Quadrennial Report

Fiscal Years 2000-2003

Marshall Islands Social Security Administration

Table of Contents

Page

MARSHALL ISLANDS SOCIAL SECURITY ADMINISTRATION

P.O. Box 175, Majuro, Marshall Islands, MH 96960
Phone: (692) 625-3101, Fax: (692) 625-4570
E-mail: missa3@ntamar.net

February 2, 2004

His Excellency Kessai Note, President
Republic of the Marshall Islands

Honorable Litokwa Tomeing, Speaker
Nitijela of the Marshall Islands

Honorable Members
Nitijela of the Marshall Islands

Dear Sirs and Madam:

On behalf of the Board of Directors of the Marshall Islands Social Security Administration, I am pleased to present this Quadrennial Report covering our organization's activities for the fiscal years of 2000 to 2003.

After being constituted by newly elected President Kessai Note and his Cabinet in early 2000, the MISSA board faced the daunting task of correcting the wayward direction of an organization that had been unauditable and unaccountable for more than four years, and that appeared to be hopelessly mired in corruption. The retiree's trust fund was being raided on a regular basis because revenues were not covering the expenses of the operation. At stake for the people of the Marshall Islands was the future welfare of their elders and their disabled citizens.

Our newly appointed Board, the first in the history of the Marshall Islands ever to have a majority of women as sitting members, established three main goals for our mission to put Social Security back on a sound financial footing:

*To be fully auditable and accountable.

*To increase revenues via the institution of aggressive tax collection policies mandated by the Social Security Act.

*To drastically decrease expenses and streamline the operation of the Administration.

The Board's first task toward accomplishing these formidable goals involved the reorganization and replacement of top management. The Board selected Ms. Saane K. Aho, a U.S. educated Marshallese woman, to be the Administrator directed to change the direction of MISSA. Despite immediate demands for corrective action from the Board, Ms. Aho, along with her staff, successfully responded with courage, dedication and professionalism.

As this report will show, our previously stated goals have been achieved:

*MISSA is now fully auditable and accountable. For the fiscal year of 2002 there were no findings in our audit for the Social Security system.

*MISSA revenues have increased each year, from a low of $5.51 million in 1999 to $13.04 million in 2003.

*MISSA expenses have decreased from $1.55 million in 1999, or 14.5% of total revenues, to $862,000 in 2003, or only 6.6% of total revenues.

MISSA has now earned the respect of an entire nation. As an organization, our mission for the future is simple: To continue to improve for the welfare of the people of the Marshall Islands.

In closing, I would like to thank the families of the MISSA Board members, administration and staff for supporting us over the past four years. Without their patience for and understanding of the long hours that we have put in for the people of the Republic, none of our successes would have been achievable.

Sincerely,

Jack Niedenthal
Chairman of the MISSA Board

Board of Trustees

John M. Niedenthal
Board Chairman (2003-2006)
Vice-Chairman (2000-2003)
* Liaison Officer, Bikini Atoll Local Gov't.
* Board Member, Bank of the Marshall Is.
* Vice-Chairman, Prior Service Tust Fund
* Treasurer, Majuro Coop. School Board

E. Tommy Milne
Vice-Chairman (2003-2006)
Board Member (2000-2003)
* Administrator, Ebeye Hospital

Saeko Shoniber
Board Member (2000-2006)
* Secretary of Finance, RMI
* Board Member, Bank of the Marshal Is.

Cradle Alfred
Board Member (2000-2006)
*Manager/Proprietor, Liepajid Handicrafts

Grant Labaun
Board Chairman (2000-2003)
* GM, G & L Enterprises & Affiliates
* Board Chairman, Bank of the Marshall Is.
* Executive Member, General Council of the Assemblies of God Churches

Maria K. Fowler
Board Member (2000-2006)
* Board Member, Judicial Commission
* Partner, KL & K Corporation

M. Biram Stege
Board Member (2000-2006)
* Secretary of Education, RMI
* Board Member, Bank of the Marshall Is.

Suzanne Murphy-Chutaro
Board Member (2003-2006)
* Advertising Manager, Marshall Is. Journal

To Our Beneficiaries, Contributing Members, and the People of the Marshall Islands,

I am very pleased to present you with the Marshall Islands Social Security Administration's Quadrennial Report for fiscal years 2000 through 2003 which contains the Administration's financial statements and analysis for this period, the system's accrued actuarial liabilities at October 1, 2001, information on our benefit programs, and other significant changes and activities that have taken place since the beginning of my tenure as the Administrator for MISSA in mid 2000.

The appointment of MISSA's Board of Directors by the Cabinet in early 2000 and their hire of a new management team enabled MISSA to ensure the accountability of its financial records, improve its financial condition, and effectively manage its operations and benefit programs.

Under the auspices and direction of the Board, the Administration's primary objective to ensure accountability of its financial records was achieved in early 2001 when MISSA's audited financial statements for fiscal years 1997, 1998, 1999, and 2000 were finally released. To date, MISSA's audited financial statements are current and unqualified.

In addition, the decline in tax collections in the late 1990s and the uncertainties surrounding the financial condition of the MISSA Funds forced the Administration to strengthen its policies on internal controls and procedures, revamp its collection efforts and restructure its operations. Consequently in FY 2003, MISSA's annual revenues from tax contributions, penalties, and interest have more than doubled and its operating expenses cut by half the amounts in FY 1999. This allowed the Administration to invest more than $4.43 Million into the Retirement Trust Fund over the past four years.

In FY 2004, MISSA anticipates greater interaction with RMI government leaders, social security counterparts in the region, and the general public regarding the development and implementation of sound strategies and legislation aimed to address the widening gap in the Fund's assets and actuarial liabilities. We are also optimistic of the continued growth in the Fund's assets as we continue to control and minimize administrative spending, enforce tax collection, and anticipate positive returns on our investments. In line with our goal to better and more effectively serve our members and beneficiaries, we expect the modernized version of our computer operating system to be installed in mid 2005.

