



2006
Annual Report

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Letter from the Chairman

This report covers calendar year 2006, the 20th fiscal year of operation of Social Security as an independent program under the Federated States of Micronesia.

Although I have been a member of the Board since 2002, this is my first year as the Chairman. I am proud to serve along side the other dedicated Board members and to work with the fine people who make up the Administration. I look forward to working hand-in-hand with the Executive and Legislative branches of the Federal Government to ensure that any and all legislation that affects Social Security will ensure the future health of the program and benefit payments to all beneficiaries.

In April of 2006 the Social Security Administration assumed the responsibility of paying Prior Service Benefits to citizens of the Federated States of Micronesia. The Administration is also responsible for collecting funds to pay these benefits from the United States. It is important to note that unless otherwise indicated, this Annual Report does not reflect the assets or liability of the Prior Service program and that Prior Service Benefits are not paid from the general revenues of the Social Security System, but rather are separately funded and accounted for.

During 2006 the trust realized total net investment income of \$4,143,561, a 10% return which extended the trend of a positive return to four years in a row. Also during 2006, Social Security received \$12,049,988 in contributions, paid \$1,036,253 in administrative expenses and disbursed \$12,852,053 in benefit payments and refunds of contributions. Benefit payments increased by 4.8% in 2006 compared to 2005. It is also important to note that the increase in benefit payments was accompanied by a very slight decrease, 0.66%, in the amount of contributions collected.

Public Law 14-86 was enacted in 2006. This law will increase the funded status of the system and help to insure the future of social security in Micronesia. This law is a good example of the Board of Trustees and Administration working together with the Federal Government to enact legislation with the sole benefit of the citizens of Micronesia in mind.

I would like to thank the Board members whose terms expired in 2006; Bernes Reselap, who served from 2000, and Nena Ned, who served from 1997, for their service on the Board. Their commitment to the people of Micronesia through their service on the Board is evident in the progress that Social Security has made over the years.

And finally, I would like to thank the other members of the Board and the Administration for their hard work and dedication that continue to ensure old age, disability, and survivor benefits to the people of Micronesia.

Sincerely,

Jack E. Yakana
Chairman
Board of Trustees

Board of Trustees

The Board of Trustees is the governing body of the Federated States of Micronesia Social Security System. Members are nominated by the President, confirmed by the Congress and serve three-year terms.

Nominations to the Board take into account the need to have adequate geographical representation and to have representatives from public and private sector employers and employees. The Social Security Administrator is an ex officio member of the Board.

Board Members

Terms

Pohnpei State
Jack E. Yakana



10/10/02 to 10/09/05
10/10/05 to 10/10/08

Chairman

FSM National Government
Nahoy G. Selifis



10/10/02 to 10/9/05
10/10/05 to 10/9/08

Vice-Chairman

Yap State
Charles L. Chieng



5/26/89 to 5/26/92
6/05/92 to 6/05/95
5/13/96 to 5/13/99
5/26/99 to 5/26/02
11/05/02 to 11/04/05
11/15/05 to 11/14/08

Kosrae State
Nena Ned



3/19/97 to 3/18/00
3/19/00 to 3/19/03
9/04/03 to 9/03/06

Chuuk State
Bernes Reselap



2/11/00 to 2/11/03
3/14/03 to 3/14/06

Administrator
Alexander R. Narruhn



7/01/00 to 6/30/02
7/01/02 to 6/30/05
7/01/05 to 6/30/08

I submit this Annual Report of the Federated States of Micronesia Social Security System (FSMSSS, or the "System") covering the period January 1, 2006 to December 31, 2006, the 2006 fiscal year, for the review of all interested parties.

As management of the FSMSSS, the Administration is responsible for the accuracy of the data presented in this report. We believe that this data is accurate in all material aspects and is reported in such a manner as to accurately represent the financial condition of the FSMSSS operations.

In 2006 Social Security celebrated its 38th year of operation and was proud to host the third annual meeting of the Freely Associated Social Security Administrators in Pohnpei from July 19th through the 22nd. The Administrators from the social security systems of the Federated States of Micronesia, the Republic of Palau, and the Republic of the Marshall Islands were in attendance. The main topics discussed were the new database that was implemented in 2005 and the totalization agreement that will allow a member to combine his or her service and earnings from each of the three systems in order to determine if he or she is eligible for a social security benefit payable, on a pro-rata basis, from each system.

Public Law 14-86, which was enacted in 2006, added a fourth tier of 1.0% of total cumulative covered earnings in excess of \$302,500 to the calculation of retirement and disability benefits that begin on or after January 1, 2007. The law also scheduled regular increases in the maximum quarterly covered wages in \$1,000 increments from \$5,000 to \$10,000 beginning January 1, 2008 until January 1, 2028, and increased the minimum monthly benefit from \$50 to \$75 and then \$100 effective on January 1, 2012. It changed the definition of currently insured to require that an individual must have earned at least 20 quarters of coverage during the 25 quarter period ending with the quarter: in which he died, became entitled to old age benefits at age 60, or became disabled. Lastly, to be fully insured for old age or death benefit after December 31, 2006, a worker must have no more than 50 quarters of coverage and contributions of at least \$2,500 to the Social Security System and to be fully insured for a disability benefit, the worker must have no more than 45 quarters and have contributed at least \$1,500 to the Social Security System

Board Meetings

The Board of Trustees held two regular meetings and one special meeting during 2006.

