

**Trust Fund for the People
of the Republic of the
Marshall Islands**

Financial Statements

September 30, 2016 and 2015



Candor. Insight. Results.

Trust Fund for the People of the Republic of the Marshall Islands

Table of Contents

September 30, 2016 and 2015

	<u>Page</u>
Management's Discussion and Analysis	1
Independent Auditors' Report	8
Financial Statements	
Statement of Fiduciary Net Position	10
Statement of Changes in Fiduciary Net Position	11
Notes to Financial Statements	12
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	34

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

The following represents the Trust Fund Committee's management discussion and analysis of the Trust Fund for the People of the Republic of the Marshall Islands' ("Trust Fund") financial performance for the years ended September 30, 2016 and 2015. Please read it in conjunction with the Trust Fund's financial statements, which follow this section.

Summary of Fiscal Year 2016 Financial Highlights

- The Trust Fund's fiduciary net position value increased 19.2% to \$294.5 million for fiscal year 2016 from \$247.1 million for fiscal year 2015. The increase was due to net investment income of \$27.6 million and contributions from the United States (\$15.3 million), Taiwan (\$2.4 million), and the Republic of the Marshall Islands (\$2.2 million).
- The Trust Fund had a weighted annual rate of return of 10.4%, following a loss for fiscal year 2016 (4.1%) and gains in the three previous fiscal years: 8.0% for 2014, 13.9% for 2013 and 18.5% for 2012. On a performance basis, net of fees, the Trust Fund gained 10.4% compared to a benchmark of 11.7%.¹
- A transfer was made to the C account for fiscal year 2016 in the amount \$11.6 million given that annual income was earned over the 6% threshold.² The C account amounts to \$59.8 million as of the end of fiscal year 2016.
- Investment expenses, including money manager fees, increased to \$1.9 million for fiscal year 2016 from \$1.7 million for fiscal year 2015. As a percent of restricted fiduciary net position, investment expenses were at 0.64% for fiscal year 2016 compared to 0.68% for fiscal year 2015, in line with the agreed fee schedule.
- Administrative expenses decreased to \$166,168 for fiscal year 2016 from \$193,644 for fiscal year 2015. As a percent of restricted fiduciary net position, administrative expenses decreased to 0.06% for fiscal year 2016 compared to 0.08% for fiscal year 2015. The main reason for the decrease was the contracting for the one-time independent and objective external evaluation in fiscal year 2015.

¹ The Total Trust Benchmark is comprised of 25% Russell 3000, 30% MCSI ACWI ex USA, 20% Fixed Income Benchmark, 5% Dow Jones US Select REIT, 15% T-Bills+3% and 5% S&P 500+3%.

² The C account contains annual income on the Fund over 6%. The C account shall contain no more than three times the estimated equivalent of the fiscal year 2023 annual grant assistance, including the estimated inflation adjustment provided in the amended Compact of Free Association (Section 218). After fiscal year 2023 the C account may be drawn on, to the extent it has sufficient funds, to address any shortfall in the B account, if income from the A Account year falls below the previous year's distribution (not including any amount distributed that year for Special Needs), adjusted for inflation, to the Government of the RMI, and for Special Needs agreed to by the Committee. Income was provided to the C account in fiscal years 2006, 2007, 2010, 2013, 2014, and 2016, the years with over 6% annual income. The A and C accounts are managed collectively and are only separated for accounting purposes.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

The Trust Fund for the People of the Republic of the Marshall Islands Fiduciary Net Position Summary

	September 30,	
	2016	2015
Assets		
Cash and investments	\$ 294,654,837	\$ 247,244,991
Total assets	294,654,837	247,244,991
Liabilities		
Accrued expenses	109,304	102,933
Total liabilities	109,304	102,933
Restricted fiduciary net position	\$ 294,545,533	\$ 247,142,058

Financial Highlights - Fiduciary Net Position at September 30, 2016

The fair value of the Trust Fund's fiduciary net position was \$294.5 million as of September 30, 2016, compared to \$247.1 million as of September 30, 2015. The 19.2% increase in fiduciary net position of \$47.4 million is attributable to contributions from member governments that totaled \$19.9 million and net investment income of \$27.6 million. The investment gain is an improvement of the loss in fiscal year 2015 (\$10.4) million, but is back on track with the streak of significant investment gains during the fiscal year 2012-2014 period. The total weighted annual rate of return on investment was 10.4%. Given the positive performance for the year, a transfer of \$11.6 million was made to the Trust Fund's C account for fiscal year 2016.

At September 30, 2016, the Trust Fund's assets consisted of commingled funds invested in U.S. domestic public equities (28.7% of the portfolio as of September 30, 2016), international equities (27.4%), fixed income (18.9%), real estate (5.4%), a hedge fund (12.7%) and private equity funds (7.0%). The asset category percentages are within the ranges established by the Trust Fund's Investment Policy Statement.

Accrued expenses represent amounts payable for accounting, investment advisor, and custodian services incurred during the fiscal year.

Financial Highlights - Fiduciary Net Position at September 30, 2015

The fair value of the Trust Fund's fiduciary net position was \$247.1 million as of September 30, 2015, compared to \$240.1 million as of September 30, 2014. The 2.9% increase in fiduciary net position of \$7.0 million is attributable to contributions from member governments that totaled \$17.6 million and an investment loss of \$10.4 million attributable to negative public equity and capital market performance periodically throughout the year. The investment loss breaks the streak of significant investment gains during the fiscal year 2012-2014 period. The total weighted annual rate of return on investment was (4.1%). Given the negative performance for the year, no transfer was made to the Trust Fund's C account for fiscal year 2015.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

At September 30, 2015, the Trust Fund's assets consisted of commingled funds invested in U.S. domestic public equities (29.5% of the portfolio as of September 30, 2015), international equities (27.4%), fixed income (18.0%), real estate (5.5%), a hedge fund (15.0%) and a private equity fund (4.6%). The asset category percentages are within the ranges established by the Trust Fund's Investment Policy Statement.

Accrued expenses represent amounts payable for accounting, investment advisor, and custodian services incurred during the fiscal year.

The Trust Fund for the People of the Republic of the Marshall Islands Changes in Fiduciary Net Position Summary

	Year Ended September 30,	
	2016	2015
Contributions	\$ 19,923,100	\$ 17,584,573
Net investment income (loss)	27,646,543	(10,370,058)
Total additions	47,569,643	7,214,515
Administrative expenses	166,168	193,644
Change in fiduciary net position	47,403,475	7,020,871
Restricted fiduciary net position, beginning	247,142,058	240,121,187
Restricted fiduciary net position, ending	<u>\$ 294,545,533</u>	<u>\$ 247,142,058</u>

Financial Highlights - Changes in Fiduciary Net Position for Fiscal Year Ended September 30, 2016

The following contributions were received: scheduled annual contribution of \$15.3 million inclusive of a base amount of \$12.5 million, a \$0.5 million increment plus a cumulative partial inflation adjustment from the Government of the United States on October 1, 2015, a scheduled annual contribution of \$2.4 million from the Government of Taiwan on March 24, 2016, and an additional contribution by the Government of the Republic of the Marshall Islands of \$2.2 million made between February 12-22, 2016.