I want to recognize and thank MISSA's Board of Directors, managers, staff, consultants and their families for their selfless dedication, patience, cooperation and hard work in the past four years. In addition, I want to thank H.E. President Kessai Note, his Cabinet, and the Nitijela for allowing the Administration to maintain an open relationship with the government built upon mutual trust, respect, and integrity. Finally, I want to thank the beneficiaries and contributing members for giving me the opportunity to serve them and the wider community.

Sincerely,

Saane K. Aho

Organizational Structure

Executive Officers and Staff

Saane K. Aho
Administrator

Lillian Andrew
Deputy Administrator

Alice Sanchez
Chief Financial Officer

Ave Gimao, Jr.
Operations & Personnel Officer

Dunstan Lokboj
I.T. Manager

Ricky Kurn
Tax Examiner

Jabkol Harry
Branch Manager-Ebeye

Newton Matthew
Accountant

Emlin Andrike
Claims Benefit Specialist

Joseph Hesley
Claims Benefit Specialist

Bill Joseph
Deputy Tax Examiner

Brad Lamille
Tax Officer

Almitha Clement
Tax Officer

Ruthann Korean
Tax Officer

Ernest Harry
Tax Officer-Ebeye

Rosemond Jetnil
Administrative Assistant

Tenia Kaiko
Administrative Assistant

Bluerose Laik
Adm. Assistant-Ebeye

Antonio Rear
Accounting Clerk

Joe Wottokna
I.T. Clerk

Priscilla Baso-Joab
Receptionist

Angeline Balos
Cashier

Elvie Morales
Registration Clerk

Glenn Joshua
Logistics Support

Catherine Jibaiur
General Custodian

Consultants

Investor Solutions, Inc.
Investment Advisor

Fidelity Investments IBG
Investment Custodian

Atty. David Strauss
Legal Counsel

Deloitte, Touche & Tohmatsu
External Auditors

Buck Consultants
Actuary

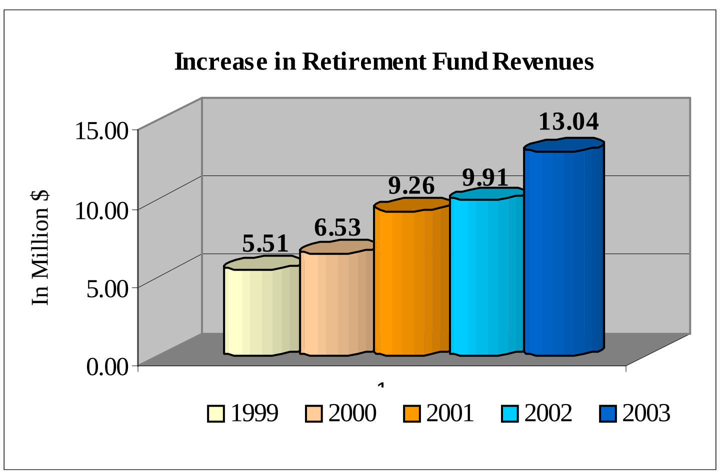
White Coconut Computers
I.T. Consultant

Financial Highlights

At the onset of the new millennium, MISSA's financial performance started to change dramatically as a new Board of Directors and Administrator were appointed by the Cabinet. The reorganization that occurred within MISSA brought significant innovations in its operating strategies. With the concurrence of the Nitijela, certain legislation was passed that increased rates for both Retirement and Health Fund contributions. Likewise, considerable amounts of subsidies from the RMI government and remittances from the Ministry of Health were received. Consequently, revenues rose to unprecedented levels. Implementing guidelines and procedures on retirement, healthcare, survivor and disability benefits were reviewed and strengthened which led to a more equitable and faster benefit distribution. Likewise, sound operational policies and tighter internal controls were put in place, greatly decreasing costs and expenses. This is a prime example of the Administration's determination to fulfill its mission to ensure that workers have a measure of security in their old age or during disability, and that their families would have a source of financial support after their deaths, and also to provide an orderly means to finance and deliver comprehensive medical care to the people of the Marshall Islands.

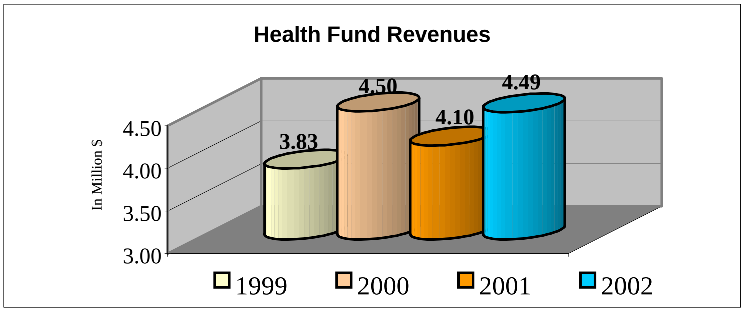
Revenues from Retirement Fund contributions

Revenues increased steadily in FYs 2000, 2001, 2002 and 2003, with collections of $6.53 Million, $9.26 Million, $9.91 Million and $13.04 Million, respectively. The large increase in 2001 was the result of an increase in the Retirement Fund rate from 5% to 7%. The $13.33 Million collected in FY 2003 is 43% higher than the combined Retirement and Health Fund contributions in 1999.



Revenues from Health Fund contributions

Collections in FY 2000 increased to $4.50 Million or 17.4% higher than the previous year. However, collections decreased to $4.10 Million in FY 2001 as a result of a reduction in the Health Fund contribution rate from 3.5% to 2.5%, effective January 1, 2001. Collections rebounded to $4.49 Million in FY 2002, when the rate was brought back to 3.5%. With the transfer of the Health Fund to MOH in 2003, no additional revenues were recorded by MISSA.

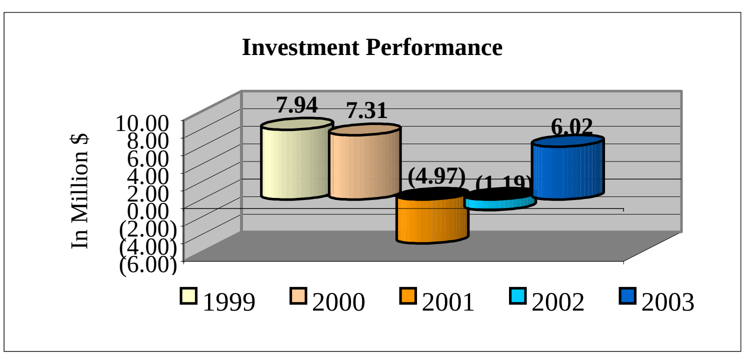


Revenues from investments

FYs 2001 and 2002 were the most challenging years for MISSA's investments. As an aftermath of the September 11, 2001 terrorist attacks in the United States and the uncertainties of war in the Middle East, the world stock market faced the most difficult market environment of the past several decades, and MISSA was not spared from this downturn.

