

REPORT ON EXAMINATION

OF THE

PXC INC.

AS OF

DECEMBER 31, 2012

DATE OF REPORT

SEPTEMBER 10, 2014

EXAMINER

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

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Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
Albany, New York 12257

September 10, 2014

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31042 dated September 12, 2013, attached hereto, I have made an examination into the condition and affairs of PXC Inc. as of December 31, 2012 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 designation “Parent” appears herein without qualification, it should be understood to refer to Paychex, Inc.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

## **1. SCOPE OF EXAMINATION**

The examination covers the period from January 1, 2008 through December 31, 2012, and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including invested assets, and losses and loss adjustment expense reserves. The examination included a review of income, disbursements and Company records deemed necessary to accomplish such analysis or verification. Additionally, a review was performed to determine whether the captive insurer was operating within its by-laws, conforming with its plan of operation, as submitted to the New York State Department of Financial Services, and was in compliance with Article 70 of the New York Insurance Law.

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 and its opining actuary to the extent considered appropriate.

## **2. DESCRIPTION OF COMPANY**

PXC, Inc. was incorporated under the laws of New York State as a captive insurance company on December 31, 2003 and commenced business on January 1, 2004. The Company is a wholly-owned subsidiary of Paychex, Inc. ("Paychex"). The Company provides various types of insurance coverage to Paychex and some Paychex subsidiaries. Paychex provides payroll, human resources, and benefits services to small to medium size businesses.

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

The Company is organized to transact the kinds of insurance specified in Sections 1113(a) and 1114 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 examination determined that the Company is in compliance with its by-laws in all material respects.

C. Capital Structure

As a pure captive insurance company incorporated as a stock insurer, the Company is required to maintain surplus as regards policyholders of not less than \$250,000, of which \$100,000 shall represent paid in capital pursuant to the provisions of Section 7004(a)(1) of the New York Insurance Law.

As of December 31, 2012, the Company's paid in capital was \$152,376,500 consisting of 100 shares of \$5 par value per share common stock and paid in surplus of \$152,376,000. Its surplus as regards policyholders was \$625,887,000.

D. Corporate Records

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

E. Reinsurance

During the examination period, PXC, Inc. did not assume or cede any business.

F. Management and Control

(i) Captive Manager

Section 7003(b)(4) of the New York Insurance Law provides that no captive insurer shall do any captive insurance business in this state unless it utilizes a captive manager resident in the State of New York that is licensed as an agent or broker under the provisions of the Article 21 of the New York Insurance Law, or any other person approved by the Superintendent.

Effective July 1, 2009, the Company has been managed by Blue Bear Risk Management, Inc. (“BBRM”), which is licensed as a broker by the New York Department of Financial Services.

Pursuant to the Management Agreement between the Company and BBRM, BBRM shall render the following services to the Company:

- Underwriting and reinsurance services;
- Risk management safety and loss control services;
- Claims administration and management services;
- Management information services;
- Accounting services;
- Statutory reporting and regulatory compliance services;
- Consulting services;
- General Program Management services;
- Any agreed upon additional services relating to the insurance program and operations of the Company and Paychex.

Prior to July 1, 2009, the Company was managed by Wright Risk Management.

(ii) 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 nor more than ten members. At December 31, 2012, the board of directors was comprised of the following three members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Efrain Rivera Rochester, NY 14610	Senior Vice President, Chief Financial Officer and Treasurer, Paychex Inc.
Kevin Hill Pittsford, NY 14534	Vice President, Insurance Sales & Operations, Paychex Inc.
Lynn Belecki Fairport, NY 14450	Manager, Business Development, Paychex Inc.

The board meets the size and residency requirements pursuant to Section 7005(g) of the New York Insurance Law.

During the period covered by this examination, the board met formally at least one time each year, in compliance with Section 7003(b)(2) of the New York State Insurance Law. A review of the meeting minutes during the examination period indicated that all formal board meetings were generally well attended.

(iii) Officers

As of December 31, 2012, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Efrain Rivera	President and Treasurer
Stephanie Schaeffer	Secretary

G. Certified Public Accountant (“CPA”) and Actuarial Services

The Company was audited by the independent CPA firm Ernst & Young for the years 2008 to 2012. The Company’s opening actuary as of December 31, 2012 was Towers Watson, 800 Boylston Street, Suite 600, Boston MA 02199.