The first regular meeting of the Board of Trustees was held in Honolulu, Hawaii on February 9 and 10. Present during the meeting were: Pohnpei State Lt. Governor Jack E. Yakana, concurrent Chairman and Representative of Pohnpei State, Vice-Chairman and at-large member Nahoy G. Selifis, Chuuk State Representative Bernes O. Reselap, and Kosrae State Representative Nena Ned. Mr. Alexander R. Narruhn, the Administrator and ex-officio member of the Board, also attended the meeting.

The main purpose of the meeting was to select a replacement for Provident Investment Counsel (PIC). PIC, which had managed the System's fixed income portfolio, had informed the Board of its decision to dissolve its fixed income core in March 2006. Merrill Lynch, the System's investment consultant, recommended three money managers that were deemed qualified to administer the fixed income portfolio. These institutions were: Bank of Hawaii, First Hawaiian Bank, and Payden and Rygel. After reviewing the presentations of each institution and considering their past performance, the Board chose Payden and Rygel.

Administrator's Report

The Board also reviewed the status of its investment portfolio with Merrill Lynch. As of January 31, 2006, the value of the portfolio was at \$40 million. The portfolio which began in 1988, has earned over \$33.8 million for the past 18 years.

The Board also acted on the participation of Chuuk Social Security employees to Chuuk State Health Care Plan (CSHCP). The issue had been previously deferred pending a legal opinion. Based on the legal opinion, the Board decided that enrollment to CSHCP by Chuuk social security employees is voluntary and not mandatory as had been claimed.

The second regular meeting of the Board of Trustees took place on August 1st and 2nd of 2006 in Pohnpei. In attendance were: Chairman and Pohnpei State Representative Jack E. Yakana; Vice Chairman and National Government Representative Nahoy G. Selifis; Charles Chieng from Yap State; Nena Ned of Kosrae State. The Administrator Alexander R. Narruhn and Deputy Administrator, Dernista I. Capelle, were also present.

The Administrator reported to the Board that the 3rd Freely Associated States Social Security Administrators' Conference had been a success. During the said conference, the participating social security administrations were able to make progress with the installation of the new database software. Also discussed during the conference were how to improve services to the public in general and the totalization agreement. The totalization agreement had been ratified in the Federated States of Micronesia and Republic of Palau and its implementation was set on September 1st of 2006 whether or not ratified in the Republic of Marshalls. Perhaps the most significant issue was that the conference began the process of implementing a totalization agreement between the three participating nations and the United States of America. In order for this to move forward, each administration will be working closely with its respective Foreign Affairs to bring about this totalization agreement. The goal is for the Foreign Affairs of each nation include the totalization agreement in its Compact II Reviews.

The Administrator reported on the financial status of the System and informed that a total of \$322,034 in delinquent taxes had been collected in the first quarter of 2006. From January 1st to March 31st of 2006 a total of \$3.387 million had been collected. Total benefits paid during the same period were \$3.029 million. As of March 31, 2006, administrative expenses totaled \$233,408, which represent 24% of the approved budget for calendar year 2006. Investments increased by \$895,905 in the first quarter. As a result of the positive performance in both operations and investments, net assets increased by \$981,288 during the first quarter.

Moving on to new business, the Board entertained appeal cases. As mandated by law, an individual whose claim had been denied by the Administration has the right to make an appeal to the Board within 60 days after the denial.

The Board then reviewed responses to a Request for Proposal that was posted by the Administration for a new investment consultant to replace Merrill Lynch, the current investment consultant.

A special meeting of the Board of Trustees was convened in Pohnpei on September 2 and 4 to decide whether to maintain or to select a new consultant. Attending the meeting were: Chairman of the Board, Jack Yakana, who also represented Pohnpei State; Vice Chairman and National Government Representative, Nahoy G. Selifis; Yap State Representative, Charles L. Chieng; Nena Ned, representative of Kosrae; and ex-officio member, Administrator Alexander R. Narruhn.

Previously in June, the Administration began accepting responses to a Request for Proposal seeking a qualified investment consultant. Of the several responses submitted, three firms showed the most promise and were thus chosen for the second phase of the selection process.

They were Merrill Lynch, Morgan Stanley and Smith Barney. During the selection process the Board took into consideration these factors: 1) Investment Policy Review & Development; 2) Asset Allocation Analysis; 3) Manager Search, Due-Diligence and Selection; 3) Performance – Compliance Monitoring and Evaluation; 4) General Consulting; 5) Strategic and Tactical Planning; 6) Investment Education and Communication; 7) Research Analysis & Sub advising on Asset Allocation; 8) Advisory Services or Risk Management Services; and 9) Special Projects.

