

# FSM Social Security Administration



## ANNUAL REPORT 2011



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## Letter from the Chairman

This report covers calendar year 2011, which marked a year of challenges facing the Social Security System of the Federated States of Micronesia. From tax increases to public hearings to dismal investment returns, it was a year that tested our resolve and resourcefulness.

It was inevitable that the economic downturn that has rocked the international financial market would eventually affect the System's investments. In 2011, investment income decreased by 147.65% from \$2.98 million net gain in 2010 to a \$1.42 million net loss in 2011. The loss was attributed to underperformance of the equity investment. Additionally, \$500,000 was withdrawn from the investment portfolio in fiscal year 2011. The drawdown was required to cover benefits. The FSM National Government also infused an additional \$300,000 to supplement benefit payments, a portion of the \$1.2 million appropriation for CY2012. The remaining \$900,000 is to be released on a quarterly basis of \$300,000 per quarter.

While contributions increased, disbursements also increased, resulting in an operating deficit during the year. Contributions increased 14.17% as a result of the 2% tax rate increase and collections of delinquent accounts. For FY2011, we were able to recover more than \$1.24 million in delinquent taxes. However, this was not enough to cover benefit payments and administrative expenses.

After decreasing administrative expenses the past several years, actual expenses increased by 8.2% in 2011. The increase was attributed primarily to the costs associated with upgrading the System's outdated computer server and hardware as well as the biennial actuarial valuation. The increase was anticipated and budgeted for, so Administrative Expenses, although higher than the prior year, were 3% or \$31,000 under budget.

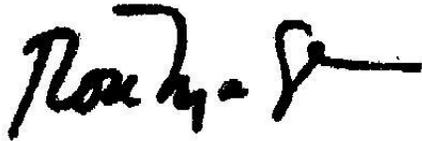
The Actuarial Valuation review was completed and presented in 2011. Findings reported a funded ratio of 14.7%. According to the report, the System should aspire to a higher funded ratio to strengthen the viability of the System. Increasing contributions while decreasing benefits is the short answer to the funding shortfall. Changes made to the System during the latter part of 2010 and 2011 strive toward that goal.

Despite these efforts, the System still remains critically underfunded. Benefit payments were \$17.37 million compared with contributions received of \$16.59 million. Although collections are expected to increase in 2012, benefits are expected to increase as well as more beneficiaries become eligible.

Immediate action must be taken to slow down the rate of benefit payments and increase the rate of contributions. Absolutely no bills can be introduced that increase benefits. If immediate action is not taken to rectify the deficit, System assets will be depleted within the next few years.

I appreciate the ongoing support from our Board Members, Administration and the FSM Government and the willingness of all to work together to amend the System's critical financial needs.

Sincerely,

A handwritten signature in black ink, appearing to read "Rose Nakanaga". The signature is stylized and cursive, with a long horizontal stroke extending to the right.

Rose Nakanaga  
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*  
Rose N. Nakanaga  
*Chairman*



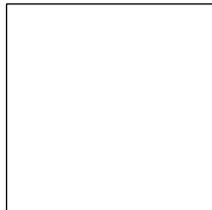
10/02/08 to 10/01/11  
10/02/11 to 10/01/14

*FSM National Government*  
Gillian Doone



10/10/11 to 10/9/14

*Yap State*  
Vacant



*Kosrae State*  
Vacant



*Administrator*  
Alexander R. Narruhn  
Ex-Officio Member



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  
7/1/11 to 6/30/14

## **Administrator's Report**

I submit this Annual Report of the Federated States of Micronesia Social Security System (FSMSSA, or the "System") covering fiscal year 2011, the period from January 1, 2011, to December 31, 2011, 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.

### **Board Meetings**

The Board of Trustees held two regular meetings during 2011.

