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## Letter from the Chairman

Overall, 2012 was a comparatively good year for the FSM Social Security Administration. After a year of dismal investment returns, the System's net position grew by 5.71% or \$2.30 million compared to fiscal year 2011 when it suffered a decline of \$1.98 million. The investment portfolio performed well with a net gain of \$3.67 million during the year.

Although contributions were lower this year, the increase in benefit payments also was lower compared to steadily climbing percentage increases in prior years. Several cost-controlling programs were established during 2012, including an eligibility survey conducted in the last quarter of 2012. Benefits were withheld for those individuals who did not complete this survey.

The total amount of contributions collected was \$16.37 million, a decrease of 1.33% compared to 2011. The lower collection is attributed to a decrease in contributions from the private sector, including collections from delinquent accounts. Total delinquent taxes collected in 2012 totaled \$896,000.

Benefit payments increased by 2.18% from \$17.37 million in 2011 to \$17.74 million in 2012. The increase was attributed mainly to new claims. The percentage increase is much lower than in prior years. As of December 31, 2012, there were 5,854 members and beneficiaries receiving benefits in fiscal year 2012.

The FSM Public Law 5-120 mandates the FSMSSA to present an annual budget not to exceed 11% of its projected income for the ensuing fiscal year. The budget for fiscal year 2012 was \$1.70 million. However Management's cost containment policies resulted in a budget surplus of 7% or \$80,000.

Investment income increased by 358.21% from a \$1.42 million net loss in 2011 to \$3.67 million net gain in 2012. The net gain is attributed to the good performance of both the equity and fixed income investment accounts. As a result the market value of the investment portfolio as of the end of FY2012 rose to \$37.21 million from \$35.22 million in 2011. This end of year market value is net of the \$1 million drawdown during the year to supplement benefit payments in addition to the \$1 million funding received from the FSM National Government.

Other income decreased by 16.32% from \$1.25 million in 2011 to \$1.04 million in 2012. The decrease was attributed mainly to appropriation from the FSM National Government which was reduced by \$200 thousand in 2012. Out of the \$1.0 million appropriation granted by the FSM National Government for 2012, \$500,000 was collected by end of year 2012. The remaining \$500,000 was received in February 2013.

The smaller gap between contributions and benefit payment means the System is going in the right direction. However, benefit payments still outpaced contributions, a scenario that severely compromises the viability of the System. Cash infusions from the investment portfolio and the FSM National Government were again required to cover benefit payments. This temporary fix cannot be maintained long-term.

Immediate action must be taken to slow down the rate of benefit payments and increase the rate of contributions. Recent proposed legislation to increase benefits will only hasten the demise of the System. If immediate action is not taken to rectify the deficit, System assets will be depleted within the next few years.

We have all worked together to establish a program designed for the sole benefit of the good people of Micronesia. I am certain together we can make it our combined priority to ensure continued financial stability and lasting benefits for those we serve, the citizens of the Federated States of Micronesia.

We would also like to sincerely thank Mr. Orin Simion, Chuuk State Branch Manager, for his four decades of service to the program. With Mr. Simion's guidance and dedication, the Chuuk Branch experienced increased collections and sound leadership. We welcome Uman native Mr. Domingko Asor as the new Chuuk State Branch Manager.

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. Positions for the States of Kosrae and Yap are currently vacant.

### Board Members

### Terms

*Pohnpei State*  
Rose N. Nakanaga  
*Chairman*



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

*Chuuk State*  
Innocente Oneisom  
*Vice-Chairman*



10/10/10 to 10/9/13

*FSM National Government*  
Gillian Doone



10/10/11 to 10/9/14

*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 2012, the period from January 1, 2012, to December 31, 2012, 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

*On April 18, 2012*, the FSM Social Security Board of Trustees held a meeting in Weno, Chuuk. Acting chairman Mr. Innocente Oneisom facilitated the meeting. Rose N. Nakanaga from Pohnpei, Program Administrator Alexander Narruhn as ex-officio member, Program Deputy Administrator Dernista I. Capelle, and Gillian Doone, new member from the National Government and the new Branch Manager for Chuuk, Mr. Domingko Asor, were in attendance.