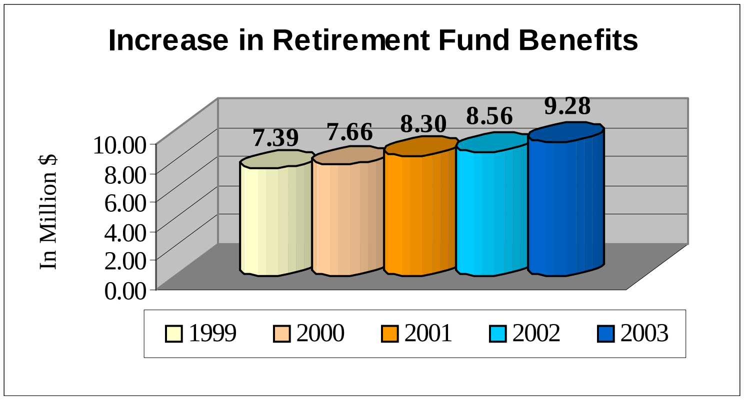
While MISSA investments gained $7.31 Million in FY 2000, they lost $4.97 Million in FY 2001 and lost an additional $1.19 Million in FY 2002. To counteract this poor performance, MISSA decided to obtain the services of a new Investment Consultant and another Investment Custodian. Fortunately, after several dismal years, the stock markets rebounded globally in 2003. Because of the improving global stock market, MISSA's strict adherence to its investment policy of investing in no-load, low-cost mutual and exchange traded funds at a set asset allocation, and the low management fees charged by the Investment Consultant and Custodian, MISSA's investments gained $7,459,305 in the calendar year 2003 – an astounding <u>net</u> return of 31.23 %.

For the past four years, MISSA's effective cash management generated a cash surplus that enabled it to invest in short term Time Certificates of Deposit (TCDs) of $0.54 Million, $1.66 Million, $2.80 Million and $3.5 Million at the end of the same fiscal years, respectively. Likewise, MISSA has received an average of almost $1.0 Million annually as dividends and interest from local financial institutions for the past four years.



Expenditures related to Retirement Fund benefits

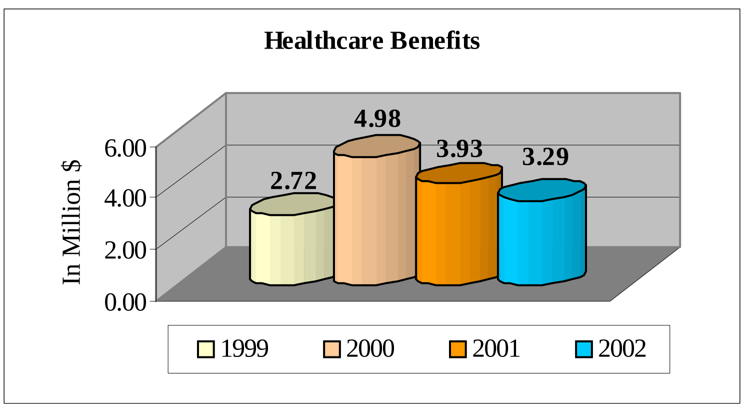
Retirement, survivor, disability, reduction-in-force and lump sum benefits proportionately increased consistently in the same years with $7.66 Million, $8.30 Million, $8.56 Million and $9.28 Million being meted out, respectively. The $9.28 Million in benefits paid in 2003 are 26% greater than the $7.39 benefits paid in 1999.



Expenditures related to Health Fund benefits

Healthcare benefits paid out in FYs 2000, 2001 and 2002 amounted to $4.98 Million, $3.93 Million and $ 3.29 Million, respectively. With the transfer of the Health Fund to MOH in 2003, no more expenditure was recorded by MISSA.

Medical supplies and hospital equipment acquired in FYs 2000 and 2001 amounted to $1.78 Million and $1.39 Million, respectively.

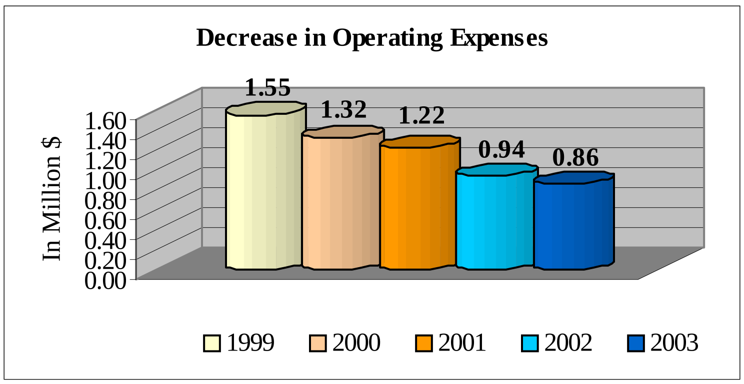


Expenditures related to operations

At the end of FY 1999, MISSA employed about 40 personnel and spent $1.55 Million annually in salaries and operating expenses or about 14.5% of the total revenues (before investment income) for the same year. In the next four years, the organizational structure was downsized, job-duplication was eliminated and cross functions introduced. In effect, individual productivity increased while annual administrative expenses went down considerably. The number of personnel was further reduced when the administration of the Health Fund was transferred to MOH in 2003. The savings generated from the unnecessary positions previously eliminated, enabled MISSA to employ additional Tax Officers without adversely affecting its annual budget. These savings also enabled the Administration to reward the noticeably improved performance of its employees with salary increments, a morale booster that has made them more productive and hardworking.

At the end of FY 2003, MISSA's personnel structure of 25 employees has significantly reduced its annual administrative expenses to $0.86 Million or 6.6% of the total revenues (before investment income) for the same year.