The net investment income of \$27.6 million was due to an unrealized gain of \$24.4 million, interest and dividends of \$4.4 million and a realized loss of \$0.7 million, net of investment expenses of \$0.4 million during the fiscal year ended September 30, 2016.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

Investment expenses increased by 6.4% compared to fiscal year 2015 to \$424,798 from \$399,083. For fiscal year 2016, the Trust Fund incurred investment advisory fees of \$359,132 and custodian fees of \$65,666. In addition, as similar to fiscal year 2015, as the portfolio was invested in actively managed funds, part or all of money manager fees, totaling \$1,459,410, were deducted from the asset values and not included in the investment advisor's fee and the investment expense category. All investment expenses, inclusive of custodial, investment advisory and all money manager fees, amounted to \$1,884,208 for fiscal year 2016 compared to \$1,688,430 for fiscal year 2015. The increase was due to the increased value of the Trust Fund on which the fees are based, driven by additional contributions and market appreciation during the year. The overall investment expense amounted to 0.64% of restricted net position for fiscal year 2016, down from 0.68% for fiscal year 2015.

Administrative expenses amounted to \$166,168, a decrease of 14.2% over the fiscal year 2015 amount of \$193,644. The change is mainly due to a one time service charge for the conduct of the independent and objective external evaluation of the Trust Fund performed in fiscal year 2015, which was somewhat offset by the services for a web site and file access system design and implementation in fiscal year 2016. The percentage of administrative expenses of restricted net position decreased to 0.06% for fiscal year 2016 compared to 0.08% for fiscal year 2015.

The U.S. Departments of the Interior, State and Education contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2016. No amounts for these contributions were recorded in the accompanying financial statements.

Financial Highlights - Changes in Fiduciary Net Position for Fiscal Year Ended September 30, 2015

The following contributions were received: scheduled annual contribution of \$14.5 million inclusive of a base amount of \$12.0 million, a \$0.5 million increment plus a cumulative partial inflation adjustment from the Government of the United States on October 6, 2014, a scheduled annual contribution of \$2.4 million from the Government of Taiwan on April 17, 2015 and an additional contribution by the Government of the Republic of the Marshall Islands of \$0.65 million made in two tranches with \$0.44 million contributed on July 15, 2015 and \$0.21 million contributed on September 11, 2015.

The net investment loss of (\$10.4) million was due to a realized gain of \$0.24 million, interest and dividends of \$11.1 million and an unrealized loss of (\$21.3) million, net of investment expenses of \$0.4 million during the fiscal year ended September 30, 2015.

Investment expenses increased by 3.7% compared to fiscal year 2014 to \$399,083 from \$384,949. For fiscal year 2015, the Trust Fund incurred investment advisory fees of \$338,400 and custodian fees of \$60,683. In addition, as similar to fiscal year 2014, as the portfolio was invested in actively managed funds, part or all of money manager fees, totaling \$1,289,346, were deducted from the asset values and not included in the investment advisor's fee and the investment expense category. All investment expenses, inclusive of custodial, investment advisory and all money manager fees, amounted to \$1,688,430 for fiscal year 2015 compared to \$1,510,998 for fiscal year 2014. The increase was due to the increased value of the Trust Fund on which the fees are based, driven by additional contributions and market appreciation during points of the year, as well as full asset strategy implementation for the entire fiscal year based on a fee adjustment made during fiscal year 2014. The overall investment expense amounted to 0.68% of restricted net position for fiscal year 2015, up from 0.63% for fiscal year 2014.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

Administrative expenses amounted to \$193,644, an increase of 42.6% over the fiscal year 2014 amount of \$135,751. The increase was mainly due to a one time service charge for the conduct of the independent and objective external evaluation of the Trust Fund approved by the Trust Fund Committee per Resolutions 2015-1 *Independent and Objective Trust Fund Evaluation Search and Approval* and Resolution 2015-2 *Independent and Objective Trust Fund Evaluation Firm Selection*. The percentage of administrative expenses of restricted net position increased to 0.08% for fiscal year 2015 compared to 0.06% for fiscal year 2014. Minus the additional cost of the independent and objective external evaluation, administration expenses would have remained at 0.06% of fiscal year 2015 restricted net position.

The U.S. Departments of the Interior, State and Education contributed staff time, equipment usage and incidental expenses during the fiscal year ended September 30, 2015. No amounts for these contributions were recorded in the accompanying financial statements.

Future Prospects Beyond September 30, 2016

As stated in Article 3 of the Trust Fund Agreement: "The purpose of the Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Republic of the Marshall Islands ("RMI") by providing an annual source of revenue, after fiscal year 2023, for assistance in education, health care, the environment, public sector capacity building, private sector development, and public infrastructure described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the Original Parties, with priorities in education and health care."³

The investment objective as set forth in the Investment Policy Statement of September 2010, and amended in March 2014 with an effective date of January 2014, states:

"The broad investment objective will be to maximize investment returns, subject to constraints aimed at containing fluctuations in returns over shorter periods within acceptable limits. Over shorter periods, outperformance will be sought relative to the notional return on a benchmark portfolio designed to reflect the risk profile according to which the assets are invested at the time."

The Trust Fund's weighted annual rate of return on investment, after discounting for contributions, fees and expenses, was 10.4% for the fiscal year compared to a rate of (4.1%) for fiscal year 2015, 8.0% for fiscal year 2014, and 13.9% for fiscal year 2013. In terms of performance measurement, net of fees, the Trust Fund was up 10.4%, underperforming its benchmark of 11.7%.

³ Original Parties is defined as, collectively, the Government of United States and the Government of the Republic of the Marshall Islands.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

Each asset class, net of fees, was above, near or below its benchmark. U.S. domestic equities posted a 14.9% gain (benchmark gain 15.0%), international equities 9.6% (benchmark 9.3%), fixed income 11.0% (benchmark 13.9%), real estate 18.0% (benchmark 17.7%), and the hedge fund 0.1% (benchmark 3.2%). The private equity fund strategy grew as a component of the Fund to approximately 7.0% of total fund assets from 4.5% for fiscal year 2015 and provided an estimated return of 12.0% compared to the S&P 500 +3% aspirational benchmark return of 18.9% and the Burgiss Global Private Equity Index benchmark return of 7.4%. Given the nature of private equity funds, the private equity strategy will continue to call capital over the next several years as the underlying money managers invest in private equity deals that may or may not come to fruition for several years.

The positive fiscal year 2016 performance resulted in a contribution to the C account for fiscal year 2016 of \$11.6 million. The C account now totals \$59.8 million. The current amount in the C account is 2.32 times the amount of estimated annual Amended Compact of Free Association Section 211(a) sector grant assistance for fiscal year 2023.

Since inception, the Trust Fund's average annual net rate of return on investment is 6.7%, net of fees, an increase from the 4.9% rate at the end of fiscal year 2015. The growth rate is above the Total Trust Benchmark of 6.4%.

