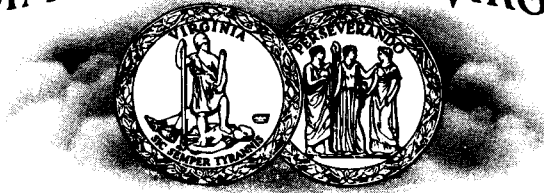


**EXAMINATION REPORT**  
**of**  
**LEGAL SERVICE PLANS OF VIRGINIA, INC.**  
**Ada, Oklahoma**  
**as of**  
**December 31, 2009**

# COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS  
COMMISSIONER OF INSURANCE



P.O. BOX 1157  
RICHMOND, VIRGINIA 23218  
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<http://www.state.va.us/scc>

## STATE CORPORATION COMMISSION BUREAU OF INSURANCE

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Legal Service Plans of Virginia, Inc. as of December 31, 2009, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand  
and affixed to the original the seal of the Bureau at the City  
of Richmond, Virginia this 11<sup>th</sup> day of August, 2010

A handwritten signature in cursive script that reads 'Alfred W. Gross'.

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Alfred W. Gross  
Commissioner of Insurance

(SEAL)

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Richmond, Virginia  
May 6, 2010

Honorable Alfred W. Gross  
Commissioner of Insurance  
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by the authority of Section 38.2-1317 of the Code of Virginia, an examination of the records and affairs of

**LEGAL SERVICE PLANS OF VIRGINIA, INC.**

Ada, Oklahoma

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

**DESCRIPTION**

The Corporation became licensed in Virginia as a legal services plan pursuant to Chapter 44 of Title 38.2 of the Code of Virginia on December 13, 1996. The Corporation was last examined by representatives from the State Corporation Commission's Bureau of Insurance (the "Bureau") as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009.

**HISTORY**

The Corporation was incorporated in the Commonwealth of Virginia effective October 2, 1995. According to its Articles of Incorporation, the purpose of the Corporation is as follows:

To establish and market legal service plans in the Commonwealth of Virginia and to engage in those activities set forth in Section 13.1-627 of the Code of Virginia, as amended; and to transact any and all lawful business for which corporations may be incorporated under Section 13.1-601 et. seq. of the Code of Virginia, as amended.

## MANAGEMENT AND CONTROL

The Corporation's bylaws provide that the business and affairs of the Corporation shall be managed by a Board of Directors (the "Board"). The Board shall consist of three directors elected annually by stockholders who shall serve until the election and acceptance of a duly qualified successor. The Board shall annually choose a president, a treasurer and a secretary to serve as officers of the Corporation.

At December 31, 2009, the Board and Officers were as follows:

