these achievements to you in this report—some of them again record setting—as well as the challenges we faced throughout the year.

Importantly, we continued rebuilding a strong surplus and, by year-end, it had reached the highest level ever in the history of TMLT, $227 million.This was due, in part, to our 7% growth in policyholders. A substantial surplus underpins the financial stability of an insurance carrier like TMLT. It indicates whether or not a company has enough money to pay future claims and it provides the cushion required to handle the inherent variability in estimating claims losses.

Although 2006 was not a legislative year, the vigilance of TMLT, TMA, TAPA and many others, continued to protect Texas' historic medical liability reforms. I would like to salute all those individuals and organizations who continue to work tirelessly to protect these hard-won reforms. We have seen a 50% drop in claim frequency since tort reform went into effect. Three years post tort reform, the Texas Department of Insurance lists over 30 carriers licensed to write medical liability coverage in Texas. Competition has returned providing Texas physicians with significant choices in medical liability providers. In addition, according to the Texas Alliance for Patient Access, since the passage of 2003 tort reform, Texas has improved its national standing in the American Medical Association's measurement of patient-care doctors per capita from 45th to 42nd. The number of physicians applying for licensure in Texas has climbed significantly since 2003. With a friendlier environment in which to practice medicine, doctors are coming to our state and patient access to care has increased.

Rates continue to decline. In fact, on the September anniversary of the passage of Prop 12, TMLT announced its fourth rate reduction effective January 1, 2007, making total rate reductions since the inception of medical liability reform 29.5%. In addition, our strong financial position allowed us to declare a $32 million dividend credit effective January 1, 2007. This is the second dividend credit in TMLT's history. The first was a $10 million dividend credit effective in January 2006.

I am especially proud of TMLT's ability to retain existing policyholders. Many companies conduct ongoing market research to determine why a physician chooses a particular medical liability carrier and then, why a physician remains loyal to a particular company. In a competitive market, a high retention rate indicates a company is doing something right for its customers. Achieving a high level of customer service is paramount at TMLT. Our commitment to service has contributed to TMLT's retention of existing accounts which reached 95%, an amazing accomplishment.

In 2006, TMLT won 73 of 75 cases taken to trial. We reduced indemnity payout by $25 million. These represent the

…high retention rate indicates a company is doing something right for its customers. Achieving a high level of customer service is paramount at TMLT.

highest win percentage record and lowest trial loss record ever chronicled in TMLT history. Our defense philosophy has not changed since the formation of the Trust: we focus on defending physicians versus settling cases to save legal expenses. TMLT's reinsurance auditors who audit medical liability companies nationwide have indicated that TMLT claim operations is one of the finest in the nation. To learn more, please review "2006 a Record Year for TMLT's Defense" as well as our claim operations message on the following pages.

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TMLT's commitment to risk management is unmatched by others in the medical liability industry. TMLT policyholders can earn their CME credits by taking our accredited online courses, attending our seminars, or completing our home studies such as *Case Closed* or *the Reporter*. Our education offerings continued to grow and participation continued to increase in 2006. We wrote, produced and distributed a DVD, *You've Been Sued*, to help physicians understand the litigation and deposition process. This DVD is approved for CME and physicians who have screened it have given it a "thumbs up."

We were challenged in 2006 as we launched a new company wide computer data system. This system was custom designed for TMLT. The conversion to this new system has been demanding, and at times, trying for both our staff and our policyholders. We did not anticipate the extended amount of time this conversion would require but we are solving problems daily and we will soon be able to take full advantage of the new features and functions this data system has to offer.

IN 2007

We will not rest on the successes of 2006. We must be prepared for the 2007 legislative session where we may see confrontations over previously achieved medical liability reforms, or other issues. As more and more physicians embrace the Internet for insurance information, quotations to apply for coverage, and to take CME courses, we will ensure that TMLT's web site is a user-friendly service center for physicians with limited time. Our web site's *members only* section on www.tmlt.org, to be introduced in 2007, will provide policyholders with convenient access to account services. Our litigation preparation DVD will continue to be available to physicians. We will continue our philosophy of involving physicians in the areas of risk management, underwriting review, and claims review.

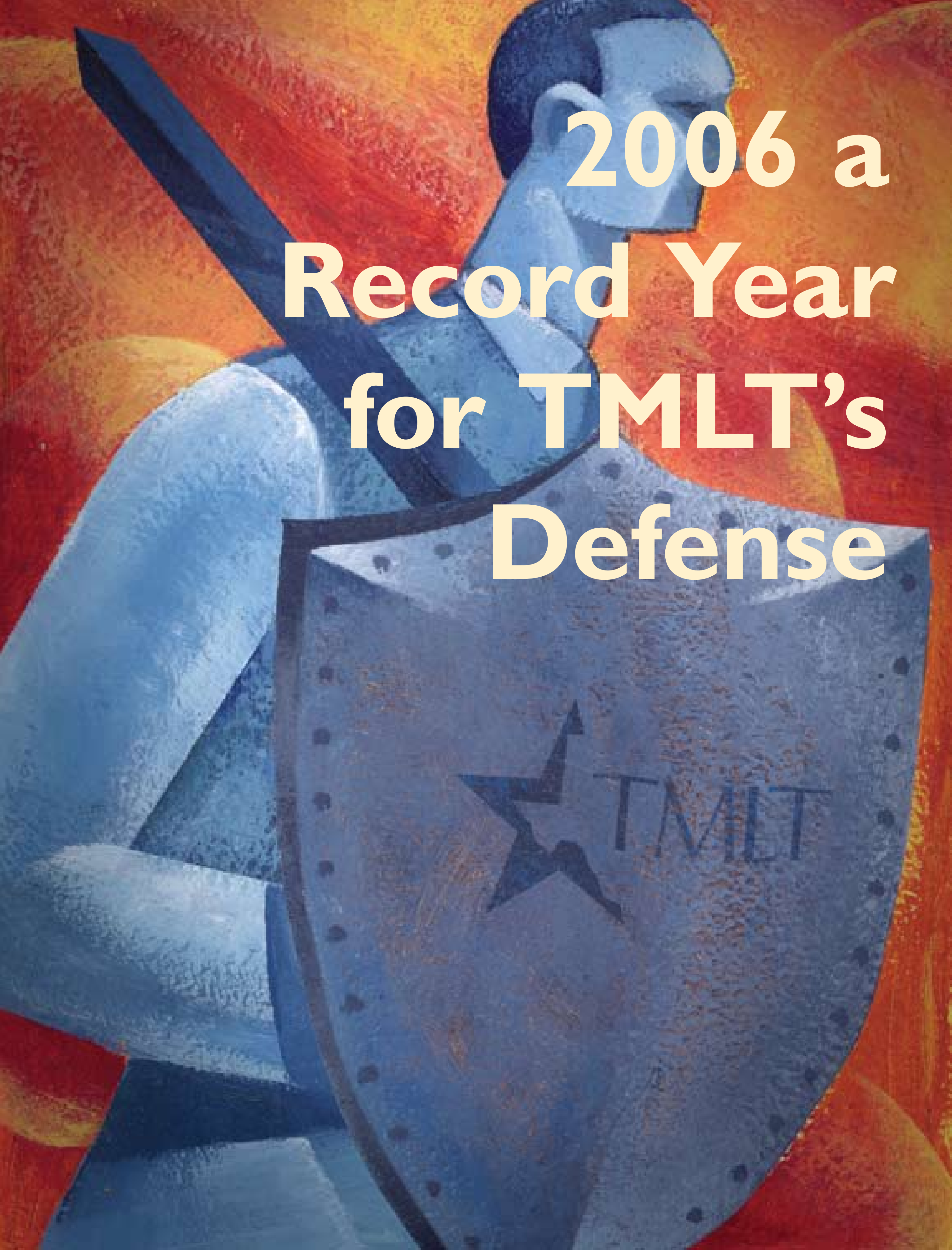
In the year ahead, we will see more competition and more rate pressure. Our objective is to provide the best products and services in the industry while keeping our premiums at the lowest responsible levels. In a soft market, competitors may be tempted to engage in pricing wars in order to secure new policyholder growth. TMLT expects to practice responsible pricing and we expect to grow while maintaining high policyholder retention.

As acting president, I would like to again thank the Governing Board, the TMLT staff, and our policyholders for their confidence and support in 2006. Though not without its challenges, TMLT is looking at a very bright and promising future.

Bob R. Fields
Acting President and CEO

TMLT senior leadership at work.

2006 a Record Year for TMLT's Defense



In 2006, TMLT experienced a trial win record of 97%, ending the year with 73 trial victories and 2 losses. This was the highest trial victory percentage in the company's history. For the two trial losses, TMLT incurred less than $351,000 in indemnity—another record.

"TMLT claim staff and defense attorneys performed their jobs admirably," says Jill McLain, vice president of claim operations. "Our physicians should also be applauded for their willingness to see the cases through to a verdict. We saved more than $31 million because we took the cases to trial instead of settling for the plaintiffs' demands."

Claim staff noted that one reason physicians want to proceed to trial instead of settling out of court is fear of an investigation by the Texas Medical Board (TMB). The TMB may now investigate any physician who has three lawsuits within five years. Physicians also worry because any indemnity payment—either from a settlement or jury verdict—must be reported to the National Practitioner Data Bank.

