2012 Annual Report

Office of the State Treasurer

State of Vermont

Issued January 2013

Beth Pearce
State Treasurer

Our Commitment to Vermonters

The State Treasurer's Office manages money that belongs to all citizens of Vermont. The Treasurer and staff are committed to doing this efficiently, responsibly, and professionally. The Treasurer's office operates as a business, serving the needs of Vermonters while working to save the taxpayers money and earn the highest possible investment returns in its funds within acceptable risk parameters.

Office of the State Treasurer / 109 State Street / Montpelier, Vermont 05609 / www.VermontTreasurer.gov

Office of the State Treasurer
Mission Statement

To manage the financial resources within our purview effectively and efficiently and to promote prudent financial practices in the State of Vermont.

Vision Statement

The overall vision of the State Treasurer's Office is to be the best office of the treasury in the U.S.A. This vision is further defined to state that the Treasurer's office staff will:

- **Give Vermont taxpayers an excellent value.**

  Excellent value to Vermont taxpayers implies highly competent investment and funds management; and initiative and creativity to "leave no stone unturned" with regard to either maximizing returns on investments or achieving maximum savings without compromising other office objectives.

- **Offer the best customer service possible.**

  Excellent customer service implies an effort to understand customer needs, a timely and appropriate response, and a proactive approach to solving problems.

- **Deliver the highest quality operational services.**

  Providing high-quality services requires the pursuit of operating practices within the office that utilize valuable resources efficiently.

- **Create a productive employee work environment.**

  A productive employee work environment implies teamwork, satisfied and motivated staff, and an appropriate set of core objectives and values.

CORE VALUES & SUPPORTIVE BEHAVIORS

Integrity above all
Supported by honesty, fairness, trust, and self-reflection.

A strong team spirit
Supported by open communication, mutual respect and support, and consistent treatment of all.

Desire for excellence
Supported by professionalism, accountability, and pride in work.

Letter of Transmittal

Beth Pearce
State Treasurer

With a lot of hard work over many years, Vermont has earned its ratings.

In September, 2012, S&P announced it had improved its outlook on its AA+ rating on Vermont's general obligation bonds from stable to positive.

TO: Members of the General Assembly
Honorable Peter Shumlin, Governor
Citizens of Vermont

I am pleased to submit my second annual report as your State Treasurer. The State Treasurer's Office serves the citizens of Vermont. We do this in a number of ways. We serve as the State's banker and invest State funds in a prudent manner, protecting taxpayer assets. We manage the State's debt, finding the most cost effective way to borrow funds that provide needed infrastructure and jobs. We disburse more than $4.7 billion each year to vendors, State employees, retirees and other Vermonters. We promote economic well-being through our financial literacy programs and administer retirement programs for more than 46,000 active, vested and retired members of our public pension systems. As you read this report, you will find useful information on these and many other Treasury-related activities and initiatives.

Bond Rating

One critical issue is the State's bond rating. The bond rating is an indicator of our overall financial health. It is a reflection of our economic condition, debt structure, overall financial condition, and the management practices of the State. Vermont has the best bond rating in New England. Therefore, it is my top priority as State Treasurer to partner with the Administration, General Assembly, local and municipal governments, and the financial community to take steps to both maintain and improve Vermont's bond rating.

Aaa

State bond ratings reflect credit worthiness. The nation's three major credit rating agencies, Moody's, S&P, and Fitch, have recognized Vermont's strong fiscal position by awarding it top ratings – Aaa, AA+, and AAA, respectively. To build and maintain this rating, the Treasurer's office works every day to ensure stable cash reserves, responsible management of our pension funds, and prudent issuance of bonds.

A good bond rating is analogous to a consumer who builds a strong credit score through many years of financial discipline. Good credit allows you to refinance at lower rates, saving valuable dollars; it also opens the door to a variety of services that will strengthen your bottom line.

The same is true of the State and its strong bond rating. We issued $93.2 million of general obligation bonds in September 2012 at record low interest rates, providing needed funds for capital projects including school construction, maintenance of State buildings, pollution control, public safety, maintenance and construction at UVM and the Vermont State Colleges. These infrastructure projects, in turn, promote economic development and create jobs.

We also have been able to leverage our bond rating to refinance our debt, saving taxpayer dollars. Called a bond refunding, this is similar in concept to a homeowner refinancing a mortgage. In March 2012 we issued $69 million of refunding bonds that saved $5.36 million over the life of the bonds.

Our bond rating also positively impacts the activities of many State authorities that rely on our bond rating to lower the cost of financing their activities, including affordable housing through the Vermont Housing Finance Agency (VHFA), higher education loans through the Vermont Student Assistance Corporation (VSAC) and economic development through the Vermont Economic Development Agency (VEDA). The Vermont Municipal Bond Bank offers municipal bonds at attractive rates for cities and towns.

With a lot of hard work over many years, Vermont has earned its ratings. It also has had some significant positive news in 2012. In July 2012, the Treasurer's office sold $10 million of transportation infrastructure bonds (TIBs). Two rating agencies, Fitch and Moody's, reaffirmed their ratings of AA and Aa2, respectively, both with a stable outlook. The TIBs received a ratings upgrade from AA to AA+ by S&P. The rating upgrade helped secure a large number of bids on the competitive bond sale, which in turn helped secure record low interest rates. TIBs are backed by the State's motor fuels transportation infrastructure assessment. These revenue bonds are generally rated lower than general obligation bonds because they are not backed by the full faith and credit of the State.

In September 2012, S&P announced it had improved its outlook on its AA+ rating on Vermont's general obligation bonds from stable to positive. This improvement signals that the State is one step closer to securing the highest bond rating available, triple-A, from all three of the agencies that rate Vermont's bonds. It also requires that we remain on a path of fiscal discipline, living within our means, as we approach the future.

Over the next year, there will be many fiscal stresses at the national level that could put pressure on our bond rating. The debt ceiling stalemate at the national level that occurred in the summer of 2011 had a negative impact on the nation's rating and many highly rated states were notified of potential adverse actions. While Vermont was ultimately unaffected by these events, future protracted impasses on debt ceiling and budget issues could negatively impact Vermont's hard-earned triple-A bond ratings. Even though Vermont is fiscally sound and we are responsibly managing our finances, we also are affected by national public policy decisions. Given this environment, it is incumbent for Vermont to continue on the track of sound financial management and conservative debt management practices, and to continue to fund its long-term obligations, including pensions.

Even though Vermont is fiscally sound and we are responsibly managing our finances, we also are affected by national public policy decisions.

It is incumbent for Vermont to continue on the track of sound financial management and conservative debt management practices.

The three most important legislative priorities to support Vermont's bond ratings are: (1) continued 100 percent funding of the annual required contribution, or "ARC," for the State employees' and teachers' pension systems; (2) maintaining the 5 percent budget stabilization reserves, and building the newly-created General Fund Balance Reserve (or "rainy day reserve") to a target level of 3 percent of the general fund; and (3) funding retired State teachers' healthcare costs from the annual budget.

Continued Recovery from Irene

The Treasurer's office played a key role in the State's response to Tropical Storm Irene and will continue to do so. As documented in last year's report, more than $155 million was advanced to municipalities and local schools that assisted in the Irene recovery effort. This provided needed capital so that repairs could begin in anticipation of receiving FEMA, federal highway, State, and private insurance funds. Also in 2011, towns were provided the option of a one-time only deferral of payment of their education tax from December 2011 to February 2012. Eleven towns deferred all or a portion of their payments totaling $7.1 million. I am pleased to report that all towns made the required payments as scheduled in February 2012.

Hurricane Irene Response Support

Recognizing that some towns would benefit from an additional round of accelerated payments, the Treasurer's office, with the cooperation of the Administration, offered a program whereby towns could request advances of their 2012 payments as needed to cover to-date unreimbursed FEMA payments. Six towns received $1.47 million in advanced payments.

The Treasurer's office played a key role in the State's response to Tropical Storm Irene and will continue to do so.

In January 2012, the Governor and I requested that the General Assembly increase the State's moral obligation to VEDA by $15 million to provide additional loans to businesses in response to the Irene recovery. I thank the General Assembly for passage of this request in 2012. This provided needed capital for recovery.

As the State deals with the important task of rebuilding the Waterbury complex and State Hospital, the Treasurer's office will continue to partner with the Administration and General Assembly to stretch available dollars. The 2012 Capital Bill included new criteria for review of residual funds in prior year projects and the "recycling" of more than $4.8 million in old project dollars to new initiatives. This involved an ongoing review by the Treasurer's office, the Institutions Committees, and the Department of Buildings and General Services (BGS). The Treasurer's office is currently working with BGS to identify additional funds and to map out the cash flows of various projects so that we can optimize funds for all projects, including Irene recovery.

Fee Reductions

The Treasurer's office remains committed to implementing fee reductions for our customers wherever available. Our customers include the citizens and taxpayers of Vermont and our State employees. In addition to savings noted above through bond refinancing, we have been able to negotiate decreases in fees for our retirement programs. This includes the reduction in fees for State and Municipal Defined Contribution Plans. Over the summer, the Treasurer's office requested proposals for plan administration of the State and municipal employees' defined contribution plans. After successful negotiations, Fidelity was re-engaged to administer both plans. As part of their proposal, Fidelity offered institutional share class funds and lower administrative fees, providing overall fee savings to plan participants of 22 percent.

In addition to savings through bond refinancing, we have been able to negotiate decreases in fees for our retirement programs.

Per participant fees for the State of Vermont 457 Deferred Compensation Plan also were reduced. In 2011, the Treasurer's office determined that the per participant fee could be reduced from 15 basis points, or 0.15 percent of assets, to 12 basis points -- a reduction of 20 percent. In 2012, the Treasurer's office further determined, based upon a 10-year projection of fee collections and expenses, that the per participant fee could be further reduced from 12 basis points to 10 basis points -- an additional reduction of 16.7 percent and a combined reduction of 33.3 percent over two years.

Finally, the Treasurer's office in 2012 completed the transition of the master custody contract for the Vermont Pension Investment Committee's $3.5 billion of investments from State Street Bank, the incumbent for more than 20 years, to JP

Morgan Chase. JP Morgan Chase provides enhanced data analysis, performance reporting, compliance, administrative, and operational capabilities, and is expected to provide cost savings in excess of $100,000 per year.

Consumer Protection & Unclaimed Property

It was a record-breaking year for the unclaimed property program. In fiscal year 2012, the Treasurer's office paid a record number of 14,536 claimants approximately $4.28 million with an average claim of $294.70. This represents a 23.4 percent increase in the number of claims paid over fiscal year 2011.

Although I am pleased that we are in the process of reuniting Vermonters with funds that rightfully belong to them, I believe additional steps should be taken to encourage earlier distribution to beneficiaries.

Vermont was one of the first states in the nation to initiate a project to audit national insurance companies offering life insurance policies to determine whether beneficiaries had received their funds. In a multi-state initiative, the Treasurer's office reached an agreement with several national life insurance companies to facilitate the surrender of funds from old, sometimes forgotten, policies of people who have died. As of December 1, 2012, the Treasurer's office had received approximately $1.7 million in insurance funds and expects to receive at least $3 million in total through this year. Although I am pleased that we are in the process of reuniting Vermonters with funds that rightfully belongs to them, I believe additional steps should be taken to encourage earlier distribution to beneficiaries. I testified in front of the National Conference of Insurance Legislators (NCOIL) on behalf of the National Association of Unclaimed Property Administrators to secure adoption of an amended Model Unclaimed Life Insurance Benefits Act. This model legislation requires insurers to compare their in-force life insurance policies against the U.S. Social Security Death Master File (DMF) and establishes protocol for insurer identification and contact of beneficiaries. My office is working with the Department of Financial Regulation and legislative members and expect to submit legislation in January to the General Assembly, consistent with this model legislation.

Investment Returns

The pension portfolio produced attractive investment performance relative to other public pension funds--ranking in the top 15 percent of public funds. The pension fund investments are overseen by the Vermont Pension Investment Committee (VPIC). The annualized rate of return for three years is 10.3 percent. These results suggest the restructuring of the portfolio toward a more broadly diversified, lower volatility portfolio, is working well.

Reliable and adequate income in retirement is important to the future economic prosperity of Vermont.

Financial Literacy

Promoting financial security is a win-win proposition for Vermont's future. It helps Vermonters prepare for and, hopefully, attain a lifetime of financial well-being. Reliable and adequate income in retirement, however, is not just good for the individual, but is important to the future economic prosperity of Vermont. Citizens with adequate income can buy goods and services, becoming an economic generator that creates jobs. The Treasurer's office continues to support financial literacy programs through collaboration and partnership with other groups. Now in its third year, the Reading is an Investment program is being used in 128 Vermont elementary schools. At the conclusion of year two, 2,236 Vermont children completed the personal money reading requirement for the program and submitted their reading logs. This fall, 30 public libraries are supporting the program through their involvement in a one-year pilot project. The aim of the pilot project is to determine how Reading is an Investment can promote financial literacy in local communities.

Retirement Security

Retirement Division staff calculated approximately 6,028 retirement estimates for prospective retirees and met with 889 individual members to provide retirement counseling during fiscal year 2012. Staff conducted these counseling appointments while devoting significant time to testing the new VPAS pension administration system.

The Treasurer's office continues to evaluate and strengthen our pension and post-retirement programs, through cost savings in provision of services, maximizing investment returns consistent with risk, maximizing federal revenue opportunities, continued evaluation of recent benefit changes, and advocating for full funding of our pensions and health care programs. The State's continued commitment to funding these programs is essential for a prosperous future. More detail is provided in this report, but the need to find an explicit funding source for teacher health care is essential to maintaining the health of the retirement system. In 2012, the General Assembly responded by taking steps in this direction. Additional steps are needed.

We will continue our work to provide Vermont taxpayers an excellent value, offer the best customer service possible, and meet the fiscal challenges that lie ahead.

Conclusion

The recent economic recession presented significant challenges for all of us. Vermont has been proactive in its response to these challenges, maintaining a disciplined fiscal approach. It also has been an approach characterized by partnership. Over the past several years, State employees, teachers and public employees have worked with the Treasurer's office and the General Assembly to address pension funding changes to benefits and contributions. While difficult, these changes have put the pension system on firmer ground. We need to continue to work together to address these issues and provide a solid foundation for retirement security that is fair and affordable to system members and taxpayers alike.

Recent economic times have been challenging and Irene certainly added even more challenges. Vermont, however, continues to meet these challenges through a combination of hard work, resiliency, fiscal prudence, fairness and partnership. I am privileged to serve as Vermont's State Treasurer and am proud of the contribution my office makes to the financial health and well-being of the State. We will continue our work to provide Vermont taxpayers an excellent value, offer the best customer service possible, and meet the fiscal challenges that lie ahead. I look forward to our continuing partnership.