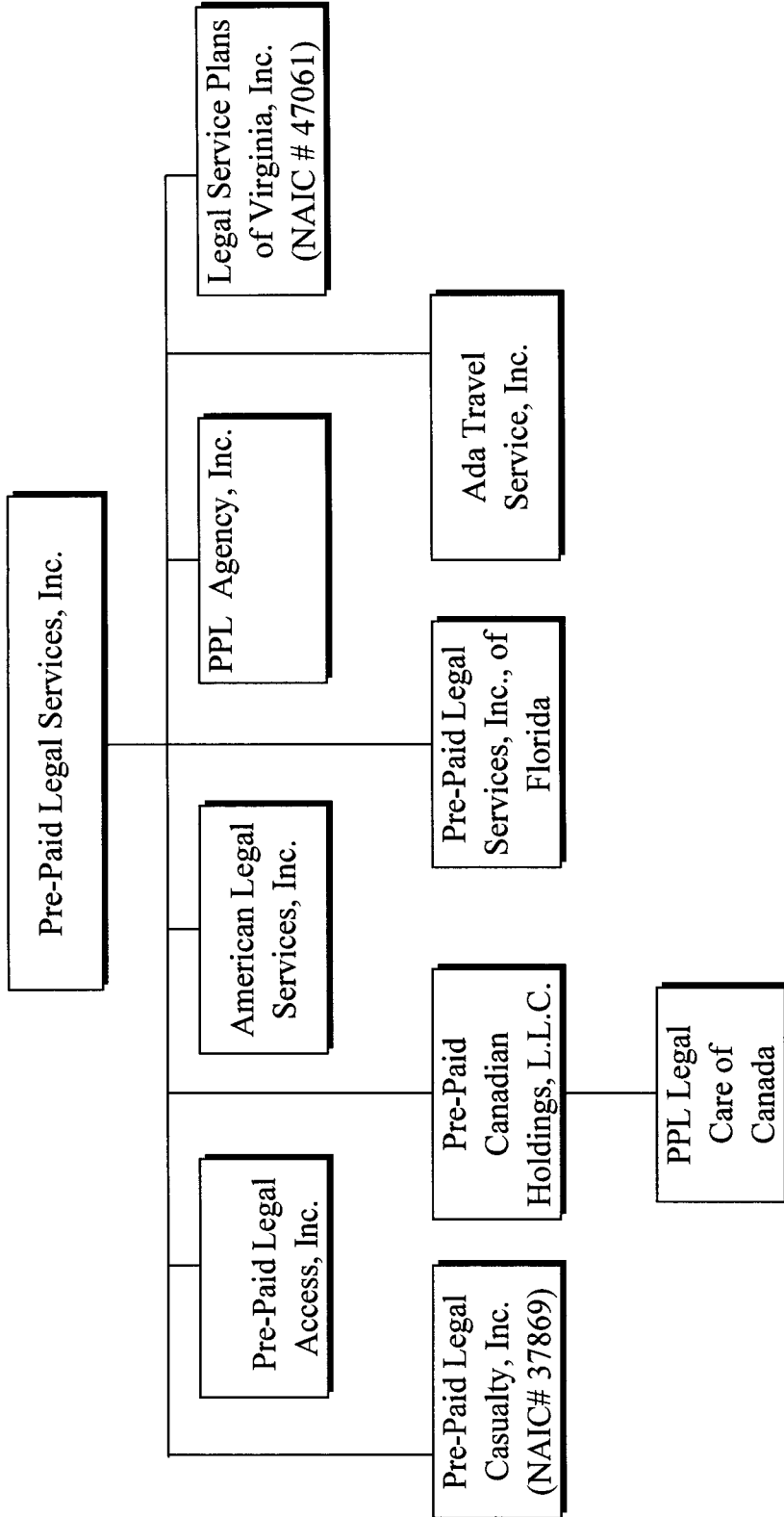
<u>Directors</u>	<u>Principal Occupation</u>
Martin H. Belsky	Dean University of Akron School of Law Akron, Ohio
Peter K. Grunebaum	Independent Investment Banker and Corporate Consultant New York, New York
Harland C. Stonecipher	Chairman of the Board of Directors Pre-Paid Legal Services, Inc. Ada, Oklahoma

### Officers

Harland C. Stonecipher	President
Kathleen S. Pinson	Secretary
Mark R. Harp	Treasurer

## AFFILIATED COMPANIES

According to its Articles of Incorporation, the Corporation has the authority to issue 5,000 shares of common stock with a par value of \$.01 per share. At December 31, 2009, there were 100 issued and outstanding shares which were owned by Pre-Paid Legal Services, Inc. (PPLSI) The chart on the following page illustrates the organizational structure of the Corporation and selected affiliated entities at December 31, 2009:



## TRANSACTIONS WITH AFFILIATES

### Management Agreement

Effective October 23, 2001, the Corporation entered into a management agreement with PPLSI. Under the terms of the agreement, PPLSI shall provide the Corporation certain record keeping, accounting services and administrative assistance, including, but not limited to the following:

- a. The preparation, processing and issuance of contracts to qualified applicants and the maintenance of adequate records concerning such contracts.
- b. The disbursement of commissions to sales agents in accordance with approved commission schedules.
- c. The processing of payment of benefits in accordance with the terms of issued contracts and attorney provider agreements.
- d. The provision of certain customer services including responding to member inquiries regarding contracts and recording payment and address changes of members.
- e. The preparation of financial data to assist management or as required by regulatory authorities.
- f. The preparation and mailing of periodic statements of account to contract holders.
- g. The preparation of deposits, handling of funds and issuance of drafts.
- h. Coordination with attorneys to provide benefits under the attorney provider agreement and the resolution of member complaints regarding services provided by attorneys.