"At TMLT, we understand the very real consequences a settlement can have on a physician's career. That's why our philosophy is to defend doctors, not pay non-meritorious claims," says McLain.

The cases taken to trial in 2006 involved issues such as lack of communication between health care providers, poor communication between physicians and patients and their families, failure to complete tests, and failure to review prior medical records. "Some of theses cases involved complicated legal issues and the medicine was complex," says McLain.

In addition to providing the best defense, TMLT claim staff pledge personal attention to policyholders. The TMLT team works closely with defense counsel and physicians to develop a defense strategy. We make it a priority to keep the physicians informed during the progress of their cases. When a case goes to trial, the claim supervisor attends the trial, observing all aspects of the case. "Our supervisors and attorneys work hard to help physicians feel prepared and confident through this stressful process," says McLain.

Medical liability reform continues to positively impact the ability of the TMLT Claim Department to achieve important goals. This is very apparent in the area of claim severity. Since House Bill 4 and Proposition 12 passed in 2003, claim severity has moderated. In 2006, the average paid claim dropped to about $138,000, down from around $173,000 last year.

"The $250,000 cap on non-economic damages has brought actuarial soundness to the system," says McLain. "The caps mitigate the unpredictability and subjectivity of awards for pain and suffering."

With damage caps in place, physicians are able to fight non-meritorious claims. "Our policyholders want to defend themselves from unreasonable allegations and they are more willing to do so because they believe the system will treat them fairly," says McLain.

Physicians are also aware that reform has brought the medical liability crisis to the public's attention. Juries are not as easily swayed by plaintiff

"At TMLT, we understand the very real consequences a settlement can have on a physician's career. That's why our philosophy is to defend doctors, not pay non-meritorious claims."

attorneys' appeals to emotion and are more understanding of the great strain litigation places on physicians.

It is important to note that legitimate medical liability claims are still being filed. Plaintiffs can still collect unlimited damages for medical bills, lost wages and custodial care. Pain and suffering damages are recoverable up to $250,000, or up to $750,000 if institutions are involved. Patients are not being deprived of reasonable redress under the law.

"Because of the benefits to physicians and health care in Texas, we will fight to keep medical liability reform intact, " says McLain. "That is a top priority for TMLT in 2007."

Expect new services at www.tmlt.org in 2007

TMLT's web site, www.tmlt.org, will launch a *members only* section for policyholders in 2007. On our secure site, you will be able to view your account information, request special services, and access information for policyholders only.

One of these new features in our *members only* section will be the ability to securely sign in and download your proof of coverage and claims history. You will then be able to view and print your information instantly and have the information you need.

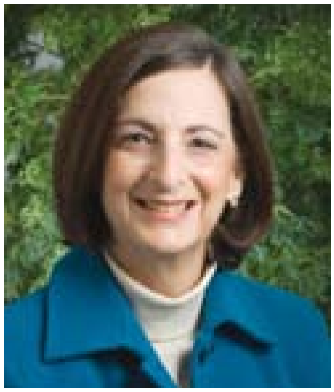
You will be able to access your account information, sign in to see account details and view TMLT credits applied to your account. You will also be able to look for risk management, CME, and your experience discount. If you don't have these discounts, it might be time for you to take advantage of TMLT's many opportunities to reduce your premium.

In the second phase of the *members only* section you will be able to see when you paid your premium, how much you paid, and when your next payment is due.

TMLT.org has it all! In addition to the new *members only* section, we continue to provide you with resources that are quick, easy and up-to-date. You can schedule a risk management practice review, request a quote, apply for coverage, read TMLT closed claim studies, review current risk alerts, take an accredited CME course, pay your premium by credit card, and request a change of your address or contact information.

Claim Operations

The Claim Department ended 2006 with a record 97% trial win percentage, consisting of 73 wins and 2 losses. The two cases lost accounted for less than $351,000, paving the way to the best overall year ever. This compares with pretrial demands on these 75 cases of over $31 million. Since July of 2005, our trial record includes 117 cases won and only two lost.



Jill McLain
Vice President, Claim Operations

In order to achieve the best possible results for each insured, the TMLT claim staff works collaboratively throughout the life of a claim with the defense attorney, the insured physician, consultants and experts to investigate and prepare the case for trial. Claim supervisors then attend trial, using their years of experience to evaluate the case as it unfolds before the jury. Keeping our fingers on the pulse of each claim as it progresses is the key to achieving favorable outcomes for our insureds. In addition, we strive to consistently provide information, service, and support for our physicians who are going through the difficult and stressful litigation process. Lower claims intake resulting from tort reform has enabled us to make more personal visits to physicians during the early investigation of their claim or suit.

Success in trial has been a major factor in enabling us to substantially lower indemnity payout. The average paid claim dropped to $138,587 in 2006 from $173,541 in 2005. Claims intake remained stable, and the frequency with which physicians are being sued has stabilized at a much reduced level, compared to pre-tort reform days. During the years prior to 2003 tort reform, physicians were getting sued each year at rates of about 25%. Currently, that number has been reduced to approximately 11%.

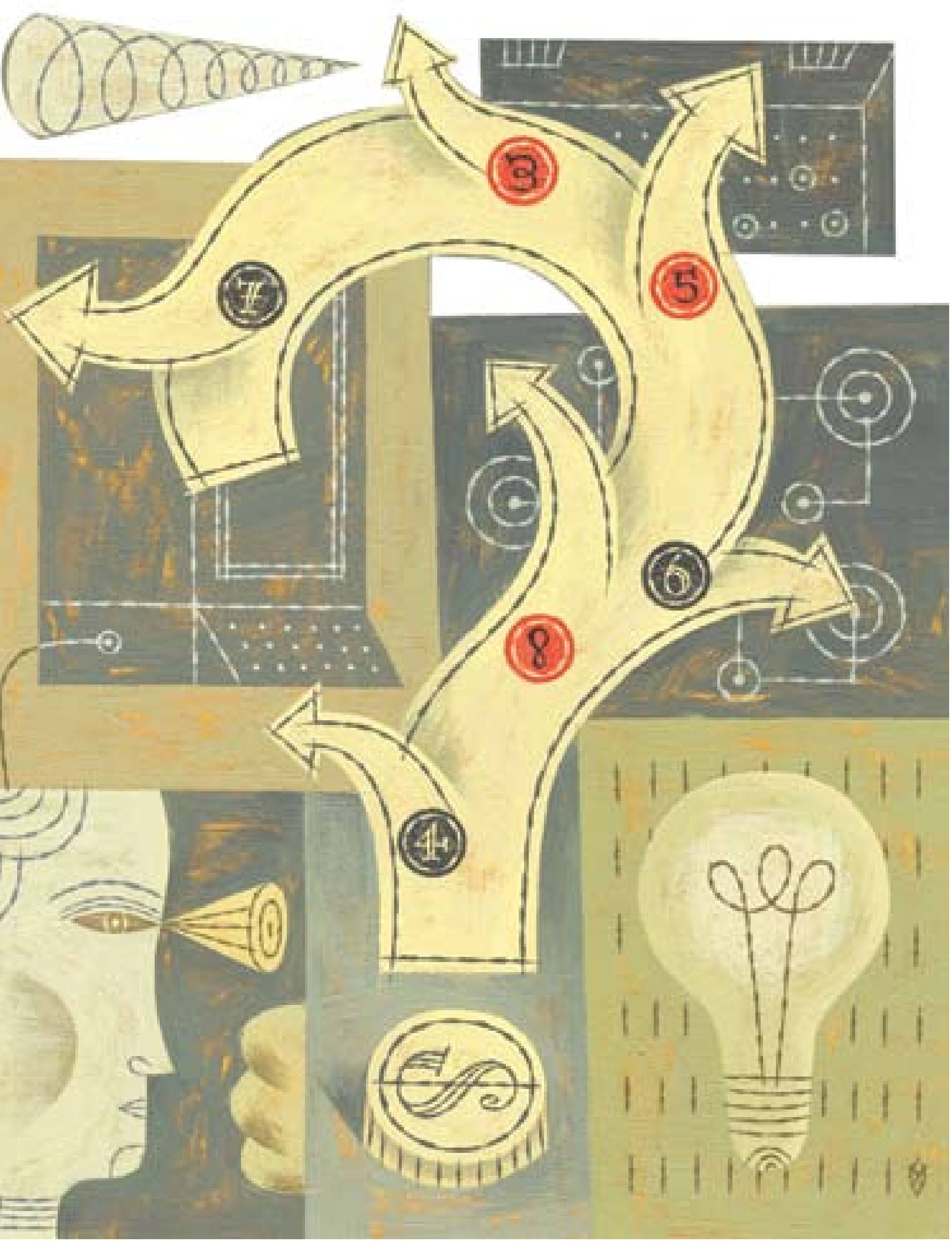
Claims Review Committee and staff at work.

We continue to reduce our outstanding inventory by closing more claims than we take in, while still closing over 89% of those claims without any indemnity payment.