*On January 31, 2011*, the FSMSSA Board met with the investment consultant and money manager to discuss the annual review of its investment portfolio. Acting Chairperson and Representative of Pohnpei State Rose Nakanaga, Representative of Chuuk State Innocente Oneisom, Representative of Kosrae Jefferson Timothy, Administrator Alexander R. Narruhn as ex-officio on board, and Deputy Administrator Dernista Capelle were present. Absent were Representative of the National Government Nahoy Selifis, and Representative of Yap State, the position vacant.

After review of the poor investment performance results, the Board resolved to adopt to rebalance the portfolio by diversifying asset allocations and finding new money managers. Following the investment presentation, the regular Board meeting progressed with the adoption of the prior meeting's minutes. The Representative of Kosrae, Mr. Jefferson Timothy, announced that the State of Kosrae increased the mandatory retirement age to 65. Moreover, Mr. Innocente Oneisom, also expressed hopes that Chuuk State Senate would pass the proposed age increase in 2011. Concerns still remain about the increasing the retirement age in Pohnpei and Yap, although the sooner they comply the better to alleviate the system's chronic underfunding.

The Tax Division continues to collect delinquent taxes and has initiated the practice of spot audits, a new process the administration would like maintain on an ongoing basis.

The Board nominated Rose Nakanaga for Chairperson and Jefferson Timothy of Kosrae State for Vice Chairman, reviewed two appeals cases, then concluded the meeting on February 11, 2011.

*On May 31 2011*, the FSMSSA Board executed their second regular meeting of the year, which coincided with an investment review.

Chairman of the Board Rose Nakanaga opened the meeting with the results of the Board's money manager review and recommendations. The Board interviewed eight applicants, four for the large capital growth fund and four for the large capital value fund. From these findings, the board recommended Winslow Capital for managing the large capital growth and Cambiar Investors for the large capital value fund. The recommendation was passed with a unanimous vote, and the Board passed Resolution number 2011-05 on the reorganization of money managers.

Other topics included integrating the accounting department for beneficiaries through the ACH program to make it easier for citizens working overseas to make contributions to the System.

## Administrator's Report

Administrator Mr. Alexander R. Narruhn outlined needs to upgrade the technological system, and the Board consented for Mr. Narruhn to research costs of the project.

The Board also entertained an appeal case before adjourning on June 1, 2011.

### Financial Reports

#### Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>Assets</b>			
Cash and equivalents	\$ 1,209,552	\$ 2,780,258	\$ 1,600,034
Investments	35,220,871	36,910,189	36,409,513
Other current assets	4,059,782	2,770,894	2,831,584
Fixed assets, net	109,787	<u>77,190</u>	<u>66,491</u>
Total	40,599,992	42,538,531	40,907,622
<b>Liabilities</b>			
	<u>217,523</u>	<u>177,461</u>	<u>162,056</u>
<b>Net Assets</b>			
Held in trust for retirement, disability and survivors; benefit	\$ <u>40,382,469</u>	\$ <u>42,361,070</u>	\$ <u>40,745,566</u>

#### Changes In Net Assets

FSMSSA follows the calendar year as its fiscal year. The following table presents information about FSMSSA Retirement Fund results of operations for CY2011.

	<u>2011</u>
<b>Contributions</b>	\$16,593,155
<b>Benefit Payments</b>	(17,366,480)
<b>Admin Expenses</b>	(1,032,036)
<b>Other Income, net</b>	<u>1,247,807</u>
<b>Operating Deficit</b>	(557,554)
<b>Investment Income/(Loss), net</b>	<u>(1,421,047)</u>
<b>Change in Net Assets</b>	(1,978,601)
<b>Net Assets, beginning of year</b>	<u>42,361,070</u>
<b>Net Assets, 12/31, end of year</b>	<u>\$40,382,469</u>