Rose Nakanaga resumed her seat as chairman of the board while former acting chairman Innocente Oneisom became vice chairman. Vacancies remain for the States of Yap and Kosrae

Items on the meeting agenda included review and approval of the new budget, investment policy review, an appeal case and the Deputy Administrator's contract renewal proposal. The Board approved changes to allow the investment portfolio to be invested, when necessary, in non-US currency fixed income.

The Board gave a warm welcome to Mr. Gillian Doone, an FSM native from the State of Chuuk, now representing the National Government on the Board. Mr. Doone brings his valuable knowledge to the Board as a Chaminade University alumnus in Accounting and experience as financial analyst, accountant, auditor and a director for various divisions in both the state and national governments and abroad. The Board looks forward to benefiting from Mr. Doone's vast expertise in leading the System into the future. The Board also welcomed Uman native, Mr. Domingko Asor, the new branch manager for Chuuk.

*On Aug. 12, 2012*, Chairman Rose Nakanaga called a special Board Meeting to order in Weno Chuuk. Members present were Vice Chairman Inocente Oneisom, Trustee Gillian Doone and Administrator Narruhn. Chairman Nakanaga emphasized the importance of calling the special meeting to resolve pending appeal cases, suggesting a need to establish a special subcommittee whose job it would be to review appeals, freeing the entire Board from this task. Trustee Doone, Trustee Oneisom and Administrator Narruhn were appointed to the review subcommittee, scheduled to hear appeal cases Aug. 23-24 in Pohnpei.

The Board also discussed administration's request to establish a savings account at the Bank of Guam to serve as the security deposit for the new ACH program. This would allow FSM citizens who work abroad to make voluntary contributions to the system more conveniently. After much discussion, it was agreed to adopt the request and make a resolution to establish a \$100,000 savings account at the Bank of Guam to serve as a security deposit for the voluntary ACH contribution program. The Board further agreed that the certification of the resolution would require the signatures of all Board members, including those absent from the current meeting and discussion.

## Administrator's Report

The Board also discussed Administrator Narruhn's participation in the gubernatorial race for the State of Chuuk, advising that official duties as Administrator should not overlap with campaigning. Administrator Narruhn assured the Board that he will keep the two separate, however there may be unavoidable overlap as Social Security is a priority issue for the population. Administrator Narruhn also requested some time off from Administrator duties while campaigning during October-November. This request was granted with the understanding that Administrator Narruhn will ensure FSMSSA's operations are maintained during this time.

In closing, Trustee Doone thanked the Chairman and Administrator for scheduling the meeting despite the Board's busy schedules. Vice Chairman Oneisom showed appreciation for Chairman Nakanaga's dedication to achieving Board goals and selecting him to serve on the appeal subcommittee. Administrator Narruhn thanked the Board for authorizing the ACH system, which serves as an added convenience to participants while encouraging voluntary contributions as well.

*On August 23, 2012*, the FSM Social Security Board of Trustees held a special task force on appeals in Pohnpei. Vice Chairman Innocente Oneisom, along with Gillian Doone from the national government, and Program Administrator Alexander Narruhn, ex-officio member, hosted the meeting. Program Deputy Administrator Dernista Capelle and Francky Ilai from the claims department also attended the meeting.

A variety of appeals were presented, including adoption, remarriage and disability dependent. The citizens were represented by legal counsel from the Micronesian Legal Services Corporation (MLSC). Representatives from each party held an open dialogue to clarify the appeals process, emphasizing the need for evidence and approved documentation. Of the nine requests for appeal brought before the board, four were withdrawn, pending additional documentation. The appellants' benefits were put on hold and not denied.

# Administrator's Report

## Legislative Meetings and Public Hearings

Several proposed legislative changes were proposed that could increase benefit payments, a situation that would further compromise the System's already precarious funded status. To communicate the impact of these proposed changes, the FSMSSA held several meetings and public hearings throughout the year.

**On February 4 2012**, System Administrator Alexander R. Narruhn and the System's actuary Joseph A. Nichols reported the current status of the FSM Social Security Program to the State/National Leadership Conference. Mr. Nichols discussed the projected effects of System changes proposed by legislation. Based on current assumptions, the System's funded ratio could reach 26% over the next 15 years if the proposed benefit changes were adopted. A standard funded ratio benchmark of a pension system that is adequately funded is 80%. The proposed benefit changes would leave the System seriously underfunded and unable to pay pensions to its beneficiaries.

The specific bills addressed were

17-24: Restore benefit levels to 100% for workers turning 60 in 2011 and after.