Annual Statements and Certified Public Accountant’s Financial Statements

A review of the Company’s audited financial statements for years 2010, 2011 and 2012 indicated that such statements included material adjustments to the Company’s annual statements to correct errors including:

- An understatement of the Company’s investment in affiliated partnership in the amount of \$195 million in 2010 and 2011; and
- An overstatement of the Company’s receivable from affiliates in the amount of \$5.608 million in 2012 due to an error in the calculation of deferred income taxes.

It is recommended that the Company take greater care in the preparation of its financial statements.

H. Growth of Company

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

<u>Year</u>	<u>Net Premiums Earned</u>	<u>Net Income</u>	<u>Assets</u>	<u>Shareholders' Equity</u>
2008	\$7,915,000	\$414,321,000	\$345,205,000	\$338,850,000
2009	7,435,000	214,312,000	622,364,000	615,888,000
2010	7,000,000	330,773,000	770,629,000	765,844,000
2011	6,960,000	462,450,000	747,047,000	743,257,000
2012	7,320,000	505,120,000	630,673,000	625,887,000

### 3. FINANCIAL STATEMENTS

With the Department's permission, the Company's financial statements have been prepared in conformity with generally accepted accounting principles, which differ from statutory accounting principles prescribed or permitted by the Department for insurance companies. The Company's independent CPA firm concluded that the following financial statements present fairly, in all material respects, the Company's financial position as of December 31, 2012.

#### A Balance Sheet

##### Assets

Cash and cash equivalents	\$ 20,802,000	
Investments	9,748,000	
Investment in affiliated partnership	595,184,000	
Accrued investment income	176,000	
Intercompany receivable	3,643,000	
Deferred tax asset	<u>1,120,000</u>	
Total Assets		<u>\$630,673,000</u>

##### Liabilities

Reserves for loss and loss adjustment expenses	\$ 3,490,000	
Accounts payable and other current liabilities	74,000	
Income taxes payable	<u>1,222,000</u>	
Total liabilities		\$ 4,786,000

##### Capital and Surplus

Common stock	\$ 500	
Paid in surplus	152,376,000	
Retain earnings	<u>473,510,000</u>	
Total capital and surplus		<u>\$625,887,000</u>
Total liabilities and capital surplus		<u>\$630,673,000</u>

B. Statement of Income

The Company's capital and surplus increased \$2,248,630,000 during the five-year period detailed as follows:

STATEMENT OF INCOMEUnderwriting Income

Net premiums earned		\$ 36,630,000
Deductions:		
losses and net loss adjustment expense	\$ 17,047,000	
Management fees to Paychex, Inc.	1,380,000	
General and administrative expenses	<u>1,754,000</u>	
Total underwriting deductions		<u>20,181,000</u>
Net underwriting gain or (loss)		\$ 16,449,000

Investment Income

Net investment income	\$ <u>1,671,000</u>	
Investment income		<u>1,671,000</u>
Net income before tax and distributions from affiliated partnership investment		\$ 18,120,000
Federal income tax expenses		5,826,000
Distributions from affiliated partnership investment		<u>1,914,682,000</u>
Net income		<u>\$1,926,976,000</u>

C. Capital and Surplus Account

Capital and surplus as of December 31, 2007			\$304,234,000
	<u>Gains in</u>	<u>Losses in</u>	
	<u>surplus</u>	<u>surplus</u>	
Net income	\$1,926,976,000		
Paid in capital	19,077,000		
Net Changes in non-admitted assets	5,887,000		
Undistributed equity of partnership investment	207,078,000		
Net change in deferred tax asset		\$ 180,000	
Prior period adjustment	85,148,000		
Unrealized loss in security		13,810,000	
Equity activity related to stock-based awards	18,454,000		
Shareholder dividend	<u>0</u>	<u>1,926,977,000</u>	
Net increase in surplus	<u>\$2,262,620,000</u>	<u>\$1,940,967,000</u>	<u>321,653,000</u>
Capital and surplus as of December 31, 2012			<u>\$625,887,000</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

As of December 31, 2012, the Company reported total loss and loss adjustment expense reserves of \$3,490,000. The Company's opining actuary stated the following in its Statement of Actuarial Opinion as of December 31, 2012:

In my opinion, the amounts recorded in the audited financial statement for the reserve for unpaid losses and loss adjustment expenses:

- a) meet the requirements of the captive insurance laws of New York;
- b) are consistent with amounts computed in accordance with the Casualty Actuarial Society Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves and relevant standards of practice promulgated by the Actuarial Standards Board; and
- c) make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements.

