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Missouri State Auditor

January 11, 2013

Honorable Jeremiah W. (Jay) Nixon, Governor
and
Members of the General Assembly
Jefferson City, Missouri

This letter communicates the results of our review of the financial condition of the Second Injury Fund (fund). The objective of our review, which was requested by the Attorney General, was to follow-up on our previous report¹ regarding the fiscal soundness of the fund. Our review has confirmed our previous finding that the fund does not have sufficient resources to pay existing obligations. Fund administrators have been able to maintain a positive cash balance in the fund by delaying the payment of court ordered benefits. However, some claimants recently filed suit to require the fund to pay benefits immediately, raising concerns about how payments can be made when the cash balance of the fund is exhausted.

Background

The General Assembly created the Second Injury Fund in 1943 to benefit the physically disabled and individuals with previous work-related disabilities. The legislature established the fund to encourage the employment of previously injured or disabled individuals without exposing employers to liability for previous disabilities. When an employee sustains a compensable work injury and the combined effect of the current work-related injury and the previous injury or disability results in permanent total disability, or increased permanent partial disability, the employer at the time of the current injury is only liable for the compensation resulting from the second injury. Any additional compensation due to the employee over and above the current injury is paid from the fund. The Attorney General defends the state against claims made against the fund.

Fund revenues are generated by an employer surcharge which is based on each employer's workers' compensation insurance premium. The surcharge is paid by both insured employers and self-insured employers.² The surcharge rate is set annually by the Department of Labor and Industrial Relations (DOLIR), Division of Workers' Compensation (division) using a formula which is set by statute.³ The formula required the division to project fund expenditures for the ensuing year and, in combination with the beginning fund balance, the surcharge rate was set to provide enough revenue to pay expenses for the ensuing year plus a 10 percent cushion. In 2005, the General Assembly changed the law to cap the surcharge rate at 3 percent and the maximum rate of 3 percent has been set and imposed since that time.

¹ Report No. 2007-19, *Second Injury Fund*, issued in April 2007.

² An insured employer includes the fund surcharge, along with an insurance payment, to its insurance company. The insurance company remits the surcharge payment to the state. The division bills self-insured employers for the surcharge and those employers remit payments to the state.

³ Section 287.715.2, RSMo.

Our previous report, issued in 2007, concluded the fund would become insolvent as a result of the 2005 legislative change.

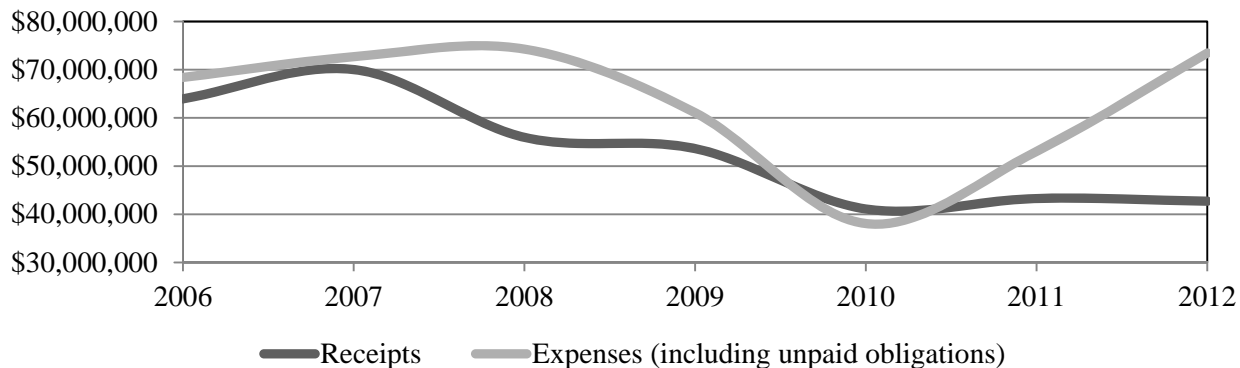
Current Methodology

The methodology to accomplish our objectives included (1) obtaining and evaluating claims data and case data to determine historical claims information as well as project short-term financial obligations, (2) reviewing and evaluating certain applicable legal provisions, and (3) interviewing key personnel from the division and the Attorney General's office regarding fund financial status and litigation involving the fund.

