

REPORT ON EXAMINATION

OF THE

PXC INC.

AS OF

DECEMBER 31, 2007

DATE OF REPORT

JUNE 17, 2009

EXAMINER

VERONICA DUNCAN BLACK

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STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 10004

June 17, 2009

Honorable Eric R. Dinallo  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30291 dated January 29, 2009 attached hereto, I have made an examination into the condition and affairs of PXC Inc. as of December 31, 2007, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate PXC Inc.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's administrative office located at 333 Earle Ovington Boulevard, Uniondale New York 11553.

## **1. SCOPE OF EXAMINATION**

The purpose of this examination was to determine whether the Company was operating within its by-laws, was conforming to Article 70 of the New York Insurance Law, and was in compliance with its plan of operation as submitted to the Department.

A review was conducted of the Company's operations, from its date of incorporation as a New York captive insurance company, December 31, 2003, through December 31, 2007. The review included an analysis of the Company's financial condition, the corporate records, and limited tests of the various income and disbursement items as deemed necessary. This report is submitted on an "exception" basis. Comments and recommendations are limited to those items requiring financial adjustment, procedural recommendations, or instances where the Company was not conforming to the application submitted to the Department or Article 70 of the New York Insurance Law.

The report utilized work performed by the Company's independent certified public accountants ("CPA") to the extent considered appropriate.

## **2. DESCRIPTION OF COMPANY**

The Company was incorporated and licensed on December 31, 2003, and commenced operations as a captive insurance company under the laws of the State of New York on January 1, 2004. PXC Inc. is a wholly owned subsidiary of Paychex, Inc. ("Paychex"). Paychex is a recognized leader in the payroll, human resource and benefit services for small to medium size business. In addition to its core payroll services, Paychex meets more complex requirements of large business with its major market payroll services, and Paychex premier human resources. Paychex is based in Rochester, NY and has more 100 locations across the country. Paychex was founded by B. Thomas Golisano in 1971.

### **A. Articles of Incorporation**

The purpose of the Company, as stated in its articles of incorporation, was to form a corporation for the purpose of transacting the kinds of insurance specified in Section 1113 of the New York Insurance Law, subject at all times to the limitations on the business of pure captive insurance companies set forth in Article 70 of the New York Insurance Law.

B. By-Laws

The by-laws of the Company were reviewed, and it was determined that the Company was operating in full conformity with its by-laws in all material respects.

C. Capital Structure

The Company was incorporated as a pure captive insurance company on December 31, 2003. On December 31, 2003, the Company issued 100 shares of its common stock having \$5 par value per share to its parent Company, Paychex, Inc. for \$450,000. In 2004, subsequent to the issuance of the common shares, Paychex made a cash contribution of \$9,000,000 to the Company. During 2004, Paychex also made non-cash contribution of \$337,268,000 representing its capital interest in certain wholly owned subsidiaries. This non-cash contribution was as an initial funding mechanism for the formation of a limited partnership, Paychex Investment Partnership LP (“PIP”), whereby the Company would hold a 99% interest and Paychex would hold a 1% interest. In PIP, the Company would be a limited partner and Paychex would be the controlling partner. Further, PIP would be the sole owner of a limited liability company, Paychex of New York LLC, and the sole owner of a corporation, Paychex Management Corp. This transaction was presented to the Department as part of the initial plan of operation for the Company.

In 2005, the Company received a cash contribution of \$15,840,000 from its parent company. During 2006 and 2007, the parent company also made capital contribution of \$99,000,000 to the Company for each year, respectively. Further, according to the Company's 2007 certified public accountant's financial statements, “a return of capital invested by Paychex in its subsidiary PXC, of approximately \$427,258,000, was authorized by the Board of Directors (the Board) of PXC.”

In reviewing the Company's annual statements for each year under examination, it was noted that the paid in capital (par value) was reported incorrectly. A paid in capital of \$100,000 was reported, which represented 20,000 shares at a \$5 par value per share. However, according to the Company's records, 100 common shares having \$5.00 par value per share were issued to the Company's parent for \$450,000. As of the date of incorporation (December 31, 2003), the Company's capital structure should have been recorded as \$500 in paid in capital and \$449,500 in contributed surplus. It is recommended that the Company amend its annual statement to reflect the proper paid in capital amount.