As monthly compensation for these services, PPLSI will bill the Corporation a monthly fee. The monthly fee shall be calculated based upon a two-part formula. Part one equals the number of new contracts issued during the month multiplied by the per policy acquisition cost incurred by PPLSI during the previous quarter. Part two equals the number of existing contracts at the end of the month multiplied by the per policy maintenance cost incurred by PPLSI during the previous calendar quarter. During 2009, the Corporation incurred \$1,697,063 in fees related to this agreement.

### Tax Allocation Agreement

On October 1, 2005, the Corporation entered into a Tax Allocation Agreement with and among PPLSI and its subsidiaries. The agreement establishes methods for allocating consolidated federal and state income tax liabilities among the affiliates, for payment of such liabilities, and for sharing the benefits that may be derived from filing a consolidated federal and state income tax return.

### Dividends to Stockholders

The Corporation paid the following cash dividends to its parent, PPLSI, during the three-year period under review:

<u>For the Calendar Year Ended</u>	<u>Total Dividends Paid</u>
December 31, 2007	\$ 1,600,000
December 31, 2008	4,118,000
December 31, 2009	1,800,000

### **TERRITORY AND PLAN OF OPERATION**

The Corporation is licensed to transact business in the entire Commonwealth of Virginia. Participation is offered to individuals and to for-profit business entities with 99 or fewer employees. Covered business entities do not include companies whose stock is publicly traded. Premiums are collected monthly, quarterly, semi-annually or annually through bank draft, payroll deduction, and credit card payment.

The Corporation has contracted with a participating law firm to provide covered services to members. The law firm is paid a per member per month fee on the enrollee's status as an individual or a business entity.

Covered services provided under contracts with individuals include, within limits specified in the contract, the following:

1. Legal Consultation and Assistance Services. Includes telephone consultations, drafting of letters, review of legal documents, preparation of Last Will and Testament and review of and changes to existing Last Will and Testament.
2. Motor Vehicle Related Services. Includes defense of moving traffic violations, legal assistance in maintaining or retaining a driver's license and the filing of lawsuits to collect personal injury or property damage claims.



3. Trial Defense Services. Includes pre-trial and trial services for members named as defendants in covered civil or criminal actions.
4. IRS Audit Protection Services. Includes services for tax return audits or appearances before the IRS concerning tax issues.
5. Other Legal Services. All other legal services may be obtained for a 25% discount from the participating law firm's standard hourly rate.

Covered services provided to business entities also include basic contract review, executed contract review, document review and debt collection letters. Exclusions include costs such as fines, court costs, expert witness fees, bonds, bail bonds, out-of-pocket expenses and any matter that the participating law firm determines is raised an inordinate number of times without substantial change of circumstances.

### **CONFLICT OF INTEREST**

The Corporation has adopted PPLSI's corporate conflict of interest policy. The policy states that directors, officers and associates must discharge their business responsibilities in a manner that furthers the interests of the Corporation and must not compromise the interests of the Corporation because of a conflict of interest with their other business or personal interests. Directors, officers and responsible employees are required to complete a conflict of interest disclosure form in order to disclose business and personal interests that could be adverse to the interests of the Corporation. The objective of the disclosure is to protect the interests of the Corporation and alert its directors, officers and its responsible employees to business decisions and activities for which they must exercise special care or in which they should not participate.

### **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2009, the Corporation was listed as a named insured on PPLSI's executive protection policy, which included crime coverage with a \$1,000,000 limit of liability, subject to a \$10,000 deductible, to insure against losses arising from dishonest acts of its officers and employees. Additionally, the Corporation was listed as a named insured on a commercial property insurance policy, a business auto policy, a worker's compensation policy, and an umbrella insurance policy.

## GROWTH OF THE CORPORATION

The following data is representative of the growth of the Corporation for the ten-year period ending December 31, 2009. The data is compiled from the Corporation's filed Annual Statements, the previous examination report, and the current examination report.

