

FSM Social Security Administration



2008-2009 ANNUAL REPORT

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This report covers calendar years 2008-2009. During this period, Social Security celebrated its 40th anniversary in the region. Its purpose then, and its purpose now, remains the same – to provide for the needs of workers and their beneficiaries when they retire or are unable to work. However, as the worldwide economic outlook continues to look bleak, the Board faces major challenges attempting to meet this goal.

The years 2008-2009 marked significant landmarks in the Social Security System, including increasing the quarterly taxable wage base, instituting an updated investment policy and improving tax collection. Despite these best efforts, the negative gap between benefit payments and collections continues to increase. Further changes must be made for the System to continue.

In 2009, investment income experienced a \$6.1 million gain, compared to an \$8.3 million loss sustained during 2008. However, because of the \$3.0 million drawdown from investments to supplement benefit payments, investments netted only a \$3.1 million increase.

The drawdown, required to cover benefits, was a result of contributions falling short of the benefit payments. This trend continues to drain the fund. During 2008, Social Security received \$12,488,497 in contributions, paid \$989,810 in administrative expenses and disbursed \$14,241,374 in benefit payments and refunds of contributions. During 2009, contributions increased slightly to \$12,955,409, while administrative expenses decreased to \$961,778, but benefit payments, including refunds of contributions, increased to \$15,322,114.

It will be impossible to maintain the System long term with this type of ongoing drain, although efforts continue to rectify this problem, with amendments to the FSM Social Security Act: Public Law 14-86 and Public Law 15-73.

Public Law 14-86 implements limitations on adopted beneficiaries as well as sets a minimum contribution for eligibility. The amendment also raises the minimum monthly benefit from \$50 - \$75 and adds a tenet for FSM citizens working abroad the ability to participate through voluntary contributions.

Public Law 15-73 allows individuals aged 60-64 to continue to work, and pay into the system, while receiving a reduced retirement benefit. This amendment becomes effective January 1, 2011. The amendment also increases the tax rate from 6% to 7% for both employees and employers as of October 1, 2010; with further increases to 7.5% for both on January 1, 2013. The amendment also defines minimum participation requirements for retirement and disability benefits as well as imposes penalties for avoiding payment of taxes. A change broadening the System's investment options as well as payment limits for non-citizens also are included in the amendment.

We must continue to work together with the FSM Congress, Administrator, State Legislators and Citizens to address the serious issues facing the System.

I have been a member of the Board since 2007. 2009 marks my final year as the Chairman. During this time, I have had the pleasure of serving alongside the other dedicated Board members and Administration, including Vice Chairman Rose N. Nakanaga, Pohnpei State Representative. Ms. Nakanaga will assume the duties of Acting Chairman in 2010. We have worked closely together over the years, and we expect a seamless transition in our common goal to guarantee the future health of the program and benefit payments to all beneficiaries.

I would like to thank the Board members whose terms expired in 2008 and 2009: Jack Yakana who has served since 2002; and Yosiwo George, who has served since 2007; for their service on the Board and commitment to the people of Micronesia.

And finally, I would like to thank the other members of the Board and the Administration for their hard work and dedication.

Sincerely,

Garrison Irons

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

Chuuk State
Garrison Irons



3/29/07 to 3/29/10

Chairman

Pohnpei State
Rose N. Nakanaga



10/2/08 to 10/1/11

Vice Chairman

FSM National Government
Nahoy G. Selifis



10/10/02 to 10/9/05
10/10/05 to 10/9/08
10/10/08 to 10/09/11

Vice-Chairman

Yap State
Charles L. Chieng



5/26/89 to 5/26/92
6/5/92 to 6/5/95
5/13/96 to 5/13/99
5/26/99 to 5/26/02
11/5/02 to 11/4/05
11/15/05 to 11/14/08
11/15/08 to 7/24/10

Kosrae State
Jefferson Timothy



2/01/09 to 1/31/12

Administrator
Alexander R. Narruhn



7/1/00 to 6/30/02
7/1/02 to 6/30/05
7/1/05 to 6/30/08
7/1/08 to 6/30/11

Ex-Officio Member

Administrator's Report

I submit this Annual Report of the Federated States of Micronesia Social Security System (FSMSSA, or the "System") covering fiscal years 2008 and 2009, the period from January 1, 2008, to December 31, 2009, for the review of all interested parties.

As management of the FSMSSA, 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 FSMSSA operations.

In 2008, Social Security celebrated its 40th year of operation. Progress is being made to further increase the financial stability of the fund. A significant amount of education was provided by the Administration to the Board of Trustees, the Legislatures and the participants of the fund as to the importance to make sure money is available in the future to pay promised benefits. As part of this education, a new public law was passed as a step in the right direction. However, many provisions, essential to the long-term stability of the System, have been delayed or repealed.

Board Meetings - 2008

The Board of Trustees held three regular meetings during 2008 and three regular meetings during 2009.

The first regular meeting of the Board of Trustees was held in Honolulu on April 8-10, 2008. Board members that were present included Chairman and Representative of Pohnpei, Lt. Gov. Jack E. Yakana; Vice-Chairman and at-large member, Nahoy G. Selifis; Representative of Yap, Charles L. Chieng; Representative of Chuuk, Garrison Irons; and Representative of Kosrae, Yosiwo George. Social Security Administrator Alexander R. Narruhn, serving as ex-officio member, was also present.