#### 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.

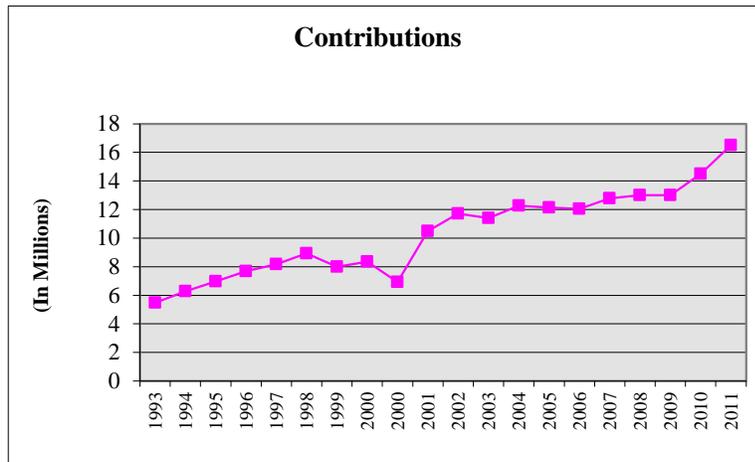
# Administrator's Report

## Contributions

2011 contributions totaled \$16.59 million, an increase of 14.17% from the previous year's collections of \$14.53 million. The increase was attributed mainly to the increased tax rate of 2% effective Oct. 1, 2010, as well as the collection of delinquent accounts.

Contributions were comprised of:

<b>Government</b>	\$7,495,281
<b>Private</b>	8,772,936
<b>Judgment</b>	82,192
<b>Pen./Interest</b>	<u>242,746</u>
<b>Total</b>	\$16,593,155



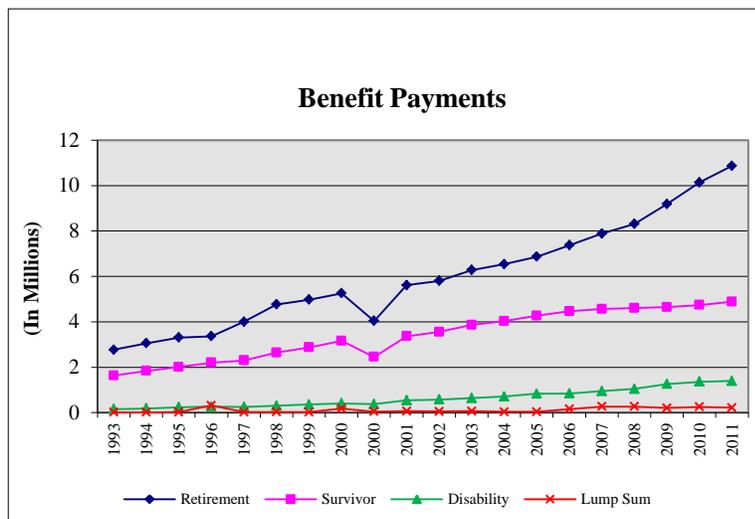
## Benefit Payments

A total of \$17.37 million was disbursed in benefit payments during fiscal year 2011.

Disbursements were comprised of:

<b>Retirement</b>	\$10,870,989
<b>Survivor</b>	4,881,958
<b>Disability</b>	1,395,552
<b>Lump Sum</b>	<u>217,981</u>
<b>Total</b>	\$17,366,480

Benefit payments increased by 5.34% from \$16.49 million in 2010 to \$17.37 million in 2011. The overall increase was attributed mainly to an increased number of recipients, totaling 6,492 members or beneficiaries.

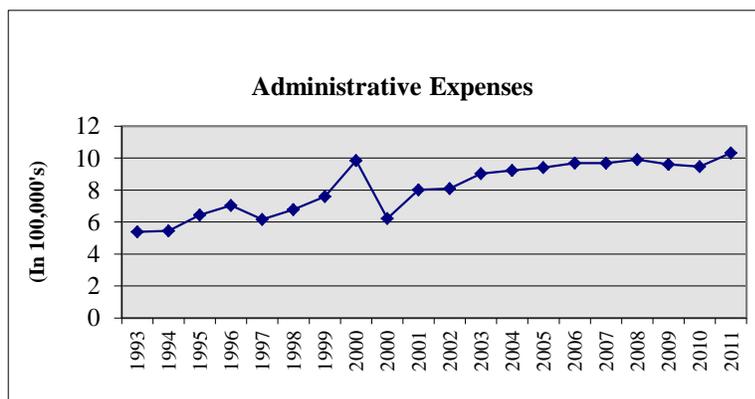


## Administrative Expenses

Net administrative expenses totaled \$1,032,036 for 2011, increasing 8.2% over 2010. The cost to upgrade computer systems and the cost of the actuarial valuation contributed to the increase. Despite the increase over the prior year, administrative expenses came in 3% under budget.