<u>Year</u>	<u>Total Admitted Assets</u>	<u>Total Liabilities</u>	<u>Capital and Surplus</u>
2000	\$1,668,857	\$414,016	\$1,254,841
2001	2,257,971	515,260	1,742,711
2002	3,987,357	510,194	3,477,163
2003	4,818,247	749,600	4,068,647
2004	7,835,590	677,909	7,157,681
2005	5,685,638	2,276,934	3,408,704
2006	7,167,945	1,709,547	5,458,398
2007	7,077,002	1,472,356	5,604,646
2008	4,601,084	1,419,514	3,181,570
2009	4,261,606	1,303,365	2,958,241

<u>Year</u>	<u>Total Revenue</u>	<u>Net Investment Gains</u>	<u>Legal Expenses</u>	<u>Administrative Expenses</u>	<u>Pre-Tax Income (Loss)</u>
2000	\$6,109,009		\$7,234,903		(\$1,125,894)
2001*	9,280,736	104,809	2,988,573	3,729,816	2,667,156
2002	10,406,581	143,782	3,280,114	4,760,794	2,509,455
2003	10,541,221	137,618	3,318,706	6,668,970	691,163
2004	10,236,029	282,086	3,275,740	5,148,477	2,093,898
2005	10,644,245	150,573	3,396,475	5,416,518	1,981,825
2006	10,694,884	162,985	3,387,644	5,023,151	2,447,074
2007	10,384,646	260,175	3,318,589	4,862,736	2,463,496
2008	10,014,885	164,448	3,218,417	4,601,982	2,358,934
2009	9,440,619	211,119	3,033,442	4,200,868	2,417,428

\*Prior to 2001, Net investment gains or losses were included in Total Revenue and Administrative Expenses were included in Legal Expenses.

The Corporation's enrollment data at year-end is illustrated as follows:

<u>Year</u>	<u>Number of Members</u>
2000	30,672
2001	38,144
2002	41,345
2003	41,058
2004	41,079
2005	43,198
2006	41,282
2007	41,207
2008	39,664
2009	37,841

#### **CAPITAL AND SURPLUS**

On December 28, 2009, after receiving approval from the Bureau, the Corporation paid off a \$100,000 surplus note (plus accrued interest of \$8,430) that was issued to PPLSI on December 10, 1996.

At December 31, 2009, the Corporation's capital and surplus was \$2,958,241. Capital and surplus is comprised of 100 shares of \$.01 par value common stock issued and outstanding, with gross paid in and contributed surplus of \$4,659,999 and unassigned funds of (\$1,701,759). The Bureau requires the Corporation to maintain total reserves and unassigned funds of at least \$35,000.

**SCOPE**

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2007 through December 31, 2009. Assets were verified and liabilities established at December 31, 2009.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook. The Handbook requires that the Bureau plan and perform the examination to evaluate the financial condition and identify prospective risks of the Corporation, assess corporate governance, identify and assess inherent risks within the Corporation, and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Corporation were considered in accordance with the risk-focused examination process.

**FINANCIAL STATEMENTS**

There follows a statement of financial condition as of December 31, 2009; a statement of revenue and expenses for the year ending December 31, 2009; a reconciliation of capital and surplus for the period under review; and a statement of cash flow for the year ending December 31, 2009. The financial statements are presented in accordance with Statutory Accounting Principles.

**ASSETS**

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$3,102,760		\$3,102,760
Cash and short-term investments	<u>804,662</u>		<u>804,662</u>
Subtotals, cash and invested assets	\$3,907,422	\$0	\$3,907,422
Investment income due and accrued	36,175		36,175
Uncollected premiums and agents' balances in course of collection	198,405		198,405
Net deferred tax asset	119,604		119,604
Prepaid commissions	<u>902,530</u>	<u>902,530</u>	<u>0</u>
Total assets	<u><u>\$5,164,136</u></u>	<u><u>\$902,530</u></u>	<u><u>\$4,261,606</u></u>

**LIABILITIES, CAPITAL AND SURPLUS**

Premiums received in advance	\$400,970
General expenses due or accrued	51
Current federal income tax payable	73,804
Amounts due to parent, subsidiaries and affiliates	<u>828,540</u>
 Total liabilities	 <u>\$1,303,365</u>
 Common capital stock	 \$1
Gross paid in and contributed surplus	4,659,999
Unassigned funds (surplus)	<u>(1,701,759)</u>
 Total capital and surplus	 <u>\$2,958,241</u>
 Total liabilities, capital and surplus	 <u><u>\$4,261,606</u></u>