Stepped up enforcement activities by the Texas Medical Board have resulted in more physicians defending themselves in TMB investigations. Our Medefense endorsement provides reimbursement coverage to assist our insureds with resulting unanticipated legal expenses. Medefense claim intake has more than quadrupled since 2003 and increased over 40% since 2005.

The 2003 medical liability reforms are working as intended to reduce the number of non-meritorious cases being filed. By capping only non-economic damages, Proposition 12 has injected actuarial predictability into the insurance market, without hampering the rights of plaintiffs to collect their economic damages on meritorious claims. Since reform measures were enacted, Texas physicians have saved millions of premium dollars. TMLT has reduced rates in record numbers and provided dividends to its policyholders. Access-to-care problems are disappearing as new physicians flock to Texas in record numbers. Dollars saved are being reinvested in the health care industry, and all of this is certain to benefit the health care available to Texans.

UNDERSTANDING How to Compare Carriers HELPS YOU MAKE the Best CHOICE



How do you know what to look for when you are choosing a medical liability insurer for your practice? A sophisticated buyer seeks to understand the key areas of comparison among different medical liability insurance carriers. Without this knowledge, you are relegated to making this important decision based on price. So what do you look for?

Begin with annual report evaluations of all insurance companies you are considering. Each year your medical liability insurance carrier should provide you with an audited financial statement. The statement may be in printed form or offered online. In either case, the statement should include a signed opinion by the company's auditors along with auditors' notes to the financial pages of the report. The auditors should be independent, experienced with evaluating financials in the medical liability industry, and reputable. Your accountant should be able to gauge the professional standing of the audit team.

Examine the balance sheet.

Having a clear understanding of what you must look for in a medical liability insurer's annual report may help determine your choice of carrier.

The chief financial officer's message summarizes the financial facts that are detailed in the financial pages, comparing them to the performance of the previous year. Graphs often accompany these comments so that you can compare the changes in company performance over time.

Examine the balance sheet. Look at the company's assets and assess their adequacy. Because an insurance carrier has made a promise through their policy contract to be prepared to pay substantial amounts in the future, it must have accumulated sufficient assets to meet those future commitments.

Check the company's overall policyholder surplus. The premiums that insurance companies collect from policyholders are computed to cover anticipated losses. However, carriers must also raise and accumulate additional funds to ensure that losses, in excess of the premium collected, can be paid in the years ahead. These funds are known as surplus, which comes from accumulated earnings or capital contributions.

An insurance company is only as strong as its surplus. Is the company's surplus growing or shrinking? Analyze why change in surplus is taking place. During the previous medical liability crisis, many companies left Texas because high claims activity had negatively affected their surplus, thus jeopardizing their financial stability. TMLT's surplus at that time was challenged by high claims frequency and severity. The medical liability reforms of 2003 have resulted in decreased claims activity and a strong surplus recovery over the past four years for TMLT.

If applicable, check the company's policy on returning surplus contributions made by policyholders. Some companies will return your surplus under certain conditions; others will not.

Next, check the company's premium to surplus ratio. This is an important measure of the stability of a medical liability insurance carrier. Ideally the ratio should reflect a minimum of $1 of surplus for every $1 of premium, or 1:1.

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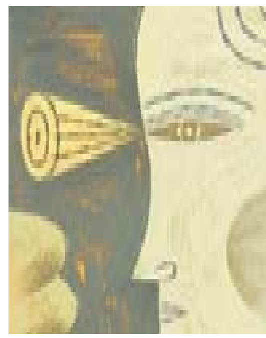


Read the footnotes that accompany the audited financials. There you will find information relating to the quality and duration of the investments, information on reserve development and other valuable information about the company.

After looking at the financial portion of the annual statement, there are other areas you will want to examine that will appear in the narrative of most annual reports. Continue to compare and contrast this information to help you select the medical liability carrier that will be the best fit for you and your practice.

Evaluate the management team of each company by comparing years of experience in the medical liability insurance industry and their track records—especially that of their claim department leadership. Medical liability is a highly specialized and volatile field. A company that has been in business in Texas for a number of years and whose leadership has been successful through the ups and downs of the industry has demonstrated expertise in the field.

An established company should have historical loss data that help it make better projections of future liabilities than a carrier new to the Texas market. The longer the company has been in business, the more data it has collected and the greater its knowledge. For insurance companies, accurate predictions help reinforce stability. TMLT has been protecting Texas physicians since 1979.

Some companies will offer a variety of liability limits. Policies with higher limits have greater financial exposure to potential loss. Most insurance companies will purchase reinsurance to provide a portion of that insurance coverage. While it may not be in the annual statement, you can check with the company's underwriting department to find out who provides this reinsurance.

If you want to have the best defense possible in case of a claim or lawsuit, you should pay particular attention to a company's legal defense firms, the defense team members, and their experience handling medical liability cases. A track record of success in Texas courtrooms is another meaningful mark. TMLT has closed more than 40,000 claims in its history. TMLT claims defense teams average more than 25 years experience defending doctors. In 2006, TMLT won 73 out of 75 cases taken to trial.

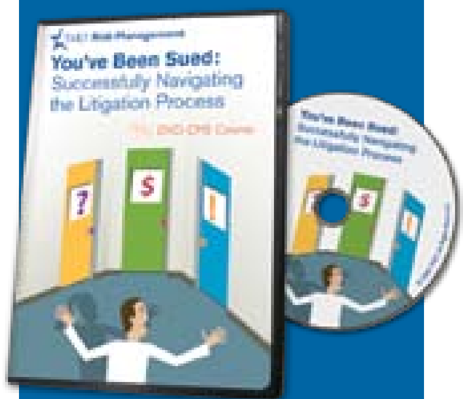
If customer service is important to you, see how many policyholders the company has in Texas. The larger the number, the greater that company's commitment to business in that state.

If customer service is important to you, see how many policyholders the company has in Texas. The larger the number, the greater that company's commitment to business in that state. If the company you are considering has a dedicated account services unit in Texas, then you have a good chance of receiving prompt service. A well-developed web site is another communications tool that can help you stay apprised of issues and more conveniently allow you to handle some of the administration of your insurance account.

Most other carriers issue a statutory financial statement while TMLT issues a financial statement prepared according to generally accepted accounting principles or GAAP. The auditors' opinion letter will state whether the report is a statutory or a GAAP report. In order for a comparison to be valid, you must compare GAAP to GAAP or statutory to statutory.

If you follow these suggested guidelines, you will be better able to determine the right carrier for you and your practice needs.

Order a copy of *You've Been Sued: Successfully Navigating the Litigation Process.*



This 3-hour DVD CME course is intended for physicians of all specialties who are interested in practical ways to reduce the potential for malpractice liability.

Contact TMLT's Risk Management Department at 800-425-5912 or email us at rebecca-henson@tmlt.org.

Risk Management

In addition to providing a stable, affordable source of medical liability insurance to Texas physicians, TMLT is committed to offering effective risk management services to minimize adverse events in patient care. Embracing risk management as an opportunity to create a safer environment for patients is important in our constantly changing health care environment. In 2006 the Risk Management Department continued the ongoing commitment of TMLT to provide proactive risk management services to policyholders that differentiate the Trust from other medical liability carriers.

Jane Holeman
Vice President, Risk Management

One of our most valuable services is the number of educational offerings we make available to our policyholders. Like many ACCME accredited providers nationally, we identified a trend away from live seminars and toward online courses and other independent studies. We were challenged with shifting gears to develop several new, innovative CME opportunities to meet the needs of busy physicians.

In 2006 compilations of actual TMLT closed claims studies, *Case Closed Volumes I* and *II,* were printed and accredited for 3 hours of CME. These courses contain actual cases from most specialties and illustrate situations where sound risk management practices may have either prevented a claim or improved the defensibility of the physician. A collaborative project with the Communications and Advertising Department produced the first 3-hour CME independent study, "Conflicts of Interest," published in the November-December issue of *the Reporter* newsletter.

Three new online courses were also added. "He's Not My Patient, Is He? Second Edition" incorporates real-life examples of patient-physician relationships and examines case law, to assist physicians in understanding how the courts interpret a physician's legal duty to provide care to a patient. "TMB Investigations Second Edition," written by a former TMB investigator, provides an insider's perspective on how to stay in the good graces of the TMB, with an emphasis on the new documentation rules. "Caring for the Young, the Old and Other Ethical Challenges," addresses difficult situations encountered while providing care in our complex health care system. Ethical standards combined with prudent risk management limit liability and lay the foundation for quality patient care and safety.

> …proactive risk management services…that differentiate the Trust from other medical liability carriers.

Finally the DVD, *You've Been Sued: Successfully Navigating the Litigation Process,* was finalized and is now available as a 3-hour independent study. The DVD depicts various deposition scenarios, demonstrating physician responses to often intimidating questions of a plaintiff attorney. The Claim Department uses this tool in preparing physicians for deposition and it is also available through the Risk Management Department as a 3-hour CME activity. Ed Mason, MD, Valley Emergency Physicians in Harlingen, states, "…I would like to commend TMLT for doing such a great job on the DVD… it's not only very complete and thorough in its coverage of the topic, but it's also very well done in it's video production… [I] encourage TMLT to automatically send this to any physician who reports receiving even a letter of intent to sue from a lawyer. This would not only be a tremendous help to the doctor, but would make for much better defendants at the outset for TMLT."