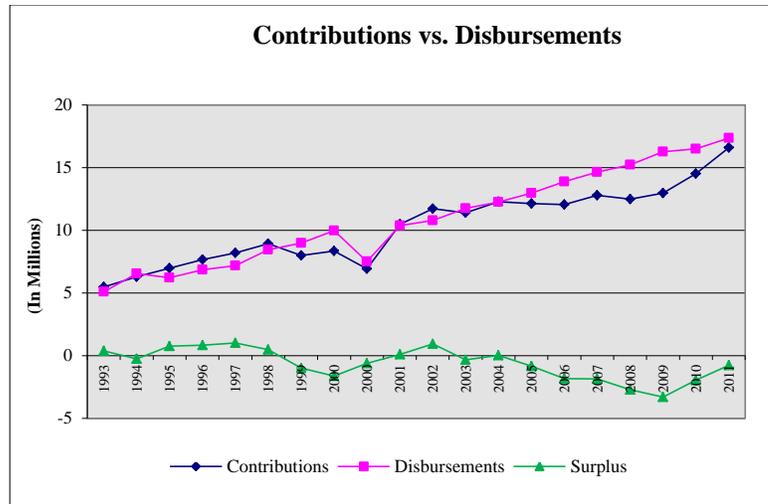
Administrative expenses were:

<b>Budget</b>	\$1,063,046
<b>Actual</b>	1,032,036
<b>Surplus</b>	31,010
<b>% Surplus</b>	3%



## Contributions and Disbursements

While contributions increased to \$16.59 million, disbursements also increased, resulting in an operating deficit during the year. Contributions increased 14.17% as a result of the 2% tax rate increase and collections of delinquent accounts. However, increased collections were not enough to cover disbursements of \$17.37 million.



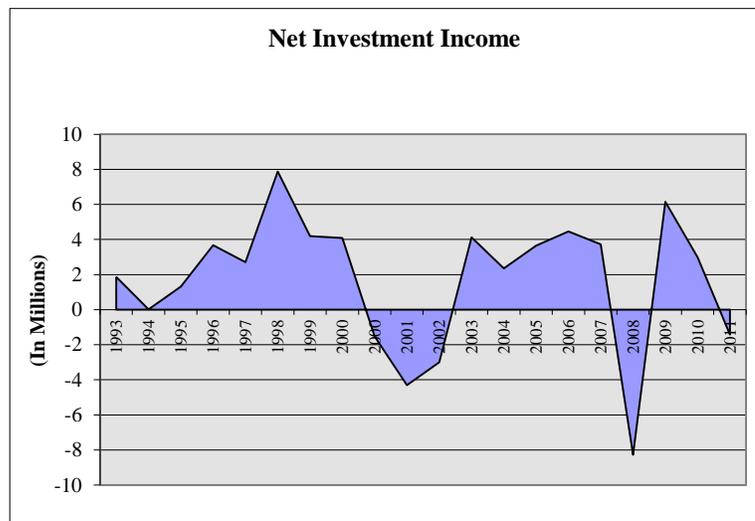
## Investments

The Administration retained Morgan Stanley/Smith Barney as its investment advisor and custodial trustee. Missouri Valley Partners, Golden Capital, Renaissance, and Payden & Rygel serve as money managers. During 2011, the Board replaced Atalanta Sosnoff Capital Corporation with Winslow Capital and Cambiar Investors.