It is also noteworthy to mention that there was a significant amount of reduction on airfare, per diems, Board sitting fees and related costs for the last four years. These reductions are attributable to the Board's policy of waiving sitting fees and holding Board meetings in Majuro, instead of off-island.



Budgetary control

As a result of a more aggressive collection campaign, actual Retirement and Health Fund collections from FYs 2000 to 2003 far exceeded the targeted figures by $0.42 Million (or 4%), $0.19 Million (or 1.4%), $0.34 Million (or 2.4%) and $2.79 Million (or 27%), respectively.

(Revenues in Million Dollars)

	Budget	Actual	Variance
2000	10.61	11.03	0.42
2001	13.16	13.35	0.19
2002	14.06	14.40	0.34
2003	10.25*	13.04	2.79

*Retirement fund only, as the Health Fund was transferred to MOH in 2003

Likewise, tighter accounting and operational controls generated remarkable savings in terms of administrative expenses by $0.09 Million (or 6%), $0.59 Million (or 33%), $0.60 Million (or 39%) and $0.09 Million (or 10%) for the same fiscal years, respectively.

	(Administrative Costs in Million Dollars)		
	Budget	Actual	Variance
2000	1.41	1.32	0.09
2001	1.81	1.22	0.59
2002	1.54	0.94	0.60
2003	0.95	0.86	0.09

Actuarial valuation of System's accrued liabilities

In October 2002, MISSA obtained its 5th actuarial valuation of the Retirement Fund as of October 1, 2001. The valuation reported Actuarial Accrued Liabilities (AAL) of $218 Million while the total assets held cover approximately $35 Million or 16% of the AAL as of the same period. Although this condition indicated that MISSA may be unable to meet its future benefit obligations, the Administration has already started developing strategic plans to correct this potential funding deficiency such as continued higher long-term investment return, more rigorous tax collection, stricter administration of all System eligibility requirements and continued cost control.

MISSA's actuary has recommended that the Board consider a funding policy that seeks to raise the funded percent from 16% to 30% over 30 years. This can be attained with the passage of new legislation that will put tighter controls on survivor and disability benefits. Any bill opposing this direction, like the proposal to abolish the earnings test, may adversely affect MISSA's payment ability in the future. In this regard, the Nitijela's positive consideration of proposed amendments to the Social Security Act of 1990 that are in line with the actuarial recommendations will play a very significant role in strengthening MISSA's future financial condition.

In conclusion, the report said that MISSA is delicately balanced on the edge of soundness. The next actuarial valuation is scheduled in 2004.

Audit reports and findings

Deloitte, Touche & Tohmatsu, in its Independent Auditor's Reports from FYs 2000 to 2002, has given MISSA an "unqualified opinion", which means that MISSA's financial statements for the said years, present fairly, in all materials respects, the financial position of MISSA and the results of its operations and the cash flows of its proprietary fund type for the years then ended, in conformity with accounting principles generally accepted in the U.S. This "clean bill of health" manifests MISSA's resolve to maintain accurate and transparent accounting records, open to scrutiny by the public any time.

The number of audit findings was drastically reduced from 16 in FY 2000 to 3 in FY 2001, and then 2 in FY 2002. Most of these findings were related to Health Fund issues prior to 2000. Although the audit for FY 2003 is not yet completed, it is expected that MISSA will merit another "A+" rating, as in the past 2 years.

Executive Summary

General

The Marshall Islands Social Security Administration (MISSA), a component unit of the Republic of Marshall Islands (RMI), was established pursuant to RMI Public Law 1990-75 (the Social Security Act of 1990), as amended. The law repealed the Social Security Act of 1987 and established MISSA to administer the Marshall Islands Social Security Retirement Fund. On March 6, 1991, the Nitijela passed Public Law 1991-118 (the Social Security Health Fund Act of 1991), as amended, which directed MISSA to administer the Marshall Islands Social Security Health Fund.

On April 11, 2002, the Nitijela passed Public Law 2002-57 to repeal the Social Security Health Fund Act of 1991 and to transfer the administration of the Health Fund to RMI's Ministry of Health (MOH). However, the formal turn over did not take effect until December 1, 2002, with MISSA's Deputy Administrator for Health Fund and its entire Medical Referral Team being absorbed by MOH. For accounting purposes, all Health Fund collections starting January 1, 2003, are no longer reflected in MISSA's books. As part of an agreement with MOH, however, MISSA will still be responsible for the quarterly collection of Health Fund contributions.

Principal provisions

- *Coverage* – Social Security applies to all employees working within the Marshall Islands and RMI citizens working outside the Marshall Islands, and include self-employed persons, with or without employees. It also applies to every employer doing business in the Marshall Islands which is required to contribute an amount equal to that contributed by employees. Currently, the maximum taxable wages for employees is $5,000 per calendar quarter. In the case of self employed individuals with one or more employees, the tax is based on the actual wages or at twice the wages of the highest paid worker, whichever is greater, in the calendar quarter the employees whose earnings were reported. Self-employed individuals without employees are taxed based on their gross revenue per calendar quarter, which is multiplied by 75% to arrive at the gross taxable wages.

- *Reporting period* – all employers are required to file the quarterly SS tax returns and pay the contributions within the ten day period following the end of each quarter ending on March 31st, June 30th, September 30th and December 31st. Reporting deadlines shall be: 1st quarter – April 10th, 2nd quarter – July 10, 3rd quarter – October 10th and 4th quarter – January 10th.

- *Contributions* – workers and their employers each contribute a percentage of their wages to the Retirement and Health Funds according to the following schedule:
  Retirement Fund: 3% for wages paid from October 1, 1987 to June 30, 1990
  4% for wages paid from July 1,1990 to Sept. 30, 1990
  5% for wages paid from October 1, 1990 to June 30, 1995

6% for wages paid from July 1, 1995 to March 31, 1997
5% for wages paid from April 1, 1997 to Dec. 31, 2000
7% for wages paid from January 1, 2001 to present

Health Fund: 2.5% for wages paid from Oct. 1, 1991 to March 31, 1997
3.5% for wages paid from April 1, 1997 to Dec. 31, 2000
2.5% for wages paid from Jan. 1, 2001 to Dec. 31, 2001
3.5% for wages paid from January 1, 2002 to present

Retirement programs

The Retirement Fund was established to provide a financially sound social security system with pension benefits and early retirement, whereby workers would obtain a measure of financial security in their old age and during disability, and whereby surviving spouses and children of deceased workers would receive some financial support after the death of the worker.