An analysis by the investment advisor estimates that if the Trust Fund averages a 5% return annually from fiscal year 2017 to fiscal year 2023, and assuming a 6% payout from the Trust Fund, the distribution from the estimated assets for fiscal year 2024 would probably provide revenue equivalent to about 137.3% of the Amended Compact's Section 211(a) estimated fiscal year 2023 Annual Grant Assistance, with the partial inflation adjustment for fiscal year 2023 but will not provide any inflation adjustment for fiscal years beyond 2023.⁴ There would also be a build-up of the C account possibly to the maximum level permitted under the terms of the Trust Fund Agreement.⁵ As previously mentioned, the average annual net rate of return on investment is 6.7%, net of fees.

If the Trust Fund were to achieve an average 8% return annually, the Trust Fund would probably provide fiscal year 2024 revenue equivalent to about 163.3% of the partially inflation adjusted fiscal year 2023 Annual Grant Assistance and possibly allow for 2% annual inflation adjustments for each fiscal year beyond fiscal year 2023. There would also be a build-up of the C account to the maximum level permitted under the terms of the Trust Fund Agreement. The Trust Fund has achieved 8% or more return in 6 of its 13 fiscal years of existence - for fiscal years 2006, 2007, 2010, 2012, 2013, and 2016.

⁴ The Amended Compact's Section 211(a) estimated FY23 sector grant level includes those funds provided by Section 211(a) plus the associated Amended Compact's partial inflation adjustment, previously described. The amount does not include grant funding provided by the Amended Compact's Section 211(b) that consists of Ebeye Special Needs, Kwajalein Impact and Kwajalein Environmental Impact Assessment as these grants will continue per the Agreement between the U.S. and RMI governments Regarding Military Use and Operating Rights so long as that agreement is in force. The 6% payout estimate is based on an estimated average annual rate of return over the medium term and is used here for calculation purposes.

⁵ Consistent with the Trust Fund Agreement's Articles 16.7 and 16.8, for FY24 only the amount equal to the FY23 sector grant assistance plus a full inflation adjustment may be disbursed to the RMI government. Any remaining funds shall be allocated to the C account if not at its maximum level and, if so, any remaining funds will be returned to the A account. For FY25 and thereafter, the maximum to be disbursed will be the FY23 sector grant assistance amount plus the cumulative full inflation adjustment thereon, plus any additional amount for special needs approved by the Committee. Any remaining funds shall be allocated to the C account if not at its maximum level and, if so, any remaining funds will be returned to the A account.

Trust Fund for the People of the Republic of the Marshall Islands

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2016 and 2015

If the Trust Fund were to achieve an average 10% return annually, the Trust Fund would probably provide fiscal year 2024 revenue equivalent to about 183.0% of fiscal year 2023 Annual Grant Assistance with the partial inflation adjustment, allow for 2% annual inflation adjustment for each fiscal year beyond fiscal year 2023 and fund the C account fully. However, there is a low probability to achieve such growth annually.

Any growth projections are estimates, subject to fluctuation based on actual market performance. Cautionary advice also extends to future fiscal planning. As intended in the Amended Compact, Trust Fund payments will be a post-2023 "source of revenue" to supplement other financial resources of the RMI government.

Independent Auditors' Report

Joint Trust Fund Committee
Trust Fund for the People of the Republic of the Marshall Islands

Report on the Financial Statements

We have audited the accompanying financial statements of the Trust Fund for the People of the Republic of the Marshall Islands (a District of Columbia not for profit corporation), which comprise the statement of fiduciary net position as of September 30, 2016 and 2015, and the related statement of changes in fiduciary net position for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Trust Fund for the People of the Republic of the Marshall Islands as of September 30, 2016 and 2015, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2017, on our consideration of Trust Fund for the People of the Republic of the Marshall Islands' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Trust Fund for the People of the Republic of the Marshall Islands' internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Philadelphia, Pennsylvania
March 27, 2017

Trust Fund for the People of the Republic of the Marshall Islands

Statement of Fiduciary Net Position

September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Assets		
Cash equivalents	\$ 10,076	\$ 4,892
Investments, at fair value	<u>294,644,761</u>	<u>247,240,099</u>
Total assets	<u>\$ 294,654,837</u>	<u>\$ 247,244,991</u>
Liabilities and Restricted Fiduciary Net Position		
Liabilities		
Accrued expenses	<u>\$ 109,304</u>	<u>\$ 102,933</u>
Total liabilities	<u>109,304</u>	<u>102,933</u>
Restricted Fiduciary Net Position	<u>294,545,533</u>	<u>247,142,058</u>
Total liabilities and restricted fiduciary net position	<u>\$ 294,654,837</u>	<u>\$ 247,244,991</u>

See notes to financial statements

Trust Fund for the People of the Republic of the Marshall Islands

Statement of Changes in Fiduciary Net Position

Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Additions		
Contributions:		
Government of the United States of America	\$ 15,323,100	\$ 14,534,573
Government of Taiwan	2,400,000	2,400,000
Government of the Republic of the Marshall Islands	<u>2,200,000</u>	<u>650,000</u>
Total contributions	<u>19,923,100</u>	<u>17,584,573</u>
Investment income:		
Interest and dividends	4,371,539	11,102,119
Net increase (decrease) in the fair value of investments	<u>23,699,802</u>	<u>(21,073,094)</u>
Gross investment income (loss)	28,071,341	(9,970,975)
Less: investment expenses	<u>424,798</u>	<u>399,083</u>
Net investment income (loss)	<u>27,646,543</u>	<u>(10,370,058)</u>
Total additions	47,569,643	7,214,515
Deduction		
Administrative expenses	<u>166,168</u>	<u>193,644</u>
Change in fiduciary net position	47,403,475	7,020,871
Restricted Fiduciary Net Position, Beginning	<u>247,142,058</u>	<u>240,121,187</u>
Restricted Fiduciary Net Position, Ending	<u><u>\$ 294,545,533</u></u>	<u><u>\$ 247,142,058</u></u>

See notes to financial statements

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

1. Summary of Significant Accounting Policies

Overview of the Trust Fund

Compact

The Compact of Free Association between the Governments of the United States of America (“United States”) and the Federated States of Micronesia and the Republic of the Marshall Islands (“RMI”) was approved by the United States Congress in Section 201 of Public Law 99-239 (January 14, 1986) and went into effect with respect to the RMI on October 21, 1986 as amended by Public Law 108-188 approved December 17, 2003 (“Compact”) and provided legislation to establish The Trust Fund for the People of the Republic of the Marshall Islands (“Trust Fund”).