After reviewing the responses submitted by each firm and listening to the presentations made by their respective representatives, the Board chose Smith Barney to replace Merrill Lynch as the Administration's investment consultant. Smith Barney (SB) showed the most promise with an impressive track record. Further, SB maintains an office in Guam which is considerably closer to FSMSSS headquarters. Having an investment consultant situated closer to home would be convenient for the Board and Administration as well as reduce travel costs should the need arise.

Along with this change, the Board also decided to hire Citigroup Global Markets Inc. to replace Bank of Hawaii as the System's asset custodian. Citigroup Global Markets Inc. is a subsidiary of Smith Barney and by combining the consulting and custodian services of its assets under one company, the Administration will be able to reduce costs associated with servicing the portfolio.

Funding Status

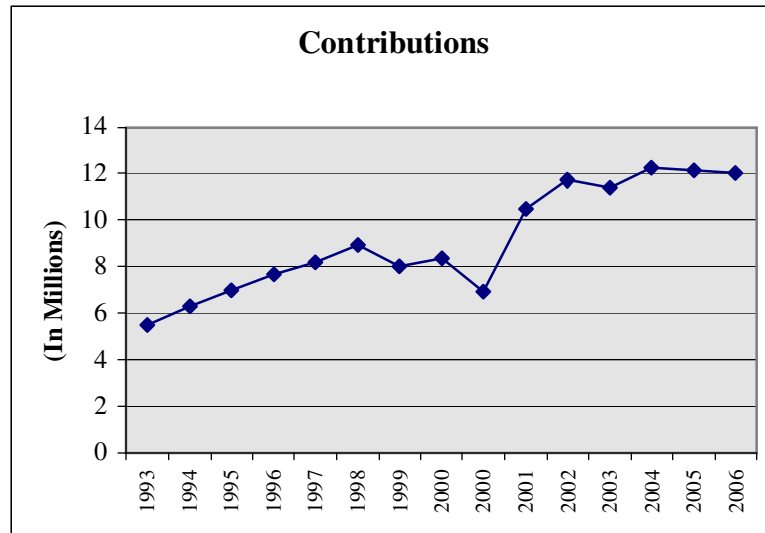
The Administration continues its efforts to ensure that collected contributions and investment income are sufficient to pay current benefits, meet administrative expenses, and reduce the unfunded accrued liability. The long term goal of the Administration is for the System to accumulate assets sufficient to guarantee that future benefit obligations will always be met.

The following graphs illustrate current and historical levels of contributions received as well as benefit payments and administrative expenses paid. The graphs also track the overall historical value of the assets and realized past investment performance.

Administrator's Report

Contributions

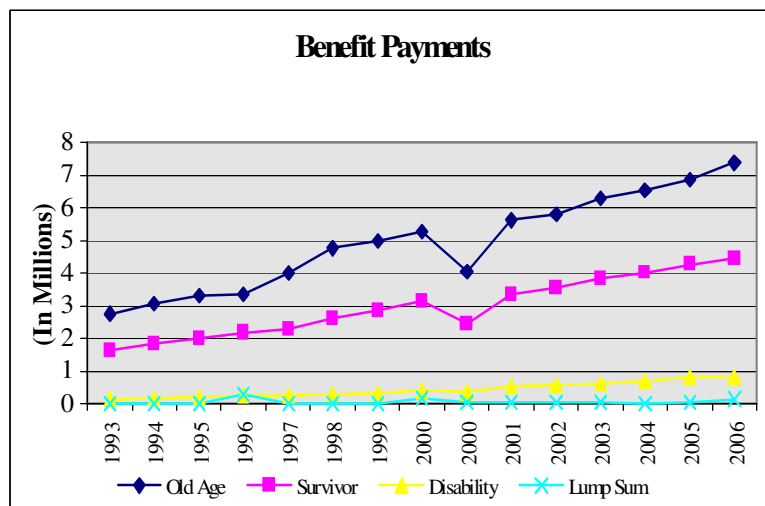
Contributions collected during fiscal year 2006 totaled \$12,049,988 which was \$79,808 less than what was collected in the prior fiscal year. The administration continues to pursue an aggressive campaign of audits of public and private sector employers to assure compliance with the Social Security Act.



Benefit Payments

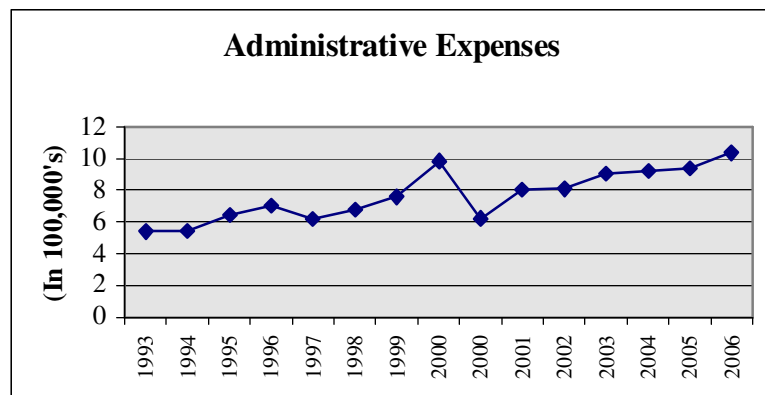
A total of \$12,828,256 was disbursed in benefit payments during fiscal year 2006. In addition, \$23,797 was disbursed as refunds of contributions. The following benefits were paid during fiscal year 2006:

Type	Amount
Old Age	\$ 7,368,763
Survivor	\$ 4,464,194
Disability	\$ 841,012
Lump Sum	\$ 154,287



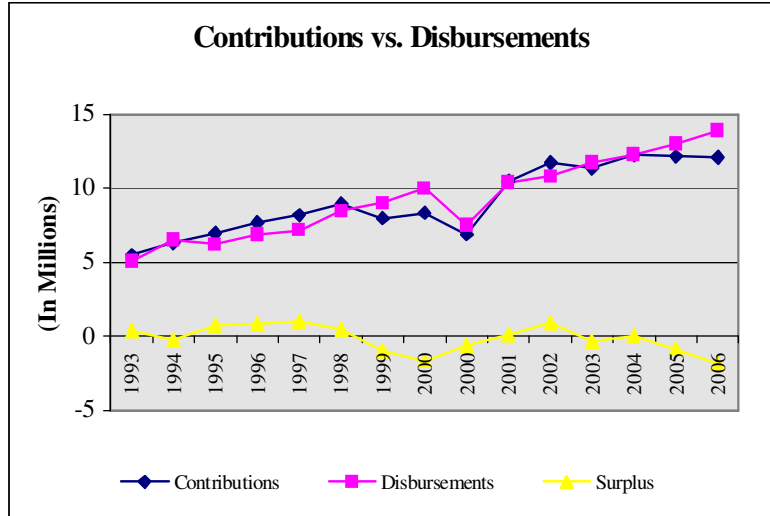
Administrative Expenses

Net administrative expenses of \$1,036,253 were paid during fiscal year 2006. This represents a 10.2% increase from the prior year.



Contributions and Disbursements

During fiscal year 2006, disbursements exceeded contributions by \$1,838,318. For this comparison, disbursements consist of payments to beneficiaries and payments for administrative expenses.

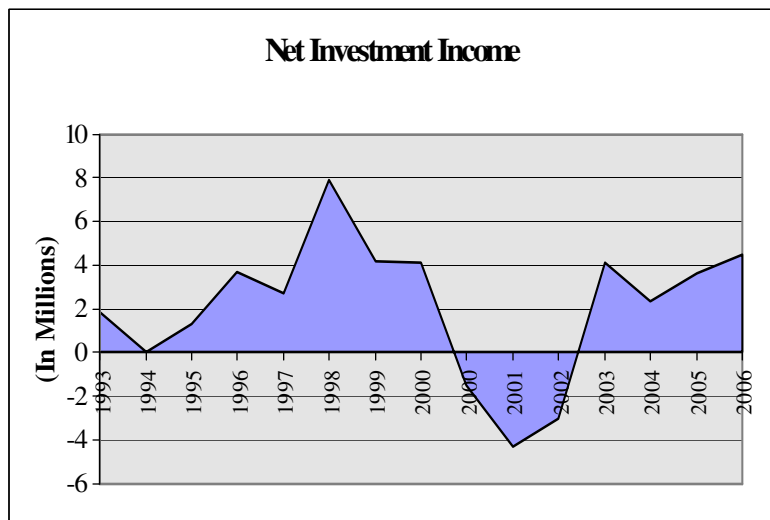
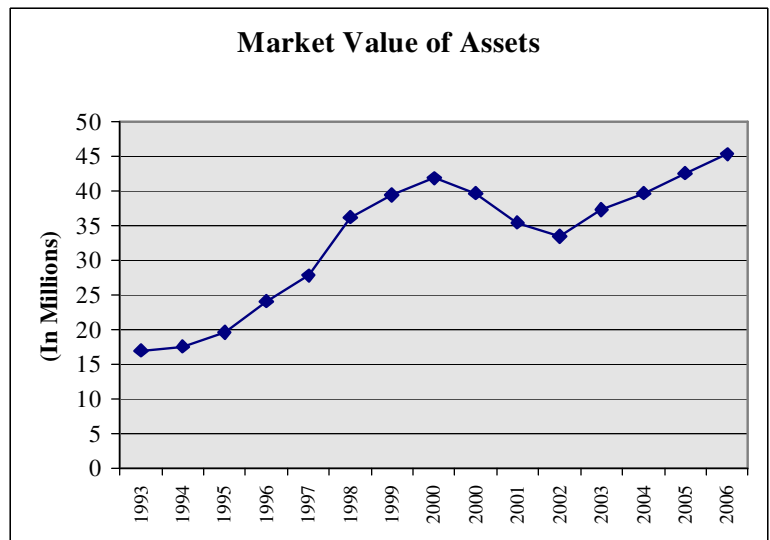


Investments

The Administration retains Smith Barney as its investment advisor, Atlanta Sosnoff Capital Corporation, Missouri Valley Partners, and Payden & Ryley as money managers and as custodial trustee.