Retirement benefits are computed on the Basic Benefit. The *basic benefit* is one-twelfth (1/12) of the sum of the pension element and the social element, where the pension element is two percent (2%) of indexed covered earnings and the social element is fourteen and one-half percent (14.5%) of the first $11,000 of cumulative covered earnings plus seven tenths percent (0.7%) of cumulative covered earnings in excess of $11,000 but not in excess of $44,000.

- <u>*Retirement benefits*</u>
    - *a. Early retirement benefits* – to be entitled, the claimant must be: (i) service insured; (ii) have attained the age of 55; and (iii) have filed an application.

      "Service insured" means having earned at least 80 quarters of coverage.

    - b. *Normal Retirement benefits* – to be entitled, a claimant must be: (i) fully insured; (ii) have attained the age of 60; (iii) have filed an application; and (iv) have not applied for and received early retirement benefits.

      "Fully insured" means having earned at least one quarter of coverage for each year commencing after after the later of (a) the year beginning after June 30, 1968 or (b) the year beginning after the worker attains the age of 21, and up to but excluding the year of the worker's retirement, disability or death, provided that a minimum of twelve quarters of coverage are required.

    - c. *Deferred retirement benefits* – to be entitled, the claimant must be: (i) fully insured; (ii) have attained the age of 60 and one month; (iii) have filed an application; and (iv) have not applied for and received early retirement benefits or normal retirement benefits.

- <u>*Disability insurance benefits*</u> – to be entitled, the claimant must be *"fully insured" and "currently insured"* and must be or have been unable to engage in the continued performance of his duties by reason of any medically determinable physical or mental impairment.

"Currently insured" means having earned at least six quarters of coverage during the most recent forty (40) quarters ending with the quarter of the worker's retirement, disability or death, whichever first occurs. Currently, the minimum disability insurance benefit is $128.99.

- *Surviving spouse insurance benefits* – the surviving spouse of a worker who is fully insured and dies is entitled to a surviving spouse insurance benefit of 100% of the "*basic benefit*", subject to the maximum and minimum survivor benefits, and subject to the earnings test. This is paid until remarriage or until death of the surviving spouse, whichever occurs first.

- *Surviving child insurance benefits* – each surviving child of a worker who is fully or currently insured and dies is entitled to a surviving child's insurance benefit of 25% of the basic benefit; provided, however, that the total monthly survivor's insurance benefits payable to both Surviving Spouse and the Surviving Children shall neither exceed the basic benefit applicable to the deceased wage earner nor be less than $128.99; and where more than one person is entitled to survivor's benefits, the payments shall be made to all such beneficiaries proportionately to the percentage of basic benefit due them.

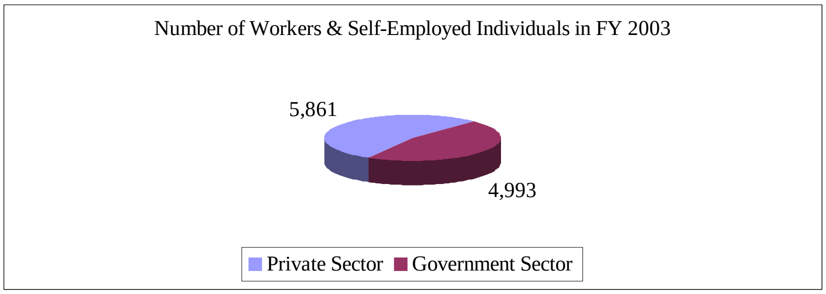
- *Lump-sum benefits* – if monthly survivor benefits are not paid or are stopped because all beneficiaries become disqualified as a result of death, remarriage, adoption, attainment of 18 (or age 22 if a bona fide student), or recovery from disability, a lump-sum benefit is due; provided that the benefits paid for under the wage earner's account are less than 4% of his CCE. The amount of lump-sum benefit equals the total CCE multiplied by 4% less the total monthly benefits already received under the wage earner's account.

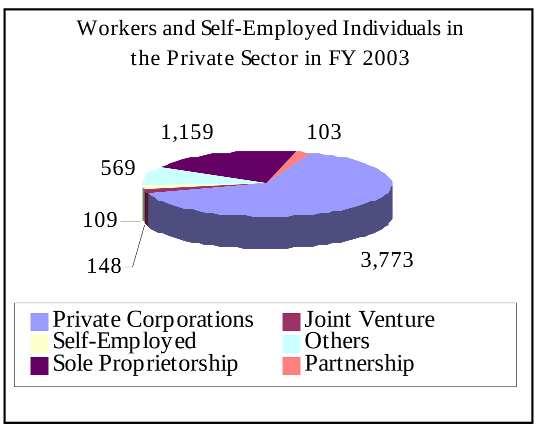
Statistical information on contributors

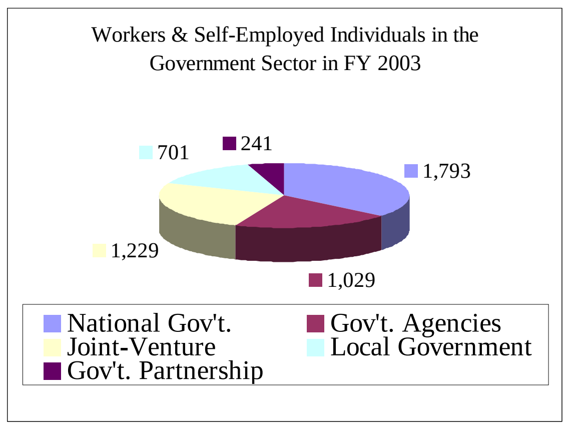
The number of workers and self-employed individuals whose tax contributions have been filed and paid totaled 10,338, 10,629, 10,632 and 10,854 in FYs 2000, 2001, 2002 and 2003, respectively.