Gross paid in and contributed surplus increased by \$132,850,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
2003	Beginning gross paid in and contributed surplus		\$ 449,500
2004	Surplus contribution	\$ 9,000,000	
2004	Surplus contribution	337,268,000	
2005	Surplus contribution	15,840,000	
2006	Surplus contribution	99,000,000	
2007	Surplus contribution	<u>99,000,000</u>	
	Total Surplus contribution		\$560,108,000
2007	Surplus reduction	<u>\$(427,258,000)</u>	
	Total surplus reduction		<u>(427,258,000)</u>
	Total net surplus contribution		<u>132,850,000</u>
2007	Ending gross paid in and contributed surplus		<u>\$133,299,500</u>

#### D. Corporate Records

The corporate records reviewed appeared to be substantially accurate and complete in all material respects.

#### E. Plan of Operation

The Company was formed to provide its parent company and affiliates with certain insurance coverage as permitted by Article 70 of the New York Insurance Law. The initial plan provided coverage to the parent company and affiliates for liabilities not covered by primary insurance contracts purchased by the parent company from other insurance carriers. The liability coverage includes losses in excess of limits and losses within the deductibles or self-insured retentions of the primary insurance coverage. The Company provides the following insurance coverages to its parent company and affiliates: property, general liability, automobile, directors and officers, professional liability, employment practices liability, errors and omissions, warranty liability, crime, fiduciary liability, lawyers' liability and terrorism. In addition, the Company affords gap coverage insurance to its parent and affiliates in circumstances where no insurance coverage exists. The company currently provides gap insurance for employment practices liability, errors and omissions, warranty liability, and acts of terrorism.

F. Reinsurance

The Company did not engage any type of reinsurance program for the period under examination.

G. Management and Control

Captive Manager

The Company is managed by Wright Risk Management Company, Inc. ("WRM") pursuant to Section 7003(b)(4) of the New York Insurance Law. Effective December 31, 2003, the Company executed a management agreement with WRM. The agreement requires WRM to perform certain insurance, risk management, risk financing, consulting and captive management services to the Company, its parent company, Paychex, and their related entities. Such captive management services include the following: underwriting and reinsurance, risk management services, safety and loss control services, claims administration and management services, management information systems, accounting services, statutory reporting and regulatory compliance services, and consulting services.

Service Agreement

For the period under examination, the Company entered into an agreement with an affiliate. Pursuant to the terms of the agreement, the Company agrees to reimburse its affiliate for various expenses related to human resources, payroll, accounting, tax, technology and other support services that the Company may incur operating as a captive insurer.

Board of Directors

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than three, but nor more than ten members. At December 31, 2007, the board of directors was comprised of the following three members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John Morphy Fairport, NY	Chief Financial Officer & Senior Vice President, Paychex Inc.
Martin Stowe Westford, MA	Vice President, Paychex Inc.
Craig Hill Treasure Island, FL	Director, Paychex, Inc.

A review of the minutes of the board of directors' meetings held during the examination period indicate that the meetings were generally well attended and that each board member has an acceptable record of attendance.

The Company's charter provides that at least two members of the directors shall be residents of the State of New York pursuant to Section 7005(g) of the New York Insurance Law. A review of the board of directors' residency requirements shows that the directors' met the residency requirements for all of the years under examination except for calendar year 2007. This review also shows that the Company was not in compliance with its charter or the captioned section of the law for calendar year 2007. Effective March 13, 2008, the board of directors elected Kevin Hill to serve as a member of the Company's board of directors. This appointment resulted in the Company's compliance with Section 7005(g) of the New York Insurance Law.

As of December 31, 2007, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
John Morphy	President and Treasurer
Martin Stowe	Secretary & Vice President

#### H. Certified Public Accountant and Actuarial Services

The Company was audited by Ernst & Young LLP for the entire examination period. Martin Menard of Towers Perrin provided actuarial services to the Company as of December 31, 2007. The Company filed its certified public accountant's financial statements annually on or before July 1, 2007, for all of the years under examination.

#### Annual Statements and Certified Public Accountant's Financial Statements

In reviewing the Company's annual statements and its certified public accountants financial statements for the years under examination, the examiner noted a few variances between the annual statement numbers and the CPA financial statements for calendar years 2004, 2006 and 2007. The CPA noted that for calendar year 2004, the variances were primarily related to the 2004 annual statement being reported in accordance with the accounting principles generally accepted in the United States and their financial statements being reported in accordance with statutory accounting principles as prescribed by

the Department. For calendar years 2006 and 2007, the CPA note that the variances were attributed to reclassification or adjustments to the Company's investment in affiliated partnerships, inter-company accounts, dividends, net income and surplus account. It is recommended that the Company amend its annual statement balance sheet and income statement so that such statements agree to its certified public accountant financial statements.