Sincerely,

Beth Pearce
State Treasurer

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The Vermont State Treasurer's Office Strives to:

- Give Vermont taxpayers an excellent value.
- Offer the best customer service possible.
- Deliver the highest quality operational services.
- Create a productive employee work environment.

About the Treasurer's Office

The State Treasurer's Office serves as the State's banker and chief investment officer. The office is organized into an executive office and five divisions. The executive office is responsible for overall strategic planning, legislative initiatives, constituent relations, debt management, financial literacy, and supervision of the divisions.

The Treasury Operations Division is responsible for the State's banking, cash management, and financial transaction services. The Retirement Division administers three public retirement systems authorized by the legislature (see report section on Vermont Retirement Systems). Investment Services provides cash and investment management for the State of Vermont and the three pension systems administered by the office. The Unclaimed Property Division serves as the caretaker of abandoned or unclaimed financial property, while seeking to return it to its proper owner. Technology Services is responsible for developing and maintaining automated systems, providing appropriate access to information, maintaining the office web site, and maintaining the overall security of the office network and automated interactions with other State departments and entities outside of State government.

We handle money that belongs to all of the citizens of Vermont to support government operations. We are committed to managing these funds professionally,

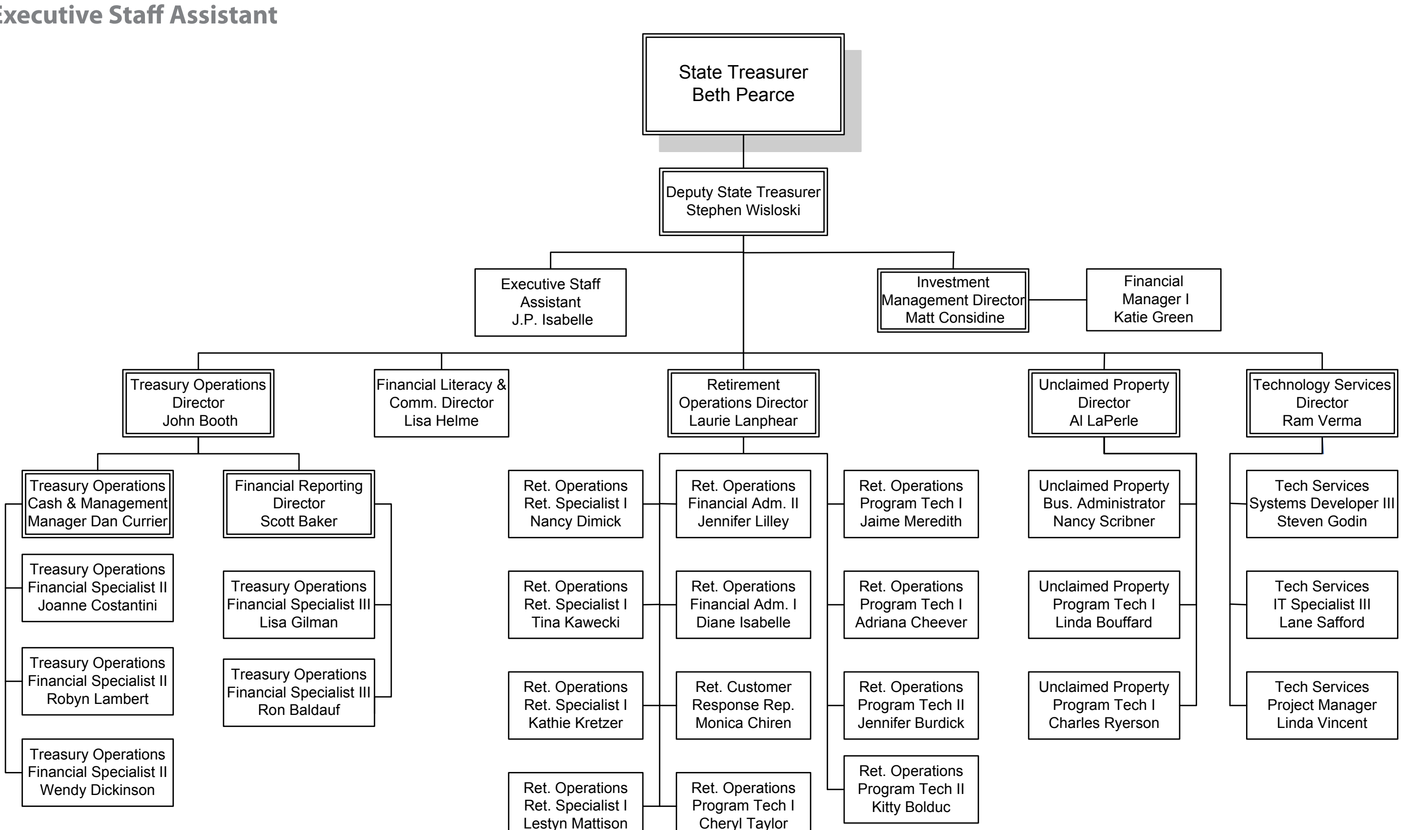
Executive Office
(802) 828-1452

Beth Pearce
State Treasurer

Stephen Wisloski
Deputy Treasurer

J.P. Isabelle
Executive Staff Assistant

Vermont State Treasurer's Office



efficiently, and responsibly, and to maintaining Vermont's hard-earned reputation as a fiscally sound and disciplined state. Specific administrative and service duties as prescribed by State statutes include:

- Investment of State funds;
- Issuing all State bonds authorized by the General Assembly;
- Serving as the central bank for State agencies;
- Management of the State's cash balances, processing of checks, and the reconciliation of payroll and vendor checks;
- Safeguarding and return of unclaimed or abandoned financial property, which is held in trust by the State until the rightful owner can be located; and
- Administration of three major pension plans, the deferred compensation plan, and the defined contribution plans for State employees, teachers, and participating municipalities.

There are 34 staff positions within the State Treasurer's Office. The organizational chart and staff listing on the previous page are effective as of January 2, 2013.

Employee of the Year

The State Treasurer's Office "Employee of the Year" selection for 2012 was Katie LaRaus, a program technician II staff member within retirement operations. Katie was honored for her dedication and perseverance in helping to keep the new Vermont Pension Administration System database project on track and the extra effort she routinely exerts on behalf of her customers.

"She is always willing to go above and beyond her duties to assist with daily tasks throughout the office. Katie worked hard to make the VMERS payroll reporting website efficient and user friendly for the 500 plus entities that she works with, she comports herself with professionalism, and is an asset to the office," said State Treasurer Beth Pearce.

Vermont Retirement Systems

Retirement plans administered by the State Treasurer's Office serve approximately 46,577 active and retired members. These plans serve members of the Vermont State Employees' Retirement System (VSERS), Vermont State Teachers' Retirement System (VSTRS), and the Vermont Municipal Employees' Retirement System (VMERS). Each system is statutorily overseen by a board of trustees.

The Boards of Trustees

The boards have the responsibility of considering the needs of their members, addressing those needs in the face of escalating costs, while at the same time working to provide secure and adequate benefits after retirement. It is a challenging task. As of June 30, 2012 there were 14,967 retirees and beneficiaries receiving pensions totaling more than $237 million annually.

Retirement plans administered by the State Treasurer's Office serve approximately 46,577 active and retired members. There are currently 14,967 retirees receiving pensions totaling more than $237 million annually.

Boards Administration
(802) 828-2305

Monica Chiren
Assistant to the Boards

The boards of trustees are statutorily charged with establishing rules and regulations for the administration of their systems and for the transaction of their business. The boards delegate the day-to-day administration of the plans to the Retirement Division staff, utilizing the governing statutes and board-established rules and policies as guidelines. If questions arise, or if a member or retiree does not agree with a decision made by staff, they may appeal to their board for reconsideration.

The Attorney General's Office provides legal counsel to the boards when necessary. The boards also are charged with approving regular retirement applications, disability retirement applications, and withdrawals from membership. Each board of trustees acts as a fiduciary of the funds held on behalf of its members and retirees. Each board designates an actuary to make an annual valuation of the assets and liabilities of the funds of the system. Based on the actuarial recommendation, the State and teachers' boards advise the Governor on the annual amount of State contribution that should be appropriated for the next fiscal year to achieve and preserve the financial integrity of the funds.

Work of the Boards

The boards of trustees generally meet once a month. The boards are required to keep a record of their proceedings, which are open to the public. Minutes from each meeting are posted on the Treasurer's office web site. To read in detail actions taken by the boards, go to www.VermontTreasurer.gov and click on "Retirement" located in the menu on the left side of the page. Each retirement system has its own set of web pages. Click on the pension plan for VSERS, VSTRS or VMERS. There is a link to each system's board of trustees located in the menu on the right side of the page. For updates on the individual systems, see the Retirement Division Operation section of this report. Information on pension fund performance is located in the Investments section of the annual report.

Membership of the Three Boards of Trustees - As of Dec. 20, 2012

The State Treasurer is an ex officio member of all three boards.

Vermont State Employees' Retirement System
Secretary Nancy Dimick

Kevin Gaffney, Chair, VSEA
Roger Dumas, Vice Chair, VRSEA
Beth Pearce, State Treasurer
James Reardon, Commissioner, Dept. of Finance & Management
Kate Duffy, Commissioner, Dept. of Human Resources
Richard Johannesen, Governor's Appointee
Jeff Briggs,VSEA
Paul White, VSEA
Tom Hango, Alternate-VSEA
Al Blake, Alternate-VRSEA

Vermont State Teachers' Retirement System
Executive Secretary Kathie Kretzer

Jon Harris, Chair, Active Teachers
Joe Mackey, Vice Chair, Retired Teachers' Association
Tom McConnell, Active Teachers
Justin Norris, Active Teachers Alternate
Linda Deliduka, Alternate, VRTA
Beth Pearce, State Treasurer
Thomas Candon, Department of Financial Regulation
Vaughn Altemus, Department of Education

Vermont Municipal Employees' Retirement System
Secretary Tina Kawecki

Steve Jeffrey, Chair, Employer Representative
Peter Amons, Vice Chair, Employee Representative
Beth Pearce, State Treasurer
David Rowlee, Employee Representative
Tom Golonka, Appointed Employer Representative

Retirement Division Operations

Overview

The primary function of the Retirement Division is to serve the needs of the active contributing members and retired members receiving benefit payments. The vast majority of State employees, teachers, and municipals employees participate in a defined benefit plan. There are more than 46,000 active, vested and retired members within the Vermont Retirement System. The three defined benefit plans are statutorily defined. These plans are the Vermont State Employees' Retirement System, Vermont State Teachers' Retirement System, and the Vermont Municipal Employees' Retirement System.

The largest expenditure for all three defined benefit plans is the retirement benefit. During fiscal year 2012, the three retirement systems paid out more than $237 million in monthly benefit payments. As noted in the appendices (historical

ACCOMPLISHMENTS IN 2012

- The Retirement Division staff calculated approximately 6,028 retirement estimates for prospective retirees and met with 889 individual members to provide retirement counseling during fiscal year 2012. Staff conducted these counseling appointments while devoting significant time to testing the new VPAS pension administration system.

- The staff conducted 26 member informational sessions across the state with 783 individuals in attendance. Great-West, the administrator of our 457 plan, also brought in nationally known retirement advocate Ron Nichols who presented two seminars for active and retired members of the Vermont Retirement Systems.

- The months of June, July and August are typically the busiest months of the year for the staff in the Retirement Division. This year was exceptionally busy as the office retired 497 individuals effective July 1. Of this number, teachers made up the greatest share of new retirees at 405, followed by 60 municipal employees and 32 State employees. The office recorded 1,068 new retirees in total this past year across all three systems. The 497 retirees for July 1 accounted for almost half of all new retirees in one year.

- The Retirement Division did a complete update to the web content for retirement on the State Treasurer's Office web site. Group plans for each system also were updated. Plan documents for the 457 and 403(b) were posted on the web site. Additionally, the 457 plan administrators completed a complete redesign of their web site for members.

- Legislative changes made in the 2010 session to the Vermont State Employees' Retirement System through Act 139 went into effect on July 1, 2012. Known as the spiking law, the change pertains to members of groups A, C and F who retire on or after July 1, 2012. If a member's compensable hours in any year used to calculate the average final compensation exceeds 120 percent of the average compensable hours, the compensation for hours worked in excess of 120 percent will be excluded from that year when calculating average final compensation. The legislative intent is to preclude abuses by implementing a 20-percent limit on increases in compensable hours in any year used to calculate average final compensation.

Retirement Operations

(802) 828-2305
(800) 642-3191 (toll free in VT)

Laurie Lanphear
Director of Retirement Operations
Monica Chiren
Administrative Services Coordinator I
Nancy Dimick
Retirement Specialist I
Tina Kawecki
Retirement Specialist I
Kathleen Kretzer
Retirement Specialist I
Lestyn Mattison
Retirement Specialist I
Jennifer Lilley
Financial Administrator II
Diane Isabelle
Financial Administrator I
Kitty Bolduc
Program Technician II
Jennifer Burdick
Program Technician II
Jaime Meredith
Program Technician I
Cheryl Taylor
Program Technician I
Adriana Cheever
Program Technician I

summary of operations charts), the benefit payout number continues to rise as more employees retire and as retirees live longer. This will put a continued burden on the systems and increases the need to meet annual funding requirements. In addition, both the Vermont State employees' and the teachers' retirement systems have traditionally offered health insurance to their members by picking up a large portion of the premium – 80 percent for retired teachers and 80 percent for retired State employees and their dependents. In fiscal year 2012, these health care expenses for the two retirement systems totaled more than $46.4 million. The Vermont Municipal Employees' Retirement System does not offer a health insurance plan, but instead instituted a health retirement savings plan in fiscal year 2008.

Serving Members' Needs

Retirement Division staff oversee enrollments, transfers, refunds, processing of employee and employer contributions, and adjustments to members' accounts for all active members. On the retiree side, the division oversees the issuance of payroll, changes to dependents, adjustments to payments, and replacement checks. Other responsibilities include employee reinstatements, calculation of buy-backs and refunds, disability retirements, and determination of survivor benefits. The division's accountant maintains all retiree data and ensures the timely processing of pension payment checks each month. The Retirement Division Performance Indicators chart provides an update of division activities.

UPDATES

Retirement Re-engineering Project

A multi-year process to develop and implement a new computer system to support retirement operations for the more than 46,577 active, vested and retired members of the three systems continues to make steady progress toward completion. A phased implementation approach has allowed the Retirement Division to utilize significant portions of the project, while other functions remain under development and will be implemented over the course of the next year. The new system replaces a more than 36-year-old legacy retirement system that has become inefficient, unsustainable and costly to maintain. The new system is referred to as the Vermont Pension Administration System or VPAS.

This solution will provide the State of Vermont with a stable, state-of-the-industry, fully-integrated pension administration solution that will allow the division to operate its business more efficiently and effectively.