	2000	2001	2002	2003
Private Sector				
Private corporations	2,661	2,909	3,003	3,773
Joint venture	251	254	214	148
Partnership	106	106	105	103
Self-employed	51	43	70	109
Sole proprietorship	1,382	1,536	1,440	1,159
Others	758	710	616	569
	5,209	5,558	5,448	5,861

	2000	2001	2002	2003
Public Sector				
National Government	1,669	1,596	1,709	1,793
Local Government	1,057	903	694	701
Government Agencies	1,243	1,213	1,243	1,029
Joint-Venture	1,088	1,197	1,453	1,229
Government Partnership	72	162	85	241
	5,129	5,071	5,184	4,993
Total	10,338	10, 629	10,632	10,854



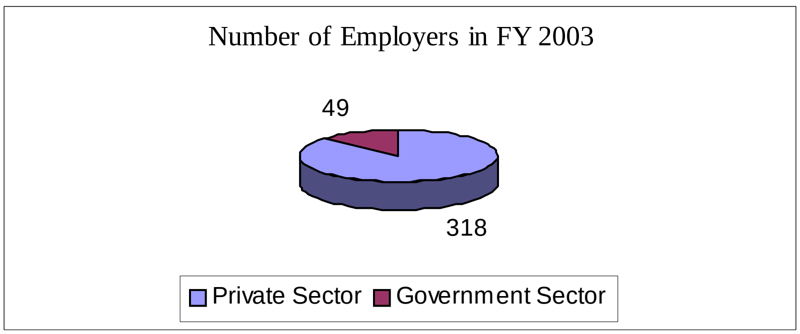


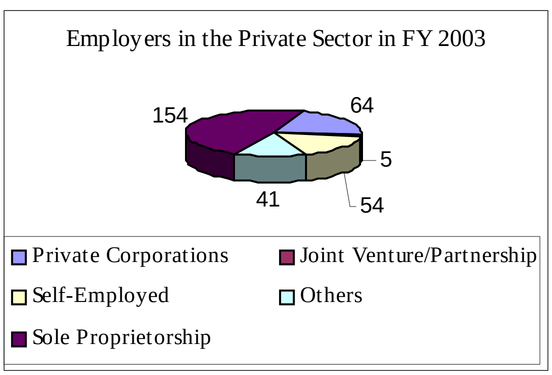


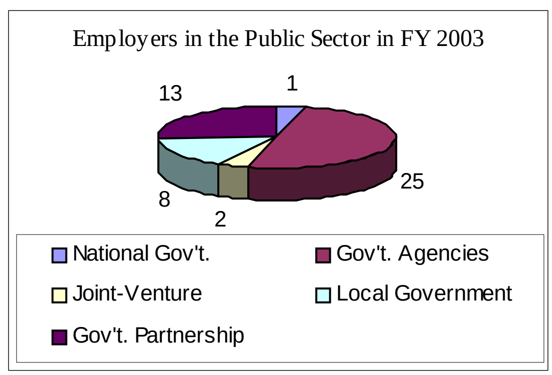
The number of employers whose tax contributions have been filed and paid totaled 350, 337, 355 and 367 in FYs 2000, 2001, 2002 and 2003, respectively.

	2000	2001	2002	2003
Private Sector				
Private corporations	48	52	58	64
Joint venture	1	1	1	1
Partnership	6	4	4	4
Self-employed	28	26	38	54
Sole proprietorship	162	158	161	154
Others	53	51	47	41
	298	292	309	318

	2000	2001	2002	2003
Public Sector				
National Government	1	1	1	1
Local Government	14	9	8	8
Government Agencies	23	21	23	25
Joint-Venture	3	3	3	2
Government Partnership	11	11	11	13
	52	45	46	49
Total	350	337	355	367







Statistical information on benefits

The number of beneficiaries with the corresponding amounts disbursed out for FYs 2000-2003 is shown below:

(Number of beneficiaries)

	2000	2001	2002	2003
Retirement benefits	1,000	1,041	1,082	1,154
Disability benefits	171	193	219	246
Survivor benefits	1,484	1,533	1,522	1,559
Lump-sum benefits	55	86	109	98
Total	2,710	2,853	2,932	3,057

	2000	2001	2002	2003
	(Amounts in Millions)			
Retirement benefits	$ 3.99	$ 4.25	$ 4.52	$ 4.93
Disability benefits	.72	.84	.94	1.09
Survivor benefits	2.58	2.80	2.95	3.15
Lump-sum benefits	.02	.06	.05	.05
Total	$ 7.31	$ 7.95	$ 8.46	$ 9.22

Statistical information on membership

To date, MISSA has a registered membership of 49,208 individuals, comprised of active contributors, past contributors who may have died, retired or are no longer actively employed, foreign workers who left RMI permanently, students and survivors of deceased workers.

Prior Service Benefits Trust Fund and its beneficiaries

The Administration provides claims processing and other support services for the Prior Service Benefits Trust Fund (PSBTF), a separate program that was spun off from the Trust Territory Social Security System. This program provides benefits to Micronesians with five or more years of service with the Naval Administration or Trust Territory Government prior to 1968. The program is fully funded by the United States Government and is controlled by a Trust Agreement entered into by the Department of the Interior and the four other governments - the Commonwealth of the Northern Mariana Islands, the Republic of Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands.

The Trust Agreement by and between the U.S. Secretary of the Interior and the Trust Territory Social Security Board and approved by the four Micronesian governments became effective on September 28, 1987. On the same year, the U.S. Congress released $8 Million for initial capitalization of the PSBTF that generated over $9.5 Million in investment income to pay benefits and operating costs. To-date, nearly $16 Million in benefits were already paid.

As of March 31, 2003, there are 237 Marshall Islanders currently receiving monthly benefits of about $8,527.00, at a monthly average of $36.00 per beneficiary. An additional 185 eligible members are yet to apply, after they meet the age or retirement requirements.