2006 TMLT facts at a glance

Claim Operations

Number of claims received	1,653
Number of claims closed	1,763
Claim frequency (including mass litigation)	11.2%
Percentage of claims closed without indemnity	89.73%
Number of cases taken to trial	75
Number of trial victories	73

Risk Management

Number of physicians attending TMA-TMLT CME programs	1,002
Number of physicians completing TMLT online CME courses	1,903
Total number of TMLT CME course completions	13,043
Number of physicians completing *Reporter* CME	4,088
Number of physicians completing *Case Closed* CME	1,340
Number of physicians receiving practice reviews	1,807

Problems most frequently encountered during practice reviews

1. Lack of after-hours patient telephone call documentation
2. Incoming reports initialed but not dated to demonstrate physician's timely review and necessary actions.
3. No consistent process identified to track consultant referrals, lab or diagnostic tests.

Sales and Marketing

Number of new policies	1,636
Total quotes made	4,578
Number of personal visits by sales staff	192
Number of medical conferences & events attended	33
Total number of direct mail campaigns	67
Total new written premium	$13,168,307

Underwriting Services

Total policyholder count	14,163
Number of policies cancelled due to underwriting action	21
Retention rate	95%
Total number of applications received	1,871

Underwriting Services

The year 2006 was the most successful year of operation in the history of Texas Medical Liability Trust. Along with reaching a new historic high policyholder count of 14,163 and achieving an impressive overall net growth of 7%, TMLT also managed to retain 95% of its physician policyholders!

John Alexander
Vice President, Underwriting Services

This accomplishment is remarkable for several reasons. First, policies can cancel during the year for a variety of reasons beyond our control. For example, physicians who retire or move out of the state will most definitely have their policies cancelled and consequently there is very little that can be done to retain their business. In fact, 58% of all cancellations in 2006 were for one of these "non-controllable" reasons.

The second reason why such a strong retention rate is significant is because of the level of competition that was present in the market in 2006. National insurance companies as well as new start-up companies competed aggressively for the business of TMLT's insureds. Despite the increase in competitors, TMLT not only held on to most of its existing business, but also acquired a sizeable amount of new business.

Finally, TMLT's high rate of retention cannot simply be explained by offering coverage at the lowest price. Even though TMLT has led the way by reducing premium rates in each year since the passage of medical liability reform in 2003, some of our major competitors have drastically lowered their price below that of TMLT, just in hopes of landing the business. This is not something TMLT will engage in. We prudently apply responsible rates and sound underwriting standards to the selection of new business. While we aim to provide superior coverage at the most reasonable price, we are often times not the lowest available.

The real reason for the strong retention begins with our commitment to Texas physicians. Our first priority is to provide a stable, reliable source of medical liability coverage and to combine that with unmatched service. Every member of the staff at TMLT is dedicated to assisting in their own way with safeguarding the professional reputations of our policyholders.

When the lasting benefits of medical liability reform became apparent in 2005, the TMLT Governing Board declared a policy dividend. At the time when policies renewed in 2006, a credit of 5% was applied to the premium invoice. Similarly, the board authorized a dividend of 20% for policies that renew in 2007. This type and level of return of profits to policyholders is unique at TMLT. Physician participation and guidance are TMLT trademarks and result in decision making that is consistently focused on the doctor.

The Underwriting Department strived to find ways for policyholders to do business quickly and easily with TMLT in 2006. An account services unit was created and charged with the responsibility of increasing TMLT's visibility to its policyholders. Underwriters and Account Representatives made more than 280 personal visits to TMLT policyholders in 2006. They delivered renewal information, inquired about changes to practices and answered questions. These visits provided us with information on developing trends and insight on how we can improve our services.

TMLT's strong retention expands its already prominent market share. This is further proof of the recognizable value of a policy with the Trust.

Strong membership loyalty allows TMLT to remain the market leader

Physician testimonials

"I would like to thank you for your insights and moral support through the years. Your encouragement and professionalism have been of great value to me. You are a great asset to the TMLT and its physician members."
from a TMLT policyholder *to a* claim supervisor

"I really appreciate your care and help with my recent situation. I was more than satisfied with the aid and cooperation I received. I believe that my issue (of the need to increase my limits of coverage) was handled with fairness and understanding, and at surprising speed. Again, thank you very much."
from a TMLT policyholder *to an* underwriter

"Thank you for all your help. You did a great job explaining my policy details. I appreciate your expertise and professionalism."
from a TMLT policyholder *to an* underwriter

"I want to thank you for all of your hard work & efforts in arriving at a successful outcome for this case. You were a supportive professional throughout & I always felt I could turn to you for support & advice. We as physicians insured by TMLT are fortunate to have you working on our behalf…I want to thank you for your availability & willingness to give me advice over the past many years when I call you with questions regarding "tricky" situations. You have excellent advice & have helped me to navigate the mine-field of medicine. Thanks again for all your hard work & talent."
from a TMLT policyholder *to a* claim supervisor

"At any time that I am asked by a D.O., I always recommend that they purchase TMLT or TMIC medical liability insurance. I find that your companies have provided a quality malpractice product. I have been greatly appreciative of all TMLT has done for TOMA and me."
from a TMLT policyholder *to a* sales manager

"I enjoyed meeting with both of you. TMLT is a great organization and I am sure that it is the people that make it so!"
from a group administrator *to* underwriting and sales representatives who traveled to meet them at their office site

"Well, I'm looking forward to working with you guys for another year! Everyone has been extremely helpful and always available to field all my questions. I sincerely appreciate it and I also speak on behalf of my doctors. Take care!"
from a group administrator *to an* underwriter

"TMLT is the best medical liability insurance I have had in 35 years of medical practice. Keep up the good work!"
from a TMLT policyholder responding *to a claim supervisor*

"We greatly appreciate your efforts to drive down, present a meaningful and interactive CME, stay late to further discuss issues and answer questions, then rush back to Dallas at the crack of dawn. We look forward to seeing you again…"
from a TMLT policyholder's medical staff analyst *to our* risk management education manager

"I want to thank you so very much for all the support, that you and TMLT have given us. I believe that you being there at the courthouse was more than a job. We both felt the support."
from a TMLT policyholder *to a* claim supervisor

"I would like to commend TMLT for doing such a great job on the DVD, 'You've Been Sued.' As I told you, it is not only very complete and thorough in its coverage of the topic, but it is also very well done in its video production. It is a much better quality production than the usual videoed conference…again, congratulations on a great job."
from a TMLT policyholder *to* risk management

"I have been looking at information at your web site as well as competitors, and really like what I see at TMLT. This process is a little overwhelming, being my first time to look at malpractice insurance, but the TMLT web site is very well designed. It is straightforward and easy to navigate. I felt like a 'little fish in a big ocean' with some of the competitors' web sites. It is for these reasons I plan to go with TMLT."
an applicant to TMLT writing *to our* sales department

"Absolutely the best supervisor and best attorneys in Texas. Lawsuits are horrible, but if you have to fight, TMLT is the only company I would want in my corner. Great job!"
from a TMLT policyholder responding on a satisfaction survey

Sales and Marketing

Since the passage of tort reform in 2003, Texas has become a very desirable market for medical liability coverage. Along with the fact it is the fourth largest market countrywide with an available premium base in excess of $800 million, Texas has become an attractive venue for carriers offering medical liability coverage.

The entry of new carriers as well as existing ones seeking to grow market share has led to a very competitive environment. With excess capacity and favorable earnings driven by a dramatic reduction in claims intake and severity, many competitors are aggressively selling on price often engaging in bidding wars to secure the business.

As the industry leader with a statewide market share of 45%, TMLT continues to operate from a position of strength resisting the urge to seek top line growth at the expense of responsible pricing. Our objective remains unchanged—provide Texas physicians with the best value by offering uncompromised coverage at fair and reasonable rates backed by the best service in the industry.

For those physicians seeking a long term relationship that provides value and stability, TMLT continues to offer its policyholders opportunities to manage their medical liability costs through risk management based programs that are informative and include earned premium credits. And for those policyholders that maintain favorable claims experience premium credits up to 20% are available.

Don Chow
Senior Vice President, Sales & Marketing

In addition, TMLT has reduced rates a total of 29.5% during the past four years and declared two dividends totaling 25%. The cumulative premium savings for our policyholders is in excess of $180 million.

As you can see, the true cost of medical liability coverage needs to be measured in the context of a long term perspective. Actual cost needs to be evaluated by the opportunities offered to manage your premium, not just upfront rates that appear to suggest a premium savings. TMLT has effectively demonstrated the ability to combine value added services with competitive pricing over an extended period of time.