Trust Fund

Pursuant to the provisions of the Compact and its subsidiary *Agreement Between the Government of the United States of America and the Government of the Republic of the Marshall Islands* (“Original Parties”) *Implementing Section 216 and Section 217 of the Compact, as Amended, regarding a Trust Fund* (“Trust Fund Agreement”), the Trust Fund for the People of the RMI was incorporated in Washington, D.C. on April 28, 2004, as a nonprofit corporation. The purpose of the Trust Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the RMI by providing an annual source of revenue, after fiscal year 2023, for assistance in education, health care, the environment, public sector capacity building, private sector development, and public infrastructure described in Section 211 of the Compact, as amended, or other sectors as mutually agreed by the RMI and United States Governments, with priorities in education and health care. In accordance with the agreement, the situs of the Trust Fund was established within the United States. The Original Parties are committed to contribute to the Trust Fund amounts described in the Compact, as amended. “Subsequent Contributors” are any government, international organization, financial institution, or other entity or person who grants, not lends, funds into the Trust Fund, not including the Original Parties. Subsequent Contributors may contribute to the Trust Fund if first approved by all Joint Trust Fund Committee (“Committee”) voting members. The Government of Taiwan is currently a Subsequent Contributor. The composition of the Committee consists of four voting members from the United States appointed by the Government of the United States, which include the Chairman of the Joint Trust Fund Committee; two voting members appointed by and for the Government of the RMI; and one voting member appointed by and for the Government of Taiwan. The Committee has the authority to make decisions, appoint administrators and managers, and significantly influence operations. It also has primary accountability for fiscal matters. By a majority vote of the Committee, other voting or non-voting members may be appointed from Subsequent Contributors that contribute to the Trust Fund from time to time, provided that the United States maintains the majority vote in the Committee.

After the initial twenty (20) years, beginning October 1, 2023, the Original Parties will consult regarding the future composition of the Committee. The Committee shall remain the same, unless otherwise agreed by the Original Parties.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

The Government of the United States may unilaterally withdraw the accumulated market value of its contributions from the Trust Fund, plus any undistributed income under certain circumstances which include the Government of the RMI's gross misuse of the Trust Fund's financial resources. The Trust Fund's operations may be terminated by written agreement of the Original Parties.

On May 2, 2005 the Trust Fund entered into a Subsequent Contributor Accession Agreement ("Accession Agreement") between the Government of the United States and the Government of the RMI in accordance with Section 216 and Section 217 of the Compact of Free Association Act of 2003, as amended, and the Government of Taiwan. The Government of Taiwan has agreed to contribute to the Trust Fund during the Trust Fund period as described in more detail in Note 2.

Tax Exempt Status

As provided by the terms of the Compact, the Trust Fund is exempt from income tax.

Trust Fund Financial Statements

The statement of fiduciary net position and the statement of changes in fiduciary net position are private purpose trust fund financial statements. They report information on all of the Trust Fund's assets, liabilities, fiduciary net position, and activities. The Trust Fund's activities are supported primarily by contributions by the Original Parties and Taiwan, and investment income. The Trust Fund has no business or proprietary type activities that rely on fees or charges for support.

Contributions represent amounts paid by the Original Parties and Taiwan to help meet the operational requirements of the Trust Fund; such contributions represent principal.

The Trust Fund consists of three accounts: the "A" Account, the "B" Account, and the "C" Account, respectively (collectively, the "Accounts"). Each account has a specific purpose with respect to the use of contributions and income derived from investments as specified by the Trust Fund Agreement in accordance with the special purpose of the Trust Fund.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The Trust Fund's financial statements use the economic resources measurement focus and are prepared using the accrual basis of accounting. Contributions are recorded when due and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Additional contributions are recognized as revenue as soon as all eligibility requirements imposed by the Compact have been met. Investment earnings are recorded as earned, since they are both measurable and available.

The Trust Fund has adopted applicable Government Accounting Standards Board ("GASB") pronouncements. With this measurement focus, all assets and all liabilities associated with the operation of the Trust Fund are included in the accompanying statement of fiduciary net position. The Trust Fund's fiduciary net position is restricted for future use after fiscal year 2023.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Credit Risk, Custodial Credit Risk, Concentration of Credit Risk and Interest Rate Risk

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, the Trust Fund has assessed the credit risk, concentration of credit risk, and the interest rate risk applicable to its cash and cash equivalents, and investments. The Trust Fund's policy is to report cash equivalents at cost which approximates fair value. Cash equivalents consist of money market investments in the custodian State Street Bank and Trust Company's SSgA Money Market Fund. This portfolio invests in short term, highly liquid certificates of deposit and notes issued by international banks and finance companies, and repurchase agreements with domestic banks collateralized by debt securities issued or guaranteed by the U.S. government or its agencies. Investments in money market funds are not issued or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the funds seek to preserve the value of the investment at \$1.00 per share, it is possible to lose money investing in this type of fund. Custodial credit risk for cash and cash equivalents is the risk that in the event of a bank failure, the Trust Fund's deposits may not be returned to it. The Trust Fund does not have a deposit policy for custodial credit risk.

The Trust Fund does not have any concentrations of credit risk. See Note 3 for a discussion of credit risk and interest rate risk.

Investments

Investments are reported at fair value unless a legal contract exists which guarantees a higher value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of private equities and investments in hedge funds are based on management's valuation of estimates and assumptions from information and representations provided by the respective general partners, in the absence of readily ascertainable market values. The fair value of real estate assets within REITs are based on estimates and assumptions from information and representations provided by the respective general partners, in the absence of readily ascertainable market values and may be reported at fair value utilizing an income approach to valuation. Investment income consists of interest, dividends and net investment gains or losses resulting from changes in the fair value of investments. Accrued expenses may include amounts due to brokers for purchases of securities as of the fiscal year end which have not settled and for which payment has not yet been transferred to the broker.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

The investment policy adopted by the Trust Fund Committee on September 15, 2010 and amended through March 11, 2014 requires the Trust Fund to allocate its managed investment portfolios among domestic and foreign equity and fixed income securities. All or a portion of the Trust Fund may be invested in exchange traded funds ("ETFs"), mutual funds, real estate investment trusts ("REITs"), common trust funds ("commingled vehicles"), hedge funds, private equity funds, and other pooled investment vehicles ("pooled vehicles"). Equity securities issued by ETFs, mutual funds, REITs, commingled and pooled vehicles which invest exclusively in fixed income securities are considered to be fixed income securities for the purpose of compliance with the Trust Fund's investment policy. The fair values of ETFs, mutual funds, commingled and pooled vehicles are generally determined by the fair value of the underlying marketable equity and debt securities owned, which are principally common stocks and bonds, respectively. The fair value of REITs is generally based upon the quoted market value of underlying REIT units owned. Publicly traded ETFs, mutual funds, REITs, and similar vehicles may trade at prices above or below the fair values of the underlying investments owned; therefore the fair value of such investments may differ from the sum of the fair values of the underlying investments owned.

The Trust Fund's equity investment objective is for its various portfolios to achieve total returns similar to their benchmark equity indices. Benchmark indices include the Russell 2500, the S&P 500 and the MSCI ACWI ex-US Index.

The core fixed income portfolios may be invested in securities issued by the U.S. government and government agencies, foreign governments, domestic and international corporate securities, including asset-backed and mortgage-backed obligations. The fixed income portfolio may invest in high yield securities; however the average quality of the fixed income portfolio must be rated "investment grade" by at least one nationally recognized rating agency at the time of purchase.