17-62: To increase the amount of earnings exempt from the earnings test from \$300 to \$600 per quarter.

17-74: To eliminate earnings test.

The combined financial impact of these bills could increase the projected liabilities of the System by more than \$20 million over the next 10 years.

**February 6, 2012**, a public hearing for the FSMSSA was called by Chairman Tony Otto, Health and Social Affairs Committee. Topics discussed included nominations for the FSM Social Security Board of Trustees, the System's financial status and current bills 17-24, 17-26, 17-74. For the FSMSSA Board of Trustees, His Excellency Manny Mori nominated Gillian Doone as the new representative for the National Government, while Pohnpei State Governor, the Honorable John Ehsa, renominated Rose Nakanaga to serve as Chairman. As for the current status of the FSMSSA, Alex Narruhn reported that continued collection efforts, including delinquent taxes, is vital. Mr. Narruhn also made recommendations against the proposed legislative changes because they would compromise the sustained financial stability of the System.

**During June 2013**, public hearings were held in the states of Yap, Chuuk and Kosrae to discuss the impact of proposed Bills 17-24, 17-62 and 17-74. In general, the three proposed bills will increase the liability and reduce the long-term stability of the pension system. These public hearings provided the opportunity to explain these outcomes to the public and answer questions and concerns. Mr. Francky Ilai, FSMSSA Claims Department, and a delegation from the FSM Congress led the meetings. Public response was positive and, once they learned the long-term effects of the proposed bills could compromise the System's stability, they supported keeping the plan's current provisions.

**On September 10, 2012**, FSM Social Security officials met with Congress and Pohnpei State Legislature to further discuss proposed bills 17-24, 17-48, 17-62 and 17-74. FSMSSA reiterated the System's position regarding these bills – to discourage any bill that would either increase benefits or decrease contributions. Further, the delegation endorsed Bill 17-13 because it proposed to dedicate all corporate income tax revenues to the System, in an effort to increase contributions and improve the System's funded ratio.

Through these meetings, FSMSSA successfully communicated the negative financial impact of the proposed legislative changes and received positive feedback from the legislature and general public in support of keeping benefits static.

## Reducing Fraudulent Claims – Annual Survey

With the System's trend of decreasing contributions and increasing benefit payouts, FSMSSA continued its efforts to improve its long-term financial viability by reducing benefit claims from participants who do not meet the System's eligibility requirements.

During September, October and November, the FSMSSA conducted its annual survey to confirm beneficiaries meet benefit requirements as defined by FSM Social Security laws. Active beneficiaries applied in person or through power of attorney, providing proof of identification. These efforts contributed to a reduction in the number of beneficiaries receiving Social Security benefits at the end of fiscal year 2012. There were approximately 600 fewer beneficiaries receiving benefits in 2012 compared to 2011.

FSMSSA also sought to reduce fraudulent Social Security claims by establishing new positions for Investigation Officers at the Pohnpei State and Chuuk State branch offices. Investigation Officer responsibilities include ensuring current social security beneficiaries meet eligibility requirements as well as performing audits, conducting investigations and reporting findings to branch managers.

## Financial Reports

### Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets			
Cash and equivalents	\$ 2,244,250	\$ 1,209,552	\$ 2,780,258
Investments	37,206,732	35,220,871	36,910,189
Other current assets	3,424,074	4,059,782	2,770,894
Fixed assets, net	102,841	109,787	<u>77,190</u>
Total	42,977,897	40,599,992	42,538,531
Liabilities	<u>290,608</u>	<u>217,523</u>	<u>177,461</u>
Net Assets			
Held in trust for retirement, disability and survivors; benefit	\$ <u>42,687,289</u>	\$ <u>40,382,469</u>	\$ <u>42,361,070</u>

# Administrator's Report

## 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 CY2012.

	<b>2012</b>
<b>Contributions</b>	\$16,371,874
<b>Benefit Payments</b>	(17,745,448)
<b>Admin Expenses</b>	(1,035,997)
<b>Other Income, net</b>	<u>1,044,444</u>
<b>Operating Deficit</b>	(1,365,127)
<b>Investment Income/(Loss), net</b>	<u>3,669,947</u>
<b>Change in Net Assets</b>	2,304,820
<b>Net Assets, beginning of year</b>	<u>40,382,469</u>
<b>Net Assets, 12/31, end of year</b>	<u>\$42,687,289</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.