FSMSSA does not own any time deposits at the local banks. They are maintained in our general savings account and miscellaneous accounts with Bank of FSM. They are also maintained in miscellaneous accounts, benefit checking account, payroll checking account and operation checking account with Bank of Guam.

Social Security's assets totaled \$45,407,637 at the end of fiscal year 2006, a \$2,750,575 increase from the prior year. The fund experienced a net increase in the fair value of investments and interest and dividends of \$4,458,663.



Administrator's Report

Professional Service Providers

Actuary

Pacific Actuarial Services
1200 Fifth Avenue
Suite 1100
Seattle, WA 98101

Investment Advisor

Smith Barney
Citibank Building
402 East Marine Drive,
Suite 100
Agana, Guam 96910

Money Managers

Atlanta Sosnoff Capital Corporation
101 Park Avenue
New York, NY 10178

Missouri Valley Partners
P.O. Box 16901
135 N. Meramec, Suite 500
St. Louis, MO 63105

Payden & Rygel
333 South Grand Avenue
Los Angeles, CA 90071

Auditors

Deloitte & Touche LLP
361 South Marine Drive
Tamuning, Guam 96913-3911

Custodial Trustee

Citigroup Global Markets
Inc.
Citibank Building
402 East Marine Drive
Agana, Guam 96910

Legal Counsel

Federated States of
Micronesia Attorney General

Michael Sipos
P.O. Box 2069
Kolonia, Pohnpei FM 96941

Law Office of Steve Finnen
P.O. Box 1450
Kolonia, Pohnpei, FM 96941

System Legislation

Public Law 14-86 was passed during the 14th Congress and signed into law by the President during 2006. The principal provisions of this law are

- Added a fourth tier of 1.0% of total cumulative covered earnings in excess of \$302,500 to the calculation of retirement and disability benefits that begin on or after January 1, 2007,
- Scheduled regular increases in the maximum quarterly covered wages in \$1,000 increments from \$5,000 to \$10,000 on January 1, 2028,
- Increased the minimum monthly benefit from \$50 to \$75 and then \$100 on January 1, 2012,
- Provides a new definition of “currently insured”,
- Provided a new definition of “fully insured” which requires a minimum number of quarters and a minimum amount of contributions,
- Provides the Administration discretion when recognizing an adopted child,
- Allows for Voluntary contributions of 12% of \$5,000.00 wages per year from citizens working abroad which will allow them to participate in the System on a voluntary basis, and
- Provides a lump sum payment to certain non-citizens equal to 100% of their contributions should they leave the FSM permanently.

Prior Service Benefits

The Prior Service Benefits Trust Fund (PSBTF) is a supplemental retirement, disability and survivors' plan established pursuant to Section 105(m) of U.S Public Law 99-239. It was established to continue to provide benefits to those who worked for the U.S. Navy Administration or the Government of the Trust Territory of the Pacific Islands for at least 5 years prior to July 1, 1968.

In 1987 the United States Congress provided \$8 million for initial capitalization of the PSBTF. Pursuant to U.S. Public Law 99-239, future funding would be provided if warranted based on the results of actuarial valuations.

In the past six years there have been four appropriations used to pay benefits, the most recent coming from the United States Department of the Interior for \$1.5 million which was received in March of 2005. These appropriations are used to reimburse beneficiaries for payments that were missed in the past due to insufficient funds, pay current benefit payments, and to cover administrative expenses.

Effective April 1, 2006 the Federated States of Micronesia Social Security Administration assumed responsibility for benefit payments made to citizens of the Federated States of Micronesia. During 2006 the Administration paid a total of \$241,696 in Prior Service benefits and received \$341,017 to pay these benefits and to meet associated administrative costs.

Conclusion

The Administration continues to aggressively pursue its policy of collecting all contributions due and the newly acquired ability to waive interest penalties will help achieve this goal. The provisions of Public Law 14-86, especially the change to the benefit structure and the lump sum payments made to non-

Administrator's Report

citizens who leave FSM will help to reduce the System liability and increase the funded status and aid in the future financial health of the system.

The FSMSSS continued to realize a positive return on invested assets for the fourth fiscal year in a row with total net investment income of \$4,249,540 during 2006 which represented a 10.14% return for the year. Yet, during 2006 the Administration paid \$1,528,381 more in benefits, refunds of contributions, and administrative expenses than it collected in contributions. However the scheduled increases in taxable wages and change in the benefit structure that were a part of Public Law 14-86 should stem this tide.

Although the Administration continued to pay more in benefits, refunds, and expenses than it collected in contributions during 2006 (an event that began in 2005), because the trust experienced its fourth consecutive year of positive returns, the Administration was able to meet all of its benefit obligations without liquidating any trust assets. However, because of the somewhat precarious position of having total expenditures exceed collected contributions by over \$1.5 million, the Administration cautions that it would be very dangerous to the ongoing health of Social Security if future benefit increases are not accompanied with a means to pay for the additional benefits.