The main agenda items of the meeting were the review of investment portfolios and the interviews for potential small cap money managers. The Administrator also presented financial statements for the year 2007.

Annual portfolio reviews were presented by Smith Barney, Atalanta Sosnoff and Payden Rygel.

Dan Roland and Jason Miyashita presented for Smith Barney. The total portfolio is about 64% equities and, as of April, 2008, is valued at \$40.8 million. Despite the losses, Smith Barney advised the board to not make any drastic changes. To do so would force the System to miss out on any market bounce back.

Jim Staub presented for Atalanta Sosnoff, the System's large core manager. Although 2007 showed positive results, the first quarter of 2008 showed a -13.5% loss, 4% less than the benchmark. However, from 2005 to 2007, the return was 53.4%, well above the 28.2% benchmark. As of March 31, 2008, the total portfolio under Atalanta's management is \$21,210,899, 17.8% in cash and 82.2% in common stock.

Mike Salvay presented for Payden&Rydel. As of March 31, 2008, the portfolio managed by Payden&Rygel is \$14.9 million.

A summary of the Administrator financial report is as follows:

1. 2007 contributions increased by \$786,351, or 7%.
2. In February, Chuuk State Government made a \$1.2 million payment for delinquent taxes.
3. 2007 benefit payments totaled \$13,663,880, a 9% increase.
4. Administrative expenses for 2007 were \$969,029, \$70,552 lower than the budgeted amount.
5. 2007 investment income was \$3.7 million.
6. Net assets at the end of 2007 were \$47,374,295.
7. 2007 tax receivables are \$3.79 million and delinquent taxes are \$212,000.

The board interviewed three small cap money managers – Missouri Valley Partners, Golden Capital and Penn Capital. After the interviews, and discussions with Smith Barney, the board chose Golden Capital as the new small cap money manager.

After adopting the prior meeting minutes, and some closing remarks, the meeting was adjourned.

The second regular meeting of the Board of Trustees was held in Colonia, Yap on June 30-July 2, 2008. Board members that were present included Chairman and Representative of Pohnpei, Lt. Gov. Jack E. Yakana; Vice-Chairman and at-large member, Nahoy G. Selifis; Representative of Yap, Charles L. Chieng; Representative of Chuuk, Garrison Irons; and ex-officio member Administrator, Alexander R. Narruhn.

The main agenda items of the meeting were the appeal of Aurelia Rulyan, on behalf of dependent Steven Rutmag, appeal of Justin Yilubwag, and Kosrae Representative Yosiwo George's term. The Administrator also presented financial statements for the 1st quarter 2008.

The minutes of previous meeting were approved unanimously by members, and after that the members had their opening comments.

Appeal of Aurelia Rulyan who was claiming for dependent Steven Rutmag. This was a case of mental illness, denied by the Disability Examiner due to insufficient medical evidence to prove that the disability was so severe it prevented the claimant from engaging in employment before age 22. Documents submitted during the appeal were the same as initially reviewed so the board members agreed to defer its decision and to have the Administrator gather new evidence, resend the claim to the disability examiner for reconsideration. The board approved unanimously a motion, that the Administrator obtain new medical evidences for appealed cases and resend to the examiner for reconsideration. If the examiner denies it a second time, then it will go to the board for formal appeal.

Kosrae Representative Yosiwo George's term. Yosiwo George was appointed FSM Ambassador to the U.S. Because he did not resign his position as a board member, a deliberation ensued among members on how to replace him. In the end, the members agreed to have the Chairman and Administrator speak to the President to resolve the issue.

Administrator's Report

A summary of the Administrator's financial report is as follows:

1. Total assets at the end of 1st quarter 2008 totaled \$40,128,660.
2. Accounting division recommended writing off accounts receivable for three former board members while collection efforts would be ongoing based on a board resolution that receivables and payables could be written off after six years.
3. The board agreed that the administration furnish a payment agreement for all board members and beneficiaries with accounts receivable.

Appeal: Justin Yilubwag. This was a case of claimant's problem with the left eye, heart disease and migraines initially denied because the examiner deemed claimant can find other substantial gainful employment since he has a college education and extensive work experience. Mr. Yilubwag represented himself and Chieng acted as translator while he spoke in Yapese. After reviewing and discussing, the board has decided to reverse the denial and start Mr. Justin Yilubwag's disability benefit.

After announcing that the next meeting would be in the Philippines in October to coincide with the APAFS Conference, the meeting was adjourned.

The third regular board meeting was held in Makati, Philippines, on October 7- 8. The meeting coincided with the Investment Review and the APAFS Conference. On October 7, the board met with the investment consultants, Mr. Daniel A. Roland and Mr. Jason B. Miyashita, from Consulting Group/CITI Smith Barney in Hagatha, Guam. Present in the meeting were: Chairman Yakana, Vice Chairman Selifis, Trustee Chieng and Ex-Officio member Administrator Narruhn. Trustee Irons joined the board meeting at a later date due to late arrival.