This past year has allowed the Retirement Division to refine key portions of the system previously implemented as staff worked and tested functions related to retired and active members. Effective July 1, 2011 VPAS became Vermont's system of record for the State, teachers' and municipal retirement systems. For retired members, VPAS is used for payment processes for pension benefits of more than $237 million per year. The system also is used to process tax withholdings, insurance deductions and 1099 tax reporting. For active members, those individuals who have not yet retired, VPAS is utilized to process employer reporting, annual statements, estimates and retirement planning, and purchases of service credit.

Retirement Division Performance Indicators

Activity	2012	2011	2010	2009	2008	2007	2006
Estimates	6,028	7,019	7,231	7,999	6,377	8,213	8,672
Individual Counseling	889	1,054	1,077	1,196	1,136	1,173	1,050
Retirements	1,068	1,008	1,023	907	867	788	785
Withdrawals	1,393	1,312	1,386	937	945	1,507	1,485
Deaths	349	376	291	316	368	333	278
Seminars	26	45	64	90	61	88	51
Seminar Attendance	783	1,000	1,496	1,623	1,285	1,881	1,381

These numbers are for the fiscal year, not calendar year.

In the most recent fiscal year, VPAS was used to perform the data upload of actuarial information utilized to value the retirement funds. The actuary also uses this data to make system projections. The disaster recovery backup for VPAS also was tested and is now fully operational.

Upcoming work targeted for completion in the coming year includes the ability to run ad-hoc reports from VPAS and also the ability to track workflow through the system and evaluate those processes.

The original estimated completion date for VPAS was 2014. The project is expected to be significantly under budget.

Pension Overview

The Treasurer's office remains committed to providing a meaningful retirement to employees and, at the same time, making the system more affordable to taxpayers. A reliable and affordable pension system provides an important economic driver for the state. The economic output provided by both our current public employees and retirees should not be overlooked. In 2012, the National Institute on Retirement Security (NIRS) published an economic analysis study on pension benefit expenditures. The study analyzed the impact of the millions of dollars in pension checks that are spent by retirees within their local community and state. Based on fiscal year 2009 data for Vermont, researchers determined that the $206.1 million in pension benefits paid to 13,935 retirees and their beneficiaries accounted for $299.8 million in total economic output. The study calculated that pension expenditures supported some 2,459 jobs in Vermont that paid $96.2 million in income. These expenditures also supported some $61.2 million in tax revenue at the local, state and federal levels.

On the cost containment front, the Treasurer's office has worked steadily with the Administration, State Legislature, employees, and other concerned groups to implement meaningful reforms. In 2007, changes were made within the State employees' retirement system for new employees to help achieve future cost savings for the system. On the teachers' side, $15 million in savings per year was achieved through changes implemented in 2010 that included a lengthening of the date for retirement and an increase in contribution rates. In 2011, additional changes to contribution rates for all State employees resulted in another $5.3 million in annual savings.

In approaching reforms to our retirement system, the Treasurer's office uses the following guiding principles:

- **Recruitment** - The benefit plan should act as an incentive for recruiting high quality professionals. The plan must be competitive with those in other states and within Vermont.
- **Retention** - The benefit plan should act as an incentive for retaining high-quality professionals and maintaining a stable workforce. The plan also should be compatible with changing workforce and demographic trends.
- **Reward** - The benefit plan should provide a solid foundation for retirement security following a career in public service.
- **Sustainability** - The cost of the benefit plan should be sustainable and predictable over the long term.
- **Affordability** - The cost of the benefit plan should be affordable for current and future public employees and taxpayers.
- **Fairness** - The benefit plan should be fair to workers and taxpayers.
- **Equity** - The benefit plan should be equitable for all parties.

Comparative Information--Vermont Retirement System

Vermont State Employees' Retirement System (VSERS)

Active Members	June 30, 2012	June 30, 2011	% Change
Vested	5,735	5,693	0.74%
Not Vested	2,143	2,075	3.28%
Total Active members	7,878	7,768	1.42%
Average Age	46.35	47.02	-1.42%
Average Service	12.45	12.57	-0.95%
Average Compensation	$ 48,937	$ 51,270	-4.55%
Retired Members and Beneficiaries			
Number	5,600	5,375	4.19%
Annual Retirement Allowances	$ 93,712,861	$ 86,681,452	8.11%
Inactive Members	835	849	-1.65%
Terminated Vested Members	767	774	-0.90%

Vermont State Teachers' Retirement System (VSTRS)

Active Members	June 30, 2012	June 30, 2011	% Change
Vested	7,941	7,780	2.07%
Not Vested	2,321	2,343	-0.94%
Total Active members	10,262	10,123	1.37%
Average Age	46.87	46.94	-0.15%
Average Service	13.06	13.75	-5.02%
Average Compensation	$ 54,685	$ 54,109	1.06%
Retired Members and Beneficiaries			
Number	7,376	7,005	5.30%
Annual Retirement Allowances	$ 128,765,217	$ 117,019,135	10.04%
Inactive Members	2,193	2,675	-18.02%
Terminated Vested Members	793	647	22.57%

Vermont Municipal Employees' Retirement System (VMERS)

Active Members	June 30, 2012	June 30, 2011	% Change
Vested	3,985	3,838	3.83%
Not Vested	2,621	2,637	-0.61%
Total Active members	6,606	6,475	2.02%
Average Age	48.51	48.47	0.08%
Average Service	8.90	8.13	9.47%
Average Compensation	$ 32,557	$ 31,751	2.54%
Retired Members and Beneficiaries			
Number	1,991	1,779	11.92%
Annual Retirement Allowances	$ 14,733,346	$ 12,395,422	18.86%
Inactive Members	1,653	1,821	-9.23%
Terminated Vested Members	623	645	-3.41%

Funding Overview

Pension benefits accumulate for an employee while they are working and are cashed in at the time of retirement. These benefits represent a partnership, since employees make ongoing contributions to the plan with the expectation that the employer will meet its obligations. The VSERS, VSTRS and VMERS plans are defined benefit systems. As a defined benefit plan, there is a promise to provide its members with a monthly benefit beginning at each member's retirement. In order to fulfill the promise of paying employees future retirement benefits, each system has developed a funding plan. This plan aims at accumulating funds, that when properly invested, will fund member retirements. The funds come from three sources: employee contributions, employer contributions and investment income. See the historical summary of operations charts in this report's appendices.

Interest earned on investments from the retirement fund is the largest source of funds used to pay benefits. Investments vary from year to year and are based on market conditions. Investments produce interest income to fund retirement benefits. As more members approach retirement, it's anticipated that significant increases in benefit payouts will occur as employees' life spans lengthen and health care expenses rise. Each system must accumulate funds now to meet future funding needs. This is an ongoing challenge for the systems.

A key to determining how much money the system should have in the retirement fund to pay current and future benefits is the recommendation made by an actuary. An actuary is a specialist in the mathematics of risk, in which assumptions are made and evaluated. Each year an independent actuary (Buck Consultants) makes a recommendation as to the amount of funds that the employer(s) must contribute to keep the system on a funding plan. In the case of VMERS, this is in the form of a recommendation for employer rates for the various options available for participating municipalities. The State was statutorily responsible for contributions to the VMERS' pension accumulation fund prior to July 1, 1987. However, since July 1, 1987, all payments to the system's pension accumulation fund are supported entirely by employer (municipal) and employee contributions. In the case of VSERS and VSTRS, the calculation of the employer share is in the form of an annual actuarial required contribution (ARC) appropriated by the General Assembly. The other key indicators are the percentage to which the plan is funded, the unfunded accrued liability and the plan to achieve full funding.

Currently, the State's contribution to VSERS and VSTRS is based on a percentage rate of each member's annual earnable compensation. These rates include a "normal contribution" rate and an "accrued liability contribution" rate. These rates are calculated based upon the liabilities of each system as determined by actuarial valuations.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Actuarially determined amounts are subject to continual revision, as actual results are compared with past expectations and new estimates are made about the future. The actuarial method for both the VSTRS and the VSERS plans is set by State statute. Through fiscal year 2005, the method used was entry age normal (EAN) with frozen initial liability (FIL). The legislature enacted a statute change revising the method to entry age normal without FIL for the actuarial valuation for the year ending June 30, 2006. This change in method effectively reset the starting balance. Under the previous method, set by State statute, the unfunded liability was frozen at 1988 levels. Any impact of underfunding subsequent to the "freezing" of the liability in 1988 falls to normal cost, instead of being added to the unfunded liability as in more conventional funding methods. In the case of VSERS, changing the method did not have a significant impact because the contributions

Funding Progress of the Retirement Systems - (Amounts in Thousands)

	Year ending June 30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
VSERS	2012	$ 1,400,779	$ 1,802,604	$ 401,825	77.7%	$ 385,526	104.2%
	2011	1,348,763	1,695,301	346,538	79.6%	398,264	87.0%
	2010	1,265,404	1,559,324	293,920	81.2%	393,829	74.6%
	2009	1,217,638	1,544,144	326,506	78.9%	404,516	80.7%
	2008	1,377,101	1,464,202	87,101	94.1%	404,593	21.5%
	2007	1,318,687	1,307,643	(11,044)	100.8%	386,917	-2.9%
	2006	1,223,323	1,232,367	9,044	99.3%	369,310	2.4%
	2005	1,148,908	1,174,796	25,888	97.8%	349,258	7.4%
	2004	1,081,359	1,107,634	26,275	97.6%	336,615	7.8%
	2003	1,025,469	1,052,004	26,535	97.5%	319,855	8.3%
	2002	990,450	1,017,129	26,679	97.4%	300,994	8.9%
	2001	954,821	1,026,993	72,172	93.0%	278,507	25.9%
	2000	895,151	967,064	71,913	92.6%	266,519	27.0%
	1999	804,970	876,412	71,442	91.8%	238,281	30.0%
	1998	733,716	804,501	70,785	91.2%	235,956	30.0%
	1997	639,128	753,883	114,755	84.8%	227,000	50.6%
VSTRS	2012	$ 1,517,410	$ 2,462,913	$ 945,503	61.6%	$ 561,179	168.5%
	2011	1,486,698	2,331,806	845,108	63.8%	547,748	154.3%
	2010	1,410,368	2,122,191	711,823	66.5%	562,150	126.6%
	2009	1,374,079	2,101,838	727,759	65.4%	561,588	129.6%
	2008	1,605,462	1,984,967	379,505	80.9%	535,807	70.8%
	2007	1,541,860	1,816,650	274,790	84.9%	515,573	53.3%
	2006	1,427,393	1,686,502	259,109	84.6%	499,044	51.9%
	2005	1,354,006	1,492,150	138,144	90.7%	468,858	29.5%
	2004	1,284,833	1,424,661	139,828	90.2%	453,517	30.8%
	2003	1,218,001	1,358,822	140,821	89.6%	437,239	32.2%
	2002	1,169,294	1,307,202	137,908	89.5%	418,904	32.9%
	2001	1,116,846	1,254,341	137,495	89.0%	403,258	34.1%
	2000	1,037,466	1,174,087	136,621	88.4%	387,999	35.2%
	1999	931,056	1,065,754	134,698	87.4%	372,299	36.2%
	1998	821,977	955,694	133,717	86.0%	357,899	37.4%
	1997	717,396	849,179	131,783	84.5%	364,695	36.1%
VMERS	2012	$ 417,443	$ 488,572	$ 71,129	85.4%	$ 215,075	33.1%
	2011	402,550	436,229	33,679	92.3%	205,589	16.4%
	2010	376,153	409,022	32,869	92.0%	202,405	16.2%
	2009	331,407	366,973	35,566	90.3%	191,521	18.6%
	2008	348,740	343,685	(5,055)	101.5%	175,894	-2.9%
	2007	325,774	309,853	(15,921)	105.1%	162,321	-9.8%
	2006	288,347	276,552	(11,795)	104.3%	148,815	-7.9%
	2005	259,076	248,140	(10,936)	104.4%	146,190	-7.5%
	2004	232,890	225,092	(7,798)	103.5%	135,351	-5.8%
	2003	222,854	218,533	(4,321)	102.0%	126,216	-3.4%
	2002	193,278	176,109	(17,169)	109.7%	106,986	-16.0%
	2001	177,928	158,786	(19,142)	112.1%	101,873	-18.8%
	2000	161,900	138,697	(23,203)	116.7%	87,147	-26.6%
	1999	137,454	114,481	(22,973)	120.1%	70,808	-32.4%
	1998	113,678	102,005	(11,673)	111.4%	87,328	-13.4%
	1997	96,196	85,686	(10,510)	112.3%	70,800	-14.8%

received closely mirrored the actuarial requirements. However, the 30-year period for amortization of the unfunded actuarial accrued liability was restarted effective July 1, 2008.

Actuarial Accrued Liability Determinations

In the case of VSERS, the actuarial accrued liability for current retired members, terminated vested members, and beneficiaries is $1,030,219,077. The actuarial accrued liability for current active and inactive members is $772,384,730. Together, the total actuarial accrued liability comes to $1,802,603,807. The actuarial value of assets is $1,400,779,062, resulting in an unfunded accrued liability of $401,824,745.

The actuarial accrued liability for current retired members, terminated vested members and beneficiaries of VSTRS is $1,441,535,618 and the actuarial accrued liability for current active and inactive members is $1,021,377,169. The total actuarial accrued liability is $2,462,912,787. The actuarial value of assets is $1,517,410,471, resulting in an unfunded accrued liability of $945,502,316.

Benefit Changes

The legislature approved changes in the 2010 session to the Vermont State Employees' Retirement System through passage of Act 139 .The Act became effective on July 1, 2012. Changes pertained to members of groups A, C and F who retire on or after July 1, 2012. If a member's compensable hours in any year used to calculate average final compensation exceeds 120 percent of average compensable hours, the compensation for hours worked in excess of 120 percent shall be excluded from average final compensation for that particular year. Average compensable hours form the benchmark to preclude abuses by implementing a 20-percent limit on increases in compensable hours in any year used to calculate average final compensation.

Annual Actuarial Required Contributions (ARC)

Under State law, an approved actuary is required to make a valuation of each system's assets and liabilities annually. This report valuation is delivered in late October of each year. It contains an actuarial valuation of the system as of the end of the most recent fiscal year, as well as recommendations for the ARC for the current fiscal year and the next two fiscal years. Budgeted appropriations to fund the ARC for the system are determined based on the actuarial report that is completed and delivered in October of the prior fiscal year. When the next actuarial report is delivered the following October, the ARC calculation for the current fiscal year may increase or decrease relative to the ARC used for appropriation in that fiscal year. Appropriations, however, are not adjusted to reflect the true-up ARC calculation, but rather remain based on the projected ARC calculated in the prior fiscal year's October report. Using this framework, the fiscal year 2010 actuarial report is used to set the ARC for fiscal year 2012, the fiscal year 2011 for fiscal year 2013 and so on.

