

**Annual Report
2004 and 2005
Trust Fund for the People of the Federated States of Micronesia**

The Compact of Free Association between the Government of the United States of America and the Government of the Federated States of Micronesia (FSM) provides for the establishment of a trust fund. After fiscal year 2023, the proceeds of the trust fund will provide an ongoing source of revenue for assistance in the sectors receiving annual grant assistance through fiscal year 2023.

Pursuant to the provisions of the Compact of Free Association and its subsidiary *Agreement Between the Government of the United States of America and the Government of the Federated States of Micronesia Implementing Section 215 and Section 216 of the Compact, as Amended, regarding a Trust Fund* (Trust Fund Agreement), the *Trust Fund for the People of the Federated States of Micronesia* (Fund) was incorporated in Washington, D.C. on August 17, 2004.

Because the initial start-up activities of the Fund straddled fiscal years, this initial Annual Report will briefly describe all such activities to date. Future Annual Reports, starting with the Annual Report for fiscal year 2006, will have a more limited focus on activity during the particular fiscal year.

Organization

The Fund's governing board, the Trust Fund Committee (TFC), is composed of three members from the United States and two members from the FSM. As agreed by the two countries, the chairperson of the Fund is selected from among the United States members of the Committee. Mr. David B. Cohen was selected as chairperson of the Trust Fund Committee.

At its first meeting, the TFC selected Wachovia Bank to hold its assets during the process for selecting and concluding contractual agreements with an Investment Adviser and Trustee, because it paid the highest rate of return with the most liquidity of the banks that responded to the request for information issued on behalf of the Fund. The United States Department of the Interior provided \$40,000 in technical assistance funding to the FSM Government to aid the Fund in its search for an Investment Adviser and Trustee.

The process of incorporating the Fund and then putting proper and transparent procedures in place is long and arduous. Before incorporation, the United States Department of the Interior issued requests for information from potential Investment Advisers and Trustees, which requests also sought interest rate information for the initial investment of Fund assets. Once incorporated, the TFC unanimously decided that a full, fair and transparent selection process was in order for the positions of Investment Adviser and Trustee. These lengthy processes included selecting a law firm to prepare a comprehensive request for proposals (RFPs), issuing the RFPs, reviewing the numerous and voluminous responses that were submitted, selecting the top candidates for interviews, conducting the interviews, obtaining additional responses to important follow-up questions, selecting the

Investment Adviser and Trustee, negotiating and executing contracts to engage the Investment Adviser and Trustee, working with the Investment Adviser to develop an appropriate investment policy and asset allocation strategy, supervising the Investment Adviser as it develops criteria and searches for money managers on behalf of the Fund.

Specifically, with requests for proposals issued on the Fund's behalf by DLA Piper Rudnick Gray Cary US LLP of Washington, D.C. and the responses analyzed by the TFC with expert guidance from Public Resources Advisory Group of New York, the top four candidates for Investment Adviser were interviewed. The firm of Mercer Investment Consulting was selected as the Fund's Investment Adviser. JPMorgan Chase Bank, N.A. was selected as the Fund's Trustee.

Contributions and Earnings

The following contributions have been made to the Fund's A Account:

Date	Amount	Contributor
October 1, 2004	\$30,258,383	FSM
October 5, 2004	16,000 000	United States
October 5, 2004	16,188,000	United States
October 6, 2005	16,441,694	United States

Since October 1, 2004 through March 17, 2006, the Fund has received \$78,888,077 in contributions and \$3,210,385.19 in earnings for a principal balance of \$82,098,462.19.

Developments – October 2005 through March 2006

During the accrual period through fiscal year 2023, the Fund will grow through contributions and returns on investments. The Investment Adviser presented the TFC with alternative strategies for the Fund's investment policy and asset allocation. The TFC adopted an aggressive strategy for the early years of this accrual period. As the Fund approaches fiscal year 2024, the date when income begins to be paid out to the Government of the FSM for the people of the FSM, it is anticipated that the Fund will shift to an increasingly conservative investment strategy.

The Investment Policy adopted by the TFC is attached. Also attached is the Asset Allocation Analysis prepared for the TFC by the Investment Adviser, which includes, on page 15, the Asset Allocation Strategy adopted by the TFC.

Attachments