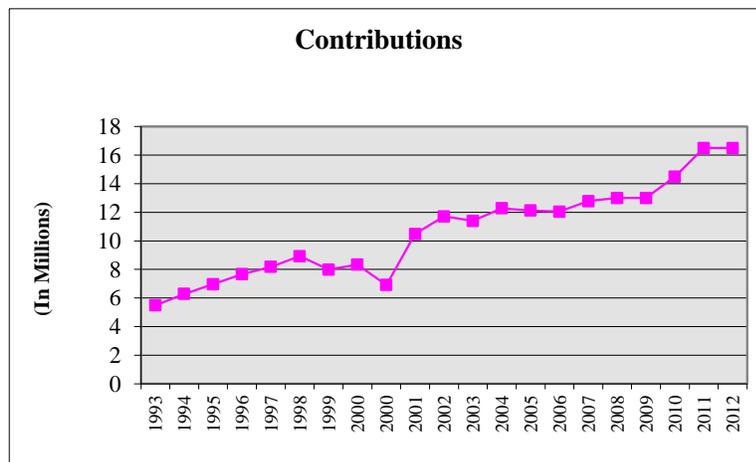
The following graphs illustrate current and historical levels of contributions received as well as benefit payments and administrative expenses paid. The graphs also track the overall historical value of the investment and realized past investment performance.

## Contributions

2012 contributions totaled \$16.37 million, a decrease of 1.33% from the previous year's collections of \$16.59 million. The decrease was attributed mainly to lower contributions from the private sectors, including delinquent accounts.

Contributions were comprised of:

<b>Government</b>	\$7,901,969
<b>Private</b>	8,266,665
<b>Judgment</b>	18,854
<b>Pen./Interest</b>	<u>184,386</u>
<b>Total</b>	\$16,371,874



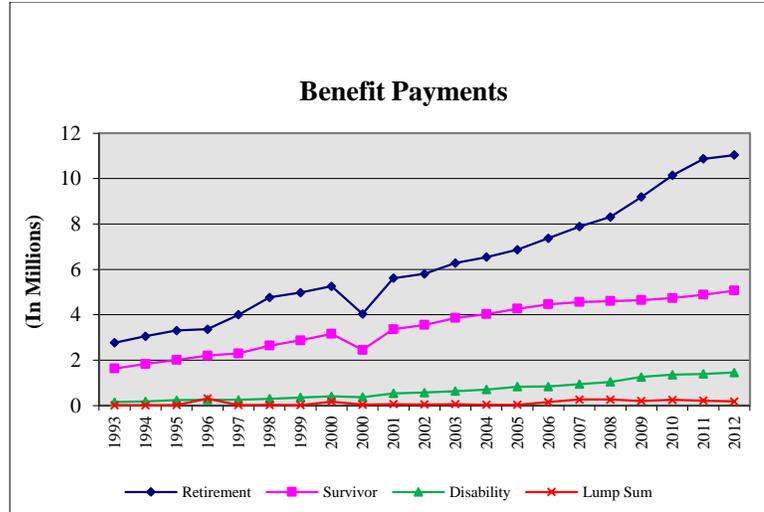
## Benefit Payments

A total of \$17.74 million was disbursed in benefit payments during fiscal year 2012.

Disbursements were comprised of:

<b>Retirement</b>	\$11,038,569
<b>Survivor</b>	5,068,023
<b>Disability</b>	1,456,825
<b>Lump Sum</b>	<u>182,031</u>
<b>Total</b>	\$17,745,448

Benefit payments increased by 2.18% from \$17.37 million in 2011 to \$17.75 million in 2012. This incremental increase is much smaller than in past years, showing a flattening of disbursements, which is a good sign for the System.



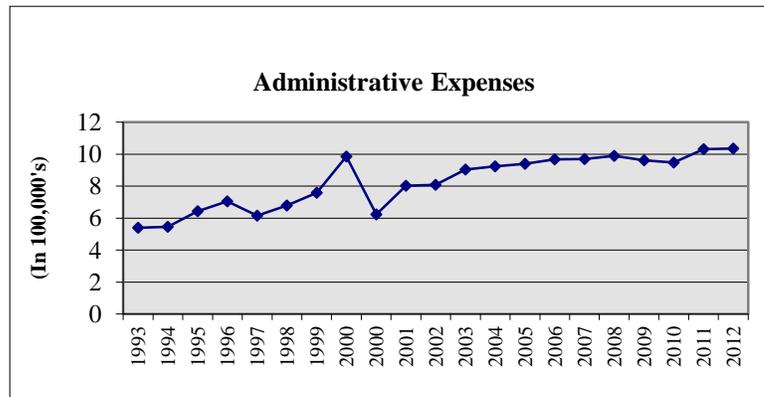
## Administrative Expenses

Net administrative expenses totaled \$1,035,997 for 2012, increasing less than half a percent over 2011.