The VSTRS appropriation is made from general fund appropriations to the pension fund. In the case of VSERS, the various State cost centers/funds are assessed and employer contribution based on the payroll associated with the cost center/fund. VSERS funding requirements are then calculated as a percentage of the State payroll and are remitted to the pension fund as an employer contribution with each bi-weekly payroll. As actual payroll for the year may vary from estimated totals and from pay period to pay period, reconciliation is completed by Finance & Management each year, and an adjustment to the subsequent appropriation calculation is made to assure that all funds required to meet the projected ARC are remitted to the pension fund.

In the case of VSERS, current year health care expenses are expressly funded, separate from the pension actuarial contribution. In the case of VSTRS, the health care expenses are paid through a sub-fund of the pension fund, but are not explicitly budgeted and are treated as an amortized actuarial loss. Therefore, they are not included in the health care or other post-employment benefit obligation, or Net OPEB Obligation ("NOO") calculation. Rather, they are reflected as part of the Net Pension Obligation ("NPO").

This year's reports showed increases to the dollar amounts of the fiscal year 2013 annual actuarially required contributions (ARCs) for both VSERS and VSTRS when compared against last year's actuarial reports. In reviewing this increase it should be noted that most of the increase is due to changes in the interest rate assumption as the retirement boards and the Vermont Pension Investment Committee have opted for a more conservative approach to the assumed investment return. While the benefit changes noted above still have had the effect of reducing the overall ARCs, the change to a more conservative investment assumption has "reset" the starting point.

There has been significant discussion on the national level relative to the appropriate interest rate assumptions used by public pension plans. The Vermont retirement systems, in concert with its investment and actuarial consultants, believed that the interest assumption should be viewed as part of an interrelated set of actuarial assumptions and thus evaluated in a comprehensive, formal experience study rather than in isolation. The trustees for each system opted to accelerate the existing schedule for conducting experience studies and complete such studies for each of the systems this past fiscal year. This was a more disciplined and methodologically sound approach than simply making an arbitrary change to the interest rate based on subjective data.

In the course of reviewing the interest assumptions, the boards of the systems also opted to move to a new method of developing interest rate assumptions called "select-and-ultimate." While largely used in the private sector, this marked a significant, and more accurate, innovation in the development of rate-of-return assumptions for public sector plans. In this method, rate of return forecasts were developed by the systems' actuary using a sophisticated capital market model. The most recent asset allocation established by the Vermont Pension Investment Committee (VPIC) was the basis of the data inputs into the model. Our independent investment advisors, NEPC LLC, were also consulted. Their independent review tracks closely to the actuary's numbers in the aggregate.

As noted by our actuary, "differences between near-term and long-term expectations of rates of return on assets may be incorporated in the assumed rate of return by setting it on a select-and-ultimate basis. A select-and-ultimate return assumption posits different rates for an initial number of years (called a select period) before stabilizing at an ultimate rate. A select-and-ultimate rate structure can be used to reflect expectations of unusually strong or weak returns in near-term years, followed by a trending to a long-term equilibrium. In this sense, it is a more elaborate and complete specification of future return assumptions than is a single rate used in all future years." All three systems adopted a uniform interest rate assumption based on the application of this model, starting with an interest rate of 6.25 percent in year one and building out to more historical levels by year 17. Over a 20-year period, the 50th percentile rate of return forecast for such a portfolio is approximately 7.9 percent, assuming equal liabilities in each year. Since the cash flows associated with each system varies, however, for computational or administrative ease, it is preferable to set the assumed interest rate equal

A Few Terms Defined

Actuarial Report:
A document prepared as a formal means of conveying an actuary's professional conclusions and recommendations; recording and communicating the methods, procedures, and assumptions; and ensuring that the parties addressed are aware of the significance of the actuary's opinion or findings.

Amortization:
The gradual elimination of a liability in regular payments over a specified period of time.

Average Final Compensation:
AFC is the average of an employee's three highest consecutive years of earnings and is used in calculating an individual's pension benefit.

Funded Ratio:
The ratio of the value of benefits members have earned to the value of the retirement systems' assets. There are several acceptable methods of measuring assets and liabilities. Using the Government Accounting Standards Board (GASB) definition, the funded ratio of a system is the actuarial value of assets over its actuarial accrued liability.

Normal Retirement Eligibility:
Normal cost represents the present value of benefits attributed by the funding method to service rendered during the valuation year. Under the Entry Age Normal method, the attribution is made by taking the cost of the full projected benefit for each participant and spreading it as a level percentage of payroll from year of hire to the assumed retirement date.

Retiree Health Savings Plan Update

In July of 2007, the Vermont Municipal Employees' Retirement System (VMERS) Board of Trustees created a Retiree Health Savings (RHS) plan, designed to provide members and retirees with funds which could be used on a tax-free basis to reimburse medical expenses and insurance premiums incurred and paid for after retirement. As of June 30, 2012, there were 5,238 active and retired members participating in the VMERS RHS plan, with investments in members' accounts totaling $10,786,329. The VMERS board deposited an initial amount of $5.1 million in July 2007. Additional employer contributions totaling approximately $6 million were collected and deposited in fiscal years 2008 and 2009. Future contributions and subsequent transfers to member accounts will be made as directed by the VMERS Board of Trustees. The RHS plan funds are invested into individual, age-appropriate Milestone accounts at ICMA-RC. Active members cannot use the RHS plan funds until they begin to draw their VMERS pension benefits. Retired members may use the money at any time for medical and insurance expenses.

to the single rate (expressed to the nearest multiple of 0.1 percent) that produces the same funding results as the select-and-ultimate rate set. At the time of the experience studies, the effective rate for VSERS is 8.1 percent and 7.9 percent for VSTRS. These will vary slightly from year to year based on the underlying liabilities and cash flows associated with the system but it is clearly a more conservative approach than previous interest rate assumptions. The portion of the interest rate assumption associated with the unfunded liability, will, however, become increasingly more conservative as you approach 2038, the end of the amortization period, as the rate is "reset" each year, essentially dropping higher rates at the end of the select-and-ultimate range in favor of more conservative near-term rates. The systems employ smoothing, which reduces the impact of short-term asset volatility and reflects market value changes over a five-year period. At the end of fiscal year 2011, the actuarial value of assets was less than the market value, impacting the calculation of the accrued liability.

The ARC for the teachers' system for fiscal year 2014 is $68,352,825 and the funding percentage as of the most recent actuarial valuation of June 30, 2012 is 61.6 percent. For the State system (VSERS) the ARC is $40,217,666 and the funding percentage, as of the most recent actuarial valuation of June 30, 2012, is 77.7 percent. Both ratios are slightly below June 30, 2011 ratios of 63.8 percent and 79.6 percent.

The unfunded liability for the teachers' system increased by $100,394,436 and the unfunded liability for the State system increased by $55,287,007. Of the teachers' total, 43 percent is attributable to a more conservative investment approach by resetting the interest rate assumption for the unfunded liability to a more conservative interest rate assumption. In the State system, this accounts for 57 percent of the total. In addition, the annual payments for amortization of the unfunded liability increase 5 percent each year per statute through 2038; this has the effect of deferring the repayment of the unfunded liability so that through 2022 the unfunded liability will rise, even if all actuarial assumptions were to hold, before declining to zero in 2038. The Treasurer's office plans to review alternative amortization schedules with the Appropriations Committees and the legislative leadership to determine if a more optimum amortization schedule, reducing interest payments made by the taxpayer, can be achieved.

While the actual outcomes differ slightly from the actuarial assumptions, the more significant impact has come from the interest and amortization schedules. Retirement experience assumptions, which are estimates as to when a current employee may opt to retire, varied from expected results. One component is that, in the current economic environment, many employees in their later years that are eligible for retirement are working longer than projected. Purely from an actuarial funding perspective, to the extent they worked beyond years assumed in the actuarial model and continue to earn additional benefits, this creates additional funding liabilities. In the case of termination experience, the valuations incorporate assumptions about termination of individuals that are not yet eligible to retire. There are many scenarios that would create upward pressure, but some are at least attributable to less turnover of non-vested members of the system. Finally, mortality experience is a factor in that people are living longer in retirement, and thus are receiving pension payments longer than actuarially estimated. Off-setting this, salary levels are actually lower than projected for the teachers' system, which reduces the unfunded liability.

Health care for teachers remains, however, the most significant issue. The new benefit structures have had a positive impact on the overall liabilities of the system. However, benefit changes cannot replace the need for a permanent funding source to pay benefits. Lacking an explicit funding source creates an actuarial

	VSERS	VSTRS
Unfunded actuarial accrued liability, June 30, 2011	346,537,738	845,107,880
Normal cost	41,517,079	35,205,405
Contributions	(68,388,004)	(88,065,116)
Interest on unfunded liability, normal cost & contribution	22,148,689	52,309,253
Restart of select-and-ultimate interest structure	31,587,726	43,012,727
Actuarial (gains) and losses/experience	28,421,517	57,932,167
Unfunded actuarial accrued liability, June 30, 2012	$ 401,824,745	$ 945,502,316

loss each year that adds to the unfunded liability and increases the ARC each year to pay for the prior year's costs. The result is a continuing spiral upwards in the ARC and an inability to make-up ground in the unfunded liability. This "retrospective funding" is costing the system millions of dollars. Health care premiums in fiscal year 2012 totaled $20.6 million. By absorbing this as an actuarial loss over the remaining amortization period of the plan, the "cost'" absorbed in the unfunded liability grows to well over $60 million. This is compounded each year, and with the lack of funding, it creates an escalating problem. <u>This funding shortfall represents the single greatest risk to the financial integrity of the system.</u>

The General Assembly made some incremental increases in funding in fiscal year 2012 ($1,750,000) and additional funds were appropriated ($4,750,000) in fiscal year 2013. In addition, the VSTRS system has benefited from the receipt of approximately $4.5 million over the last two years through an application filed by the Treasurer's office for the federally funded Early Retiree Reinsurance Program. The program is intended to provide health care relief in a transition to the national health care program. Additional steps are, however, needed and delay only compounds the problem.

Single Deposit Investment Account Update

The Single Deposit Investment Account (SDIA), a non-contributory defined contribution plan reported in the Pension Trust Funds, was established according to the provisions of Public Act 41 of the 1981 session. The SDIA was intended to provide an investment vehicle in which to deposit contributions made by members of the State and teachers' contributory retirement systems who voluntarily elected to transfer to the newly established non-contributory retirement systems. In addition to the initial deposits made into the SDIA in 1981, there were three subsequent opportunities (in 1984, 1987, and 1990) for contributory members to transfer to the non-contributory plans and invest their accumulated contributions and interest in the SDIA. No new monies have been invested in the SDIA since 1990. As of June 30, 2012, there were 1,788 SDIA members, with net assets of $74,074,894. Administrative services for the SDIA are provided by Great-West Retirement Services. Great-West administers the day-to-day activities of the SDIA, including maintaining all demographic and beneficiary information, processing all requests for withdrawals and minimum distributions, and maintaining member account value information.

Deferred Compensation 457 & 403(b) Plans

The deferred compensation program has been available since 1979 as a savings option for State employees, municipal employees, employees of agencies such as VEDA and VHFA, and members of the General Assembly. The program is administered by Great-West Retirement Services. Since the deferred compensation plan qualifies as a Section 457 plan under the Internal Revenue Code, the por-

What is a 12b-1 fee?

A 12b-1 fee is an annual marketing or distribution fee on a mutual fund. It is considered an operational expense and, as such, is included in a fund's expense ratio. The fee gets its name from a section in the Investment Company Act of 1940.

tion of salary that is deferred is not taxed at the time of deferral. As of September 30, 2012, the plan had 6,464 participants. Total assets in the plan were valued at $299.4 million. During fiscal year 2012, participating employees made contributions in the amount of $16.31 million to the plan.

The Treasurer's office collects 12b-1 fees from Great-West, as well as a per participant fee that is a percentage of assets invested in the plan. These amounts are then used to pay administrative expenses to Great West. In 2011, the Treasurer's office determined that the per participant fee could be reduced from 15 basis points, or 0.15 percent of assets, to 12 basis points -- a reduction of 20 percent. In 2012, the Treasurer's office further determined, based upon a 10-year projection of fee collections and expenses, that the per participant fee could be further reduced from 12 basis points to 10 basis points -- an additional reduction of 16.7 percent and a combined reduction of 33.3 percent over two years.

A 403(b) Investment Program for public school districts was implemented on January 1, 2009. The program allows school employees to deduct money from their wages on a tax-deferred basis that may be invested in a variety of mutual funds during the employee's working years. The 403(b) contributions reduce taxable wages during employment, and the money accumulates tax-free until the funds are withdrawn after retirement. At that time, all of the money is taxable as regular income to the participant. The program is administered by Great-West Retirement Service. The initial enrollment endeavor resulted in 25 supervisory unions adopting the 403(b) program. Participation in the 403(b) Investment Program for public school districts continued to grow in 2012. There are currently 30 supervisory unions that have adopted the program. As of June 30, 2012, 1,730 school employees were participating in the program and assets had grown to $32.48 million. Participating employees made contributions in the amount of $9.46 million to the plan during fiscal year 2012.

Defined Contribution Plan

Over the summer, the Treasurer's office requested proposals for plan administration of the State and municipal employees' defined contribution plans. The State received seven proposals. After successful negotiations, Fidelity was re-engaged to administer both plans. As part of their proposal, Fidelity offered institutional share class funds and lower administrative fees, providing overall fee savings to plan participants of 22 percent.

State Defined Contribution Plan

Established in 1999, the State's defined contribution plan had 633 participants and net assets of $46.4 million as of September 30, 2012. Under the defined contribution plan, which is modeled after private sector 401(k) plans, employees contribute 2.85 percent of their annual salary to their individual accounts. The State makes a fixed contribution of 7 percent to each employee's account. Employees are responsible for making all investment decisions. Fund line-ups are negotiated by the Treasurer's office and included in the contract with plan administrator, Fidelity Investment. At retirement or termination, employees receive the amount of contributions in their accounts, plus investment earnings. The defined contribution plan provides portability for an increasingly mobile workforce. The plan offers 11 mutual funds in equity, balanced, and fixed income asset classes, and age-based "life-cycle" funds that rebalance a multi-asset class portfolio of mutual funds appropriate to the age of the plan participant. Options include a stable value fund that has insured principal value; an intermediate term bond fund; a balanced fund of stocks and bonds, large-, mid- and small-capitalization domestic equity funds; and an international equity fund. The plan is self-directed with respect to investment selection, meaning that participants elect investment options consistent with their risk and reward preferences along with the timing of their need to access funds. In calendar 2007, the State modified and renewed its contract with the plan's administrator following a lengthy RFP (Request for Proposals) process. The new contract provides for increased flexibility to change investment options when warranted, and the plan continues to be provided to participants without costs above the fund investments' intrinsic expense ratios.