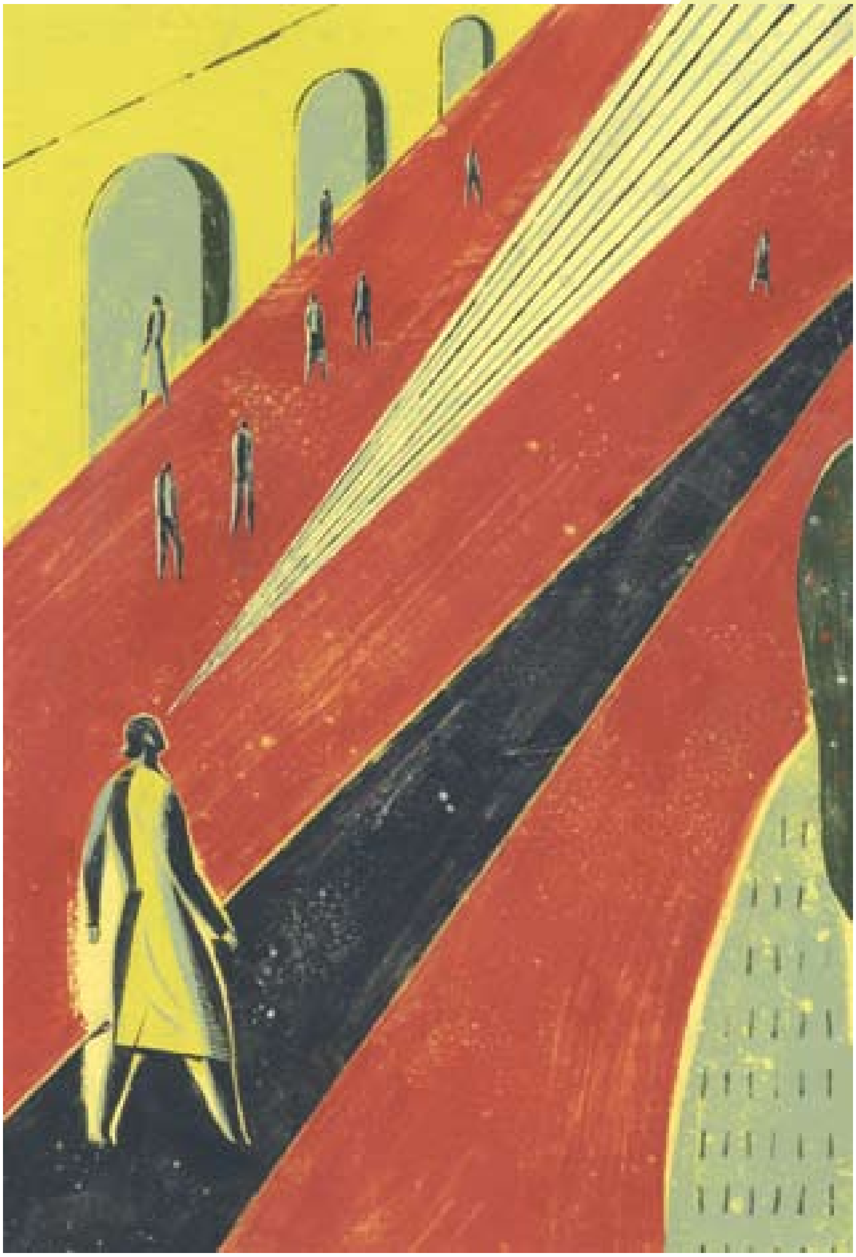
Much of our success in 2006 can be attributed to the efforts our dedicated sales staff and select group of appointed agents. This hybrid distribution system has allowed TMLT to realize the benefits of strong new business growth with physicians ranging from solo, small group, to large group practices. During the past year our agents represented 35% of new premium generated while the TMLT sales staff played an instrumental role in the 7% growth of our policyholder count.

One of our core philosophies is to listen to the issues expressed by our policyholders and our Governing Board, always focusing our business decisions so that we serve the best interests of Texas physicians. We believe our close relationship with organized medicine helps us meet this objective. None of our competitors can claim the endorsements that TMLT has earned in our 27 years of operation. We take these relationships seriously and work hard to preserve them.

We understand that our physicians often manage tight budgets. However, I would advise not to shop for medical liability coverage solely on price. Too much is at stake to trust a low-price provider with your practice. We urge you to trust the proven and respected choice in Texas—TMLT.

> TMLT offers the best coverage in Texas

Far Reaching *Effects* of *Medical Liability Reform*



It's been three years since the landmark medical liability reforms—House Bill 4 and Proposition 12—took effect in Texas. Since that time, the turnaround has been dramatic. For physicians, rates for medical liability insurance are down and several carriers have entered the Texas market. Patients now have access to more physicians and health care services. Medical liability reform has been a resounding success.

Others have taken note of Texas' success. Citing the 2003 reforms, the American Medical Association removed Texas from the list of states in medical liability crisis on May 16, 2005. In a study called the *U.S. Tort Liability Index: 2006 Report*, the Pacific Research Institute put Texas at number 1 on its list rating the most business-friendly state legal environments. (The Institute is a California-based think tank that promotes free markets.) U.S. Senator Kay Bailey Hutchison said on the floor of the U.S. Senate "Medical liability reform works! Lawsuits are down, insurers have returned to the state, rates are down, and physician numbers are up. With this insurgence of skilled physicians, access to care has improved."

Here's a look at the specific effects

on claim intake, insurance rates, and physician growth.

DECREASE IN CLAIMS

TMLT has experienced a drop in claim intake since the 2003 reforms took effect. From 2000 to 2003, claim intake at TMLT—not including mass litigation—was 2154, 2265, 2165 and 2880 respectively. (The 2003 number is inflated due to the "rush to the courthouse" to file claims before the new law took effect.) From 2004 to 2006, claim intake at TMLT—not including mass litigation—was 1228, 1351, and 1430 respectively.

The drop in claim intake across Texas has been confirmed by a number of other sources, including the *American Bar Association Journal*. According to the article, the number of malpractice cases filed in Harris County is down 41 percent from the average number of filings before tort reform was enacted. "Between 1997 and 2002, the average number of cases filed each year was 435. The 2003 rush to file before the new law took effect pushed that year's tally to 1,203. The following year, only 204 cases were filed, and that number rose only slightly in 2005 to 256."[1]

The *ABA Journal* article also reported on information from the University of Texas System Professional Medical Liability Plan, which insures more than 10,000 physicians and medical students. The plan has seen a "55% decline in new lawsuits filed when comparing 2002 and 2005."[1]

EFFECTS ON RATES

At TMLT, rates have dropped for all policyholders (regardless of specialty or practice location) as follows: 12% in 2004; 5% in 2005; and 5% in 2006. Another decrease of 7.5% took effect in January 2007. This amounts to $139 million in premium savings for TMLT policyholders.

As a result of our strong financial position, TMLT has also returned dividends to policyholders: 5% in 2006 and 20% in 2007. This amounts to $42 million in savings.

Four of the state's other physician liability carriers, including the Joint Underwriting Association, have cut their rates since the 2003 reforms took effect. These cuts have ranged from 2% to 24%.

In addition to the cuts by existing carriers, the Texas Department of Insurance lists more than 30 carriers licensed to write medical liability coverage in Texas. This is up from just four carriers in 2003. Texas physicians can compare policies, costs, and services when shopping for medical liability insurance. Real choice has returned to Texas.

ACCESS TO CARE

Texas patients are also benefiting from reform. Since 2003, there has been a net gain of 4,000 physicians in Texas. The Texas Medical Board (TMB) also reports a significant increase in physician licensure application in 2006. "Texas is experiencing an unparalleled growth in licensure applications from physicians seeking to practice in Texas," says TMB Executive Director Donald Patrick, MD, JD. "During the first half of this fiscal year, there was an 88 percent increase over the same period of fiscal year 2003. While there was mostly steady growth between 2000 and 2005, projections for 2006 are dramatically higher."[2]

Dr. Patrick says the success of Texas' liability reforms is the "only one viable hypothesis" to explain the huge increase. "Tort reform as enacted appears to be working as envisioned by the Texas Legislature. Physicians with no malpractice history are flocking to Texas because it provides a more encouraging environment for the practice of medicine," he says.[2]

Dr. James Thompson, president and CEO of the Federation of State Medical Boards, told *The Houston Chronicle* that the Texas situation is extraordinary. "To the best of my knowledge, this is unprecedented to have this level of increase in applications and have it sustained for this long."[3]

Texas has seen physician growth in traditionally underserved areas and in hard-to-recruit specialties.

In the 18 months before the passage of medical liability reform, the Beaumont medical community saw a net loss of 12 doctors. Since the reforms, the community has gained 26 physicians including seven anesthesiologists and 18 emergency medicine physicians.

The Rio Grande Valley has added 128 physicians since 2003. That represents a 10.6 percent increase in Hidalgo County and a 13.3 percent increase in Cameron County.

"Texas is experiencing an unparalleled growth in licensure applications from physicians seeking to practice in Texas."

Victoria, which had also seen a net loss in physicians in the 18 months before medical liability reform, has added two emergency medicine physicians, two cardiologists and a kidney specialist.

Laredo's Webb County has added three emergency medicine physicians, five family physicians, an orthopedic surgeon, a cardiovascular surgeon, an obstetrician, a kidney specialist, and an ear, nose and throat doctor.

The number of physicians serving the state's most populous county, Harris County, has grown by 762. Among the additions to the Houston medical community are 65 emergency medicine physicians and eight neonatologists.[4]

The Texas Medical Association keeps a list of physicians who are willing to share with the news media the details of how liability reform has helped them provide better care for their patients. These include:

A family physician from San Antonio who kept his vow to resume volunteering on Saturdays at a community health clinic in rural South Texas if Proposition 12 passed. He provides care for patients with no insurance or who are on Medicaid.