## 5. ARTICLE 70 COMPLIANCE

Article 70 of the New York State Insurance Law is the governing section of the law for the formation and continued operation of captive insurers in New York State. A review was performed to test the Company's compliance with all applicable parts of Article 70 of the New York Insurance Law. No significant areas of non-compliance were found.

## 6. ORGANIZATIONAL STRUCTURE

The Company is a wholly-owned subsidiary of Paychex, Inc. Paychex, Inc. provides payroll, human resources, and benefits services to small to medium size businesses.

## 7. INSURANCE PROGRAM

Paychex and its affiliated companies obtained primary insurance policies covering various risks through third-party insurance carriers. The Company provides additional coverage to Paychex and its affiliates via a First Party and Third Party All Risk Coverage Policy ("PXC policy"), which insures the various deductibles, self-insured retentions, and provides additional coverage above the limits of the policies insured by the third-party carriers. The PXC policy is subject to an annual aggregate limit equal to the lesser of \$25 million or 95% of the Company's capital and surplus as reflected in its latest filed annual statement.

Additionally, the Company provides gap coverage for Paychex and its affiliates in circumstances where no coverage is otherwise available or exists. The gap coverage currently covers employment practices liability, errors and omissions, warranty liability, theft and embezzlement, and acts of terrorism.

The PXC policy insures the following deductibles, self-insured retentions and amounts in excess of policy limits:

<u>Coverage</u>	<u>Deductible/Retention</u>	<u>Policy limits</u>
Auto	\$500	\$1,000,000
General Liability	n/a	\$1,000,000
Umbrella	n/a	\$25,000,000
Directors & Officers Liability	\$5,000 per person/\$50,000 per claim	\$20,000,000
Fiduciary	\$150,000	\$10,000,000

<u>Coverage</u>	<u>Deductible/Retention</u>	<u>Policy limits</u>
Employment Practices Liability coverage	\$500,000 per claim	\$500,000
Errors and Omissions	\$100,000	\$5,000,000
Crime (Fidelity Bond)	\$1,000,000	\$25,000,000
Lawyers Liability	\$50,000	\$5,000,000

The Company also provides terrorism coverage pursuant to the Terrorism Risk Insurance Program Reauthorization Act of 2007 (“TRPRIA 2007”), which provides that the Company will be reimbursed 85% of terrorism losses exceeding a statutorily established deductible by the Federal government.

## 8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Capital Structure</u>	
	It is recommended that the Company amend its annual statement to reflect the proper paid in capital amount.	3
	The Company has complied with this recommendation.	
B.	<u>Annual Statements and Certified Public Accountant’s Financial Statement</u>	
	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.	7
	The Company has complied with this recommendation.	

## 9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Annual Statements and Certified Public Accountant’s Financial Statements</u>	
	It is recommended that the Company take greater care in the preparation of its financial statements.	5

Respectfully submitted,

\_\_\_\_\_/s/  
Wei Cao  
Senior Insurance Examiner

STATE OF NEW YORK     )  
  )ss:  
COUNTY OF NEW YORK    )

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

\_\_\_\_\_/s/  
Wei Cao

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2014.

APPOINTMENT NO. 31042

**NEW YORK STATE**  
**DEPARTMENT OF FINANCIAL SERVICES**

I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

**Wei Cao**

as a proper person to examine the affairs of the

**PXC, Inc.**

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

**COMPANY**

with such other information as he shall deem requisite.

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

this 12th day of September, 2013

**BENJAMIN M. LAWSKY**  
Superintendent of Financial Services



By:

Jean Marie Cho  
Deputy Superintendent