Administrative expenses were also 7% under budget, due to monitoring of fuel, telephone, utilities, supplies and materials expenses.

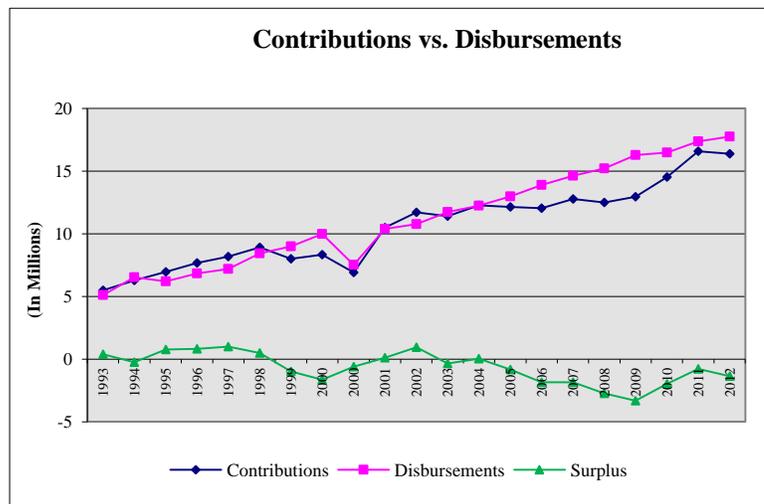
Administrative expenses were:

<b>Budget</b>	\$1,115,902
<b>Actual</b>	1,035,997
<b>Surplus</b>	79,905
<b>% Surplus</b>	7%



## Contributions and Disbursements

Contributions decreased slightly to \$16.37 million while disbursements increased slightly to \$17.75 million. Although the percentage increase in benefit payments was lower compared to prior years due to several new policies designed for this purpose, disbursements continue to outpace contributions. \$1 million was withdrawn from the investment portfolio and \$1.4 million was received from FSM National Government to cover the shortfall.



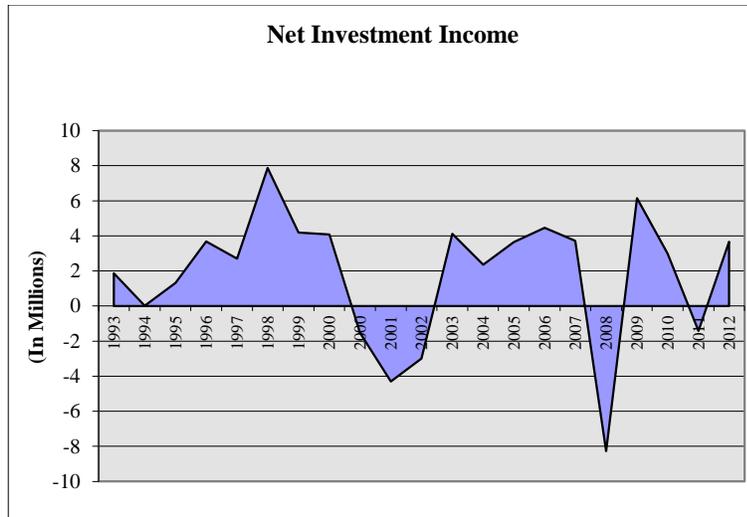
# Administrator's Report

## Investments

The Administration retained Morgan Stanley/Smith Barney as its investment advisor and custodial trustee. Missouri Valley Partners, Golden Capital, Renaissance, Payden & Rygel, Winslow Capital and Cambiar Investors serve as money managers.

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

The investment portfolio that included money market was valued at \$37,206,732 at the end of 2012. Investment income increased by 358.21% from \$1.42 million net loss in 2011 to a \$3.67 million net gain in 2012. The net gain was attributed to good performance of both the equity and fixed income investment accounts. The market value of the investment portfolio as of the end of FY2012 rose to \$37.21 million from \$35.22 million in 2011. This end-of-year market value is net of \$1 million drawdown during the year to supplement benefit payments.