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

The investment portfolio that included money market was valued at \$35,220,871 at the end of 2011. Investment income decreased by 147% from \$2.98 million net gain in 2010 to a \$1.42 million net loss in 2011. The loss was attributed to underperformance of the equity investment. Also, \$500,000 was withdrawn from the investment portfolio in addition to the \$300,000 funding received from the FSM National Government to supplement benefit payments for FY 2011.

Due to underperformance of fixed core and large cap core money managers, the Board resolved to rebalance the portfolio by diversifying asset allocations. The Large Cap Core from Atalanta Sosnoff was reallocated, and new money managers, Winslow Capital and Cambiar Investors, were hired.



## Investment Income/(Loss)

	2011	2010
<b>Investment</b>	\$35,220,871	\$36,910,189
<b>Income/(Loss)</b>	(1,421,047)	2,981,702
<b>Drawdown</b>	500,000	2,000,000

# 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.

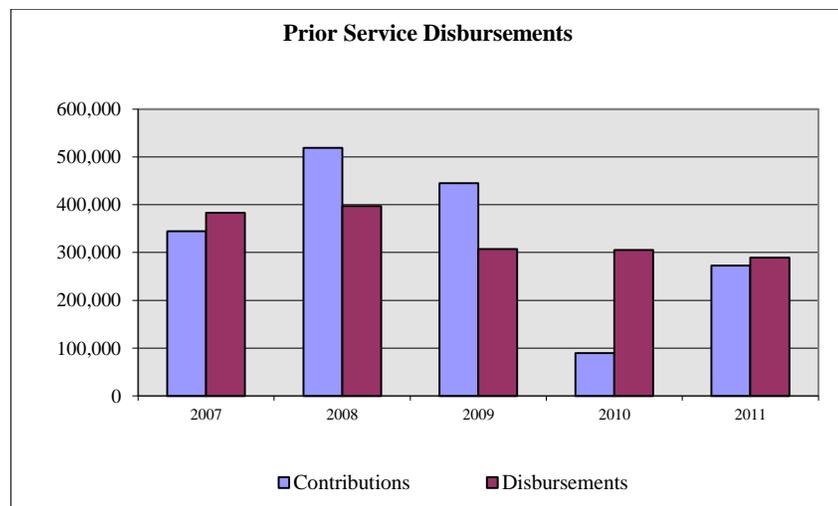
In 1987, the United States Congress provided \$8 million for initial capitalization of the PSBTF. Pursuant to U.S. Public Law 99-239, future funding would be provided, if warranted, based on the results of actuarial valuations.

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. For FY2011, total funds received from the Prior Service Trust Fund Administration amounted to \$272,800 while benefits paid and administrative expenses totaled \$253,760 and \$35,400, respectively.

As of Dec. 31, 2011, the Prior Service Fund had net assets of \$26,900. Contributions increased by 205.5% while benefit payments decreased by 6.5%.

### Prior Service

For fiscal year 2011, reimbursements to FSMSSA from the Prior Service Benefits Trust Fund totaled \$272,800 while benefits paid and administrative expenses totaled \$253,760 and \$35,400, respectively.



## 2011 Highlights

### Upgraded Computer Systems

The Information Technology (IT) System of the FSM Social Security Administration was updated during 2011. The energy-efficient systems are 30% faster and easier to maintain than the outdated system as well as providing improved backup and internet capabilities.

### Public Hearings

Several public hearings were held during 2011 in various FSM municipalities. Citizens concerned about the recent changes to the System were able to ask questions and learn about the reasons for the amended retirement age and increases in the earnings test. Through these communications, the FSMSSA was able to explain that the precarious funded status of the System necessitated the changes, gaining better public support through education.

### Actuarial Valuation

At the State/National Leadership Conference, held in February 2012, the System's Actuary, Joseph A. Nichols, reported on the current status of the System. The Valuation reported actuarial accrued liabilities of \$287 million. As of 2011, the Systems fund assets were \$42 million, leaving the System with a funded ratio of less than 15% (funded ratio = trust assets/ accrued liabilities). These conditions indicate that the Administration should not increase future or current benefits until a long-term solution to the System's precarious funded status is achieved.