According to Roland and Miyashita the fund is down but not as much as if the fund remains overweight in equity. The Consultants don't recommend changes to the portfolio diversification or allocation. They did a rebalancing of the FSMSS fund in February with asset allocation 47% Equity and 53% FI, Roland and Miyashita further recommended to buy equity when the market is down. There are more risks in equity, but in the long term, they have higher returns. They also recommended waiting in fixed income and to not put in cash because the cash rate is lower than FI and to let asset allocation do its job without changing.

On the same day, October 7, the board met in Makati, Philippines. Present during the meeting were Chairman Yakana, Vice-Chairman Selifis, Yap Representative Chieng, and ex-officio Administrator Narruhn. Adoption of minutes from previous meeting was deferred until member Irons is present. Chairman Yakana gave a briefing on current activities, congratulated vice chairman Selifis and Trustee Chieng for reconfirmation on their nominations. He mentioned Ms. Rose Nakanaga as the new member to be welcomed at the next meeting as his replacement.

Report from SS Administrator included FAS Administrators' Annual Meeting in Palau during which the three administrators had finalized and signed off on a new software enhancement proposal amounting to \$250,000 to US DOI; a high employee turnover in the system that included senior management level; \$500,000 appropriation from FSM Congress specifically for benefit payments for the remainder of the year; and a request to include an item on the agenda for Lihne Benjamin case; to discuss under Miscellaneous Business refunds or reimbursement of deposits made to meet the \$2,500 minimum

contribution requirement. Financial Statements and Collection reports presented by Administrator included: Unliquidated travel advances; decrease in net asset from \$44M in 12/31/07 to \$40.8M as of 6/30/08 due to market volatility; and Audit and Delinquent Tax collection Reports.

The meeting on October 7 included discussions from among the members themselves: possible grant money from China that would be strictly designated for SS benefit payments; and administration to track down the \$500,000 appropriation from FSM Congress before withdrawal from investment.

On the second day of the meeting, October 8, the minutes of previous meeting were adopted. A part of the meeting is comments from board members. Vice Chairman Selifis thanked the administration for arrangement of this trip which is his first time in Manila. Trustee Irons apologized for his travel delays due to misplacement of his passport and disappointment in personnel's effort in his travel arrangements, with further recommendation for staff conference for continuing education. Trustee Chieng was glad to be with APAFS meeting this time which is his first and looks forward to the conference. He asked about the status of Justin Yilubwag's DI claim. Administrator Narruhn responded to both comments from trustees Irons and Chieng. He will find out what happened on travel arrangements and will rectify the situation. He was surprised that Yilubwag hasn't received communication or the first check which had been printed. Mr. Yilubwag should have received second check by now.

Two resolutions were adopted during the meeting. One: to authorize management to withdraw \$500,000 from the FSMSSA investment portfolio on the condition where the \$500,000 appropriation from the FSM Congress is not received on or before end of December 2008. If such appropriation is received after December 2008, the full amount shall be re-deposited into the FSMSSA Portfolio. Two: to allow Administration to reimburse the surviving spouses the difference of \$2,500 paid into the FSMSSS to satisfy the fully insured minimum requirement.

The budget for 2009 was adopted as presented. Trustee Chieng did not support a salary increase for the Administrator and Deputy because their contracts are subject to review by the board and without a formal evaluation review process he found it hard to support some arbitrary increases. The chairman assigned the administration to pursue a third party to do a study on the entire personnel policy in regards to all the positions and salary. The study has to be done during the operation year 2009.

The Proposed Congressional Appropriation Act was adopted. The Board voted 4-0.

The Deputy's term of contract change to three years was unanimously adopted. The board voted 5-0.

After closing remarks from the members, the meeting was adjourned.

Administrator's Report

Board Meetings - 2009

On February 23-24, 2009, the FSM Social Security Board of Trustees convened in Pohnpei for its first regular meeting of calendar year 2009. New to the board were Rose Nakanaga representing Pohnpei State and Jefferson Timothy representing the State Of Kosrae. They joined the mainstays which comprised of Chairman and Representative of the National Government, Nahoy G. Selifis; Vice Chairman and Representative of Chuuk, Garrison Irons; and Charles Chieng, representative of Yap State. The meeting was also attended by Administrator Alexander R. Narruhn who serves as ex-officio member on the board and the Deputy Administrator, Dernista I. Capelle.

After welcoming the new members, the board proceeded to vote in Garrison Irons as the new Chairman of the Board and Rose Nakanaga as the new Vice Chairman of the Board. With a full quorum, the board went ahead with its first major item on the agenda and reviewed the financial statements for calendar year 2008. The Administrator revealed to the board that calendar year 2008 saw a collections total of \$14,044,668.08 while benefit payments totaled to \$14,222,788.28. This continued the trend of benefit payments outpacing collections.

Administrative expenses for the year came in at \$993,641.17. The Administrator was happy to report to the board that calendar year 2008 was an exceptionally good year for delinquent tax collections. A total of \$3,666,077.53 was collected during the year, the highest annual delinquent tax collection since the tax division's inception. The board holds an investment conference at the beginning of every year to coincide with its first board meeting. As such, representatives from the FSMSSA investment consultant and money managers attended the meeting to provide the board with pertinent information concerning the current status and outlook of its investment portfolio. This issue was especially important to the board due to the current state of the U.S. economy where the portfolio is invested. At the end of 2007, the portfolio's investments had been valued at \$43.5 million. The FSMSSA's investment consultant, Smith Barney, was represented by Dan Roland and Jason Miyashita, and they revealed that as of December 31, 2008, the investment portfolio's market value was at \$33.8 million. This bleak outlook was shared by the money managers of the portfolio. However, optimism was present in the new U.S. administration and the steps they have already taken in addressing the economic crisis.