Private equity funds are a form of pooled investment vehicle, typically limited partnerships controlled by a private equity firm that acts as general partner. The general partner seeks to obtain specific dollar commitments from qualified institutional and accredited investors to invest capital in the fund as limited partners. The passive limited partners fund pro rata portions of their commitments when the general partner has identified an appropriate opportunity, which may be venture capital in the form of equity securities, convertible debt securities, or real estate for which no active markets exist. Venture capital is often used to finance new products and technologies, expand working capital, make acquisitions, or finance leveraged buyouts. A typical private equity fund could make between 15 and 25 separate investments over a ten-year life, with no single investment exceeding 10% of the total capital commitment. The fair values of the underlying investments held by each private equity fund are generally determined by management of the equity investee or as determined by the general partner or manager of the private equity fund and is based upon the Trust Fund's percentage ownership of the underlying investments. Investments in private equity funds generally tend to be illiquid for significant periods of time.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Hedge funds are a form of pooled investment vehicle, generally a limited partnership or a foreign (off-shore) investment corporation, that seeks to maximize absolute returns whose offering memorandum allows for the fund to take both long and short positions, use leverage and derivatives, and invest in many markets. Hedge funds often take large risks using a broad range of speculative strategies, including investing in unconventional and illiquid investments. The fair value of the Trust Fund's investment in a hedge fund is determined by the hedge fund manager and is based upon the Trust Fund's percentage ownership of the underlying investments.

Derivatives, options and futures are permitted investments for the purpose of reducing risk and efficient portfolio management. Derivatives, options and futures may not be used for speculative purposes.

Restricted Fiduciary Net Position

Fiduciary net position consists of the "A", "B", and "C" Accounts as described below and are subject to legal, regulatory, budgetary, or other restrictions in accordance with the Compact.

1. The "A" Account:

- a. The "A" Account, which was established upon the effective date of the Compact, as amended, shall form the corpus and consist of contributions from the Original Parties and Subsequent Contributors. Except as otherwise provided in the Trust Fund Agreement, it also consists of the income from the investments made from contributions (principal), and transfers from the "B" Account and "C" Account in accordance with the Trust Fund Agreement.
- b. Through September 30, 2022, payment of allowable expenses of the Trust Fund shall be made from the "A" Account. During this period, the amount, if any, of income in each fiscal year which remains after such payment of expenses shall be reinvested into the "A" Account. Except as provided in the Trust Fund Agreement, or upon termination of the Trust Fund, no funds may be removed from the "A" Account.

Total amounts included in the "A" Account as of September 30, 2016 and 2015, were \$234,764,707 and \$198,936,545, respectively.

2. The "B" Account:

- a. On October 1, 2022, the "B" Account shall be created.
- b. During fiscal year 2023, all income earned in fiscal year 2023 shall be deposited into the "B" Account for disbursement in fiscal year 2024.
- c. For fiscal year 2024 and thereafter, the "B" Account shall consist of the prior year's income from investment of funds in the "A" Account.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

3. The "C" Account:
 - a. Shall be created at the same time as the "A" Account, and beginning in fiscal year 2004 through fiscal year 2022, any annual income on the Trust Fund over six percent (6%) shall be deposited in the "C" Account, up to the limit specified in (b) below. Beginning in fiscal year 2023, the "C" Account shall be replenished from the "B" Account in accordance with paragraph 6 below;
 - b. Shall contain no more than three times the estimated equivalent of the fiscal year 2023 annual grant assistance, including estimated inflation calculated in accordance with Section 218 of the Compact. Any excess above the estimated amount shall return to the "A" Account; and
 - c. May be drawn on, to the extent it contains sufficient funds, to address any shortfall in the "B" Account after fiscal year 2023, if income on the "A" Account falls below the previous year's distribution (not including any amount distributed that year for special needs) adjusted for inflation to the Government of the RMI and for special needs agreed to by the Committee.

The "C" Account is maintained as a memorandum account within the Trust Fund, and is not separately invested.

Additions to the "C" Account during the years ended September 30, 2016 and 2015 were \$11,575,313 and \$0, respectively. The amount that is ultimately transferred to the "C" Account will be determined based on actual cumulative investment performance through the date of the transfer. The balance of the "C" Account as of September 30, 2016 and 2015 was \$59,780,826 and \$48,205,513, respectively.

4. After fiscal year 2023, if the income in the "B" Account is less than the previous year's distribution to the Government of the RMI, and the "C" Account cannot cover the shortfall in the "B" Account, then the principal and reinvested income not available for distribution (corpus) shall not be accessed to compensate for the shortfall.
5. The Committee may disburse to the Government of the RMI from the "B" Account (supplemented from the "C" Account if the "B" Account is insufficient):
 - a. In fiscal year 2024, an amount equal to the annual grant assistance provided by the Government of the United States to the Government of the RMI in fiscal year 2023, plus an inflation adjustment; and
 - b. Beginning in fiscal year 2025 and thereafter, an amount of funds no more than the amount equal to the United States annual financial assistance to the RMI in fiscal year 2023 plus a cumulative inflation adjustment thereon, plus any additional amounts for special needs as approved above.
6. Beginning in fiscal year 2023, the Committee shall transfer to the "A" Account any funds in the "B" Account in excess of the amount approved for disbursement in the following fiscal year, in accordance with paragraph 5 above, unless such excess funds are needed to bring the "C" Account to its maximum permitted level.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

7. As provided by the Trust Fund Agreement to the Compact, a special account (the "D" Account Trust") was set up as a separate trust to be funded by contributions of the Government of Taiwan in accordance with the schedule of payments prescribed by the Accession Agreement. Income from the "D" Account Trust may be utilized by the Government of the RMI at any time after the "D" Account Trust has a corpus of \$10,000,000 and proper prior consultation has been made by the Government of the RMI with the Government of Taiwan. The funds held in the "D" Account Trust are not under the control of the Joint Trust Fund Committee, and the corpus of the "D" Account Trust is not a component of the Trust Fund for the People of the Republic of the Marshall Islands. The Government of Taiwan and the Government of the RMI have contributed to the "D" Account Trust.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Recent Accounting Pronouncements

The Trust Fund adopted GASB Statement No. 72, *Fair Value Measurement and Application* during the fiscal year ended September 30, 2016. This Statement addresses accounting and financial reporting issues related to fair value measurements by defining fair value and providing guidance for determining a fair value measurement for financial reporting purposes. Guidance is also provided for applying fair value to certain investments and disclosures related to all fair value measurements.

As a result of adopting the new authoritative guidance, the Trust Fund has included additional disclosures surrounding fair value measurements, investments, and other financial instruments, which may be found in Note 4 to the financial statements.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

2. Contributions

The Government of the United States will contribute to the Trust Fund annually for twenty years from the effective date of the Compact, amounts set forth in Section 216 of the Compact. Upon termination of the annual financial assistance under Section 211 of the Compact, the proceeds of the Trust Fund shall thereafter be used for the purposes described in Section 211 of the Compact or as otherwise mutually agreed by the Original Parties.

The Government of the United States contributions to the Trust Fund were conditioned on the Government of the RMI contributing at least \$25 million to the Trust Fund, prior to October 1, 2003, \$2,500,000 prior to October 1, 2004, and \$2,500,000 prior to October 1, 2005. Any funds received by the RMI under Section 111 (d) of Public Law 99-239 (January 14, 1986), or successor provisions, would be contributed to the Trust Fund as a Government of the RMI contribution.