### ACH Program

2011 marked unprecedented technological advances for the System with the introduction of the FSM Social Security Voluntary Contribution provision for citizens working abroad. Using an Automated Clearing House (ACH) program, citizens working abroad can make voluntary contributions through electronic transactions between accounts via the Bank of Guam. Citizens can access this fast, secure system through the System's website.

### Conclusion

Although the 2% tax increase and aggressively pursuing delinquent taxes has improved contributions amounts, the System continues to pay more in benefits, refunds and expenses than it collects in contributions. That drain, coupled with investment losses and cash drawdowns from the investment portfolio, further compromise the System's viability.

It is important that Management and the Board continue to work with the FSM government to explore ways to guarantee the future sustainability of the System.

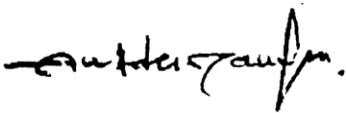
# Administrator's Report

## 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 also want to acknowledge the hard work and dedication of Mr. Orin Simion, former manager of the Chuuk State branch office. During his 40 years of service, Mr. Simion provided his leadership and wise guidance to the System. His contributions are greatly appreciated.

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

## 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

Cambiar Investors  
2401 E. Second Ave.  
Denver, CO 80206  
**CONFIRM ADDRESS**

Missouri Valley Partners  
P.O. Box 16901  
135 N. Meramec, Suite 500  
St. Louis, MO63105

Payden & Rygel  
333 South Grand Avenue  
Los Angeles, CA90071

Golden Capital Management LLC  
10715 David Taylor Dr.  
Suite 400  
Charlotte, NC 28262

Renaissance  
50 E. River Center Blvd., Suite  
1200  
Covington, KY 41011

Winslow Capital Group, LLC  
42 Western County Rd.  
Penobscot, ME 04476  
**CONFIRM ADDRESS**

### 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  
Kolonias, Pohnpei FM 96941

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

## 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 the fiscal year ended December 31, 2011. 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:

Rose N. Nakanaga	Pohnpei State	Chairwoman of the Board
Gillian Doone	National Government	Member
Innocente Oneisom	State of Chuuk	Member
Vacant	State of Yap	Member
Vacant	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 7% each, or a combined tax rate of 14% paid to the System every quarter. The FSM National and State governments as well as all private employers incorporated or doing business in the FSM are subject to social security tax. Effective October 1, 2010, the tax rate increased from 6% to 7% (employee 7%, employer 7%) and the maximum quarterly taxable wage threshold increased from \$5,000 to \$6,000.

Beginning January 1, 2008, the maximum quarterly taxable wage of \$5,000 was 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 2011, based on projected income of \$13.8 million, was \$1.52 million. However, as part of management's cost cutting measures, the budget was streamlined at \$1.06 million which is 7.7% of the projected income. The actual administrative cost incurred for FY2011 was \$1.03 million, or 3% surplus compared to the approved budget.

## Significant Events

- ✓ Contributions collected increased by 14.17% from \$14.53 million in the previous year to \$16.59 million in 2011.
- ✓ Total Retirement Fund benefit payments to members or their beneficiaries increased by 5.34% from \$16.49 million in 2010 to \$17.37 million in 2011.
- ✓ 6,490 FSM citizens received Social Security benefits in fiscal year 2011.
- ✓ 754 retirement, survivor and disability claims were received, processed, and approved in fiscal year 2011.
- ✓ In FY2011, we processed and posted more than \$108.28 million in reports of earnings to individual records.
- ✓ Investment portfolio decreased by 4.58% from \$36.91 million to \$35.22 million.
- ✓ Received \$300,000 in funding from the FSM National Government, which was used to supplement benefit payments.
- ✓ Retirement Fund net assets totaled \$40.38 million on December 31, 2011, compared to \$42.36 million in FY2010; a decrease of 4.67%.
- ✓ New retirement eligibility became effective January 1, 2011, as mandated by PL15-73 whereby individuals receive 50% of their calculated benefit from age 60 to 64 and 100% from age 65.
- ✓ \$1.24 million from delinquent accounts were collected in fiscal year 2011.
- ✓ Close monitoring of expenses led to an administrative budget surplus of 3% in fiscal year 2011, despite the added costs of updated computer systems and the annual actuarial review.