The FSMSS Board of Trustees convened for its second Regular Meeting of calendar year 2009 in Chuuk from June 23-24, 2009. Present at the meeting were Chairman of the Board and Representative of Chuuk State, Garrison Irons; Vice Chairman of the Board and Representative of Pohnpei State, Rose N. Nakanaga; National Government Representative, Nahoy G. Selifis; Kosrae State Representative, Jefferson Timothy; and serving as ex-officio member, Administrator Alexander R. Narruhn.

The board met with its investment consultant represented by Jason Miyashita to discuss the investment policy. The newly passed Public Law 15-73 made changes to the investment act that necessitated an update of the investment policy. These changes included the new areas into which the FSMSSA could invest to maximize returns. The investment consultant revealed to the board that as of June 22, 2009, the portfolio's market value was \$34.1 million. He reiterated that the ongoing woes facing the investment world would continue to yield an up-and-down trend in the performance of the portfolio.

Moving on, the board discussed the new law and the concerns expressed through resolutions from the Pohnpei State and Yap State Legislatures pertaining to Section 804(1)(c). This provision changed the law so that individuals who turn 60 beginning January 1, 2010, and thereafter, would receive 50% of

their calculated retirement amount up to age 64. From age 60 to 64, these individuals can work with no adjustment to their monthly benefit. At age 65, they would receive 100%, except that if they continue working, their benefit would be subject to the earnings test where monthly benefits are adjusted based quarterly earnings.

In its discussions, the Board acknowledged the concerns pertaining to this provision and made a resolution to delay its effective date by 3 years. The board urged the administration to lobby Congress to supplement the program during this 3-year delay.

In other areas, the board went over its financial statements. The Administrator revealed that collections for the 1st quarter of calendar year 2009 totaled \$3,309,831 while benefit payments came in at \$3,667,204. These figures continued the trend of benefit payments surpassing tax collections. Administrative expenses for the 1st quarter were \$194,269, with investments experiencing a loss of \$851,105 for the same period.

On October 10-13, 2009, the FSM Social Security Board of Trustees met in Guam for its third and final regular meeting of Calendar Year 2009. Attending the meeting were Vice Chairman and Pohnpei State Representative, Rose N. Nakanaga; National Representative, Nahoy G. Selifis; and Kosrae State Representative, Jefferson Timothy. Administrator Alexander R. Narruhn joined the meeting as ex-officio member.

First on the agenda, the board met with Jason Miyashita who represented the board's investment consultant, Smith Barney. Public Law 15-73 had amended the FSMSSA Investment Act to include international investments through ADRs (American Depository Receipts), requiring the board to hire a new money manager to manage assets in this new field. Therefore, in a previous meeting, the board assigned this task to Smith Barney.

Miyashita reported that, out of 24 possible candidates, four finalists had been selected. The candidates' screening process included a variety of factors, comparing how each manager handled investments as well as their actual performance. The top four candidates were Renaissance, Metropolitan West, Hansberger and Templeton. The Board interviewed a representative from all the final firms except Templeton, which did not send in a representative.

After interviewing the managers and closely comparing the performance, approach to risk and fees of each candidate, the board selected Renaissance as its new money manager for ADRs.

In other areas, the Board approved the budget for calendar year 2010. As mandated by law, the budget must not exceed 11% of the collections of the previous year. The CY 2010 budget was placed at \$1,068,553 which was 8.6% of 2009's income which was projected to be at \$12,374,865 and 7% lower than the CY 2009 approved budget. This illustrated the administration's continual efforts to cut costs. Narruhn pointed out that the administration had never used the total approved budget for any given year.

Administrator's Report

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 investment and realized past investment performance.

Contributions

2008 contributions totaled \$12,488,497, while 2009 contributions totaled \$12,955,409. Although there was a slight increase, disbursements continue to outpace contributions. Contributions were comprised of:

	2008	2009
Government	\$6,658,920	\$6,827,298
Private	5,655,537	5,967,099
Judgment	28,099	14,887
Penalties/ Interest	145,941	146,125

Contributions increased 3.74% compared to the prior year.