Acknowledgements

I would like to thank everyone whose hard work and dedication make Social Security a reality for the people of Micronesia. Through the continued efforts of the Congress and President, the Board of Trustees, and the Administration staff Social Security continues to promise security to the retired, disabled, and surviving spouses and children of the hard working men and women of Micronesia who make our economy grow and flourish.

This report is intended to be a complete and succinct summary of the FSMSSS as a basis for making management decisions, responsible management of the assets contributed by the members and their employers and as a preliminary means of evaluating the effects of legislation pertaining to the System. This report will be submitted to the President and Congress of the Federated States of Micronesia as well as other interested parties.

Alexander R. Narruhn
Administrator

Management's Discussion and Analysis

Program Description

The FSMSSA is one of the successor systems from the former Trust Territory Social Security System that closed down operation on March 31, 1988. The FSMSSA began its full operation on January 1, 1988 and is administered by a six-member Board of Trustees. Five members of the Board are nominated by the President and confirmed by the Congress of the FSM while the FSMSSA Administrator serves as an ex-officio member. The FSM Social Security Administration Board of Trustees comprised of the following individuals:

Lt. Governor Jack E. Yakana	Chairman of the Board and representing Pohnpei State;
Nahoy G. Selifis	Vice-Chairman, representing the National Government;
Charles L. Chieng	Member from the State of Yap;
Bernes O. Reselap	Member from the State of Chuuk;
Nena Ned	Member from the State of Kosrae; and
Alexander R. Narruhn	Administrator serves as the ex-officio member.

In April 2007, the FSM Congress has confirmed Garrison Irons as the new Member from the State of Chuuk. He replaced Bernes Reselap, whose term expired in March 2006. As of this writing, the vacancy for Kosrae State has not yet been filled after Nena Ned's term expired in September 2006.

The Federated States of Micronesia Social Security Board of Trustees operates the Social Security Program authorized under the FSM Code title 53. Their nominations to the Board should take into account the need to have adequate geographical representation and to have representatives from public and private sector employers and employees. The members of the Board serve a 3-year term, and they shall provide for its own organization and procedure. Should there be any vacancies on the Board, it shall be filled for the un-expired term only. Where a vacancy is 1 year or less, it shall be filled by appointment by the President; otherwise vacancies shall be filled by nomination by the President and confirmation by the Congress. Members of the Board who are not State or National Government employees shall be paid at the rate of \$30 per day and necessary travel expenses when actually attending meetings of the Board.

The FSMSSA was established by the Federated States of Micronesia Public Law 2-74 enacted February 02, 1983 to provide retirement, disability and survivor benefits for the citizens of the Federated States of Micronesia.

The FSM Social Security system is financed by employer/employee contributions at a rate of 6% each, or a combined tax rate of 12% paid to the system every quarter. State and national governments and all private employers incorporated or doing business in the FSM are subject to social security tax. At present, the maximum taxable wages per employee for each quarter is \$5,000, which was effectuated in the 4th quarter of 2003, and to be increased by \$1,000 every 5 years until CY2028 for a maximum of \$10,000.00.

Management's Discussion and Analysis

Significant Events

- Public Law No. 14-86 was signed into law in October 23, 2006, and was fully implemented in January 1, 2007. The new law includes among other things: definition of “fully insured” which require a minimum # of quarters and a minimum amount of contributions; definition of adopted child/ren which gives the System a discretion not to recognize any adoption on or after the wage earner turn 55; voluntary contributions of 12% of \$5,000.00 wages per year from citizens working abroad which now allow them to participate in the Program on a voluntary basis; and, lump sum payments to certain non-citizens equal to 100% of their contributions when these non-citizens decide to leave the FSM permanently.
- The FSMSSA hosted the 3rd Freely Associated Social Security Administrators annual meeting in Pohnpei from July 19-22, 2006. Attended by Administrators and key staff from the 3 participating SS Systems: FSM, Palau and the Marshalls, the conference was a huge success. Among the topics discussed during the conference included the new database software recently installed and the totalization agreement. Further enhancements to the computer system were introduced and discussed by the Systems' Software Specialist who was also invited to attend the meeting. The Totalization Agreement would allow a member to combine his or her earnings from the three countries to determine eligibility and to receive social security benefits from each country on a pro rata basis. To date, the agreement had already been ratified in the FSM and Palau. During the conference, the three Social Security Systems conducted presentations on each SS Divisions in terms of staffing, general responsibilities, performances and challenges in order to bridge collaboration between the FAS SS Systems.
- In October 2006, we have successfully completed the computerization upgrade of the 3 other branch offices of Chuuk, Kosrae, and Yap. The new system includes automated cash receipts system which is currently working well in the 4 branches including Pohnpei Branch.
- Continue to build staff capacity: knowledge, skills and abilities – through participation of key personnel to the APIPA conference held in Pohnpei in July. We also had our bi-annual employees' conference in February 2006 at the Headquarters and attended by all staff from HQ and from the four branch offices. The conference was focused mainly on the newly upgraded system where HQ staff led to train all other branch employees. The new system has significantly improved the processing of information, one key toward better service to the growing number of recipients, employers and members.
- The FSMSSA assumed the responsibility of the administration of the Prior Service Trust Fund for FSM effective April 1, 2006. As of February 2007, total funds received for this purpose amounted to \$375,993.00 while benefits paid from April 2006 to February 2007 totaled \$296,136. Fees equivalent to 20% of amount transferred will go to FSMSSA as its income for administering the funds. Monthly benefits payment will resume when new funding is received from the U.S. Department of Interiors, Insular Affairs.