**STATEMENT OF REVENUE AND EXPENSES**

Net premium income	<u>\$9,440,619</u>
Total revenues	<u>\$9,440,619</u>
Legal benefits	\$3,033,442
General administrative expenses	<u>4,200,868</u>
Total underwriting deductions	<u>\$7,234,310</u>
Net underwriting gain	<u>\$2,206,309</u>
Net investment income earned	\$168,752
Net realized capital gains	<u>42,367</u>
Net investment gains	<u>\$211,119</u>
Net income before federal income taxes	\$2,417,428
Federal income taxes incurred	<u>719,932</u>
Net income	<u><u>\$1,697,496</u></u>



**RECONCILIATION OF CAPITAL AND SURPLUS**

	<u>2007</u>	<u>2008</u>	<u>2009</u>
Capital and surplus prior reporting year	<u>\$5,458,398</u>	<u>\$5,604,646</u>	<u>\$3,181,570</u>
<b>GAINS AND LOSSES TO CAPITAL AND SURPLUS</b>			
Net income	\$1,618,290	\$1,549,912	\$1,697,496
Change in net deferred income taxes	(3,941)	(14,540)	(6,604)
Change in nonadmitted assets	131,899	159,552	(14,221)
Change in surplus notes			(100,000)
Dividends to stockholders	<u>(1,600,000)</u>	<u>(4,118,000)</u>	<u>(1,800,000)</u>
Net change in capital and surplus	<u>\$146,248</u>	<u>(\$2,423,076)</u>	<u>(\$223,329)</u>
Capital and surplus end of reporting year	<u><u>\$5,604,646</u></u>	<u><u>\$3,181,570</u></u>	<u><u>\$2,958,241</u></u>

**CASH FLOW****Cash from Operations**

Premiums collected net of reinsurance	\$9,438,238
Net investment income	217,750
Total	<u>\$9,655,988</u>
Benefit and loss related payments	\$3,033,442
Commissions, expenses paid and aggregate write-ins for deductions	4,209,481
Federal income taxes paid	639,503
Total	<u>\$7,882,426</u>
Net cash from operations	<u>\$1,773,562</u>

**Cash from Investments**

Proceeds from investments sold, matured or repaid:	
Bonds	\$1,908,900
Total investment proceeds	<u>\$1,908,900</u>
Cost of investments acquired (long term only):	
Bonds	\$1,093,893
Total investments acquired	<u>\$1,093,893</u>
Net cash from investments	<u>\$815,007</u>

**Cash from Financing and Miscellaneous Sources**

Cash provided (applied):	
Surplus notes	(\$100,000)
Dividends to stockholders	(1,800,000)
Other cash applied	<u>(180,922)</u>
Net cash from financing and miscellaneous sources	<u>(\$2,080,922)</u>

**RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS**

Net change in cash and short-term investments	\$507,647
Cash and short-term investments:	
Beginning of the year	297,015
End of the year	<u><u>\$804,662</u></u>

**CONCLUSION**

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, George E. Morgan, CFE participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink that reads "Darrin P. Bailey, Sr." The signature is written in a cursive style with a large, prominent initial "D".

Darrin P. Bailey, Sr., CFE, MHP, AIAF  
Senior Insurance Examiner



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10 JUL 19 AM 10:36

July 13, 2010

Commonwealth of Virginia  
David H. Smith, Chief Examiner  
P.O. Box 1157  
Richmond, VA 23218

RE: Legal Service Plans of Virginia, Inc.  
Examination Report as of December 31, 2009

Dear Mr. Smith,

Legal Service Plans of Virginia, Inc. received the draft examination report provided with your letter dated July 6, 2010.

The report has been reviewed by officers of the company and accepts the examination report as is. Three copies of the report should be sufficient.

We look forward to the final report.

Sincerely,

Lisa Daniel  
Regulatory Consultant

*Subsidiaries*

Pre-Paid Legal Casualty™, Inc. • Pre-Paid Legal Services, Inc., of Florida  
Legal Service Plans of Virginia, Inc. • PPL Legal Care of Canada Corporation