An emergency medicine specialist in Houston who says the reforms allow his group practice to perform less "defensive medicine," conserving precious health care resources for those who need them the most. With lower liability insurance premiums, the group is also able to provide more care to uninsured patients in the ED.

In June of 2003 the Texas Legislature passed one of the nation's most comprehensive and far-reaching medical liability reform bills.

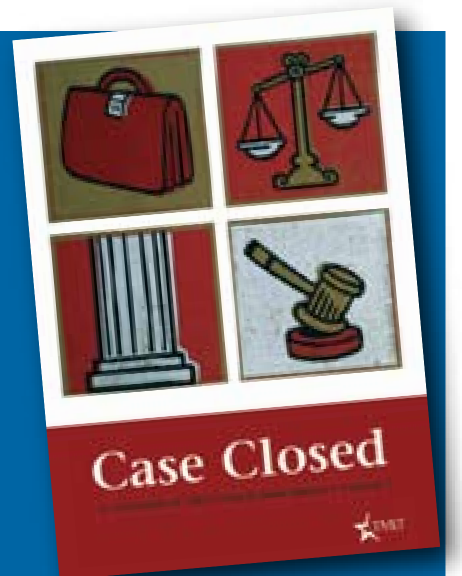
Now available

Case Closed Volume II

Case Closed: A collection of TMLT closed claim studies Volume II contains 50 closed claim studies based on actual TMLT claims. These cases represent claims with clear risk management issues—documentation errors, failure to diagnose, communication errors.

Physicians can earn 4 hours of CME—including 1 ethics hour—by completing the CME activity included in *Case Closed.* TMLT policyholders who complete this activity will earn a 3% premium discount (maximum $1,000) applied to their next eligible policy period.

Request a free copy of *Case Closed Volume II* by emailing claimbook@tmlt.org. Please include your name and mailing address in your email.



Another emergency physician in Houston says his ED is now able to provide coverage from nearly all medical specialties.

An El Paso surgeon who says he has been able to recruit two neurosurgeons and other specialists to that medically-underserved urban area.

An ophthalmologist in Tyler who now provides more charity care, including free exams to residents of homeless shelters and evacuees from Hurricane Katrina.

A family physician in Uvalde who "was rescued from giving up practicing in obstetrics" by the liability reforms. He is looking forward to delivering his 4,000th baby.

The managing physician of a large multi-specialty clinic in Houston who says his group used its savings from liability insurance premiums to purchase a comprehensive electronic medical record system.

An orthopedic surgeon in Beaumont who says his community now is able to provide wide-ranging medical services locally rather than having to transfer severely sick or injured patients to hospitals 100 miles away. He reports Beaumont has seen tremendous improvements in its ability to recruit physicians to serve in what some consider a "lawsuit war zone."

A Dallas urologist whose practice serves all types of patients, "from CEOs to people who live under bridges," who reports that he can now care for many more uninsured or underinsured patients.

An Austin family physician who decided to buy a new office and stay in private practice for 15 more years.[5]

In June of 2003 the Texas Legislature passed one of the nation's most comprehensive and far-reaching medical liability reform bills. This reform is working to keep frivolous cases out of the system and medical liability insurance rates at reasonable levels. In turn, new physicians are flocking to Texas, encouraged by the improved legal environment. Texans now have greater access to the health care they need. Overall, medical liability reform has been good for Texas patients and good for Texas physicians.

SOURCES

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3. Brune B. Doctors find a long wait to see patients in Texas. *The Houston Chronicle*. January 25, 2007.
4. Texas Alliance for Patient Access. Information available at www.tapa.info.
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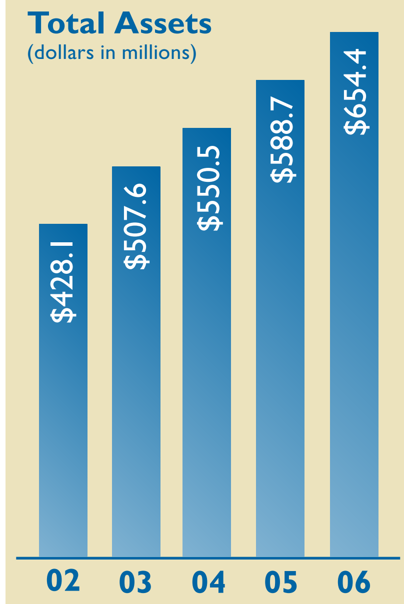
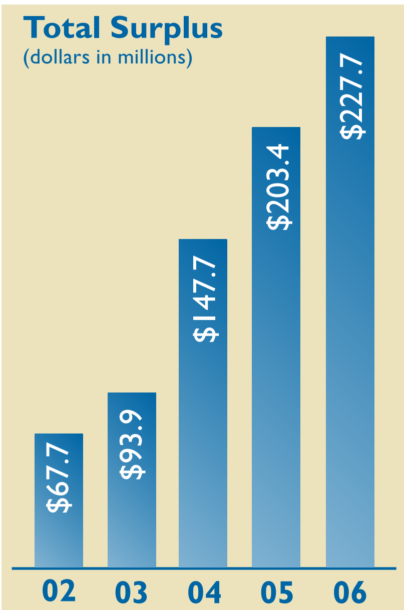
Message from the CFO

The accompanying consolidated financial statements have been prepared under TMLT management's direction in conformity with accounting principles generally accepted in the United States and, where appropriate, reflect estimates based on our management's best judgment. The financial information included in this annual report is consistent in all material respects with that contained in the audited financial statements.

TMLT management is responsible for the integrity and objectivity of the company's financial statements. We also recognize our responsibility to foster a strong, ethical climate where TMLT's business affairs are conducted according to the highest standards of personal and corporate conduct.

Ray Demel
Senior Vice President, CFO





Calhoun, Thomson & Matza, LLP, TMLT's independent public accountants, have audited TMLT's financial statements. These independent public accountants obtained a sufficient understanding of the internal controls in place in order to plan their audit and determine the nature, timing and extent of other tests to be performed. Their report appears on page 24. It expresses an informed opinion that the consolidated financial statements fairly present the consolidated financial position of TMLT.

THE NUMBERS

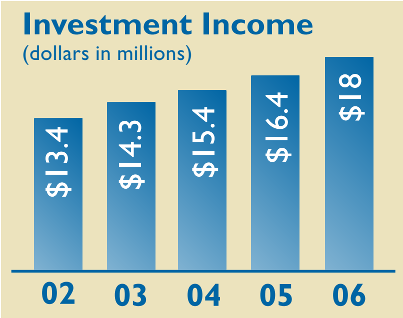
At the end of 2006, total assets were $654 million compared to $589 million in 2005, an increase of $65 million. Continued positive cash flow from operations and additional surplus contributions resulted in a boost of $55 million in total investments (bonds and equities) and cash. Total liabilities increased $41 million. This change occurred primarily because of a $16 million rise in the reserve for unpaid losses and expenses (due to reserve increases taken in 2006) and a $24 million increase in policy dividends payable as a result of the 20% dividend declared in 2006. Surplus grew $24 million to $227 million due primarily to current year net earnings of $18 Million. We are pleased to see that emerging data suggests moderating trends in loss costs, which have allowed us to lower our rates in 2006 and again for 2007.

WRITTEN PREMIUMS

Professional liability total written premiums vary from period to period for a number of reasons. Some of the more common differences result from rate changes, the volume of new business written during the period, and the loss of business to competitors or because of underwriting decisions. Total written premium in 2006 was $188 million compared to $191 million in 2005. Net earned premium income in 2006 was $161 million compared to $165 million in 2005. This small change can be attributed to a 5% rate reduction that was implemented in 2006 offset by new written business.

INVESTMENTS

Professional, third party asset managers manage TMLT's portfolio. They have the authority to make investment decisions, subject to investment policies, within the asset class



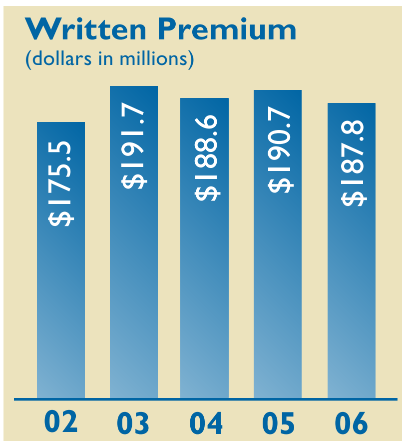
under their supervision. Net investment income and capital gains grew $1.8 million to $19.1 million in 2006. The increase in our net investment income in 2006 resulted from both higher average invested funds and a slight increase in current interest rates, which elevated the yield of our fixed maturity securities. Because of the higher after-tax yields available, we also expanded the proportion of the portfolio invested in tax-exempt securities. Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, and portfolio duration and diversification.

COMBINED RATIO

A combined ratio is comprised of the loss ratio plus the expense ratio. Our loss ratio was 58% in 2006 compared to 43.2% in 2005. Our combined ratio (including policy dividends) in 2006 was 95.2% compared to 64.2% in 2005. Without the dividends declared in 2006 and 2005, the combined ratios would have been 75.2% and 58.6% respectively.