## Investment Income/(Loss)

	2012	2011
<b>Investment</b>	\$37,206,732	\$35,220,871
<b>Income/(Loss)</b>	3,669,947	(1,421,047)
<b>Drawdown</b>	1,000,000	500,000

**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.

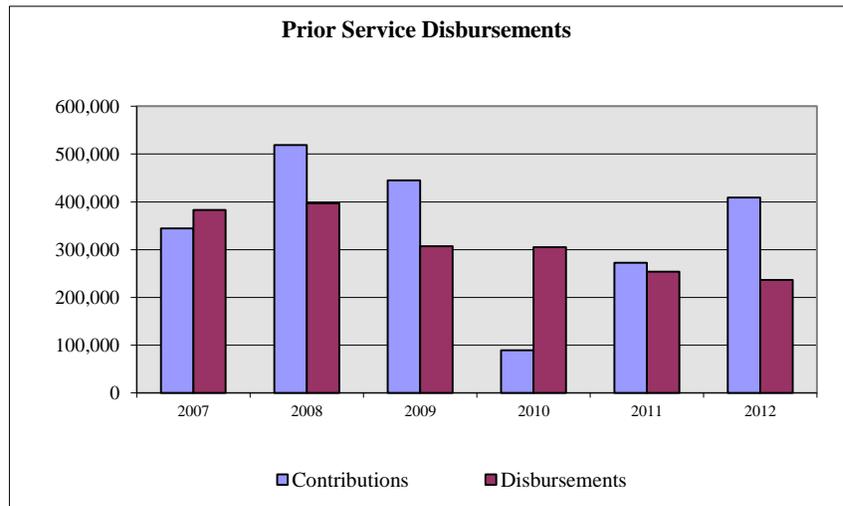
In 1987, the United States Congress provided \$8 million for initial capitalization of the PSBTF. Pursuant to U.S. Public Law 99-239, future funding would be provided, if warranted, based on the results of actuarial valuations.

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 FY2012, total funds received from the Prior Service Trust Fund Administration amounted to \$408,879 while benefits paid and administrative expenses totaled \$236,645. While the Administration accepts the liability for any amounts received, the Administration does not accept the obligation to pay future benefits unless additional funds are received from PSTFA.

As of Dec. 31, 2012, the Prior Service Fund had net assets of \$152,247.

**Prior Service**

For fiscal year 2012, reimbursements to FSMSSA from the Prior Service Benefits Trust Fund totaled \$408,879 while benefits paid and administrative expenses totaled \$236,645.



# Administrator's Report

## Conclusion

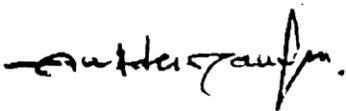
Although the Program continues to curb disbursements and increase collections through various efforts, the System continues to pay more in benefits, refunds and expenses than it collects in contributions. Improved investment performance in 2012 helped offset some of this drain, but as disbursements continue to outpace contributions, the System's long-term financial health remains critical.

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.

## 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.

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

Nichols Actuarial Consulting  
406 Court St.  
Savannah, MO 64485

### 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

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

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

### 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

## 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, 2012. 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	Chairman of the Board
Gillian Doone	National Government	Member
Innocente Oneisom	State of Chuuk	Vice-Chairman
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.

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.

# Management's Discussion and Analysis

## 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 for fiscal year 2012 was \$1.15 million, and the actual administrative cost incurred for FY2012 was \$1.04 million, or 7% surplus compared to the approved budget.

## Significant Events

- ✓ Contributions collected decreased by 1.33% from \$16.59 million in 2011 to \$16.37 million in 2012.
- ✓ Total Retirement Fund benefit payments to members or their beneficiaries increased by 2.05% from \$17.62 million in 2011 to \$17.98 million in 2012.
- ✓ 5,854 FSM citizens received Social Security benefits in fiscal year 2012.
- ✓ 752 new retirement, survivor and disability claims were received, processed, and approved in fiscal year 2012.
- ✓ Investment portfolio increased by 5.64% from \$35.22 million in 2011 to \$37.21 million in 2012.
- ✓ FSMSSA received \$1.0 million in funding from the FSM National Government and \$0.5 million from Prior Service, which was used to supplement benefit payments.
- ✓ Net position totaled \$42.84 million on December 31, 2012, compared to \$40.41 million on December 31, 2011, an increase of 6.01%.
- ✓ \$896,000 from delinquent accounts was collected in 2012.
- ✓ Close monitoring of expenses led to an administrative budget surplus of 7% in fiscal year 2012.
- ✓ Minimum benefit increased from \$75 to \$100, effective January 1, 2012, per P.L. 14-86.