## Management's Discussion and Analysis

### Financial Highlights

Net assets for the retirement fund (non-inclusive of the Prior Service Fund) decreased by 4.67% from \$42.36 million in 2010 to \$40.38 million in 2011. The decrease was attributed mainly to investment losses.

<b>Statement of Net Assets (Retirement Fund)</b>			
	<u>2011</u>	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>			
Cash and equivalents	\$ 1,209,552	\$ 2,780,258	\$ 1,600,034
Investments	35,220,871	36,910,189	36,409,513
Other current assets	4,059,782	2,770,894	2,831,584
Fixed assets, net	<u>109,787</u>	<u>77,190</u>	<u>66,491</u>
Total	<u>\$ 40,599,992</u>	<u>\$ 42,538,531</u>	<u>\$ 40,907,622</u>
<b>LIABILITIES</b>			
	<u>\$ 217,523</u>	<u>\$ 177,461</u>	<u>\$ 162,056</u>
<b>NET ASSETS</b>			
Held in trust for retirement, disability and survivors' benefit	\$ 40,382,469	\$ 42,361,070	\$ 40,745,566

<b>Statement of Changes in Net Assets (Retirement Fund)</b>			
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Contributions	\$ 16,593,155	\$ 14,525,608	\$ 12,955,409
Benefit Payments	(17,366,480)	(16,488,738)	(15,304,704)
Admin Expenses	(1,032,036)	(946,950)	(961,778)
Other	<u>1,247,807</u>	<u>1,543,882</u>	<u>1,190,244</u>
<b>Operating deficit</b>	\$ (557,554)	\$ (1,366,198)	\$ (2,120,829)
<b>Investment Income</b>	<u>(1,421,047)</u>	<u>2,981,702</u>	<u>6,149,139</u>
Change in Net Assets	\$ (1,978,601)	\$ 1,615,504	\$ 4,028,310
Net Assets, beginning	<u>42,361,070</u>	<u>40,745,566</u>	<u>36,717,256</u>
<b>Net Assets, ending</b>	<u>\$ 40,382,469</u>	<u>\$ 42,361,070</u>	<u>\$ 40,745,566</u>

## Management's Discussion and Analysis

- Investment income decreased by 147.65% from \$2.98 million net gain in 2010 to a \$1.42 million net loss in 2011. The loss was attributed to underperformance of the equity investment. A total of \$500,000 was withdrawn from the investment portfolio in fiscal year 2011 to supplement benefit payments in addition to the \$300,000 of cash funding received from the FSM National Government.

<b>Retirement Fund</b>	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
Investment*	\$ 35,220,871	\$ 36,409,513	\$ 36,409,513
Investment Income	\$ (1,421,047)	\$ 36,910,189	\$ 6,149,139
Investment Withdrawals	\$ 2,000,000	\$ 2,000,000	\$ 3,000,000
*includes cash management fund			

- The total amount of contributions collected was \$16.59 million, averaging a collection of \$4.15 million per quarter. This is an increase of 14.17% from the previous year's collection of \$14.53 million. The increase was attributed mainly to the increased tax rate of 2% (employee 1% and employer 1%) effective Oct. 1, 2010, and to the collection of delinquent accounts from prior years.

<b>Contributions</b>	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
Government	\$ 7,495,281	\$ 6,690,931	\$ 6,827,298
Private	8,772,936	7,566,503	5,967,099
Judgment	82,192	44,201	14,887
Penalties and interest	242,746	223,973	146,125
<b>Total</b>	<b>\$ 16,593,155</b>	<b>\$ 14,525,608</b>	<b>\$ 12,955,409</b>

- Benefit payments increased by 5.34% from \$16.49 million in 2010 to \$17.37 million in 2011. The increase was attributed mainly to the increased number of beneficiaries. For FY2011, 6,492 members or their beneficiaries received benefits. Of this number, 754 new claims were received, processed and approved during the year.