Totalization agreement

Significant migration occurs among the workers of the Marshall Islands, Federated States of Micronesia (FSM), and the Republic of Palau (ROP). Under the Trust Territory Social Security System (TTSSS), this migration caused no concern because the workers paid a single tax and all work credits were combined to determine a single benefit. However, with the devolution of the TTSSS into the three successor systems, this is no longer the case. In the absence of an agreement, workers who migrate between these countries may become subject to the coverage and taxation of more than one successor system. Also, since the worker's work history is split among the successor systems, the worker may not accumulate enough credits in one, or even worse, in any of the successor systems in order to qualify for a benefit.

It would be beneficial for RMI citizens, as well as FSM and ROP citizens, to eliminate dual coverage and taxation and to permit the consolidation of work credits earned in all of the successor systems to determine the eligibility for and the amount of benefits to be paid by each system. This may be accomplished by the three governments entering into an agreement, referred to as *Totalization Agreement*. Presently, the RMI, FSM and Palau Social Security Systems are each developing such an agreement and hope to finalize it in the near future.

Reduction-in-force program and its beneficiaries

The Reduction–in-Force (RIF) benefits are paid to those laid-off civil service employees during the downsizing process of RMI through the Public Sector Reform Program. The monthly benefit payments are paid out on the basis of the current benefit rules of MISSA, as if the employees were aged fifty-five and "service insured", for a maximum period of three years, or for as long as the funds are available. As of July 2003, the last benefit was paid and the program has ceased.

Issues on tax collection and enforcement

Despite the double efforts exerted by MISSA's Tax Compliance Team, difficulties in tax assessment and review of past employer quarterly returns were encountered. One reason is that numerous employers, more particularly the small and medium sized businesses, do not maintain complete payroll records that may be examined by MISSA Auditors. Moreover, voluntary tax compliance is not yet satisfactorily met, as evidenced by the fact that many businesses that have registered and renewed their business permits with the local government, have not yet registered with MISSA, and thus, have not paid any MISSA taxes at all. Some of those who registered, paid for several quarters, then skipped payment for the succeeding periods.

To address this issue, MISSA has strictly enforced its authority to charge stiff penalties against violators, to include the maximum monetary fines and imprisonment as provided for by the Social Security Act of 1990.

MISSA's civil cases and delinquencies settled out of court

The redoubled efforts of MISSA's Tax Compliance Team paid off as numerous cases were filed in court. Also, many delinquent employers opted to avail themselves of the several payment options offered by MISSA, in order to avoid the high cost of litigation.

- KalGov – in mid-2003, the court ordered KalGov to pay MISSA $2.8 Million for unpaid contributions from 1996 to 2000. However, in consideration to KalGov's financial difficulties, the MISSA Board and KalGov concurred in a post judgment agreement whereby all penalty charges were waived with the condition that KalGov pay a fixed amount monthly to cover the delinquent amounts and keep current on its quarterly obligations.

- MalGov – a settlement was agreed in 2003 whereby MalGov signed a promissory note to pay off its $1.3 Million obligations.

Hiring of new Investment Advisor and Custodian

In mid-2002, after several months of uncertainties and depressing investment performance brought by the September 11 tragedy, the MISSA Board felt the urgent need to acquire the services of a new investment advisor and custodian. Requests for Proposal (RFPs) were circulated out and numerous replies came in. Subsequently, the selection process started, with each of the interested Consultants and Custodians being required to make a presentation, personally or by telephone. After a thorough evaluation of each applicant's credentials, the Board, in its regular meeting held on November 11, 2002, finally approved the appointment of its new Investment Advisor, Investor Solutions, Inc. (ISI), a large SEC registered firm licensed to do business in the U.S. It specializes in global diversification, passive strategies and rigid risk and cost control. As expected, positive changes were noted after a year with ISI, as more effective investment choices were made at dramatically lower cost, higher returns were gained and stringent risk and cost controls taken.

Fidelity Investments Institutional Brokerage Group (FIIBG) was chosen to be the new Custodian. Unlike the previous Custodian, FIIBG is an independent consulting firm not related to MISSA's new Advisor, ISI. Thus, this set-up will allow independent investment advice from an independent investment advisor with no other conflict of interest.

Overview of MISSA's policy on investments

Understanding the need to have written investment directions, MISSA has come up with an Investment Policy Statement (IPS) that shall establish clear-cut guidelines on how its investments will be managed.

- The investment specific objective shall be to achieve an *average annual rate of return of the Consumer Price Index plus 5%* for the aggregate investments under this IPS evaluated over a period of at least 5 years.
- MISSA investment shall have a long-term time horizon, extending up to ten years or more.
- In order to raise the likelihood of achieving the targeted returns, reasonable risks may be taken. MISSA may tolerate declines in the value of its portfolio of between 5% and 10% in any given year.
- After reviewing the long-term performance and risk characteristics of various asset classes and balancing the risks and rewards of market behavior, asset allocation shall be 60% in equity and 40% in cash and bonds. Each asset class in which the portfolio invests shall be reviewed on a quarterly basis and rebalanced back to the recommended weighting, as market conditions from time to time, may cause deviations from the established allocation.
- The Board shall periodically provide the Investment Consultant with an estimate of expected net cash flow, to allow sufficient time to build up necessary liquid reserves.

- All funds shall be kept in fully liquid, readily marketable assets at all times. No unlisted securities, limited partnerships, restricted issues, or certificate of deposits with extended maturities shall be held.
- Investment of the funds shall be limited to no-load mutual funds, unit investment trusts, real estate investment trusts, Exchange Trade Funds, close-end mutual funds and other diversified marketable securities. In addition, investments in limited partnerships and other vehicles that do not have readily available objective valuations shall not be permitted. At all times, there must be a minimum of five investment categories represented among the plan assets. There shall be no maximum limit to the number of categories.
- All investments shall be accomplished through pooled investment vehicles such as no-load mutual funds, REITS, close end funds, Exchange Trade Funds and unit investment trusts.
- Investor Solutions, Inc. shall act as the investment advisor and shall be mainly responsible for the advice, design and implementation of an appropriate asset allocation, monitoring and periodic review of asset performance, preparing and presenting appropriate reports to the Board at least quarterly.
- The Board shall provide its investment advisor with all relevant information on financial conditions, net worth, and risk tolerances and shall read and understand the information contained in the prospectus of each investment in the Portfolio.
- The IPS was adopted and signed by the Board on October 21, 2002.