Results and Conclusions

The fund has not received sufficient revenue to pay benefit obligations provided by state law. A chart showing fund receipts and expenses (including unpaid obligations) for calendar years subsequent to the 2005 statutory change is presented below:

Figure 1: Fund Receipts¹ and Expenses (including unpaid obligations) - Calendar Years 2006-2012



¹ Fund receipts fluctuate despite the consistent surcharge rate due to changes in the premium base, which is tied to overall employment levels.

Source: DOLIR

As noted above, fund expenses exceeded fund receipts in 6 of the 7 years⁴ since the funding formula was statutorily capped at 3 percent in 2005. As a result, the fund's financial position has steadily declined over this timeframe and as of December 31, 2012, the fund had a cash balance of approximately \$3.2 million and unpaid obligations of \$28.1 million, leaving a deficit of \$24.9 million. Our analysis of the division's 2013 projections of receipts and expenses indicate the 3 percent maximum surcharge will be insufficient to cover the ongoing payments due from the fund in 2013. Our estimates indicate a 3.5 percent surcharge would generate approximately \$48 million and cover ongoing benefit payments in 2013, and an additional 1.5 percent surcharge would generate approximately \$22 million and allow cash settlements to resume, as recommended by the Attorney General's office. An additional 2 percent surcharge (7 percent total) would generate approximately \$28 million to pay the fund's unpaid obligations. In addition to the deficit of nearly \$25 million noted above, the Attorney General's office estimates over 30,000 cases with a potential liability exceeding \$100 million are currently filed against the fund.

⁴ Officials from the Attorney General's office stated the single year (2010) in which fund revenues exceeded expenses was a result of expenses being delayed because cash settlements were stopped in 2009, causing each case to be litigated to a final judgment.

In addition to delaying payments to fund claimants, officials have taken another step to reduce the immediate cash payments from the fund. In 2009 the Attorney General's office discontinued offering cash settlements to claimants with certain types of injuries that were likely to require long-term benefit payments in the event the case went to trial. While eliminating these settlements reduced the amount of immediate cash payments from the fund, it also likely increased the fund's long-range liabilities, according to Attorney General's office personnel.

According to discussions with Attorney General's office officials, legal action has been taken by certain claimants who received a judgment against the fund but have had their benefit payments delayed due to fund solvency issues. These claimants filed lawsuits requesting judges to issue Writs of Mandamus ordering the state to pay benefit obligations immediately. The State Treasurer and Attorney General expressed concerns that these writs will exceed the cash balance of the fund. In the event that were to happen, there is uncertainty regarding what other funding sources (if any) could be used to pay claims, whether such a ruling would encourage a significant number of additional lawsuits, and whether additional changes could be ordered by the Judicial Branch to remedy the situation. In addition, in January 2007 the Missouri Supreme Court issued a ruling in the case of *Schoemehl v. Treasurer of the State of Missouri* that found ongoing benefits were due to the dependents after the claimant was deceased. The Missouri Legislature enacted legislation in 2008 to eliminate payments to dependents. However, the state remains involved in ongoing litigation relating to the dependents of a claimant who died prior to the effective date of the legislation. Although the outcome of this litigation is not yet known, the potential exists for additional significant liabilities to be identified and charged against the fund in the future. Current projections for future fund expenditures do not include any of these potential liabilities.

Recommendations

The fund is currently insolvent, with unpaid liabilities totaling over \$28.1 million, and no means to pay the benefits required by statute. To remedy this situation, the Governor and legislature need to work together to determine whether the fund's statutory purpose remains the state public policy or the program should be reduced or eliminated. If it is decided the program should be continued, a plan should be adopted to re-capitalize the fund and ensure future revenues are adequate to cover statutorily required benefits in the future.

Sincerely,



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State Auditor

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