Municipal Defined Contribution Plan

The Vermont Municipal Employees' Retirement System was given statutory authority in 1999 to approve a defined contribution plan for its members. The board implemented a defined contribution plan on July 1, 2000. The plan provides the employer municipality with the first option of deciding whether or not to offer a defined contribution plan to its employees. Once a municipality elects to offer the plan to all eligible employees or to specific employment groups, an individual employee has the choice to remain with the defined benefit plan or transfer to the new defined contribution plan. New employees of municipalities offering both a defined contribution plan and a defined benefit plan have a choice of either plan. As of September 30, 2012, there were 70 contributing municipalities with 559 participants and assets of $17.6 million.

Other Post-Employment Benefits (OPEB): Health Care

Vermont State Employees' Retirement System

Employees retiring directly from active State service for any reason, may carry whatever coverage is in effect at that time into retirement for themselves and their dependents. During the lifetime of the retiree, currently only 20 percent of the cost of the premium is paid by the retiree. (See changes detailed below for Group F employees hired after 2008.) If the retiree chooses the joint and survivor pension option, and predeceases his or her spouse, the medical benefits may also continue for the spouse, along with the pension. However, generally the surviving spouse must pay 100 percent of the cost of the premium. In addition, once retirees become eligible for Medicare coverage (at age 65) it is mandatory that they enroll in both Medicare Part A and Part B, making Medicare the primary insurer. If an employee, other than a Group C member, does not retire directly from State service, he or she is not eligible to participate in the State's medical insurance plan. Group C members who terminate with 20 or more years of service, but are not yet 50, may pick up the medical coverage at the time they begin retirement benefits. If the insurance is terminated at any time after retirement, coverage will not be able to be obtained again at a later date. Based on legislation enacted during fiscal year 2008, Group F employees hired after July 1, 2008, will receive a tiered retiree health care reimbursement—a pro-rated percentage of paid premium based on years of service. This group also may recapture (access) subsidized health insurance at 80 percent upon initiation of retirement benefits in a manner comparable to regular retirements. This applies even if the employee terminated prior to his or her early retirement date, providing the member has 20 years of service.

Once retirees become eligible for Medicare coverage at age 65 it is mandatory that they enroll in both Medicare Part A and Part B, making Medicare the primary insurer.

As of June 30, 2012, 4,132 retirees were enrolled in the medical plan in the single, spouse, and family plan options. The retirees contributed $6.3 million in premiums and incurred $34.8 million in claims expenses for the fiscal year

What is an OPEB?

Employees of state and local governments may be compensated in a variety of forms in exchange for their services. In addition to a salary, many employees earn benefits over their years of service that will not be received until after their employment with the government ends through retirement or other reason for separation. The most common type of these post-employment benefits is a pension. As the name suggests, other post-employment benefits (OPEB) are post-employment benefits other than pensions. OPEB generally takes the form of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including in some cases their beneficiaries. It may also include some types of life insurance, legal services, and other benefits.

- Taken from GASB (Governmental Accounting Standards Board) Other Postemployment Benefits: A Plain-Language Summary of GASB Statements No. 43 and No. 45

ending June 30, 2012. The State's fiscal year 2012 contributions to this trust fund totaled $27.7 million which included a $1.8 million Medicare D reimbursement received from the federal government. The trust fund then paid premium payments of $25.9 million (calculated on a pay-as-you-go basis) to the State's Medical Insurance Fund. At June 30, 2012, the trust fund had total net assets of $13,378,884 being held in trust for postemployment benefits other than pension benefits.

Vermont State Teachers' Retirement System

VSTRS retirees participate in multi-employer health coverage plans operated by the Vermont Education Health Initiative (VEHI) which is managed jointly by the Vermont School Boards Insurance Trust and the Vermont-National Education Association. VEHI partners with Blue Cross Blue Shield to provide health insurance to retired and active teachers. VSTRS members have access to three plans in retirement that are identical to those offered to active teachers in Vermont's public school systems. Members may pick up medical coverage under one of the plans for themselves and all eligible dependents at the time of retirement, or anytime thereafter during semi-annual open enrollment periods. The system pays 80 percent of the retiree's premium only, for members with a minimum of 10 years of creditable service as of June 30, 2010. Payment is based on the cost of the "standard plan" as defined by statute. The retiree pays the full cost of the premium for all covered dependents.

VSTRS members have access to three plans in retirement that are identical to those offered to active teachers.

As of June 30, 2012, 4,751 retirees are enrolled in the single, spouse, and family medical plan options. The retirees contributed $7.6 million in premiums and the system contributed $10.5 million in premiums and paid $20.6 million on a pay-as-you-go basis, during fiscal year 2012. VEHI incurred $33.1 million in retiree claims expense for the fiscal year ending June 30, 2012.

The actuarial valuation reflects plan changes in health care coverage effective July 1, 2010. The changes affect future retirements only as no changes were adopted for those retired prior to July 1, 2010. Eligibility criteria and premium sharing levels were revised for active employees who did not attain 10 years of service as of June 30, 2010. In addition, the plan now offers subsidized spousal coverage for the first time. For new hires and those with less than 10 years of service as of July 1, 2010, there is no subsidized coverage for those retiring with less than 15 years of service at retirement, 60 percent single coverage at 15 years, 70 percent single coverage at 20 years and 80 percent single or spousal coverage at 25 years. Current employees with more than ten years of service as of July 1, 2010 continue with the current 80 percent coverage. At 25 years of service, employees in this category are generally eligible to elect subsidized spousal coverage at retirement.

Once a retiree becomes eligible for Medicare coverage (at age 65), it is mandatory that they enroll in both Medicare Part A and Part B. Medicare becomes the primary insurer and the VSTRS's medical plans become the secondary insurer. Two of the plans offered become "carve-out" plans to coordinate with Medicare, and one of the plans is replaced with a true Medicare supplemental plan. The premiums for all plans are reduced in accordance with the decrease in liability once Medicare becomes the primary insurer.

OPEB Funding Status

The State's independent actuary has prepared valuations of the OPEB liabilities for VSERS and VSTRS as of June 30, 2012. This is the seventh annual

OPEB valuation for each system. Both the VSERS and VSTRS reports present two separate calculations of the State's OPEB liability, depending on whether the liability would be prefunded or remain on a pay-as-you-go basis. Since the VSERS has accumulated some assets, a third blended calculation is also included. The Vermont Municipal Employees' Retirement System (VMERS), a cost-sharing, multiple-employer public employees' retirement system, is administered by the State, but has no associated State health care benefit or liability. While the Vermont Municipal Employees' Health Benefit Fund is classified as a post-employment benefit fund, there is no accrued liability in excess of the assets of the fund. There is no annual required contribution and unfunded actuarial accrued liability. Component units and authorities of the State will perform their own valuation as the State does not assume the risk or financial burden for their health care costs. See the Vermont Retirement SystemS Summary of Operations chart for details on the funding status of the plans, with amounts in the thousands of dollars, as of June 30, 2012.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information immediately following these notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Vermont Retirement Systems -- Year Ended June 30, 2012
Summary of Operations

	Vermont State Retirement System	Vermont State Retirement System-OPEB	State Teachers' Retirement System	Municipal Employees' Retirement System
SOURCES OF FUNDS				
Employee Contributions	$ 27,708,009	-	31,827,995	11,337,926
Employer Contributions	40,302,433	25,865,470	51,731,875	11,532,230
Other Income	377,562	1,786,719	4,505,246	118,191
Investment Income	23,604,774	375,423	24,726,665	7,671,464
APPLICATION OF FUNDS				
Retirement Benefits	90,170,209	-	117,801,002	14,214,160
Refunds	1,908,752	-	1,521,099	1,664,687
Health/Life Insurance Expenses	-	25,863,989	20,620,144	-
Administrative Expenses	1,328,919	275	1,604,735	672,851
Other Expenses	702,136	-	391,832	469,599
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ (2,117,238)	2,163,348	(29,147,031)	13,638,514

OPEB - Schedule of Funding Progress

Actuarial Valuation Date 6/30	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
VSERS (1)						
2012	$ 13,379	$ 1,011,783	$ 998,404	1.3%	$ 406,929	245.4%
VSTRS (2)						
2012	$ -	$ 827,180	$ 827,180	0.0%	$ 561,026	147.4%

(1) Reflects blended discount rate of 4.25% in 2012.
(2) Discount rate for 2012 at 4.0%, reflecting no prefunding.

OPEB Actuarial Valuation: Methods and Assumptions

For VSERS, the actuarial accrued liability for OPEB obligations earned through June 30, 2012 is approximately $1 billion. With fund assets totaling $13.4 million, the unfunded actuarial liability is $998.4 million. This is a decrease as compared to the June 30, 2011 unfunded actuarial liability of $998.6 million. The net decrease in liability was due to an expected increase in assets.

The health care trend cost rate assumption was modified to extend the period until the ultimate trend rate is reached from two years to eight years in order to reflect general market expectations. Age morbidity factors were adjusted, eliminating the assumed increase in cost for ages above 65 for prescription drug costs for Medicare-eligible participants in light of recent internal studies of claims experience for credible retiree populations comparable to the population covered by the system. Assumed costs for pre-65 medical and prescription drug and Medicare-eligible medical costs continue to reflect age adjustments. All other assumptions, including the assumed discount rate, were the same as those used in 2010.

An OPEB trust has been established, as required by statute, for VSERS that is funded in part through the deposit of Medicare-D subsidies received for State employees' prescription programs. Therefore, the VSER system reflects a "blended rate" reflecting some level of prefunding, resulting in an assumed discount of 4.25 percent instead of the pay-as-you-go liability calculated at 4 percent.

An OPEB valuation also was completed for VSTRS. An OPEB trust has not been created for VSTRS and no prefunding has been made. As noted above, an experience study was completed for the VSTR system. Valuation assumptions were updated to reflect the post-retirement benefit plans changes and the effects of changes to pension benefits adopted concurrently. Retirement rates were updated in order to reflect expected retirement patterns under the revised pension benefits. Assumptions regarding incidence of spouse coverage and spouse age difference are introduced. Benefits are attributed to expected date of retirement, consistent with the new tiered structure. Finally, the valuation no longer reflects age-morbidity factors, as it is has been determined that VSTRS liabilities are fully insured and any implicit rate subsidy is completely born by the Vermont Health Education Initiative (VEHI) health insurance purchasing arrangement. There were no changes to the discount rate.

For VSTRS, assuming no prefunding, the actuarial accrued liability and the unfunded actuarial liability for OPEB obligations earned through June 30, 2012 is $827.2 million. This is an increase compared to the unfunded actuarial liability of $780 million as of June 30, 2011. The net increase in the liability was primarily due to expected increases over time and an increase in the number of retirees, consistent with the pension valuations. In addition, updates to the demographic assumptions in the pension valuation were incorporated.

Financial Literacy

Financial Literacy
(802) 828-3706

Lisa Helme
Financial Literacy &
Communications Director

Overview

The State Treasurer's Office continued its support of financial literacy in 2012. Five years ago, the office hired a director dedicated to promoting financial literacy among Vermonters. Key goals are: (1) advocacy—working to promote the adoption of fiscally sound money management practices by Vermonters of all ages; (2) collaboration—working with local, state and national groups to build support for and participation in activities that promote and teach personal finance; and (3) development—creating new financial education programs and resources for Vermont citizens.

In addition to the specific program updates that follow in this report, the Treasurer's office works with a variety of organizations throughout the year to promote financial literacy. In Vermont, the office supports the non-profit Vermont Jump$tart Coalition. The Treasurer's office Financial Literacy Director serves on the coalition board and actively works on annual projects that include yearly financial literacy training opportunities for teachers. Nationally, in May the office supported the National Association of State Treasurer's annual conference by providing staff support to serve on the financial literacy program planning committee. An all-day track of sessions on financial literacy programs nationwide was offered and included a presentation on the Reading is an Investment program.

ACCOMPLISHMENTS IN 2012

- Now in its third year, the Reading is an Investment program is being used in 128 Vermont elementary schools. At the conclusion of year two, 2,236 Vermont children completed the personal money reading requirement for the program and submitted their reading logs. This fall, 30 public libraries are supporting the program through their involvement in a one-year pilot project. The aim of the pilot project is to determine how Reading is an Investment can promote financial literacy in local communities.

- The Money Smart Child Initiative continues. In calendar year 2012, eight parent workshops were held throughout the state with 183 people attending. Reviews by parents were very positive. The purpose of the workshop is to give parents hands-on training in teaching their children about money management concepts.

- There were 229 Vermont students who submitted posters in the statewide Be Money Wi$e Financial Literacy poster competition. The 2012 theme was "Managing Money is Not Magic!" The purpose of the competition is to promote financial education instruction and student discussion of core financial concepts.

- Seven Vermont high schools participated in the 2012 Vermont Reserve Cup Challenge. The academic competition tests student knowledge of personal finance and economics. South Burlington High School repeated as State Champions. The Southwest Vermont Career Development Center in Bennington finished second. Third place was won by the North Country Career Center in Newport.

UPDATES

Reading is an Investment

Since the program was first started in 2010, the number of Vermont elementary schools using the books and curriculum has grown from 109 schools to 128 schools. A lack of programs for young children in personal finance prompted the State Treasurer's Office to develop the program. Reading is an Investment aims to build school library collections of books that teach money management concepts; supply librarians and teachers with ready-to-use lesson plans that teach money concepts; and encourage individual learning through a statewide reading program of "money" books. Each year, ten $250 college savings accounts are awarded through a random drawing of completed and submitted reading logs. In the 2011-2012 school term, the Treasurer's office received 2,236 completed logs, up by almost a thousand from the first year of the program.

"In this age of heightened awareness about financial matters, it's great to have a platform to speak about financial literacy with young children." – Weybridge Elementary School

Year-two evaluations showed schools continue to appreciate the program, specifically (1) receiving good quality children's books and the opportunity to encourage the circulation and visibility of books teaching personal finance; and (2) having easy-to-use resources to teach financial concepts. All lesson plans are available on the web, allowing parents who home-school their children to take advantage of the resources.

New for fall 2012, the Treasurer's office has initiated a pilot project with 30 Vermont public libraries. We will evaluate the program's effectiveness in promoting not only youth financial literacy, but also adult financial literacy. In order to participate in the pilot and receive free books and materials, the public libraries were asked to commit to holding at least one financial literacy workshop or event during the year for adults or children.

The educational theme for the 2012-2013 school term is "Investing and Goal Setting." The three hardback books sent to all participating schools and

2012 Winners of College Savings Accounts

- Arnel Husrefovic
  Chamberlin School
- Sarah Boyden
  Fayston Elementary School
- Brooke Ziemba
  Franklin Central School
- Kayla Meegan
  Johnson Elementary School
- Faith Russin
  Lowell Graded School
- Taylor Miller
  Mary Hogan Elementary School
- Mary Ann Eastman
  Mary Hogan Elementary School
- Mariah Folsom
  Rutland Town School
- Maegan Winters
  Sharon Elementary School
- Gabrielle Boutin
  Swanton Elementary School

At left, State Treasurer Beth Pearce and Lt. Governor Phil Scott congratulate Sharon Elementary School student Maegan Winters. Student winners from the second year of the Reading is an Investment program were recognized at a State House ceremony on April 12, 2012. Ten student names were randomly drawn from the more than 2,200 completed reading logs to each win a $250 college savings account.