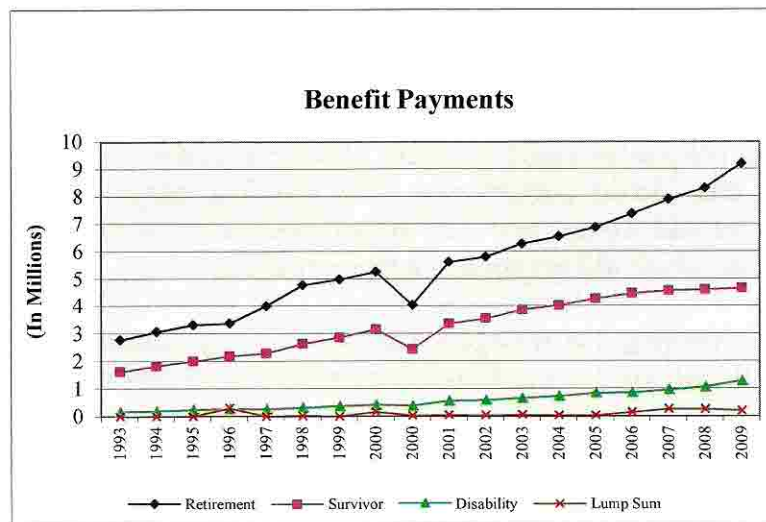
Benefit Payments

A total of \$14,222,788 was disbursed in benefit payments during fiscal year 2008 and \$15,304,704 during 2009.

Disbursements were comprised of:

	2008	2009
Retirement	\$8,309,308	\$9,188,597
Survivor	4,603,842	4,646,298
Disability	1,046,397	1,264,648
Lump Sum	263,241	205,161

Benefit payments increased by 7.61% compared to the prior year. While retirement, survivor and disability payments increased, lump sum payments decreased. The overall increase was attributed mainly to an increased number of beneficiaries.

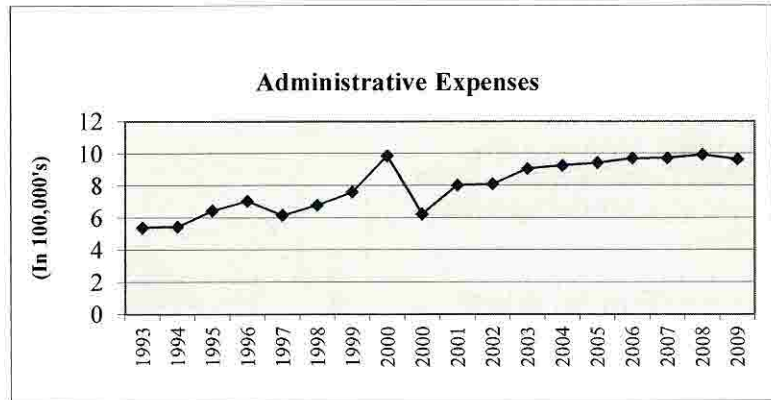


Administrative Expenses

Net administrative expenses totaled \$989,810 for 2008 and \$961,778 for 2009. The actual administrative expense was 16% lower than the approved budget.

Administrative expenses were:

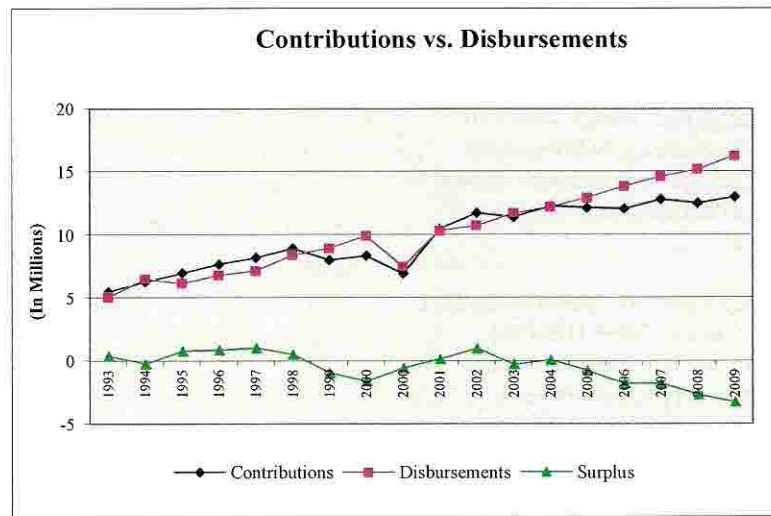
	2008	2009
Budget	\$1,104,132	\$1,149,058
Actual	989,810	961,778
Surplus	114,322	187,280
% Surplus	10%	16%



Contributions and Disbursements

For fiscal years 2008 and 2009, disbursements continued to exceed contributions, and the gap is widening.

Additional funding in the form of cash infusions from the government may stem the flow of red ink, but will not provide a long-term solution. Legislative changes to improve collections and limit benefits will help, but more must be done in fairly short order to create a viable, long-term benefit.



Administrator's Report

Investments

The Administration retained Smith Barney as its investment advisor, Atalanta Sosnoff Capital Corporation, Missouri Valley Partners, Golden Capital, Renaissance, and Payden&Rygel as money managers and as custodial trustee.