Section 108 of U.S. Public Law 108-188 allowed the RMI to request compensatory adjustments for the loss of certain tax and trade provisions of the original Compact of Free Association (PL 99-239). Under Section 216(b) of the Compact, as amended, any amount granted by Congress for this purpose must be contributed to the Trust Fund. During 2009, the RMI government submitted a report to Congress claiming compensatory adjustments, and Congress asked for the U.S. government's interagency review of the RMI's submission.

The interagency group concluded that the RMI "reasonably demonstrated net adverse impacts based on the loss of Title II benefits in making their request for \$20 million in further compensation;" and further notes that under Section 216(b) of the Compact, as amended, "any funds received by the RMI under Section of 111(d) of Public Law 99-239 (January 14, 1986), or successor provisions, would be contributed to the Trust Fund as an RMI contribution." As of March 27, 2017, no compensation had been received.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Contributions to the Trust Fund's "A" Account from inception are as follows:

Date	Amount (Millions)	Contributor
June 1, 2004	\$ 25.00	RMI
June 3, 2004	7.00	United States
October 5, 2004	7.59	United States
February 17, 2005	1.50	RMI
May 19, 2005	1.00	RMI
May 19, 2005	1.75	Taiwan
October 6, 2005	2.50	RMI
October 18, 2005	8.22	United States
May 15, 2006	0.75	Taiwan
October 6, 2006	8.95	United States
May 3, 2007	0.75	Taiwan
October 9, 2007	9.71	United States
October 6, 2008	10.78	United States
May 5, 2008	0.75	Taiwan
June 5, 2009	2.40	Taiwan
October 2, 2009	11.13	United States
April 8, 2010	2.40	Taiwan
October 14, 2010	11.80	United States
May 9, 2011	2.40	Taiwan
September 20, 2011	0.12	RMI
October 14, 2011	12.47	United States
May 24, 2012	2.40	Taiwan
October 4, 2012	13.31	United States
July 3, 2013	2.40	Taiwan
October 21, 2013	13.98	United States
June 26, 2014	2.40	Taiwan
October 6, 2014	14.53	United States
April 17, 2015	2.40	Taiwan
July 15, 2015	.44	RMI
September 11, 2015	.21	RMI
October 1, 2015	15.32	United States
February 12, 2016	.40	RMI
February 16, 2016	.40	RMI
February 17, 2016	.40	RMI
February 18, 2016	.40	RMI
February 19, 2016	.40	RMI
February 22, 2016	.20	RMI
March 24, 2016	2.40	Taiwan
Total contributions from inception through September 30, 2016	\$ 200.96	

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Past received and future scheduled contributions to the Trust Fund "A" Account by the Government of the United States during the Trust Fund period are as follows:

<u>Fiscal Year</u>	<u>Contribution (Millions)</u>
2004	\$ 7.00
2005	7.59
2006	8.22
2007	8.95
2008	9.71
2009	10.78
2010	11.13
2011	11.80
2012	12.47
2013	13.31
2014	13.98
2015	14.53
2016	15.32
2017	13.50
2018	14.00
2019	14.50
2020	15.00
2021	15.50
2022	16.00
2023	16.50

The amounts of scheduled contributions as shown above are subject to an inflation adjustment for each United States fiscal year by the percent that equals two-thirds of the percent change in the United States Gross Domestic Product Implicit Price Deflator, or 5 percent, whichever is less in any one year, using the beginning of fiscal period 2004 as a base.

Past received and future scheduled contributions to the Trust Fund "A" Account by the Government of Taiwan during the Trust Fund period are as follows:

<u>Fiscal Year</u>	<u>Contribution (Millions)</u>
2004	\$ 1.00
2005	0.75
2006	0.75
2007	0.75
2008	0.75
2009-2023	2.40

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Contributions to the “D” Account Trust are not reflected in the accompanying financial statements. As described in Note 1, the “D” Account Trust was set up to allow for additional income to the Trust Fund from unanticipated sources. These contributions may not be commingled with assets of the Trust Fund and are required to have a separate account number. The Government of the RMI has access to funds in this account for unanticipated shortfalls or other purposes. Funds in the “D” Account Trust are not part of the corpus of the Trust Fund.

Fair value of invested assets included in the “D” Account Trust as of September 30, 2016 and 2015 were \$13,204,615 and \$11,982,220, respectively.

3. Investments

During the fiscal years ended September 30, 2016 and 2015, the Trust Fund realized net (losses) gains from the sale of investments of (\$703,804) and \$235,747, respectively. The calculation of net realized investment gains and losses is independent of the calculation of the net increase in the fair values of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase (decrease) in the fair value of investments during the fiscal years ended September 30, 2016 and 2015 was \$23,699,802 and \$(21,073,094), respectively. These amounts take into account the changes in fair value of invested assets (including purchases and sales) that occurred during each year. The cumulative net unrealized gain (loss) on investments held at September 30, 2016 and 2015 was \$16,343,522 and \$(8,060,084), respectively.

The cost and fair values of cash equivalents, investments and related activity for the years ended September 30, 2016 and 2015 are as follows:

Investment Security	Fair Value (In Thousands)						Change in Fair Value
	Cost	Beginning Fair Value 10/1/15	Purchases	Sales	Subtotal	Ending Fair Value 9/30/16	
2016							
Cash equivalents	\$ 10	\$ 5	\$ 26,605	\$ 26,600	\$ 10	\$ 10	\$ -
Common trust funds:							
Fixed Income - domestic	61,134	44,543	6,910	605	50,848	55,469	4,621
Equity - domestic	75,965	72,952	16,304	15,273	73,983	84,265	10,282
Equity - international	81,303	67,777	8,832	383	76,226	80,597	4,371
Hedge fund	31,100	36,941	-	-	36,941	37,216	275
Private markets	18,312	11,490	9,390	1,470	19,410	21,118	1,708
Real estate fund	10,487	13,537	-	-	13,537	15,980	2,443
	<u>\$ 278,311</u>	<u>\$ 247,245</u>	<u>\$ 68,041</u>	<u>\$ 44,331</u>	<u>\$ 270,955</u>	<u>\$ 294,655</u>	<u>\$ 23,700</u>

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Investment Security	Fair Value (In Thousands)						Change in Fair Value
	Cost	Beginning Fair Value 10/1/14	Purchases	Sales	Subtotal	Ending Fair Value 9/30/15	
2015							
Cash equivalents	\$ 5	\$ 11	\$ 26,157	\$ 26,163	\$ 5	\$ 5	\$ -
Common trust funds:							
Fixed Income - domestic	54,894	46,231	8,136	698	53,669	44,543	(9,126)
Equity - domestic	75,579	77,673	6,503	8,803	75,373	72,952	(2,421)
Equity - international	72,847	69,046	13,601	2,100	80,547	67,777	(12,770)
Hedge fund	31,100	32,264	4,100	-	36,364	36,941	577
Private markets	10,392	4,040	6,750	687	10,103	11,490	1,387
Real estate fund	10,487	10,957	1,300	-	12,257	13,537	1,280
	<u>\$ 255,304</u>	<u>\$ 240,222</u>	<u>\$ 66,547</u>	<u>\$ 38,451</u>	<u>\$ 268,318</u>	<u>\$ 247,245</u>	<u>\$ (21,073)</u>

The Trust Fund operates under an investment policy adopted by the Trust Fund Committee. The investment policy has been established to reflect the growth objectives and risk tolerance of the Committee. The Investment Policy Statement was adjusted in March 2014 per resolution RMI 2014-1 *Fixed Income Asset Category Adjustment*. Asset allocations are targets and will be dictated by current and anticipated market conditions, and may be amended by the Trust Fund Committee from time to time. Tactical ranges anticipate fluctuation and provide flexibility for each investment manager's portfolio to vary within the range without the need for immediate rebalancing.