## Management's Discussion and Analysis

### Financial Highlights

Net assets for the retirement fund (non-inclusive of the Prior Service Fund) increased by 5.71% from \$40.38 million in 2011 to \$42.69 million in 2012. The increase was attributed to net investment gain.

<b>Statement of Net Assets (Retirement Fund)</b>			
	<u><b>2012</b></u>	<u><b>2011</b></u>	<u><b>2010</b></u>
<b>ASSETS</b>			
Cash and equivalents	\$ 2,244,250	\$ 1,209,552	\$ 2,780,258
Investments	37,206,732	35,220,871	36,910,189
Other current assets	3,424,074	4,059,782	2,770,894
Fixed assets, net	102,841	109,787	77,190
Total	<u>\$ 42,977,897</u>	<u>\$ 40,599,992</u>	<u>\$ 42,538,531</u>
<b>LIABILITIES</b>	<u>\$ 42,687,289</u>	<u>\$ 217,523</u>	<u>\$ 177,461</u>
<b>NET ASSETS</b>			
Held in trust for retirement, disability and survivors' benefit	\$ 42,687,289	\$ 40,382,469	\$ 42,361,070

<b>Statement of Changes in Net Assets (Retirement Fund)</b>			
	<u><b>2012</b></u>	<u><b>2011</b></u>	<u><b>2010</b></u>
Contributions	\$ 16,371,874	\$ 16,593,155	\$ 14,525,608
Benefit Payments	(17,745,448)	(17,366,480)	(16,488,738)
Admin Expenses	(1,035,997)	(1,032,036)	(946,951)
Other	1,044,444	1,247,807	1,543,882
<b>Operating deficit</b>	<u>\$ (1,365,127)</u>	<u>\$ (557,554)</u>	<u>\$ (1,366,199)</u>
<b>Investment Income</b>	<u>3,669,947</u>	<u>(1,421,047)</u>	<u>2,981,703</u>
Change in Net Assets	\$ 2,304,820	\$ (1,978,601)	\$ 1,615,504
Net Assets, beginning	40,382,469	42,361,070	40,745,566
<b>Net Assets, ending</b>	<u>\$ 42,687,289</u>	<u>\$ 40,382,469</u>	<u>\$ 42,361,070</u>

## Management's Discussion and Analysis

- Investment income increased by 358.21% from \$1.42 million net loss in 2011 to \$3.67 million net gain in 2012. The net gain was attributed to the good performance of both the equity and fixed income investment accounts. The market value of the investment portfolio as of the end of FY2012 was \$37.21 million, which includes a \$1 million drawdown required to supplement benefit payments.

<b>Retirement Fund</b>	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
Investment*	\$ 37,206,732	\$ 35,220,871	\$ 36,910,189
Investment Income	\$ 3,669,947	\$ (1,421,047)	\$2,981,702
Investment Withdrawals	\$ 1,000,000	\$ 500,000	\$ 2,000,000
*includes cash management fund			

- The total amount of contributions collected was \$16.37 million, averaging a collection of \$4.09 million per quarter. This is a decrease of 1.33% compared to 2011. The lower collection is attributed to lower contribution of private sectors including lower collection from delinquent accounts. Total delinquent taxes collected in 2012 was \$896,000. Of this amount, 51% was from prior years.

<b>Contributions</b>	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
Government	\$ 7,901,969	\$ 7,495,281	\$6,690,931
Private	8,266,665	8,772,936	7,566,503
Judgment	18,854	82,192	44,201
Penalties and interest	184,386	242,746	223,973
<b>Total</b>	<b>\$ 16,371,874</b>	<b>\$ 16,593,155</b>	<b>\$14,525,608</b>

- Benefit payments increased by 2.18% from \$17.37 million in 2011 to \$17.74 million in 2012. This represents much smaller incremental growth from prior years. In 2012, participants were required to complete a survey in order to receive benefits. The number of participants receiving benefits decreased from 6,492 in 2011 to 5,854 in 2012.