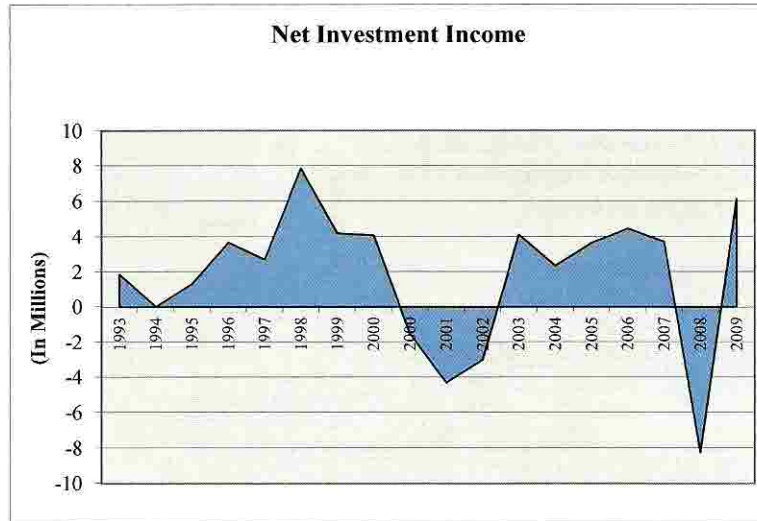
The investment portfolio that included money market was valued at \$33,715,607 at the end of 2008, down \$9,640,571 from the prior year. The portfolio showed gains during 2009, ending the year at \$36,869,621, up \$3,154,014.

The FSMSSA does not own any time deposits at the local banks.

Although the global market downturn caused a 19% *decrease* in investment income during 2008, investment income rebounded with a 20% *increase* during 2009.

The investment portfolio generated a \$6.1 million gain during 2009. However, because a \$3 million drawdown from investments to supplement benefit payments, the investment portfolio increased by only \$3.1 million overall, bringing total investments to \$36,869,621 for 2009.

The drawdown, coupled with increasing benefit payments and decreasing contributions, further compromises the viability of the plan.



Professional Service Providers

Actuary

Pacific Actuarial Services
205 W. Kansas Street
Liberty, MO64068

Investment Advisor

Consulting Group/Morgan
Stanley Smith Barney
120 Father Duenas Ave.
Hagatna, 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, CA90071

Golden Capital Management LLC
10715 David Taylor Dr.
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Charlotte, NC 28262

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50 E. River Center Blvd., Suite
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Law Office of Steve Finnen
P.O. Box 1450
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Administrator's Report

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 five 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.

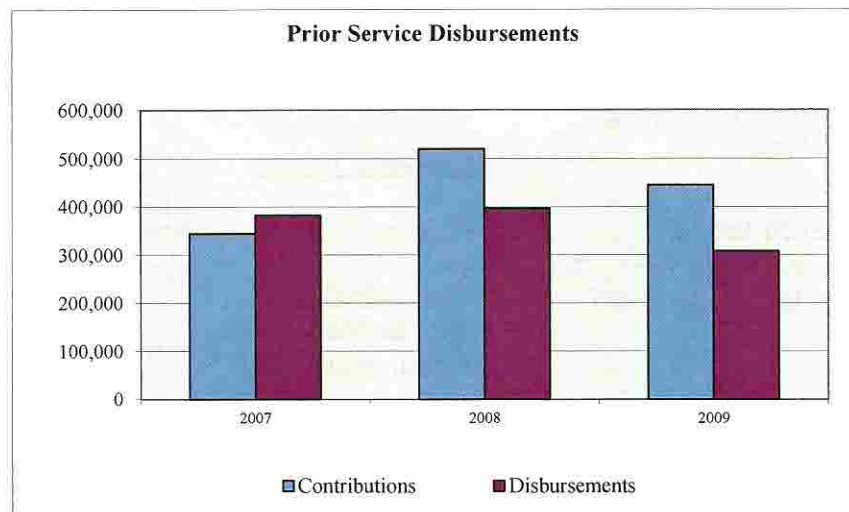
In the past six years there have been four appropriations used to pay benefits, the most recent coming from the United States Department of the Interior for \$1.5 million which was received in March of 2005. These appropriations are used to reimburse beneficiaries for payments that were missed in the 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 2008 and 2009, the Administration paid a total of \$703,892 in Prior Service benefits and expenses and received \$964,159 to pay these benefits and to meet associated administrative costs.

Prior Service

For fiscal year 2008, reimbursements to FSMSSA from the Prior Service Benefits Trust Fund totaled \$519,107.

For fiscal year 2009, reimbursements to FSMSSA from the Prior Service Benefits Trust Fund totaled \$445,052.



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-citizens who leave FSM, will help to stabilize and/or reduce the System's liability and increase the funded status and aid in the future financial health of the System. However, it is important that the provisions remain in place. Any delay or repeal of the provisions further weakens the system.

The FSMSSA is on the road to recovery from a very difficult investment year in 2008. Although the system lost 19% on investments during 2008, a gain of 20% in 2009 made up the losses.


The Administration continued to pay more in benefits, refunds, and expenses than it collected in contributions during 2008 and 2009 (now a five-year trend), and as a result, the Administration was forced to liquidate trust assets to meet the deficit. Even though Public Law 14-86 was recently passed, additional changes must be made to ensure the ongoing health of Social Security. In addition, if the current provisions are to stay in place, additional funding from Congress is imperative.

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 hardworking men and women of Micronesia who make our economy grow and flourish.

I would also like to dedicate this annual report to two people whose contributions to the program cannot be overstated: to our beloved Board Member Charles L. Chieng who we lost on July 25, 2010, and to our investment partner Jim Staub, who we lost July 5, 2010. Charles' and Jim's deaths are a sad loss to all of us at FSMSSA. They will always remain very much alive in our memories.