Management's Discussion and Analysis

Financial Highlights

- The System's net assets increased by 6.4% from \$42,657,062 as of December 31, 2005 to \$45,407,637 as of December 31, 2006. This increase was primarily due to the investment's net gain which was approximately 12.7% higher than the previous year. Included in the net asset increased was from Prior Service Trust Fund net asset as of end of CY2006 amounting to \$32,416.

At the end of 2006, net investment gain comprises the following:

Interest and dividends earned	\$ 863,671
Realized gains on sale	2,346,126
Unrealized gains on Market Value	5,457,012
Realized losses on sale	(428,968)
Unrealized losses on Market Value	(3,808,514)
Investment fees	<u>(315,102)</u>
Net Investment gain	<u>\$4,114,225</u>

The investment's market value as of December 31, 2006 reached \$42,622,091 including automated cash management fund of \$815,815. During the year, \$1,250,000 was redeemed from the investment portfolio to supplement current funds to meet benefits payment.

- Tax collections in 2006 declined by 0.7% at \$12,049,986 compared to \$12,129,796 collected in 2005. Out of 2006 collections, \$957,806 was collected from delinquent employers. About \$200,000 of this was attributed to the new Public Law 14-37 which gave delinquent employers the chance to get interest waived if they pay their accounts in full. In April 2006, the System received Prior Service allocations amounting to \$341,017.

Other income during the year included prior service reimbursements of \$68,203 and miscellaneous collections of \$35,163 from ss cards and other fees.

- Benefits payment increased nearly 5% due to increase in lump sum, retirement, and surviving spouse claims. Total benefits paid in 2006 were \$12,828,256. Of this amount, \$241,696 was paid to Prior Service recipients. Benefits paid in 2005 totaled \$12,006,929. At the end of 2006, the total number of beneficiaries of FSMSSA declined to 6,363 compared to 6,404 at the end of 2005.

Management's Discussion and Analysis

Breakdown of benefits according to entitlement follows:

	2006		2005
	FSMSSA	Prior Service	FSMSSA
Retirement	7,251,790	116,973	6,870,291
Survivor	4,339,471	124,723	4,269,263
Disability	841,012		830,813
Lump Sum	154,287		36,562

- In our efforts to cut costs, this year's total administrative expenses were lower by 0.1% compared to last year. We have successfully managed to reduce quite a number of expense items, travel expenses in particular which declined by as much as 26%. Although some of the expense items have increased dramatically including utilities due to escalating prices, we can say that these expenses were still under the budget limit.

Fixed assets acquisition during the year amounted to \$18,102 and comprised mostly of computers and computer items.

As in the past years, total administrative costs were lower than the approved budget by 7% in 2006 and lower by 29.4% when compared to the budget ceiling provided in the Social Security Act. In March 2007, the Board approved \$1,039,581 budget for CY2007. This amount is 3.19% higher than the budget approved for CY2006.

Statement of Net Assets

	<u>2006</u>	<u>2005</u>
Cash and equivalents	\$ 1,556,975	\$ 2,873,476
Investments	41,806,275	37,809,060
Other current assets	2,220,018	1,970,466
Fixed assets, net	<u>71,988</u>	<u>79,944</u>
	<u>45,655,256</u>	<u>42,732,946</u>
Liabilities	<u>247,619</u>	<u>75,884</u>
Net assets:		
Held in trust for retirement, disability and survivors' benefit	<u>\$ 45,407,637</u>	<u>\$ 42,657,062</u>

Management's Discussion and Analysis

Statement of Changes in Net Assets

Revenues	\$ 16,638,881	\$ 15,844,718
Expenses	<u>13,888,306</u>	<u>12,969,493</u>
Changes in net assets	2,750,575	2,875,225
Net assets at beginning of year	<u>42,657,062</u>	<u>39,781,837</u>
Net assets at end of year	<u>\$ 45,407,637</u>	<u>\$ 42,657,062</u>

Conclusion

In 2006, the System was able to pay \$12.6M in total benefits and still left with \$2.7M increased in net assets. Thanks to the good performance of the investment portfolio which generated 10% net return during the year. However, tax collection level in 2006 remained unchanged compared to the past 2 years resulting in an operational deficit of \$1.4M this year. To cover the deficit, management was prompted to redeem part of the investment portfolio in order to meet benefit payments.