<b>Benefit Payments</b>	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
Retirement	\$ 11,038,569	\$ 10,870,989	\$ 10,137,489
Survivors	5,068,023	4,881,958	4,738,969
Disability	1,456,825	1,395,552	1,356,728
Lump Sum	182,031	217,981	255,552
<b>Total</b>	<b>\$ 17,745,448</b>	<b>\$ 17,366,480</b>	<b>\$ 16,488,738</b>

## Management's Discussion and Analysis

- Actual administrative expenses increased by less than half a percent in 2012. Cost reduction procedures in place attributed to the cost containment. Actual costs were less than budgeted, accounting for a 7% budget surplus.

<b>Budget</b>	<b><u>Approved</u></b>	<b><u>Actual</u></b>	<b><u>Surplus</u></b>	<b><u>%</u></b>
2012	\$ 1,115,902	\$ 1,035,997	\$ 79,905	7%
2011	\$ 1,063,046	\$ 1,032,036	\$ 31,010	3%
2010	\$ 1,069,053	\$ 946,951	\$ 122,103	11%

- For FY 2012, total funds received from the Prior Service Trust Fund amounted to \$408,879, while benefits paid and administrative expenses totaled \$236,645 and \$47,373 respectively. As of December 31, 2012, the Prior Service Fund had net assets of \$152,247.

<b>Statement of Net Assets (Prior Service Fund)</b>			
	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
<b>ASSETS</b>	\$ 196,297	\$ 70,650	\$ 86,139
<b>LIABILITIES</b>	(44,050)	\$ (43,750)	\$ (43,104)
<b>NET ASSETS</b>	\$ 152,247	\$ 26,900	\$ 43,035

<b>Statement of Changes in Net Assets (Prior Service Fund)</b>			
	<b><u>2012</u></b>	<b><u>2011</u></b>	<b><u>2010</u></b>
PSTFA Reimbursements	\$ 408,879	\$ 272,797	\$ 89,593
Benefit Payments	(236,645)	(253,765)	(271,407)
Admin Expenses	(47,373)	(35,398)	(33,844)
Other	486	231	814
Change in Net Assets	125,347	(16,135)	\$ (214,844)
Net Assets, beginning of year	26,900	43,035	257,879
Net Assets, end of year	152,247	26,900	\$ 43,035

Management's Discussion and Analysis for the year ended December 31, 2012, is set forth in the report on the audit of the FSMSSA's financial statements, which is dated June 15, 2012. That Discussion and Analysis explains the major factors impacting the 2012 financial statements.

### Conclusion:

Overall, Fiscal Year 2012 was a better year for the System as its net position grew by 5.71% or \$2.30 million compared to FY2011. The investment portfolio performed well with a net gain of \$3.67 million.

While contributions decreased by 1.33%, the incremental increase in benefit payments also was lower compared to prior years. The lower benefit payments resulted from a qualification survey conducted in the last quarter of 2012. Another contributing factor to the smaller increase is the new provision mandating 50% of benefits for individuals who turned age 60 on or after January 1, 2011.

Although the gap between contributions and disbursements is closing, payments still outpaced contributions in 2012. A \$1.0 million drawdown from the investment portfolio and \$0.5 million drawdown from Prior Service Fund combined with \$1.4 million funding from the FSM National Government was required to cover the shortfall.

Collection of delinquent taxes continues to be a challenge facing the System. In FY2012, \$896,000 was collected from delinquent employers.

Management continues to pursue efforts to increase contributions and curb disbursements through the following:

- Collection of delinquent taxes.
- Audits.
- Eligibility surveys.
- Monitoring investment performance.
- Controlling administrative expenses.

Supplemental funding from the FSM National Government also may be required in the future.

Although collections are expected to increase in 2013, as a result of increased tax rate (15%) and increased maximum quarterly taxable wages (\$7,000), benefit payments also will continue to increase.

Legislative changes to increase contributions have been somewhat offset by legislative changes that increase benefits. We must continue to monitor this and pursue cost containment whenever possible.

It is projected that the System will require at least \$2.0 million additional funding to supplement benefit payments in 2013. The Administration will continue to work with the Legislature and Government to reduce the need for cash infusions and design a self-sustaining program.

# 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 quarter 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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