"Getting books with lesson plans made the program easy to implement."
– Glover Community School

"(my favorite part of the program was) watching students check-out books about money."
– Jericho Elementary School

READING IS AN INVESTMENT - Participating Pilot Project Libraries

Bennington Free Library	Middletown Springs Public Library
Bradford Public Library	Milton Public Library
Brownell Library, Essex Junction	Norman Williams Public Library, Woodstock
Calef Memorial Library, Washington	Peacham Library
Charlotte Library	Pope Memorial Library
Cobleigh Public Library, Lyndonville	Poultney Public Library
Dorothy Alling Memorial Library, Williston	Rockingham Free Public Library, Bellows Falls
Fletcher Free Library, Burlington	Rutland Free Library
Goodrich Memorial Library, Newport	Springfield Town Library
H.F. Brigham Free Library, Bakersfield	St. Albans Free Library
Highgate Public Library	Stowe Free Library
Ilsley Public Library, Middlebury	Warren Public Library
Joslin Memorial Library, Waitsfield	Weathersfield Proctor Library, Ascutney
Lawrence Memorial Library, Bristol	Westminster West Public Library
Mark Skinner Library, Manchester Center	William & Lucy Rand Memorial Library, North Troy

public libraries are: ***The Pickle Patch Bathtub*** by Frances Kennedy; ***Isabel's Car Wash*** by Sheila Bair, and ***Stock Market Pie*** by J.M. Seymour. The program is underwritten by grants and donations to the Financial Literacy Trust Fund. The program would not be possible without major underwriting support from the TD Bank Charitable Foundation and Windham Foundation. Additional contributions from Comcast and VSAC also play a key role in supporting the program.

"Keep doing it! (these workshops) How do we get personal finance in the schools? I had personal finance in 6th grade as our math class." – Parent attendee of Money Smart Child workshop

Money Smart Child Initiative

The Money Smart Child Initiative is a three-way partnership between the State Treasurer's Office, Vermont Jump$tart Coalition, and People's United Bank. The aim of the initiative is to raise awareness of the need for adults to talk with children about managing money. The initiative is now in its second year. As part of the effort, a workshop for parents called "Raising a Money Smart Child" was developed. In calendar year 2012, eight workshops were conducted at locations throughout the state and were attended by183 adults.

"I'm walking out with some great ideas and will be more comfortable talking to my kids and doing it more effectively."
– Workshop Attendee

Based on evaluations, the workshop is motivating parents to talk to their children about money. Parents were asked, "As a result of this workshop, I plan to talk to my kids about (name subject areas)." Parent responses included these topics – budgeting, saving strategies, setting goals, spending decisions, credit, credit cards, wants versus needs, earning money, allowances, internet purchases, and paying taxes.

Work will continue into 2013 to offer and conduct Money Smart Child workshops.

Other K-12 Financial Literacy Projects

Financial Literacy Poster Contest

For the fifth year in a row, the State Treasurer's Office has offered the Be Money Wi$e Financial Literacy Poster Competition. The contest is open to students in grades 3-12. The competition encourages adults to discuss the annual poster theme with students and provides a creative outlet for students to demonstrate their knowledge. The 2012 theme was “Managing Money is Not Magic!” There were 229 posters entered this year.

Students placing in the elementary school division were: first place, Charlotte DeSantos, Williston Central School; second place, Esther MacKenzie, Middletown Springs Elementary School; and third place, Oisin Harrington, Middletown Springs Elementary. Students placing in the middle school division were: first place, James Koss, Waterville Elementary School; second place, Anij Strout, Waterville Elementary; third place tie to Bailey Noel, Milton Elementary School and Nate Shanks, Williston Central School. High School division winners were: first place, Eva Orr, Fair Haven Union High School; Kaci O’Rourke, Fair Haven Union High School; and Gabrielle Granai, Lake Region Union High School.

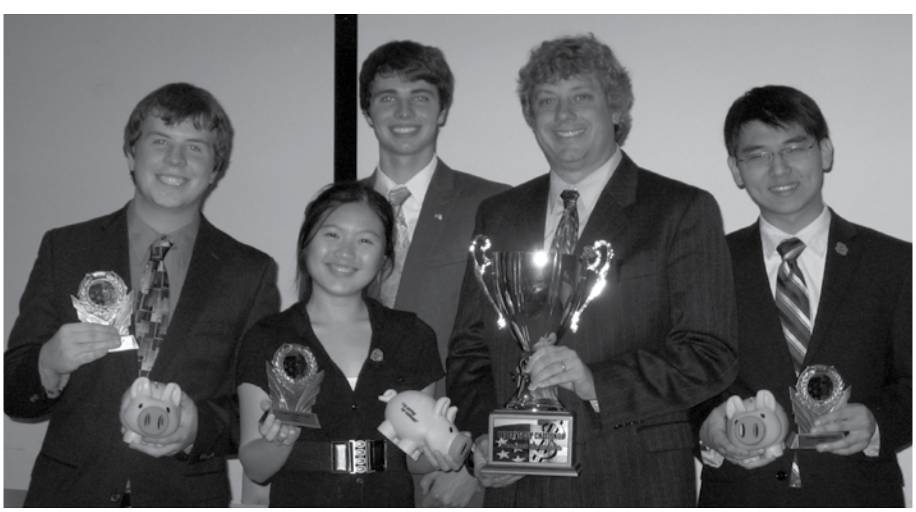
Students placing first in each division received a $100 U.S. savings bond and their school a $100 cash prize in recognition for their support for financial literacy. The contest is supported by the Vermont Bankers Association.

Reserve Cup Challenge

Seven Vermont high schools answered the challenge to compete in the fourth annual Vermont State Reserve Cup Challenge. The State Treasurer’s Office, in partnership with the Federal Reserve Bank of Boston, manages the challenge. The purpose of the academic competition is to promote student interest in and knowledge of personal finance, economics and consumer affairs topics.

Since the competition was started there have beeen 16 separate high schools that have participated in the challenge.

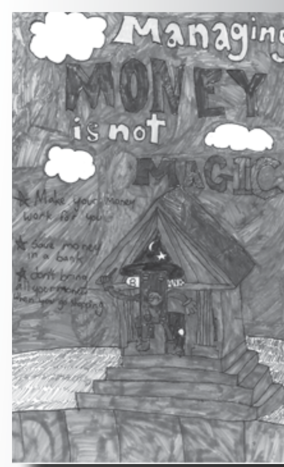
The 2012 winner was South Burlington High School. Second place in the tournament was won by a team from the southwest Vermont Career Development Center in Bennington. Third place was won by the North Country Career Center in Newport. Using a game-show-style format, teams progress through rounds of questioning that test their knowledge. The first place school wins the right to display a large gold traveling cup for one year and each student team member receives a $250 college savings account from the Vermont Student Assistance Corporation. Students from the top three teams receive individual trophies. The event is underwritten by TD Bank. Members of the Vermont Jump$tart Coalition also support the competition and volunteer at the event. Since its inception, 16 separate high schools have participated in the challenge.



The winning 2012 team from South Burlington High School is pictured above. From left to right are: Noah Bugbee, Theophila Lee, Sam Bellavance, math teacher Eric Stone and Kevin Wang.

2012 Poster Winners

Elementary School Winner
Charlotte DeSantos



Middle School Winner
James Koss

High School Winner
Eva Orr

Debt Management

Debt Management
(802) 828-5197

Stephen Wisloski
Deputy State Treasurer

Scott Baker
Financial Reporting Director

Overview

The State Treasurer's Office had a very productive calendar year 2012 in its Debt Management division. Vermont issued seven separate series of bonds: six series of General Obligation (G.O.) bonds, and one series of Special Obligation Transportation Infrastructure Bonds (TIBs). Technical details of the bond issuances are provided in the listing of 2012 bond issues on the next page.

ACCOMPLISHMENTS IN 2012

- In March, the Treasurer's office conducted a General Obligation bond sale in four parts, including a series of Vermont Citizen Bonds (2012 Series A), a series of competitively-sold tax-exempt bonds (2012 Series B), a series of competitively sold taxable bonds (2012 Series C) to finance projects of the Vermont Telecommunications Authority, and a series of refunding bonds (2012 Series D). This bond sale had been delayed from October 2011 in response to Tropical Storm Irene.

- During the legislative session, the Treasurer's office worked with the House and Senate Institutions Committees to incorporate three provisions to statute, regarding (1) use of bond premium to finance additional capital projects; (2) better tracking of the resale or leasing of bond-financed projects to assist in compliance with federal law; and (3) Governor's approval for the issuance of municipal bonds by out-of-state entities to finance Vermont-based projects.

- In July, the Treasurer's office sold $10 million of Special Obligation Transportation Infrastructure Bonds, 2012 Series A. This was the second such sale (the inaugural sale was in summer 2010), and the bond proceeds were used to leverage an additional $51 million of federal transportation funds. In addition, the State received a ratings upgrade from AA to AA+ by Standard & Poor's. The other two rating agencies, Fitch Ratings and Moody's Investors Service, reaffirmed their ratings of AA and Aa2, respectively, both with a stable outlook.

- From July to September, the Capital Debt Affordability Advisory Committee (CDAAC) met four times to review the State's debt affordability guidelines, analyze Vermont's critical debt ratios compared to those of triple-A rated peer states, and discuss critical capital needs, including the Vermont State Hospital and Waterbury State Office Complex. The committee recommended that the two-year net tax-supported debt authorization for the legislative biennium for fiscal years 2014 and 2015 not exceed $159,900,000.

- In its transmittal memo for the 2012 CDAAC Report, the Treasurer's office also recommended that the three most important legislative priorities to support Vermont's bond ratings are (1) continued 100 percent funding of the annual required contribution, or "ARC," for the State employees' and teachers' pension systems; (2) maintaining the 5 percent budget stabilization reserves, and building the newly-created General Fund Balance Reserve (or "rainy day reserve") to a target level of 3 percent of the general fund; and (3) funding retired State teachers' healthcare costs from the annual budget.

- In September, the Treasurer's office conducted a second General Obligation bond sale in two parts, including a series of Vermont Citizen Bonds (2012 Series E) and a series of competitively-sold tax-exempt bonds (2012 Series F). The outlook for Vermont's AA+ credit rating from S&P was improved from stable to positive, and Moody's and Fitch maintained their top ratings of Aaa and AAA, respectively, both with stable outlooks.

- Finally, the Private Activity Bond Advisory Committee, which was created by Executive Order 14-11 in November 2011, was adopted in statute during the 2012 legislative session. The five-member committee met three times during the year to explore potential uses and specific projects for private activity bonds and to provide recommendations to the Emergency Board in connection with the reallocation of the State's 2012 volume cap. The committee also convened a public hearing in late November and provided the Emergency Board with its recommended initial allocation for Vermont's 2013 volume cap.

Strong credit rating helping Vermont bond sales

The State of Vermont has the highest general obligation bond ratings of any New England state. Above, story published in March 5, 2012 edition of the Times Argus.

2012 Bond Issues (Calendar Year)

$25,000,000 par amount of 2012 Series A Vermont Citizen Bonds, which were sold via negotiated transaction with Citi. The true interest cost (TIC) of the bonds was 1.43 percent and the average life was 5.37 years.

$28,000,000 par amount of 2012 Series B bonds, which were sold via competitive bid to Citi, which provided the lowest TIC of 2.99 percent. The average life of the bonds was 14.45 years and the State received bids from ten banks.

$10,000,000 par amount of 2012 Series C federally taxable bonds, which were sold via competitive bid to Piper Jaffrey, which provided the lowest TIC of 0.67 percent. The average life of the bonds was 2.51 years and the State received bids from nine banks.

$69,060,000 par amount of 2012 Series D refunding bonds, which were sold via negotiated transaction with Citi. The TIC of the bonds was 1.76 percent, the average life was 7.72 years and the refinancing reduced the State's interest payments by $5.36 million over the life of the bonds.

$26,765,000 par amount of 2012 Series E Vermont Citizen Bonds which were sold via negotiated transaction with Citi. The true interest cost (TIC) of the bonds was 1.64 percent and the average life was 6.84 years.

$66,420,000 par amount of 2012 Series F bonds, which were sold via competitive bid to J.P. Morgan Securities, which provided the lowest TIC of 2.39 percent. The average life of the bonds was 11.75 years and the State received bids from twelve banks.

$10,820,000 par amount of 2012 Series A Special Obligation Transportation Infrastructure Bonds (TIBs), which were sold via competitive bid to Morgan Stanley, which provided the lowest TIC of 2.49 percent. The average life of the bonds was 11.11 years and the State received bids from nine banks.

Current Municipal Bond Market Environment

The municipal bond market has continued to recover since undergoing a dramatic transformation during the 2008-2009 financial crisis. Calendar year 2012 was characterized by new record low interest rates, a rebound in bond issuance from very low volume levels in 2011, several prominent municipal bankruptcies around the country, and renewed fears about federal budget cuts and potential impacts to the tax-exempt status of municipal bonds. Significant features of the market and notable events during calendar year 2012 include:

Continued record-breaking low interest rates. Continued economic uncertainty, exacerbated by continued economic weakness and political gridlock in the United States, sovereign credit concerns in Europe, and Federal Reserve quantitative easing or "QE" policies, continued to drive low interest rates lower. The 10-year triple-A rated benchmark bond rate, which set record lows of 2.57 percent in 2009, 2.17 percent in 2010, and 1.86 percent in 2011, set yet another record low of 1.47 percent in late November 2012. Vermont is expected to continue to benefit from these lower rates, due to both a lower cost of capital for new projects, and more opportunities to refinance existing bonds.

Higher levels of bond issuance. Through November 30, $343.8 billion of municipal bonds had been sold nationwide, an increase of more than 30 percent compared to the first 11 months of 2011. Much of the increased issuance was due to state and local governments, including the State and other Vermont-related issuers, refinancing existing debt. However, less than $297 billion of bonds were sold during 2011, which was the lowest annual volume since 2001. Sales volume in 2012 is still on track to be below average. Reduced issuance could impact Vermont because our forward-looking debt projections are benchmarked against other states, and lower issuance could constrain estimates of Vermont's future debt capacity.