The asset allocation of the Trust Fund's invested assets as of each fiscal year end is as follows:

Investment Class	% of Fund Strategic	% of Fund Tactical Range	% Allocation at 9/30/16
Domestic Equity	30.0 %	25.0 – 35.0 %	28.6 %
International Equity	30.0	25.0 – 35.0	27.4
Fixed Income	20.0	15.0 – 25.0	18.9
Hedge Fund	15.0	10.0 – 20.0	12.7
Real Estate	5.0	0.0 – 10.0	5.4
Private Markets	0.0	0.0 – 15.0	7.0
Cash	0.0	0.0 – 3.0	0.0
	<u>100.0 %</u>		<u>100.0 %</u>

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Investment Class	% of Fund Strategic	% of Fund Tactical Range	% Allocation at 9/30/15
Domestic Equity	30.0 %	25.0 - 35.0 %	29.5 %
International Equity	30.0	25.0 - 35.0	27.4
Fixed Income	20.0	15.0 - 25.0	18.0
Hedge Fund	15.0	10.0 - 20.0	15.0
Real Estate	5.0	0.0 - 10.0	5.5
Private Markets	0.0	0.0 - 16.0	4.6
Cash	0.0	0.0 - 3.0	0.0
	100.0 %		100.0 %

At September 30, 2016 and 2015 all fixed income investments were held in ETFs.

As of September 30, 2016, the Trust Fund's fixed income allocation consists of a Mercer Investment Management Opportunistic Fixed Income mutual fund ("MIM OFI") and a Mercer Investment Management Core Fixed Income Fund ("MIM CFI"); the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield, and 100% of the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 83.6% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM OFI is 3.7 years. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2016. High yield debt receiving a credit rating below "A" comprises approximately 32.2% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2016. At September 30, 2016, the weighted average maturity of the bonds comprising MIM CFI is 8.23 years.

As of September 30, 2015, the Trust Fund's fixed income allocation consists of a MIM OFI and a MIM CFI; the performance of these funds is expected to closely replicate the performance of 50% of the JP Morgan Government Bond Index Emerging Market Global Diversified Index and 50% Bank of America/Merrill Lynch Global High Yield, and 100% of the Barclays Capital U.S. Aggregate Bond Index, respectively. The bonds held by MIM OFI vary in credit quality with an average overall rating of "BB" as rated by Moody's as of September 30, 2015. High yield debt receiving a credit rating below "A" comprises approximately 84.0% of the MIM OFI fixed income portfolio as rated by Moody's at September 30, 2015. At September 30, 2015, the weighted average maturity of the bonds comprising MIM OFI is 3.35 years. The bonds held by MIM CFI vary in credit quality with an average overall rating of "Aa3" as rated by Moody's as of September 30, 2015. High yield debt receiving a credit rating below "A" comprises approximately 26.5% of the MIM CFI fixed income portfolio as rated by Moody's at September 30, 2015. At September 30, 2015, the weighted average maturity of the bonds comprising MIM CFI is 7.95 years.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements

September 30, 2016 and 2015

The Trust Fund's investment policy does not require direct investment in fixed maturity securities ("Bonds") as a means of managing its exposure to loss of principal due to increasing interest rates. The Trust Fund's investment policy requires the performance of each investment class to be periodically compared with an associated benchmark. Bonds and bond funds generally decrease in value in response to rising interest rates. Bonds, however, have a fixed date of maturity and do not have exposure to loss of principal from rising interest rates, whereas shares of a common trust fund, ETF, or similar investment vehicle have no maturity date.

The Trust Fund's exposure to foreign currency risk is derived from its investment in common trust funds, ETFs and REITs that hold investments in securities of foreign issuers and sovereigns.

The Trust Fund's investment in hedge funds includes ownership of the Mercer Hedge Fund Series A fund. Mercer Hedge Funds Investors SPC, who incorporated the hedge fund, are registered under the Mutual Funds Law of the Cayman Islands. The fair value of the Trust Fund's position in the pool is equivalent to the value of the pool shares.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

The Trust Fund's exposure to foreign currencies at September 30 is as follows:

Currency	<u>\$USD Fair Value</u> <u>Securities of</u> <u>Foreign Issuers</u> <u>Held by Common</u> <u>Trust Funds</u>
	(In Thousands)
2016	
Australian Dollar	\$ 2,604
Bermudian Dollar	343
Brazilian Real	4,584
British Pound	11,833
Canadian Dollar	860
Cayman Islands Dollar	3,120
Chilean Peso	144
Chinese Yuan	1,848
Colombian Peso	1,750
Czech Koruna	19
Danish Krone	941
European Euro	21,310
Hong Kong Dollar	1,525
Hungarian Forint	1,129
Indian Rupee	2,075
Indonesian Rupiah	3,615
Israeli New Shekel	150
Japanese Yen	10,970
Malaysian Ringgit	1,521
Mauritian Rupee	20
Mexican Peso	4,406
New Romanian Leu	769
New Taiwan Dollar	2,428
New Zealand Dollar	431
Norwegian Krone	505
Peruvian Nuevo Sol	515
Philippine Peso	121
Polish Zloty	1,204
Qatari Riyal	84
Russian Ruble	1,284
Singapore Dollar	225
South African Rand	3,344
South Korean Won	2,524
Swedish Krona	1,578
Swiss Franc	5,161
Thai Baht	1,571
Turkish Lira	3,248
United Arab Emirates Dirham	192
Total	<u>\$ 99,951</u>

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Currency	\$USD Fair Value	
	Securities of Foreign Issuers Held by Common Trust Funds	
	(In Thousands)	
2015		
Australian Dollar	\$	1,726
Bermudian Dollar		170
Brazilian Real		2,400
British Pound		9,939
Canadian Dollar		251
Cayman Islands Dollar		1,284
Chilean Peso		156
Chinese Yuan		1,663
Colombian Peso		1,253
Czech Koruna		30
Danish Krone		1,446
European Euro		17,394
Hong Kong Dollar		1,217
Hungarian Forint		1,569
Indian Rupee		1,570
Indonesian Rupiah		1,876
Israeli New Shekel		251
Japanese Yen		11,452
Malaysian Ringgit		1,272
Mexican Peso		2,567
New Romanian Leu		1,020
New Taiwan Dollar		1,978
New Zealand Dollar		76
Norwegian Krone		752
Pakistani Rupee		10
Panamanian Balboa		10
Peruvian Nuevo Sol		558
Philippine Peso		82
Polish Zloty		1,317
Qatari Riyal		96
Russian Ruble		2,010
Singapore Dollar		112
South African Rand		1,911
South Korean Won		1,753
Swedish Krona		1,520
Swiss Franc		4,929
Thai Baht		1,571
Turkish Lira		2,447
United Arab Emirates Dirham		118
Total	\$	<u>81,756</u>