This report is intended to be a complete and succinct summary of the FSMSSA 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

The following discussion and analysis provides an understanding of the FSM Social Security System Administration's (FSMSSA) financial performance for fiscal years ended December 31, 2008, and 2009. This section has been prepared by the management and should be read in conjunction with the FSMSSA's financial statements and accompanying notes.

Administration

The FSMSSA is a successor System of the former Trust Territory Social Security System. It was established by the Federated States of Micronesia Public Law 2-74 and began its full operation on January 1, 1988. The FSMSSA provides retirement, disability and survivor benefits to the citizens of the Federated States of Micronesia.

Under Title 53 of the FSM Code, the authority to administer the FSMSSA is vested to a six-member Board of Trustees, five of whom are nominated by the President and confirmed by the Congress of the FSM. The 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 Board is duly represented by the following individuals:

Garrison Irons	State of Chuuk	Chairman of the Board
Rose N. Nakanaga	Pohnpei State	Vice Chairman
Nahoy G. Selifis	National Government	Vice Chairman
Charles L. Chieng	State of Yap	Member
Jefferson Timothy	State of Kosrae	Member
Alexander R. Narruhn	Administrator	Member, Ex-officio

The Administrator, who is selected by the Board, is responsible for daily operation as well as supervision of branch managers from each of the four States of the FSM.

Funding

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. The National and State governments as well as all private employers incorporated or doing business in the FSM are subject to social security tax. Beginning January 1, 2008, the maximum quarterly taxable wage of \$5,000 is subject to an increment of \$1,000 and every 5 years thereafter for a maximum of \$10,000 until January 1, 2028.

Additional revenues are derived from interest and penalties charged to delinquent taxpayers, and other miscellaneous fees.

Budget

The FSM Public Law 5-120 mandates the FSMSSA to present an annual budget not exceeding 11% of its projected income for the ensuing fiscal year. The budget ceiling for fiscal year 2009 based on projected income of \$12.3 million was \$1.35 million. However, as part of management's cost cutting measures, the budget was streamlined at \$1.1 million, which is 8.9% of the projected income.

Significant Events

- In July 2008, the FSMSSA participated at the annual network of the Freely Associated Social Security Administrators from the Republic of Marshall Islands and the Republic of Palau. The conference/workshop focused on performance updates on investments, accounting, tax collections, claims and benefits, enhancements to the database software, and other challenges faced by the three Social Security Administrations.
- The FSMSSA continues to manage the Prior Service Benefits Program for FSM citizens, which is funded by the U.S. Department of Interior, Office of the Insular Affairs. For FY 2008 and 2009, total funds received from the Prior Service Trust Fund Administration (PSTFA) amounted to \$964,159 while benefits paid and administrative expenses totaled \$703,892.

Management's Discussion and Analysis

Financial Highlights

- Net assets for the retirement fund (non-inclusive of the Prior Service Fund) decreased by \$6.57 million or 14% from fiscal year 2007. The decrease is due to the investment losses during 2008 and the continuing trend of benefits exceeding contributions.

Statement of Net Assets (Retirement Fund)			
	<u>2009</u>	<u>2008</u>	<u>2007</u>
ASSETS			
Cash and equivalents	\$ 1,600,034	\$ 3,162,579	\$ 4,298,083
Investments	36,409,513	31,637,481	39,618,679
Other current assets	2,831,584	1,997,740	3,468,620
Fixed assets, net	66,491	87,352	85,352
Total	<u>\$ 40,907,622</u>	<u>\$ 36,885,152</u>	<u>\$ 47,470,734</u>
LIABILITIES	<u>\$ 162,056</u>	<u>\$ 167,897</u>	<u>\$ 149,227</u>
NET ASSETS			
Held in trust for retirement, disability and survivors' benefit	\$ 40,745,566	\$ 36,717,255	\$ 47,321,507

- The investment income absorbed the impact of the 2009 operating deficit of \$2.1 million as a result of lower contributions against benefit payments and administrative expenses.

Statement of Changes in Net Assets (Retirement Fund)			
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Contributions	\$ 12,955,409	\$ 12,488,497	\$ 12,783,551
Benefit Payments	(15,304,704)	(14,222,788)	(13,663,880)
Admin Expenses	(961,778)	(989,810)	(969,029)
Other	1,190,244	394,280	72,212
Operating deficit	<u>\$ (2,120,829)</u>	<u>\$ (2,329,821)</u>	<u>\$ (1,777,147)</u>
Investment Income	<u>6,149,139</u>	<u>(8,274,430)</u>	<u>3,723,433</u>
Change in Net Assets	\$ 4,028,310	\$ (10,604,251)	\$ 1,946,286
Net Assets, beginning	36,717,256	47,321,507	45,375,221
Net Assets, ending	<u>\$ 40,745,566</u>	<u>\$ 36,717,256</u>	<u>\$ 47,321,507</u>

Management's Discussion and Analysis

- The investment portfolio is down by \$6,486,557 or 15% from the 2007 balance of \$43,356,178.