<b>Benefit Payments</b>	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
Retirement	\$ 10,870,989	\$ 10,137,489	\$ 9,188,597
Survivors	4,881,958	4,738,969	4,646,298
Disability	1,395,552	1,356,728	1,264,648
Lump Sum	217,981	255,552	205,161
<b>Total</b>	<b>\$ 17,366,480</b>	<b>\$ 16,488,738</b>	<b>\$ 15,304,704</b>

## Management's Discussion and Analysis

- Actual administrative expenses were higher in 2011 than 2010, primarily due to capital costs associated with upgrading computer hardware and server as well as the cost of an actuarial valuation, which occurs every two years. Aside from these expenses, administrative costs were commensurate with prior years, and close monitoring resulted in a budget surplus of 3% or \$31,000.

<b>Budget</b>	<b><u>Approved</u></b>	<b><u>Actual</u></b>	<b><u>Surplus</u></b>	<b><u>%</u></b>
2011	\$ 1,063,046	\$ 1,032,036	\$ 31,010	3%
2010	\$ 1,069,053	\$ 946,950	\$ 122,103	11%
2009	\$ 1,149,058	\$ 961,778	\$ 187,280	16%

- For additional information concerning the capital assets and details on the costs associated with the computer upgrades, please refer to note 2F in the Financial Statements.
- For FY 2011, total funds received from the Prior Service Trust Fund amounted to \$272,800, while benefits paid and administrative expenses totaled \$253,760 and \$35,400 respectively. As of December 31, 2011, the Prior Service Fund had net assets of \$26,900. Contributions increased by 205.5% while benefit payments decreased by 6.5%.

<b>Statement of Net Assets (Prior Service Fund)</b>			
	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
<b>ASSETS</b>	\$ 70,650	\$ 86,139	\$ 295,261
<b>LIABILITIES</b>	(43,750)	(43,104)	(37,382)
<b>NET ASSETS</b>	\$ 26,900	\$ 43,035	\$ 257,879

<b>Statement of Changes in Net Assets (Prior Service Fund)</b>			
	<b><u>2011</u></b>	<b><u>2010</u></b>	<b><u>2009</u></b>
PSTFA Reimbursements	\$ 272,797	\$ 445,052	\$ 445,052
Benefit Payments	(253,765)	(271,407)	(282,835)
Admin Expenses	(35,398)	(33,844)	(24,171)
Other	231	814	694
Change in Net Assets	(16,135)	\$ (214,844)	\$ 138,740
Net Assets, beginning of year	43,035	257,879	119,139
Net Assets, end of year	26,900	\$ 43,035	\$ 257,879

## Management's Discussion and Analysis

Management's Discussion and Analysis for the year ended December 31, 2011, is set forth in the report on the audit of the FSMSSA's financial statements, which is dated April 27, 2011. That Discussion and Analysis explains the major factors impacting the 2011 financial statements.

### **Conclusion:**

Although the retirement fund continues to grow, disbursements still outpace contributions. With the loss of investment income in 2011, the financial stability of the System is further compromised.

Management's ongoing efforts to collect delinquent taxes and the 2% tax increase have improved the situation. However noncompliance with the tax increase, despite new criminal penalties mandated by PL15-73, remains a problem.

According to the Financial Report, an estimated \$1.8 million will be required to supplement benefit payments for 2012. As benefit payments continue to outpace benefit contributions, additional cash withdrawals from investments and infusions from the FSM Government will be required to cover the deficit. As the System continues to drain cash reserves, the funded status of the System remains precarious at best.

# 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, 15-73 and 16-10.

## Workers and Employer's Contributions

Workers, self-employed workers and employers each pay 7% of Maximum Covered Earnings per quarter. 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. If age 60 on or before December 31, 2006, no more than 38 quarters are required. No more than 50 quarters are required for everyone else.

**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.

## 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 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, 2011 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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