All of these ratios are lower than the composite ratio of medical liability specialty writers. TMLT ended the year 2006 with pre-tax net income of $27.4 million compared to $76.8 million for 2005. This is a decrease of $49.4 million. The primary reason for this decrease was the $24 million increase in policy dividends and an increase of $16.4 million in claims expense due to raising actuarial reserves.

The most important thing an insurance company can provide its policyholders is financial security and the peace of mind knowing that the company will be there to defend the policyholder and to pay claims when needed. We believe that our strong reputation along with our financial strength, strong customer service and proven ability to manage claims should enable us to expand policyholder base in Texas. We emphasize disciplined underwriting and we do not manage our business to achieve a certain level of premium growth or market share. We have continued to build our financial strength during difficult market conditions by responsible pricing and loss reserving practices.



We have seen an increase in competition during the year by both existing insurers as well as by new entrants – mainly in the form of risk retention groups and other risk pooling entities. While most competitors seem to be maintaining price and underwriting discipline, we are seeing an increase in competition primarily on price. New entrants to the market are usually more aggressive in searching for new business and usually willing to compete on price. Because of this, healthy growth in the future may be difficult. Our premiums are set to provide insurance coverage at a fair price - not to maximize profits. TMLT is doctor-owned and TMLT's responsibility is to provide its policyholders with a financially sound carrier and insurance coverage at a fair price.

Ray Demel
Senior Vice President, CFO

TEXAS MEDICAL LIABILITY TRUST AND SUBSIDIARY

Consolidated financial statements • Year Ended December 31, 2006 and 2005

Independent Auditors' Report

ct m Calhoun, Thomson+Matza, LLP
Certified Public Accountants

Board of Directors
Texas Medical Liability Trust and Subsidiary
Austin, Texas

We have audited the accompanying consolidated balance sheets of Texas Medical Liability Trust and Subsidiary as of December 31, 2006 and 2005, 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined 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, 2006 and 2005, 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 of America.

Calhoun, Thomson & Matza, LLP

March 23, 2007

Balance Sheets

December 31,	**2006**	2005
	(in thousands)	
Assets		
Securities, available-for-sale, at fair value:		
Fixed-maturity securities	**$ 345,573**	$ 316,764
Common stocks	**46,541**	40,457
Preferred stocks	**989**	1,197
Securities, held to maturity – fixed maturity annuities	**24,500**	24,500
Cash and cash equivalents	**58,088**	45,415
Premiums receivable	**78,445**	60,629
Accrued interest receivable	**4,214**	3,632
Surplus contributions receivable	**725**	1,025
Reinsurance recoverables:		
On paid losses	**2,880**	3,655
On unpaid losses and loss adjustment expenses	**44,547**	50,633
Prepaid reinsurance premiums	**14,768**	9,794
Federal income tax recoverable	**6,620**	-
Deferred tax asset	**15,300**	16,300
Deposits	**68**	4,145
Other	**11,178**	10,560
Total assets	**$ 654,436**	$ 588,706

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

Balance Sheets

December 31,	**2006**	2005
	(in thousands)	
Liabilities and Policyholders' Surplus		
Liabilities		
Reserves:		
Unpaid losses and loss adjustment expenses	**$ 258,458**	$ 240,833
Unearned premiums	**88,947**	90,568
	347,405	331,401
Revolving line-of-credit	**13,518**	13,518
Premiums received in advance	**5,894**	3,967
Federal income tax payable	-	1,100
Policyholder dividends payable	**32,913**	9,000
Accounts payable and accrued expenses	**1,422**	876
Reinsurance premiums payable	**25,619**	25,430
Total liabilities	**426,771**	385,292
Commitments and contingencies (Notes 3, 4, 6, 8, 9 and 10)		
Policyholders' surplus:		
Contributed surplus	**91,272**	91,629
Surplus contributions receivable	**(1,494)**	(4,761)
	89,778	86,868
Accumulated other comprehensive loss	**(431)**	(3,207)
Unassigned surplus	**138,318**	119,753
Total policyholders' surplus	**227,665**	203,414
Total liabilities and policyholders' surplus	**$ 654,436**	$ 588,706

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

Statement of Operations

Years Ended December 31,	**2006**	2005
	(in thousands)	
Premiums earned, net of reinsurance	**$ 160,122**	$ 164,656
Investment income, net of investment expenses of $921 in 2006 and $694 in 2005	**18,068**	16,447
Net realized gain on securities available for sale	**1,081**	891
Other revenue	**1,197**	3,245
Total revenues	**180,468**	185,239
Losses and expenses:		
Losses and loss adjustment expenses	**89,632**	73,223
Policyholder dividends	**32,879**	9,000
Other underwriting expenses	**30,492**	26,129
Total operating expenses	**153,003**	108,352
Net income before income tax expense	**27,465**	76,887
Income tax expense	**8,900**	24,638
Net income	**$ 18,565**	$ 52,249

Statement of Changes in Policyholders' Surplus

	Contributed Surplus	Unassigned Surplus	Accumulated Other Comprehensive Income (Loss)	Total Policyholders' Surplus
		(in thousands)		
Balance, January 1, 2005	$ 78,987	$ 67,504	$ 1,184	$ 147,675
Other comprehensive loss	-	-	(4,391)	(4,391)
Net income	-	52,249	-	52,249
Contributed surplus, net	7,881	-	-	7,881
Balance, December 31, 2005	86,868	119,753	(3,207)	203,414
Other comprehensive income	-	-	2,776	2,776
Net income	-	18,565	-	18,565
Contributed surplus, net	2,910	-	-	2,910
Balance, December 31, 2006	$ 89,778	$ 138,318	$ (431)	$ 227,665

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

Statement of Cash Flows

Years Ended December 31,	**2006**	2005
	(in thousands)	
Operating activities:		
Net income	**$ 18,565**	$ 52,249
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**2,263**	657
Gain/loss on disposal of fixed assets	**(168)**	11
Gain on investment in partnership	**(394)**	-
Deferred income taxes	**2,589**	1,562
Net realized gains	**(1,064)**	(1,185)
Amortization of premium / accretion of discount in bonds	**(2,051)**	1,713
Changes in operating assets and liabilities:		
Premiums receivable	**(15,889)**	(981)
Reinsurance recoverables	**6,861**	10,098
Federal income tax recoverable	**(6,620)**	4,300
Reserves for unpaid loss and loss adjustment expenses	**16,004**	(30,466)
Reinsurance premiums payable	**(4,785)**	3,772
Federal income tax payable	**(1,100)**	1,100
Deposits	**4,077**	(239)
Policyholder dividends payable	**23,846**	9,000
Other, net	**774**	211
Net cash provided by operating activities	**42,908**	51,802
Investing activities:		
Purchases of securities	**(128,804)**	(143,519)
Proceeds from disposals and maturities of securities	**98,421**	93,738
Investment in partnership	**(967)**	(2,400)
Purchases of fixed assets	**(2,095)**	(3,409)
Net cash used in investing activities	**(33,445)**	(55,590)
Financing activities:		
Surplus contributions	**3,210**	9,856
Net change in cash and cash equivalents	**12,673**	6,068
Cash and cash equivalents, beginning of year	**45,415**	39,347
Cash and cash equivalents, end of year	**$ 58,088**	$ 45,415

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

Summary of Significant Accounting Policies

Organization

Texas Medical Liability Trust (TMLT) was formed in June 1978 to provide professional liability insurance coverage to eligible physicians who are members of the Texas Medical Association (TMA) and who practice primarily in Texas. TMLT 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.

TMLT provides professional liability coverage to certain physicians who are non-TMA members and the ancillary staff of TMLT'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 TMLT and TMIC (collectively the "Trust") after elimination of all significant intercompany accounts.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect 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 and are computed on a daily pro-rata basis.

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 application. 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 Trust's consulting actuaries based on available industry data and the Trust's actual experience and represent estimates of the ultimate cost of all losses incurred, but unpaid, through year end. However, the ultimate cost of settling claims may vary significantly from the estimated liability. The estimates are continually reviewed and adjusted as necessary; such adjustments are included in current operations and are accounted for as changes in estimates.

Unpaid losses and loss adjustment expenses have been discounted using a 4% factor as of December 31, 2006 and 2005. This discount reduces gross unpaid losses and loss adjustment expenses to their present value. The discount amount was approximately $15.8 million at December 31, 2006 and 2005.

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, 2006 and 2005.

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%. 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

Statement of Financial Accounting Standards ("SFAS") No. 115 requires that certain debt and equity securities be classified into one of three categories: held-to-maturity, available-for-sale, or trading securities. Investments in debt securities that the enterprise has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost in the statement of financial position. Securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) are classified as trading securities and reported at fair value. Trading generally reflects active and frequent buying and selling, and trading securities are generally used to generate profit on short-term differences in price. Investments not classified as either held-to-maturity or trading securities are classified as available-for-sale securities and reported at fair value.

Investments, except investments in certain annuities, 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.

Investments in annuities are classified as held to maturity and are carried at amortized cost. The Trust has the intent and ability to hold these investments to maturity.

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 using the effective interest method. 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.