The impacts of continued federal policy uncertainty. Notwithstanding the passage of The American Taxpayer Relief Act of 2012 on January 2, Congress and the President continue to debate spending, the budget deficit, the debt ceiling, and automatic budget cuts or "sequestration." In September, the Office of Management and Budget enumerated possible federal spending cuts if sequestration occurs. Included in those proposed cuts was a 7.6 percent reduction in the federal interest subsidy associated with Build America Bonds (BABs); should this reduction take effect, then Vermont could lose more than $95,000 of interest subsidy during fiscal year 2014. In addition, all three credit rating agencies maintain negative credit outlooks on the United States and have threatened rating downgrades if insufficient progress is made to reign in budget deficits in the intermediate term, or if debt ceiling brinkmanship is repeated. The rating agencies have indicated that states are unlikely to maintain ratings more than one "notch" above the U.S. As such, if the U.S. is downgraded below AA by S&P, AA+ by Fitch, or Aa1 by Moody's, then Vermont's ratings could be negatively impacted.

Possible limitations on municipal bond tax exemption. In 2011, President Obama's American Jobs Act proposed limiting the municipal bond federal tax exemption to 28 percent, versus the current 35 percent for the top income tax bracket, and the deficit Super Committee targeted the tax exemption of municipal bonds as potential "tax expenditure" to be eliminated. During the fiscal cliff negotiations, measures such as limiting tax deductions (including the deduction for municipal bond interest) have been discussed. Any change to federal law that reduces or eliminates the tax exemption for municipal bond interest likely would increase the interest rates Vermont would need to pay to attract bond investors, substantially increasing the State's borrowing costs.

During this time frame, the State of Vermont has continued to benefit from disciplined debt issuance and debt management policies. These policies include moderate levels of bond issuance, careful consideration of debt affordability, strict adherence to credit rating agency guidelines, and strong fiscal budget policies to ensure that the State has funds readily available for bond principal and interest payments. These efforts are the result of years of attention to rating agency and investor interests and concerns and have resulted in the high debt rating – and corresponding very low borrowing costs – that the State currently enjoys. Vermont has also benefitted from its reputation for rigorous and thorough financial disclosure, and has steered clear of financial and regulatory concerns.

Vermont's Bond Ratings

As of September 2012, eighteen states had a triple-A rating from at least one rating agency. Vermont was upgraded to a Aaa rating by Moody's in February of 2007, and Fitch "recalibrated" Vermont's rating from AA+ to AAA in April 2010. Combined with a AA+ bond rating from S&P, Vermont enjoys the highest general obligation bond ratings of any New England state (see bond rating chart). Vermont's Moody's and Fitch ratings carry a stable outlook, and S&P revised its outlook for Vermont from stable to positive. The triple-A ratings by Moody's and Fitch and the excellent rating from S&P are reflective of sound fiscal practices that include: (1) budgetary discipline; (2) an economy with significant breadth; (3) strong debt management practices; and (4) effective State governance reflecting sound statutes and legislative history.

Vermont's Moody's and Fitch ratings carry a stable outlook and S&P revised its outlook for Vermont from stable to positive.

Since a higher rating enhances the State's reputation in the municipal marketplace, it makes Vermont's bonds very marketable to a broad range of individual and institutional investors. As noted previously, this generally results in a lower interest rate or cost of capital for borrowing. It also is likely to reduce borrowing costs for municipalities that issue debt through the Vermont Municipal Bond Bank or other borrowers issuing State moral obligation debt through other State agencies, as the State's rating supports these bond issues.

New England General Obligation Bond Ratings

STATE	FITCH	MOODY'S	S&P
Vermont	**AAA**	**Aaa**	**AA+**
Connecticut	AA	Aa3	AA
Maine	N/A	Aa2	AA
Massachusetts	AA+	Aa1	AA+
New Hampshire	AA+	Aa1	AA
Rhode Island	AA	Aa2	AA

Debt Affordability

The Treasurer's office, in conjunction with the Governor and General Assembly, has historically set a course of maintaining modest levels of new authorizations of long-term debt and net tax-supported debt outstanding. As a result, bond issuance is currently at substantially lower levels than in the early and mid-1990s. Reduction in debt, plus continued improvement in the State's economic indices and financial condition over recent years, has improved the State's debt ratios to those among the highest-rated states. The State's practice of issuing debt with level annual principal installments has also resulted in a favorable amortization rate. At a rate of more than 70 percent retirement within 10 years, the State's bond payoff ratio continues to be favorably received by the rating agencies.

By practicing debt issuance moderation and compliance with well-defined guidance standards that have the clear goal of Vermont being a triple-A rated state, Vermont has the ability under current challenging credit market conditions to issue debt at attractive interest rates to meet infrastructure and other capital spending needs.

A major contributing factor to Vermont's respected debt management is the work of the Capital Debt Affordability Advisory Committee (CDAAC). The CDAAC completes an annual review of the size and affordability of the State tax-supported general obligation debt and submits to the Governor and to the General Assembly an estimate of the maximum amount of new long-term general obligation debt that prudently may be authorized for the next fiscal year. The estimate of the committee is advisory, but historically has been adopted by the State as a bonding limit. The CDAAC is made up of three ex officio members, two appointees of the Governor, one appointee of the State Treasurer, and an appointee of the Vermont Municipal Bond Bank. The State Treasurer serves as chair of the committee.

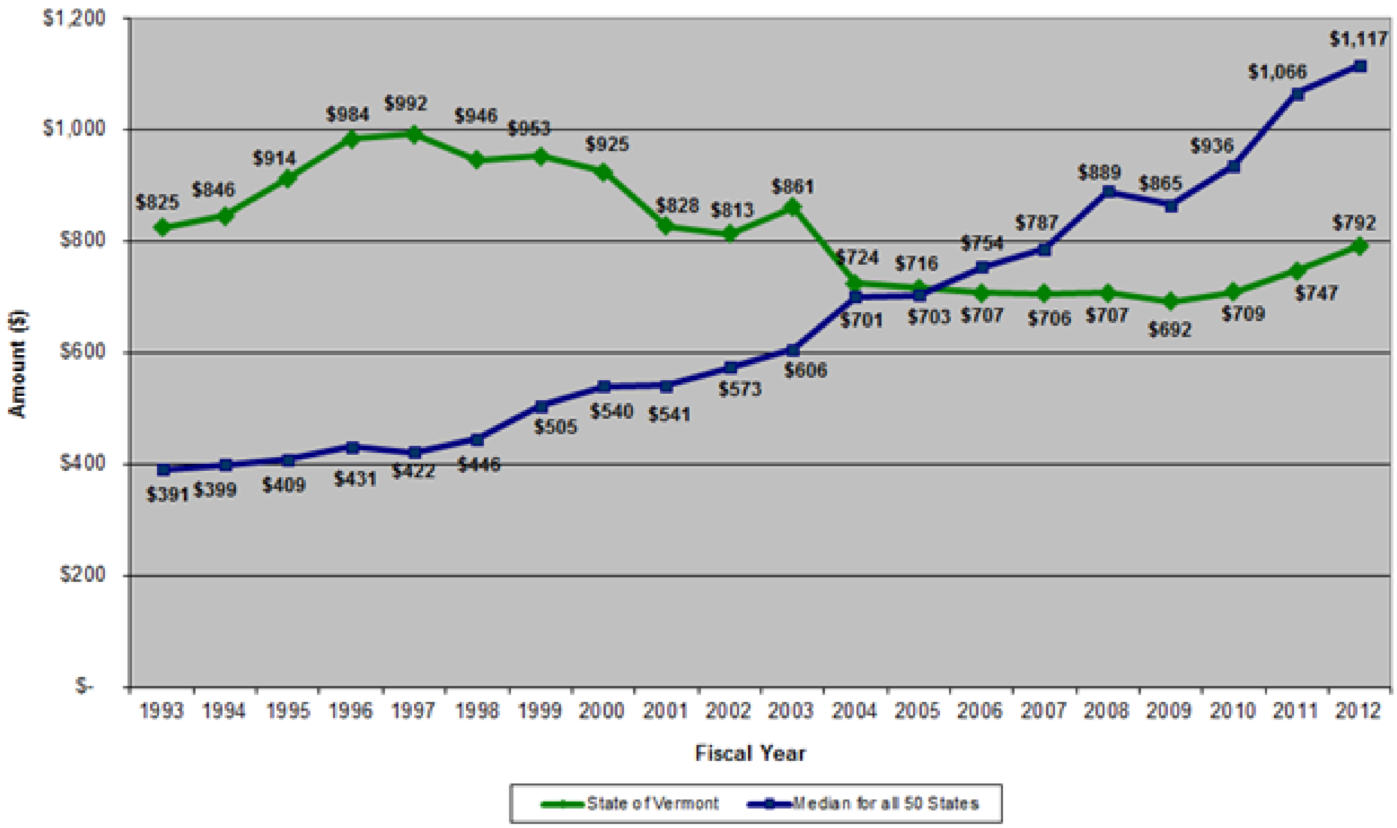
In September of 2012 the CDAAC recommended a two-year maximum net tax-supported debt authorization of $159,900,000 for fiscal years 2014 and 2015, which is the highest level that allows for adherence to CDAAC guidelines, notwithstanding creation of higher levels of debt outstanding. In addition, this will enable the State to take advantage of lower construction costs and interest rates during the economic downturn. The committee continues to believe that debt issuance moderation is appropriate in uncertain economic times.

The State's disciplined approach to debt management is paying off in today's tax-exempt marketplace. By practicing debt issuance moderation and compliance with well-defined guidance standards that have the clear goal of Vermont being a triple-A rated state, Vermont has the ability under current challenging credit market conditions to issue debt at attractive interest rates to meet infrastructure and other capital spending needs. Providing for a significant level of transportation expenditures within the capital budget is, with regard to recent history, a change for the State, and welcome in the context of needed transportation projects spending.

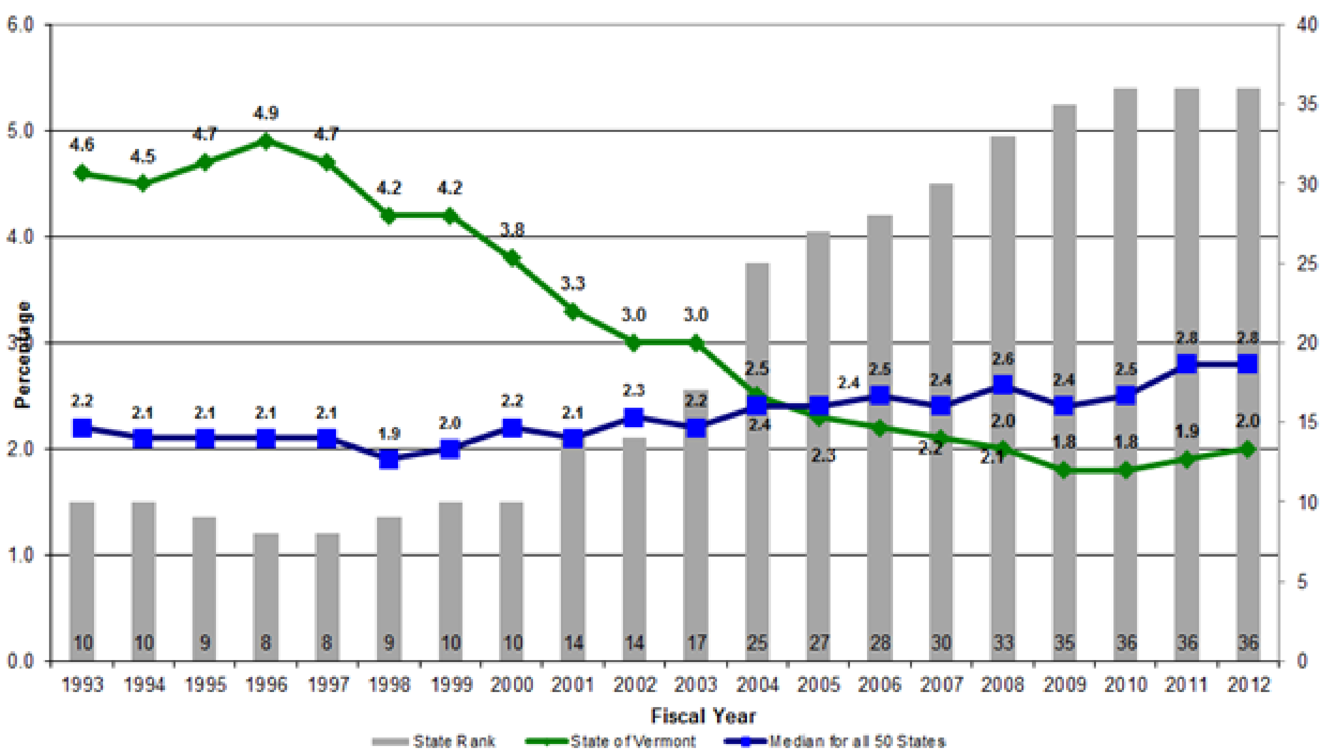
Debt Ratios

The fiscal discipline of recent years has paid off as Vermont's debt ratios rank favorably among triple-A rated states. The key to maintaining and obtaining other triple-A ratings will be to demonstrate continued diligence in the areas just discussed while making improvements on other major sustainability issues. Those

Net Tax Supported Debt Per Capita - Vermont Versus 50 States Median



Net Tax Supported Debt as a Percent of Personal Income - Vermont Versus 50 States Median



issues are: Medicaid funding; State employees' and teachers' pension funding; the funding of other post-employment benefits (OPEBs); and preservation and development of the State's infrastructure. Summarized below are some of the key debt indicators for Vermont.

Debt Per Capita

One of the key debt factors monitored by the CDAAC and the rating agencies is the State's net tax-supported debt per capita. The guideline adopted by the CDAAC establishes a target debt per capita at Moody's median and means for triple-A rated states. In 2012, the State's debt per capita was $792 versus the Moody's five-year triple-A median and mean of $969 and $1,095, respectively (see charts on pages 35 & 37). The State's ranking versus all 50 states improved steadily from 28th in 2007 to 37th in 2011, but slipped to 34th in 2012.

One of the key debt factors monitored by the CDAAC and the rating agencies is the State's net tax-supported debt per capita.

The higher the ranking figure, the lower a state's debt per capita is relative to all other states. The State's net tax-supported debt per capita is forecast to grow to $1,216 by 2023. That forecast assumes a steady level of debt authorization and the issuance of $79.95 million in future years starting in fiscal year 2014, and employs the population forecast developed by Economic Policy Resources. This increase, over a significant period of time, is expected to remain consistent with the State's debt per capita guideline (triple-A states' five-year median and mean) each year through 2023.

Debt as a Percentage of Personal Income

Another credit factor for assessing a state's relative ability to pay its general obligation debt is the ratio of net tax-supported debt as a percent of personal income. The guideline adopted for this ratio is again to target Moody's five-year median and mean for triple-A rated states. The State has steadily improved in this area. The State's ratio of debt to personal income for fiscal year 2012 increased slightly to 2 percent versus Moody's triple-A median and mean ratios of 2.8 percent (see chart on page 35). The State's ranking in its debt as a percentage of personal income improved steadily from 30th highest among all states in 2007 to 36th highest in 2010, where it has remained in the 2011 and 2012 rankings.