I. Growth of Company

The following schedule sets forth the Company's significant summary financial information for the years covered by this examination:

<u>Year</u>	<u>Net Premiums Earned</u>	<u>Net Income</u>	<u>Assets</u>	<u>Shareholders' Equity</u>
2003	\$ 0	\$ 0	\$ 450,000	\$ 450,000
2004	\$5,668,498	\$214,891,161	\$437,853,000	\$432,529,161
2005	\$3,375,628	\$227,176,741	\$546,505,625	\$537,038,902
2006	\$8,552,793	\$280,382,237	\$765,475,000	\$755,494,139
2007	\$9,918,810	\$592,743,679	\$312,664,409	\$304,233,818

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The financial statements of the Company are presented in conformity with generally accepted accounting principles. The financial position of the Company as presented and accepted was audited by the Company's certified public accountant:

#### Balance Sheet

As of December 31, 2007

#### Asset

Bonds	\$ 6,838,000
Cash	450,000
Savings and certificate of deposit	16,421,576
Other invested assets – investment is subsidiary	281,173,000
Interest income due and accrued	196,000
Deferred tax asset	2,292,095
Inter-company receivable from affiliates	<u>5,293,738</u>
Total assets	<u>\$312,664,409</u>

#### Liabilities, Capital and Surplus

#### Liabilities

Losses	\$ 4,157,325
Loss adjustment expenses	2,391,514
Commissions, expenses and fees	101,611
Taxes payable	<u>1,779,959</u>
Total liabilities	\$ 8,430,409

#### Capital and Surplus

Paid in capital	\$ 500
Contributed surplus	133,299,500
Surplus (accumulated earnings)	<u>170,934,000</u>
Total capital and surplus	<u>304,234,000</u>
Total liabilities, capital and surplus	<u>\$312,664,409</u>

B. Statement of Income

Capital and surplus increased \$303,783,818 during the four-year examination period, December 31, 2003 through December 31, 2007.

Underwriting Income

Net premiums earned		\$27,515,729
<u>Underwriting Expense</u>		
Net losses incurred	\$15,179,531	
Net loss adjustment expense incurred	2,402,509	
General and administrative	<u>2,232,821</u>	
Total underwriting expense		<u>19,814,411</u>
Underwriting profit (loss)		\$ 7,701,318
Other income		<u>1,311,116,929</u>
Income before dividends and taxes		\$1,318,818,247
Taxes		<u>3,624,429</u>
Net income		<u>\$1,315,193,818</u>

C. Capital and Surplus Account

Capital and surplus at December 31, 2003			\$ 450,000
	<u>Increase</u>	<u>Decrease</u>	
Net income	\$1,315,193,818		
Capital changes - paid in	222,840,000		
Surplus adjustment – noncash contribution	337,268,000		
Surplus adjustment – return of surplus		\$ 427,258,000	
Dividends		1,500,794,000	
Other:			
Change in non-admitted assets	9,718,000		
Undistributed equity of partnership investment	<u>346,816,000</u>	<u>0</u>	
Total increase and decrease	<u>\$2,231,835,815</u>	<u>\$1,928,052,000</u>	
Net increase in surplus			<u>303,783,818</u>
Surplus as regard policyholder, per report on examination as of December 31, 2007			<u>\$304,233,818</u>

#### **4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The Company reported losses and loss adjustment expenses of \$6,548,839 as of December 31, 2007. The examiner did not independently review the loss reserves but rather relied upon the opinion of the Company's actuary and its certified public accountant's actuaries. The Company's actuary at December 31, 2007, was Martin Menard of Towers Perrin and its certified public accountant's actuaries were Tatyana Kerbel, Robb Luck and Tom Conway of the Insurance and Actuarial Advisory Services Group.

The purpose of the actuarial opinion is to provide an evaluation as to the reasonableness of the Company's loss reserves at year end. The actuaries opined that the Company's reserves are within a reasonable range and believe that the Company has made a reasonable provision for its unpaid loss and loss expense obligations as of December 31, 2007.

Mr. Martin Menard states in his Statement of Actuarial Opinion that the Company's reserve at December 31, 2007:

“meet the requirements of the insurance laws of New York; are consistent with amounts computed in accordance with Casualty Actuarial Society Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves and relevant standards of practices promulgated by the Actuarial Standard Board; and make reasonable provision for unpaid loss and loss expense obligation of the Company under the terms of its contracts and agreements.”

Based upon the actuarial opinion, no changes have been made to the reserves reported by the Company.

#### **5. ARTICLE 70 COMPLIANCE**

Article 70 of the New York State Insurance Law is the governing law for the formation and continued operation of captive insurance companies in New York State. A review was performed to test the Company's compliance with Article 70. No material area of non-compliance with Article 70 was found during the course of this examination.