Reclassifications

Certain prior year balances have been reclassified to conform to current year presentation.

Notes to Consolidated Financial Statements

1.Comprehensive Income

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

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

Years ended December 31,	**2006**	2005
	(in thousands)	
Changes in unrealized gains (losses) on available-for-sale securities	**$ 4,270**	$ (6,653)
Deferred income tax benefit (expense)	**(1,494)**	2,262
Other comprehensive income (loss)	**$ 2,776**	$ (4,391)

Accumulated other comprehensive income shown on the consolidated statements of changes in policyholders' surplus is solely comprised of unrealized losses from available-for-sale securities, net of related tax benefit of approximately $232 thousand and $1.7 million for the years ended December 31, 2006 and 2005, respectively.

2. Securities

The amortized cost and the fair value of the Trust's investments in fixed- maturity securities and annuities for both available for sale and held-to- maturity are summarized as follows:

December 31, 2006:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
U.S. Government and its agencies	**$ 185,905**	**$ 802**	**$ 1,970**	**$ 184,737**
Annuities	**24,500**	**4,503**	-	**29,003**
Corporations	**60,310**	**98**	**1,432**	**58,976**
Loan-backed securities and collateralized mortgage obligations and other	**104,470**	**355**	**2,966**	**101,859**
	$ 375,185	**$ 5,758**	**$ 6,367**	**$ 374,576**

December 31, 2005:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
U.S. Government and its agencies	$ 116,680	$ 83	$ 1,347	$ 115,416
Annuities	24,500	3,101	-	27,601
Corporations	62,594	186	1,444	61,336
Loan-backed securities and collateralized mortgage obligations and other	143,352	666	4,006	140,012
	$ 347,126	$ 4,036	$ 6,797	$ 344,365

At December 31, the Trust's investment in common stocks and preferred stocks had a cost basis of approximately $43.1 million and $40.7 million in 2006 and 2005, respectively. Gross unrealized gains and gross unrealized losses were approximately $8.4 million and $3.9 million, respectively in 2006 and approximately $3.9 million and $2.9 million, respectively in 2005.

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 and annuities at December 31, 2006 are summarized, by stated maturities, as follows:

	Amortized Cost	**Estimated Fair Value**
	(in thousands)	
Years to maturity:		
One or less	$ 6,110	**$ 5,952**
After one through five	69,911	**68,229**
After five through ten	101,207	**101,541**
More than ten	93,487	**96,995**
Loan-backed securities and collateralized mortgage obligations	104,470	**101,859**
	$ 375,185	**$ 374,576**

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 approximately $77.5 million in 2006 and $93.7 million in 2005. Gross realized gains and gross realized losses on these sales were approximately $2.0 million and $879 thousand, respectively, during 2006, and approximately $1.7 million and $912 thousand, respectively, during 2005.

3. 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 2006 and 2005:

Years ended December 31,	**2006**	2005
	(in thousands)	
Reserve for unpaid losses and LAE, net of related reinsurance recoverables at beginning of the year	**$ 190,200**	$ 218,148
Add provision for claims, net of reinsurance, occurring in:		
Current year	**85,469**	74,192
Prior years	**4,163**	(969)
Incurred losses during the current year, net of reinsurance	**89,632**	73,223
Deduct payments for claims, net of reinsurance, occurring in:		
Current year	**5,446**	4,011
Prior years	**60,475**	97,160
Net claim payments during the year	**65,921**	101,171
Reserve for losses and LAE, net of related reinsurance recoverables, at end of year	**213,911**	190,200
Reinsurance recoverables on unpaid losses and LAE, at end of year	**44,547**	50,633
Reserve for unpaid losses and LAE, gross of reinsurance recoverables on unpaid losses, at end of year	**$ 258,458**	$ 240,833

The foregoing reconciliation shows that the Trust's reserve for unpaid losses and LAE, net of related reinsurance recoverable, at December 31, 2006 increased by approximately $4.2 million primarily as a result of unfavorable reserve development. The increase is a result of ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims. At December 31, 2005, unpaid losses and LAE, net of reinsurance decreased by $969 thousand for claims that had occurred on or prior to 2004. The decrease is a result of ongoing analysis of recent loss development trends.

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.

4. 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 affected 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:

	2006 Premiums		2005 Premiums	
	Written	**Earned**	Written	Earned
		(in thousands)		
Direct	$ 187,850	$ 188,370	$ 190,710	$ 191,466
Ceded	(32,789)	(28,248)	(23,727)	(26,810)
Net premiums	$ 155,061	$ 160,122	$ 166,983	$ 164,656

The amounts deducted from losses and loss adjustment expenses in the statements of operations that related to reinsurance were approximately $4.8 million for 2006 and $8.1 million for 2005.

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.

5. Federal Income Taxes

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

Years ended December 31,	**2006**	2005
	(in thousands)	
Current expense	**$ 8,899**	$ 25,338
Deferred expense (benefit)	**1**	(700)
	$ 8,900	$ 24,638

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

December 31,	**2006**	2005
	(in thousands)	
Deferred tax assets:		
Loss reserve discounting	**$ 9,978**	$ 9,521
Capital loss carryover	**1,974**	-
Unearned premium discounting	**5,606**	5,765
Other	**180**	1,615
Total deferred tax assets	**17,738**	16,901
Valuation allowance for deferred tax assets	**1,974**	-
Total deferred tax assets, net of allowance	**15,764**	16,901
Deferred tax liabilities:		
Other	**(464)**	(601)
Net deferred tax asset	**$ 15,300**	$ 16,300

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. Management believes that it is more likely than not that the net deferred tax asset recorded at December 31, 2006 will be realized from expected future taxable income, except for the benefits derived from the capital loss carryover of approximately $2.0 million.

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 2006 and 2005 resulted primarily from the effects of tax-exempt interest, nondeductible items, and changes in the valuation allowance. Income tax paid during 2006 and 2005 was approximately $16.6 million and $19.9 million respectively.

6. Revolving Line-of-Credit

The Trust entered into an agreement with a commercial lender which provides the Trust with a revolving credit facility of $25 million (approximately $13.5 million outstanding at December 31, 2006 and 2005). The funds available under the credit agreement may be used for general corporate purposes. The revolving credit facility expires in January, 2008. Under the revolving credit facility, the Trust granted liens with respect to certain fixed maturity investments owned by the Trust.

Interest on borrowings under the credit agreement is determined, at the Trust's option, based on the prime rate minus 2.35% or the LIBOR rate plus a margin of 0.7%. There is a commitment fee of .08% on the unused balance. At December 31, 2006, the prime rate was 7.25%. In January 2005, the Trust entered into an interest rate swap transaction, whereby the transaction effectively hedged its variable rate to a fixed rate of 4.02% on $7,500,000. The swap will expire in February 2007. The effects of this transaction are insignificant and have been included in the Trust's earnings.

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. Surplus contributions are refunded to the physician at the discretion of the Trust or when a physician dies, becomes disabled, retires, or moves out of state.

As of December 31, 2006 and 2005, surplus contributions receivable of approximately $725 thousand and $1.0 million, respectively, represent collections subsequent to year-end but prior to the issuance of the consolidated financial statements. In accordance with EITF 85-1, these amounts were recorded as an asset as opposed to a reduction of policyholders' surplus.

8. Commitments and Contingencies

The Trust leases office facilities and certain equipment through agreements which expire through 2011. As of December 31, 2006, the future minimum lease payments under these noncancelable agreements for the years ending December 31 are as follows:

Year	Amount
	(in thousands)
2007	$ 1,206
2008	1,458
2009	1,458
2010	1,458
2011 and thereafter	1,458
	$ 7,038

Total rent expense was approximately $1.3 million for 2006 and $1.2 million for 2005.

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. In lieu of purchasing surety bonds on cases being appealed, the Trust has placed approximately $35 thousand and $4.1 million in deposits with the courts at December 31, 2006 and 2005, respectively.

9. Concentrations of Credit Risk

The Trust has concentrations of credit risks relating to reinsurance recoverable balances and cash balances at financial institutions in excess of insured amounts. The Trust believes the risk of incurring material losses related to these credit risks is unlikely.

10. 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 approximately $2.3 million for 2006 and $1.5 million for 2005.

11. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents. For those cash equivalents, the carrying value amount is a reasonable estimate of fair value.

Investment in Securities. For investments in securities, fair values are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Accounts Payable, Accrued Expenses and Revolving Line-of-Credit. The carrying values approximate fair value.

The estimated fair values of the Trust's financial instruments which are not disclosed on the face of the balance sheet or elsewhere in the notes are as follows:

	2006		2005	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
	(in thousands)			
Cash and cash equivalents	**$ 58,088**	**$ 58,088**	$ 45,415	$ 45,415
Fixed maturity securities	**370,073**	**374,576**	341,264	344,365
Common stocks	**46,541**	**46,541**	40,457	40,457
Preferred stocks	**989**	**989**	1,197	1,197
Accounts payable and accrued expenses	**(1,422)**	**(1,422)**	(876)	(876)
Revolving line-of-credit	**(13,518)**	**(13,518)**	(13,518)	(13,518)

TMLT
TEXAS MEDICAL LIABILITY TRUST