Retirement Fund	<u>2009</u>	<u>2008</u>	<u>2007</u>
Investment*	\$ 36,869,621	\$ 33,715,607	\$ 43,356,178
Investment Income	\$ 6,149,139	\$ (8,274,430)	\$ 3,723,433
Investment Withdrawals	\$ 3,000,000	\$ 1,400,000	\$ 2,900,000
*includes cash management fund			

- Additional FSM contributions totaled \$1.4 million in 2008-09. A significant amount of additional contributions are necessary for the survival of the System.

Contributions	<u>2009</u>	<u>2008</u>	<u>2007</u>
Government	\$ 6,827,298	\$ 6,658,920	\$ 6,992,581
Private	5,967,099	5,655,537	5,575,798
Judgment	14,887	28,099	16,226
Penalties and interest	146,125	145,941	198,945
Total	\$ 12,955,409	\$ 12,488,497	\$ 12,783,550

- Benefit payments were 12% higher due to increased number of beneficiaries.

Benefit Payments	<u>2009</u>	<u>2008</u>	<u>2007</u>
Retirement	\$ 9,188,597	\$ 8,309,308	\$ 7,885,913
Survivors	4,646,298	4,603,842	4,563,095
Disability	1,264,648	1,046,397	947,870
Lump Sum	205,161	263,241	267,002
Total	\$ 15,304,704	\$ 14,222,788	\$ 13,663,880

- Actual administrative expenses continue to decrease.

Budget	<u>Approved</u>	<u>Actual</u>	<u>Surplus</u>	<u>%</u>
2009	\$ 1,149,058	\$ 961,778	\$ 187,280	16%
2008	\$ 1,104,132	\$ 989,810	\$ 114,322	10%

- For additional information on FSMSSA's fixed assets, please refer to note 2F of the financial statements.

Management's Discussion and Analysis

- As of FY 2009, the Prior Service Fund has net liabilities of \$37,382.

Statement of Net Assets (Prior Service Fund)				
	<u>2009</u>	<u>2008</u>	<u>Inc(dec)</u>	<u>%</u>
ASSETS	\$ 295,261	\$ 190,998	\$ 104,263	55%
LIABILITIES	\$ (37,382)	\$ (71,859)	\$ (34,477)	(48%)
NET ASSETS	\$ 257,879	\$ 119,139	\$ 138,740	116%

Statement of Changes in Net Assets (Prior Service Fund)				
	<u>2009</u>	<u>2008</u>	<u>Inc(dec)</u>	<u>%</u>
PSTFA Reimbursements	\$ 445,052	\$ 519,107	\$ (74,055)	(14%)
Benefit Payments	(282,835)	(292,964)	(10,129)	(3%)
Admin Expenses	(24,171)	(103,922)	(79,751)	(77%)
Other	694	1,209		
Change in Net Assets	\$ 138,740	\$ 123,430		
Net Assets, beginning of year	119,139	(4,291)		
Net Assets, end of year	\$ 257,879	\$ 119,139	\$ 138,740	116%

Management's Discussion and Analysis for the years ended December 31, 2008 and December 31, 2009 is set forth in the report on the audit of the FSMSSA's financial statements, which is dated June 3, 2010. That Discussion and Analysis explains the major factors impacting the 2008-2009 financial statements.

Conclusion:

The FSMSSA System assets continue to be depleted due to benefit payments exceeding contributions. That is a trend that must be reversed through either increased contribution and/or decreased benefit payments. Without these changes, the System will be out of funds within the next 10 to 15 years.

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, 14-86 and 15-73.

Workers and Employer's Contributions

Workers, self-employed workers and employers each pay 6% of Maximum Covered Earnings per quarter. Effective October 1, 2010, contributions increase to 7% each and effective January 1, 2013, the rate increases to 7.5%.

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 the quarter, up to maximum covered earnings.

Self-employed with no employees - Remuneration is deemed to be 5% of the gross revenue of the business for the previous calendar year subject to maximum covered earnings.

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 \$300 of earnings.

Currently Insured: Credited with at least 20 quarters of coverage during the most recent previous 25 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.

Maximum Covered Earnings: Effective January 1, 2008, the \$5,000 quarterly limit increases to \$6,000; \$7,000 on January 1, 2013; \$8,000 on January 1, 2018; \$9,000 on January 1, 2023 and \$10,000 on October 1, 2028.

Minimum Benefit: \$75 per month. \$100 per month effective January 1, 2012.

Management's Discussion and Analysis

Basic Benefit

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

1. 16.5% of the first \$10,000 of Cumulative Maximum Covered Earnings for which contributions have been made, plus
2. 3.0% of the next \$30,000 of Cumulative Maximum Covered Earnings for which contributions have been made, plus
3. 2.0% of the next \$262,500 of Cumulative Maximum Covered Earnings for which contributions have been made, plus
4. 1.0% of Cumulative Maximum Covered Earnings in excess of \$302,500 for which contributions have been made.

Old Age Insurance Benefit

Eligibility: Age 60 and Fully Insured

Amount: Greater of the Basic Benefit or the Minimum Benefit, subject to the earnings test. Active workers who turn 60 after January 1, 2010 will receive 50% of the Basic Benefit from ages 60 to 64. The reduced benefit will not be subject to the earnings test.

Disability Insurance Benefit

Eligibility: Disabled for three months and Currently 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.

Summary of Principal System Provisions

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.

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 who are fully insured, 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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