## **6. INSURANCE PROGRAM**

The Company was licensed as a captive insurance company to provide direct coverage as well as coverage that surrounds applicable primary contracts purchased by the parent company and/or affiliates from other insurance carriers. This coverage includes reimbursement of deductibles and/or self-insured retentions, as well as providing excess limits over underlying primary coverages. The Company provides an insurance coverage of \$15,000,000 in excess of underlying primary coverages. The Company also has maximum annual aggregate for all claims, which is the lesser of \$25,000,000 or 80% of the Company's surplus position as of December 31, 2007 preceding the start of the coverage period. The limits for the underlying primary insurance coverages are as follows:

1. Property liability insurance coverage provides a limit of ranging from \$100,000 to \$1,500,000 per occurrence, subject to various deductibles ranging from \$5,000 to \$250,000.
2. Automobile liability insurance coverage provides a limit of \$1,000,000 per occurrence excess a \$500 deductible.
3. General liability insurance coverage provides a limit of \$50,000,000 per occurrence/and aggregate.
4. Directors and officers' liability insurance coverage provides a limit of \$50,000,000 per occurrence/and aggregate excess a \$5,000 per person/\$50,000 per claim deductible.
5. Fiduciary liability insurance coverage provides coverage under two separate underlying policies with a limit of \$20,000,000 per occurrence and \$15,000,000 per occurrence excess a \$150,000 and \$100,000 deductible, respectively.
6. Errors and omissions professional liability insurance coverage provides coverage under two separate policies that provides a limit of \$5,000,000 per occurrence and \$3,000,000 per occurrence excess a deductible of \$100,000 for each policy.
7. Crime insurance coverage provides a limit of \$50,000,000 per occurrence excess a \$500,000 deductible.
8. Lawyers' liability insurance coverage provides a limit of \$5,000,000 per occurrence excess a \$50,000 deductible.
9. Extortion/Kidnap insurance coverage provides a limit of \$5,000,000 per loss.
10. Miscellaneous professional liability coverage provides a limit of \$2,000,000 per claim excess a \$50,000 deductible.

In addition to the above, the Company provides the following direct insurance coverages:

1. The Company provides employment practices liability insurance coverage on a claims-made basis with a limit of \$15,000,000 excess a self insured retention of \$500,000.
2. The Company provides warranty errors and omission insurance coverage on a claims-paid basis with a quarterly aggregate limit of \$2,500,000, subject to an annual aggregate of \$10,000,000.
3. The Company provides terrorism insurance coverage on an occurrence basis for all acts of terrorism that fall below and in excess of loss covered or reimbursed under any underlying insurance or by the Terrorism Risk Insurance Act of 2002 with a limit of \$15,000,000.

On November 26, 2002, the Terrorism Risk Insurance Act of 2002 ("TRIA" or "the Act") was signed into law. On December 26, 2007, the President of the United States ("U.S.") signed the Terrorism Risk Insurance Program Reauthorization Act of 2007 into law, which extended TRIA through December 31, 2014. The Act created a U.S. government facility that provides reinsurance coverage to insurers as a result of declared terrorism events. The Act established a "program trigger" that must be met before the Treasury will cover a loss. The program trigger is currently \$100 million and applies to all certified acts of terrorism. When the program is triggered, the Federal government is required to pay 85% of insured terrorism losses in excess of individual insurer trigger/deductible while the insurer pays 15%.

## **8. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Capital Structure</u></p> <p>It is recommended that the Company amend its annual statement to reflect the proper paid in capital amount.</p>	3
<p>B. <u>Annual Statements and Certified Public Accountant's Financial Statement</u></p> <p>It is recommended that the Company amend its annual statements balance sheet and income statement so that such statements agree to its certified public accountant financial statements.</p>	7

Respectfully submitted,

\_\_\_\_\_/s/\_\_\_\_\_  
Veronica Duncan Black,  
Senior Insurance Examiner

STATE OF NEW YORK     )  
                                  )SS:  
                                  )  
COUNTY OF NEW YORK    )

VERONICA DUNCAN BLACK, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

\_\_\_\_\_/s/\_\_\_\_\_  
Veronica Duncan Black

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

Appointment No. 30291

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Veronica DuncanBlack**

*as proper person to examine into the affairs of the*

**PXC, INC**

*and to make a report to me in writing of the condition of the said*

**Corporation**

*with such other information as she shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by the  
name and affixed the official Seal of this Department, at  
the City of New York,*

*this 29th day of January, 2009*



  
ERIC R. DINALLO  
Superintendent of Insurance