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

4. Fair Value Measurements, Investments and Other Financial Instruments

The Trust Fund has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical financial assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the hierarchy are described below:

Level 1 - Financial assets whose values are based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Financial assets whose values are based on one or more of the following:

1. Quoted prices for similar assets or liabilities in active markets;
2. Quoted prices for identical or similar assets or liabilities in non-active markets;
3. Pricing models whose inputs are observable for substantially the full term of the asset or liability; or
4. Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset.

Level 3 - Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Trust Fund's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

A review of the fair value hierarchy classifications is conducted on an annual basis. Changes in the type of inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in/out of the Level 3 category as of the beginning of the year in which reclassifications occur.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

The following table presents information about the Trust Fund's financial assets measured and disclosed at fair value as of September 30, 2016 and 2015 and indicates the fair value hierarchy of the valuation techniques utilized by the Trust Fund to determine such fair value.

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Reported at Fair Value				
Fixed income	\$ 55,469	\$ -	\$ -	\$ 55,469
Domestic equity	84,265	-	-	84,265
International equity	80,597	-	-	80,597
Real estate fund	15,980	-	-	15,980
Total investments valued by valuation hierarchy	<u>\$ 236,311</u>	<u>\$ -</u>	<u>\$ -</u>	236,311
Alternative investments valued at net asset value (a)				<u>58,334</u>
Total investments, at fair value				<u>\$ 294,645</u>
Disclosed at Fair Value				
Cash and equivalents	<u>\$ 10</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10</u>
	September 30, 2015			
	(In Thousands)			
Reported at Fair Value				
Fixed income	\$ 44,543	\$ -	\$ -	\$ 44,543
Domestic equity	72,952	-	-	72,952
International equity	67,777	-	-	67,777
Real estate fund	13,537	-	-	13,537
Total investments valued by valuation hierarchy	<u>\$ 198,809</u>	<u>\$ -</u>	<u>\$ -</u>	198,809
Alternative investments valued at net asset value (a)				<u>48,431</u>
Total investments, at fair value				<u>\$ 247,240</u>
Disclosed at Fair Value				
Cash and equivalents	<u>\$ 5</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5</u>

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

- (a) In accordance with GASB Statement No. 72, certain investments that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the statement of fiduciary net position.

The following provides a brief description of the types of financial instruments the Trust Fund holds, the methodology for estimating fair value, and the level within the hierarchy of the estimate:

Fixed income: Fixed income investments consist of registered funds under the Investment Company Act of 1940 or underlying investments that are traded on active markets and values based on unadjusted quoted prices. They are considered Level 1 input in the hierarchy.

Domestic equity: Domestic equity investments consist of registered funds under the Investment Company Act of 1940 or underlying investments that are traded on active markets and values based on unadjusted quoted prices. They are considered Level 1 input in the hierarchy.

International equity: International equity investments consist of registered funds under the Investment Company Act of 1940 or underlying investments that are traded on active markets and values based on unadjusted quoted prices. They are considered Level 1 input in the hierarchy.

Real estate fund: The real estate fund consists of the AEW Real Estate Securities Value Fund, LLC, which is a portfolio of publically traded equity securities issued by real estate investment trusts and other real estate or real estate-related operating companies. Securities held by the fund are generally valued based on available market quotations. Securities listed on an exchange or traded on the NASDAQ national market system are valued at the last reported sale price on their principle exchange or NASDAQ. The real estate fund is considered Level 1 input in the hierarchy and audited financial statements are available for the fund.

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

Investments Measured Using NAV per Share Practical Expedient

A listing of the alternative investments reported at net asset value held by the Trust Fund and their attributes, that may qualify for these valuations consist of the following as of September 30:

Investment Category	Investment Strategy	2016		Redemption Frequency	Redemption Notice Period
		Net Asset Value	Unfunded Commitment		
(In Thousands)					
Hedge Fund	Fund invests in private investment funds operated by Portfolio Managers to produce consistent capital appreciation with controlled volatility and reduced risk of major drawdowns. The investment is a master fund in a master-feeder structure.	\$ 37,216	\$ -	Quarterly	90 days
Private Equity Funds	Funds invest in diversified portfolios of private equity, private debt, and real assets investment funds which selectively target funds that, in the Investment Manager's opinion, have above average prospects for generating quality investment performance through the underlying investments.	<u>21,118</u>	<u>35,585</u>	N/A	N/A
Total for investments reported at net asset value		<u>\$ 58,334</u>	<u>\$ 35,585</u>		

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

		2015			
Investment Category	Investment Strategy	Net Asset Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
(In Thousands)					
Hedge Fund	Fund invests in private investment funds operated by Portfolio Managers to produce consistent capital appreciation with controlled volatility and reduced risk of major drawdowns. The investment is a master fund in a master-feeder structure.	\$ 36,941	\$ -	Quarterly	90 days
Private Equity Funds	Funds invest in diversified portfolios of private equity, private debt, and real assets investment funds which selectively target funds that, in the Investment Manager's opinion, have above average prospects for generating quality investment performance through the underlying investments.	<u>11,490</u>	<u>19,125</u>	N/A	N/A
Total for investments reported at net asset value		<u>\$ 48,431</u>	<u>\$ 19,125</u>		

Trust Fund for the People of the Republic of the Marshall Islands

Notes to Financial Statements
September 30, 2016 and 2015

5. Commitments

At September 30, 2016 and 2015, the Trust Fund had capital funding commitments relating to its investment in private equity funds. Capital commitments, capital contributions, and unfunded capital commitments at September 30, 2016 and 2015 were as follows:

2016			
Currency	Capital Commitments	Capital Contributions	Unfunded Capital Commitments
Private equity funds	<u>\$ 55,000,000</u>	<u>\$ 19,415,000</u>	<u>\$ 35,585,000</u>
2015			
Private equity fund	<u>\$ 30,000,000</u>	<u>\$ 10,875,000</u>	<u>\$ 19,125,000</u>

**Independent Auditors' Report on Internal Control
Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of
Financial Statements Performed in Accordance
with *Government Auditing Standards***

Joint Trust Fund Committee
Trust Fund for the People of the Republic of the Marshall Islands

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Trust Fund for the People of the Republic of the Marshall Islands (a District of Columbia not for profit corporation) ("Trust Fund") which comprise the statement of fiduciary net position as of September 30, 2016 and 2015, and the related statement of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated March 27, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Trust Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Trust Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Trust Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Trust Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Philadelphia, Pennsylvania
March 27, 2017