With benefits increasing at an average yearly rate of 5%, we have yet to find other resources to supplement ss tax contributions for the growing benefits and administrative expenses. We hope that with the new amendments to the Social Security Act which gave the Administrator the power to waive interest on delinquent taxes, we would be able to increase our tax collections from delinquent employers. Also, we believe that our continued efforts in auditing as well as controlling administrative expenses will help maintain the balance in our operations.

Overall, during fiscal years 2006 and 2005, the System generated a net income of \$2,718,159 and \$2,875,226 respectively.

Summary of Principal System Provisions

Applicable Laws

Public Law 2-74, as amended by Public Laws 5-120, 6-111, 7-118, 7-119, 7-120, 9-56, 12-51, 12-76, 14-37, and 14-86

Workers and Employer's Contributions

Workers, self-employed workers and employers each pay 6% of earnings up to a maximum of \$5,000 of earnings per quarter.

Self-employed with employees - remuneration shall be deemed to be twice the amount paid to the highest paid employee reported by the self-employed person in quarter, up to \$5,000 taxable per quarter.

Self-employed with no employees- Remuneration is deemed to be 2.5% of the gross revenue of the business for the previous calendar year subject to \$5,000 taxable per quarter.

Coverage

All employees employed by an employer incorporated or doing business in the Federated States of Micronesia are covered unless both the employer and employee are currently subject to another recognized social security system.

Eligibility for and Computation of Benefits is based on the following definitions:

Quarters of Coverage: A calendar quarter in which contributions were made for at least \$50 of earnings.

Currently Insured: Credited with at least 8 quarters of coverage during the most recent previous 13 calendar quarters.

Fully Insured: Credited with at least one quarter of coverage for each year since the later of attainment of age 21 or June 30, 1968 and having not less than 12 quarters of coverage. No more than 38 quarters are required for Fully Insured status.

Maximum Covered Earnings: Earnings up to a maximum of \$5,000 each quarter.

Minimum Benefit: \$50 per month.

Summary of Principal System Provisions

Basic Benefit

A worker's Basic Benefit is calculated as 1/12 of:

1. 16.5% of the first \$10,000 of total Maximum Covered Earnings for which contributions have been made, plus
2. 3.0% of the next \$30,000 of total Maximum Covered Earnings for which contributions have been made, plus
3. 2.0% of total Maximum Covered Earnings in excess of \$40,000 for which contributions have been made.

Old Age Insurance Benefit

Eligibility: Age 60 and Fully Insured

Amount: Greater of the Basic Benefit and the Minimum Benefit, subject to the earnings test.

Disability Insurance Benefit

Eligibility: Disabled for three months and Fully Insured at time of disability

Amount: Unreduced Basic Benefit earned at time of disability. Sum of disability benefit and workers compensation benefit may not exceed 80% of the highest covered compensation earned in the year of disability and the prior five years. The benefit ceases should the worker recover from the disability.

Surviving Spouse Benefit

Eligibility: Worker must have been Fully Insured at time of death.

Amount: 60% of the Basic Benefit earned at the time of death, subject to the earnings test. Paid until the earlier of the date the spouse remarries or dies. This benefit is reduced by any Old Age Insurance Benefit that the spouse may be entitled to based on his or her own earnings history.

Surviving Child Benefit

Eligibility: Worker must have been Fully or Currently Insured at time of death.

Amount: 15% of the Basic Benefit for each dependent child under the age of 18 or 22 if a student. The benefit ceases if the child marries or is adopted by a close relative.

Summary of Principal System Provisions

The minimum total Survivor benefit is \$50 per month and is subject to the Earnings Test.

The sum of all survivors' benefits cannot exceed 100% of the Basic Benefit earned at the time of death.

Payment to Foreign Citizens residing outside the FSM

Payments to citizens and nationals of the Republic of Palau, the Republic of the Marshall Islands and the United States shall be made as if they were citizens or nationals of the Federated States of Micronesia as long as those nations give citizens and nationals of the Federated States of Micronesia reciprocal treatment. For citizens and nationals of other countries, a lump sum payment equal to total worker paid contributions as of the date the worker turned age 60, became disabled, or died. The lump sum payment is reduced by any payments already made to the employee, surviving spouse or child before the lump sum is paid.

Lump Sum Death Benefit

Eligibility: After the death of any covered worker and rights to all survivors' benefits have ceased.

Amount: Four percent of total Maximum Covered Earnings for which contributions have been paid, less the value of any benefits already paid.

Lump Sum Benefit (other than death)

Eligibility: Age 60 and not fully insured, native born citizen of the Federated States of Micronesia or resident for at least 10 years and must have lived in the Federated States of Micronesia for at least one year immediately preceding death.

Amount: Four percent of total Maximum Covered Earnings for which contributions have been paid.

Earnings Test

Benefits are reduced by \$1 for every \$2 of earnings in excess of \$300 received each quarter.

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