MISSA's membership to the Bank of the Marshall Islands' Board

On February 18, 1999, RMI fully repaid a loan and related interest, totaling $1.94 Million, through transferring its ownership of 94,485 shares of the Bank of Marshall Islands (BOMI) stock to MISSA. Later, 30,000 of these shares were sold to a third party that subsequently reduced MISSA's shareholdings with BOMI. At present, MISSA holds a 32% interest in BOMI. This shareholding earned Mr. Grant Labaun, MISSA Board Chairman during that time, and two other Board Members, Saeko Shoniber and Biram Stege, seats to the 10-member BOMI's Board of Directors.

During BOMI's annual stockholders' meeting held on April 29, 2003, John M. Niedental, MISSA's newly appointed Board Chairman, was elected as a Board Member, joining Saeko Shoniber and Biram Stege, who were re-elected for a second term. Likewise, Saane K. Aho, MISSA Administrator since 2000, got the post of Board Secretary.

Transfer of the Health Fund to the Ministry of Health

The Administration realized that MOH would be more effective in managing the Health Fund, as it controls all Healthcare expenditures, while MISSA is limited only to a custodial function. Likewise, certain findings were brought out by MISSA's external auditors attributed to the Health Fund which were beyond the control of MISSA. In this regard, the Administrator recommended to the Board to transfer the Health Fund to MOH. A Board Resolution approving of this transfer was submitted to the Nitijela for approval.

The bill allowing for the transfer of the Health Fund from MISSA to MOH was passed on April 2002 by the Nitijela but the transition period took several months. Formal transfer was only finalized on December 1, 2003. In effect, the Deputy Administrator for Health Fund, one Accounting staff and the entire Medical Referral personnel based in Honolulu, were absorbed by MOH. For accounting purposes, as of January 1, 2003, the collections related to Health Fund and Supplemental Health Plan are not recorded in MISSA's books.

At present, MISSA is still responsible for the collection of Health Fund contributions which are then remitted to MOH, while the Supplemental Health Plan contributions are the responsibility of MOH.

Renovation of Majuro and Ebeye offices

In the early part of 2003, major repairs were completed on both Majuro and Ebeye Offices of MISSA, at a cost of $45,000 and $36,000, respectively. The final layout of both projects was designed by the Ministry of Public Works, who also oversaw the renovation until its completion. The MISSA offices in Majuro and Ebeye are now comfortable, clean and esthetic.

Development of policies, procedures and regulations

On October 11, 2001, the Board of Directors adopted and approved the "*Employee Policy Handbook*" which encompasses official guidelines about working conditions, employee benefits, acceptable conduct in the workplace and how the Administration relates to the employee. By providing MISSA employees with such directions, it has not only allowed for an environment conducive to both personal and professional development, but has encouraged the efficient operation of the Administration.

Recognizing the need to continuously search for innovation, growth and improvement, the Administration has produced another manual that has effectively set forth detailed operational standards and norms of employee conduct and helped management in measuring and rewarding excellence in performance and guiding non-performers to the right direction. The first part of this manual was approved by the Board on September 19, 2002 and covers systems, policies and procedures on human resource management, internal administration and general operations. Part Two of this manual will soon be presented to the Board for approval. This will cover accounting and control, tax compliance guidelines and information technology.

A Retirement Fund manual is also in development that will identify clear-cut guidelines and regulations on retirement benefits and operations.

Ebeye operations

Since 1987, MISSA operates a branch in Ebeye which has successfully collected an average of about $3.5 Million annually from 2000 to 2003. This represents about 20% of MISSA's total annual collections. The majority of Ebeye contributions came from Raytheon, the main contractor of the United States Army in Kwajelein Atoll (USAKA), until 2002. In early 2003, Raytheon was replaced by a new contractor, Kwajelein Range System (KRS) but the change did not bring any adverse effect to MISSA collections.

Development and upgrade of computer system

On May 28, 2003, the Technical Assistance Division Office of Insular Affairs, U.S. Department of Interior has provided a $215,000 grant that will jointly finance the design, development, upgrade and modernization of the Social Security Programs currently operational in RMI, FSM and Palau. Requests for Proposals (RFPs) were circulated and subsequently, White Coconut Computer Services, a long-time I.T. consultant of MISSA, won the bid. Currently, the project is already in full swing and is expected to be fully operational by early 2005.

The new system shall replace the current MISSA software that was designed and placed into operation over 12 years ago, a program whose system architecture is already outdated and may encounter difficulty operating on the next generation of computers. The main feature of the new program is the integration of the three systems, Cash Receipts Entry and Reporting, Delinquent Employer Tracking and Reporting, and Social Security Maintenance. Currently, the three systems are separate programs that share files. Likewise, a possible integration of the new system with the MIP-NPC Accounting software is being considered. This interface shall ultimately link all financial transactions of MISSA to the General Ledger.

Interaction with SS counterparts in the Pacific

To keep abreast with the current Social Security trends and practices, MISSA management maintains close ties and is in constant dialogue with its counterparts in the Pacific, more particularly FSM and Palau. On July 30, 2003, MISSA hosted a two-day meeting (inter-sharing of practices, problems, programs, etc.) with delegates from Palau and FSM. This is just one of numerous regular meetings that the three Pacific partners held for the past several years.

Future outlook on sustainability

Fiscal year 2003 ended with high optimism of improved voluntary tax compliance in the coming years, as more employers came forward willingly to pay their contributions. Delinquencies were reduced as enforcement actions by MISSA became known. An increase in tax collection is expected, particularly in 2004, as Tax Auditors are sent out in the field to examine prior years' payroll records and past quarterly returns filed.

MISSA investments have begun to recover from the period of recession. Hopefully, this trend will continue, thereby increasing MISSA's total assets and decreasing the unfunded Actuarial Accrued Liabilities (AAL). The effect of the newly extended Compact of Free Association, and its related funding and grants, on local businesses is uncertain, but looks promising.

These factors, directly or in some ways, should help MISSA reach its targeted revenues and sustain its retirement benefit programs and the healthcare services of the Ministry of Health in 2004 and for some years to follow.