Debt as a Percentage of Revenue

The guideline used for this ratio states that projected annual State debt service on bonds should not be in excess of 6 percent of projected revenues in the combined general and transportation funds. The debt service as a percentage of revenues ratio was 4.9 percent for fiscal year 2012. This percentage is expected to fall to 4.2 percent by fiscal year 2015 and then rise to 4.9 percent by fiscal year 2023. This is based on the assumption of the issuance of $79.95 million of debt from fiscal year 2014 through fiscal year 2023.

Moody's Investors Service -- Debt Per Capita -- State of Vermont

Triple-A Rated States--5-Year Average Mean and 5-Year Median Excluding Vermont

MEAN: $947 MEDIAN: $893 5-Year Average - VERMONT: $729

Triple-A Rated States[1]	Moody's Ratings[2]	S&P Ratings[2]	Fitch Ratings[2]	Moody's Debt Per Capita 2008	2009	2010	2011	2012
Alaska	Aaa/Stable	AA+/Stable	AA+/Stable	$924*	$861*	$1,345*	$1,257	$1,454
Delaware	Aaa/Stable	AAA/Stable	AAA/Stable	2,002	2,128	2,489	2,676	2,674
Florida	Aa1/Stable	AAA/Stable	AAA/Negative	1,005	1,115	1,123	1,150	1,167
Georgia	Aaa/Stable	AAA/Stable	AAA/Stable	954	984	1,120	1,103	1,099
Indiana	Aaa/Stable	AAA/Stable	AA+/Stable	478	482	492	471	446
Iowa	Aaa/Stable	AAA/Stable	AAA/Stable	98*	79	73	270	310
Maryland	Aaa/Negative	AAA/Stable	AAA/Stable	1,297	1,507	1,608	1,681	1,742
Minnesota[3]	Aa1/Stable	AA+/Stable	AA+/Stable	879	866	1,037	1,159	1,148*
Missouri	Aaa/Stable	AAA/Stable	AAA/Stable	675	670	780	775	741
Nebraska	Not Rated	AAA/Stable	Not Rated	22*	17*	15*	13	15
New Mexico	Aaa/Negative	AA+/Stable	Not Rated	1,429*	1,394*	1,398	1,827	1,406
No. Carolina	Aaa/Stable	AAA/Stable	AAA/Stable	898	832	765	782	815
So. Carolina	Aaa/Stable	AA+/Stable	AAA/Stable	966	899	917	887	827
Tennessee	Aaa/Negative	AA+/Positive	AAA/Stable	221*	233*	318	345	343
Texas	Aaa/Stable	AA+/Stable	AAA/Stable	481*	520*	520	612	588
Utah	Aaa/Stable	AAA/Stable	AAA/Stable	542	447	957	1,222	1,393
Virginia	Aaa/Negative	AAA/Stable	AAA/Stable	764	782	895	1,058	1,169
Wyoming	Not Rated	AAA/Stable	Not Rated	91*	84*	77*	71	64
MEAN[4]	___________	__________	__________	**951**	**899**	**966**	**964**	**956**
MEDIAN[4]	___________	__________	__________	**898**	**849**	**917**	**973**	**827**
VERMONT	Aaa/Stable	AA+/Stable	AAA/Stable	707	692	709	747	792

[1]Indiana carries a Municipal Issuer Rating from S&P, assigned in 2008 and it is first reflected in 2008 numbers – this is a G.O. bond equivalent rating. The Fitch rating for Indiana (AA+) is for lease revenue bonds. Iowa carries a Municipal Issuer Rating of triple-A from Fitch – an implied G.O. rating. S&P assigned its respective rating on Iowa in 2009 and it is first reflected in 2009 numbers. Fitch raised Florida, Iowa, Vermont, Tennessee and Texas to triple-A in 2010 as part of their Ratings Recalibration effort. Moody's raised Indiana, Iowa, New Mexico, Tennessee and Texas to triple-A in 2010 as part of their Ratings Recalibration effort. Eighteen states are currently rated triple-A by one or more of the nationally recognized rating agencies: Triple-A ratings assigned as follows: Delaware and Florida (2005), Georgia, Maryland, Missouri, North Carolina, South Carolina, Utah, Virginia and Vermont (2007), Indiana (2008), Iowa (2009), New Mexico, Tennessee and Texas (2010), Alaska, Nebraska and Wyoming (2011).

[2]Ratings as of June 30, 2012.

[3]Minnesota was downgraded by Fitch to AA+ from AAA on July 7, 2011 and it was downgraded by Standard and Poor's to AA+ from AAA on September 23, 2011. Minnesota is included in calculating the means and medians in the years from 2008 to 2011.

[4]These calculations exclude all Vermont numbers.

*Indicates that the state was not rated triple-A by any of the three rating agencies during the year shown. Amount not used in calculating the mean or median for the year.

Additional Factors Affecting Bond Ratings

There are many other factors considered in a state's bond rating besides ratio analysis. These include:

Budget Stabilization Reserves: The State has budget stabilization reserve levels required by statute for each of the State's General Fund, Transportation Fund, and Education Fund. Required reserves for the General Fund and Transportation Fund are 5 percent, and for the Education Fund are 3.5 percent to 5 percent of the previous year's appropriations. Currently, all three funds are at their statutory requirements and as stated above, have not yet been tapped in response to the current economic downturn. The combined effect of full budget stabilization reserves, plus the caseload reserves, is positive for the State's ratings. Additionally, both the Governor and the State Treasurer have recommended a long-term goal to increase the general fund reserve to 8 percent, and in its 2012 session the State Legislature created a General Fund Balance Reserve (or "Rainy Day Fund"). The Treasurer's office recommends building to a target of 3 percent for the Rainy Day Fund, which combined with the budget stabilization reserves would match the rating agencies' preferred 8 percent total reserves level.

Pension Funds Funding Percent: Of the three State-level pension funds, two receive State contributions—the Vermont State Employees' Retirement System (VSERS) and the Vermont State Teachers' Retirement System (VSTRS). Inasmuch as State contributions derive from taxes, the rating agencies are very concerned with the percentage of future pension liabilities that are funded in these plans. As of June 30, 2012, the VSERS funding level is at 77.7 percent and the VSTRS funding level is 61.6 percent. These levels are down from 79.6 percent and 63.8 percent, respectively in 2011. While budgets are squeezed as a result of the recent economic downturn, continued discipline in funding the actuarial required contribution (ARC) is an important factor for the rating agencies. In 2010, the Vermont National Education Association (VNEA) worked with the Treasurer's office to help pass some of the most progressive pension reform in the country, significantly improving the sustainability of the teachers' pension system. In addition, changes to other post-employment benefits (OPEBs) significantly reduced the unfunded liability associated with retired teacher health care costs. In 2011, the State enacted employee rate increases improving the long-term stability of State employee pension benefits.

Other Factors: The rating agencies also consider the breadth of the economy; the level and condition of the State's transportation, utilities and other infrastructure; personal income levels; fiscal responsibility; employment levels; workforce size and training; population demographics and trends; internal controls and auditing standards; need for short-term borrowings; and other factors.

Short-Term Borrowing

The seasonal nature of the revenue and expenditure cycles occasionally requires the use of short-term borrowing. Typically, education payments to local towns and school districts occur in the first half of the fiscal year, while tax revenues are collected later in the year, primarily April. By April the revenue flow is generally positive. In the early 1990s, Vermont was issuing approximately $150 million of short-term debt obligations annually, not including $65 million in deficit notes. The State did not require the issuance of short-term debt in fiscal years 1999-2002. With the economic decline in 2002, the State issued $75 million in revenue anticipation notes (RANs) for part of 2003 and $48 million in September to early March 2004.

Current economic conditions and declining State revenues require monitoring in the context of short-term borrowing needs. The State has been diligent in managing expenditures according to revised revenue projections and has not needed to borrow short-term funds since 2003. At this point the Treasurer's office is reasonably confident it will not need to borrow during the balance of fiscal year 2013. If the State is required to borrow funds, such needs are planned to be met using the letter of credit, which can be repaid immediately. Using the letter of credit is preferable to longer-term financing alternatives such as revenue anticipation notes (RANs), which would generate higher interest costs for the State. The State began fiscal year 2013 with approximately $379.98 million in unrestricted cash and investments on hand, and maintained $179.9 million in unrestricted cash and investments as of December 31, 2012. While these cash balances do not bear a direct one-to-one relationship to fund balance, they indicate a stable and solid position as of fiscal year 2013.

Mean Debt Ratios -- State of Vermont

Per Capita	2008	2009	2010	2011	2012
All States	$1,158	$1,195	$1,297	$1,408	$1,408
Triple-A[1]	951	899	966	964	956
VERMONT	**707**	**692**	**709**	**747**	**792**

% of Personal Income.	2008	2009	2010	2011	2012
All States	3.2%	3.1%	3.2%	3.2%	3.4%
Triple-A[1]	2.8	2.4	2.6	2.6	2.5
VERMONT	**2.0**	**1.8**	**1.8**	**1.9**	**2.0**

1 These calculations exclude all Vermont numbers and include only states rated triple-A by any one of the three rating agencies during the year shown. See chart on "Debt Per Capita" for a complete listing of triple-A states and respective ratings and triple-A time periods.

Moody's Investors Service -- Debt as % of Personal Income -- Vermont

Triple-A Rated States--5-Year Average Mean and 5-Year Median Excluding Vermont

MEAN: 2.6% MEDIAN: 2.6% 5-Year Average VERMONT: 1.9%

Triple-A Rated States	Moody's Investors Service 2008	2009	2010	2011	2012
Alaska	2.4%*	2.2%*	3.2%*	3.00%	3.30%
Delaware	5.2	5.4	6.2	6.8	6.8
Florida	2.8	2.9	2.9	3.0	3.0
Georgia	3.0	3.0	3.3	3.3	3.1
Indiana	1.5	1.5	1.5	1.4	1.3
Iowa	0.3*	0.2	0.2	0.7	0.8
Maryland	3.0	3.3	3.4	3.5	3.6
Minnesota	2.3	2.1	2.4	2.8	2.7*
Missouri	2.1	2.0	2.2	2.2	2.0
Nebraska	0.1*	0.0*	0.0*	0.0	0.0
New Mexico	4.8	4.6	4.4	5.6	4.2
North Carolina	2.8	2.5	2.3	2.3	2.3
South Carolina	3.3	2.9	2.9	2.7	2.5
Tennessee	0.7*	0.7*	0.9	1.0	1.0
Texas	1.4*	1.4*	1.4	1.6	1.5
Utah	1.9	1.5	3.2	3.9	4.4
Virginia	1.9	1.9	2.1	2.4	2.6
Wyoming	0.2*	0.2*	0.2*	0.1	0.1
MEAN[1]	**2.8**	**2.4**	**2.6**	**2.6**	**2.5**
MEDIAN[1]	**2.8**	**2.3**	**2.6**	**2.6**	**2.5**
VERMONT	2.0	1.8	1.8	1.9	2.0

[1]These calculations exclude all Vermont numbers and include only states rated triple-A by any one of the three rating agencies during the periods shown, year ended June 30th.

*Indicates that the state was not rated triple-A by any of the three rating agencies during the year shown. Amount not used in calculating the mean or median for the year.

Investments

Overview

Investment services, within the State Treasurer's Office, provides cash and investment management for the State of Vermont and the pension systems administered by the office. The Treasurer's office administers the investment policies and strategies adopted by the Vermont Pension Investment Committee (VPIC) for the benefit of the Vermont State Employees' Retirement System, Vermont State Teachers' Retirement System, and the Vermont Municipal Employees' Retirement System. VPIC also oversees the investment assets of the Burlington Employees' Retirement System. The combined assets of the retirement plan portfolios were approximately $3.5 billion as of October 31, 2012.

VPIC acts as the trustee for the defined benefit plan investments, while the board of trustees for each system maintains its fiduciary role in the area of benefits administration and actuarial recommendations. The State Treasurer serves on the

Investments
(802) 828-3668

Matt Considine
Investment Management Director

Katie Green
Investments Manager

John Booth
Treasury Operations Director

Dan Currier
Cash & Investments Manager

ACCOMPLISHMENTS IN 2012

- The Vermont Pension Investment Committee substantially completed implementing an asset allocation plan begun in 2009 in response to the Great Recession. Year-over-year, the asset allocation saw equities reduced to 33.5 percent, fixed income reduced to 35 percent, alternatives unchanged at 11.5 percent and risk parity and global asset allocation strategies increased to 20 percent. The portfolio's total return was approximately 2.3 percent, ranking the funds in the top one-third of institutional fund returns.

- Several investment managers received increased allocations, two funds were removed, and securities lending activities were ceased. Finally, the addition of a private equity manager was approved and negotiations begun for funding of that strategy in fiscal year 2013.

- A search for a new pension investment custodian bank was undertaken, with JP Morgan being selected from the finalists. During the past year, a new contract was negotiated and the transfer of assets from the prior custodian was coordinated, resulting in a smooth transition at the end of the fiscal year. Among the benefits of the new custodial relationship are increased flexibility with respect to intra-month allocation changes, additional performance measurement tools and expanded compliance-monitoring services.

- During the fiscal year, the Treasurer's office completed a review of the fee structure associated with the deferred compensation plan under its administration, resulting in a reduction to the administrative fee levied on participants. The plans also saw its capability expanded with the addition of a self-directed brokerage window.

- Finally, a number of RFPs were issued and evaluated, resulting in new contracts in fiscal year 2013 for a stable value fund and administration of two defined contribution plans. Additional contracts for proxy voting services and monitoring state sponsors of terrorism and genocide are ongoing.

retirement boards and the VPIC and is also the custodian of the funds, providing administrative support and oversight.

With respect to pensions, the VPIC employs an outside investment consultant, NEPC LLC, to assist them in their fiduciary responsibility, including development of investment policies and objectives; risk management assessment and asset allocation plans; investment manager and custodian searches; monitoring of management performance; industry issues; SEC compliance; and on-going due diligence on investment managers, performance measurement, and education on various issues (asset classes, alternative investments, risk assessment).

Short-term operating funds are invested by the Treasury Operations Division, which also is responsible for banking and cash management and projections. These funds are invested based on the Treasurer's authority in State statute. The State Treasurer has issued further guidelines for these investments, consistent with statute. The guiding principles for these investments are safety first and foremost, followed by liquidity and yield. Certain trusts, including the Higher Education Trust Fund, Tobacco Trust Funds, a State OPEB Trust Fund and other trusts are pooled and invested in a Trust Investment Account (TIA) that has a longer maturity horizon than operating funds. The State Treasurer serves as trustee for these funds. The State Treasurer is also the trustee for the state employees defined contribution fund.

The various retirement boards (state, teachers, municipal) act as trustees for various benefit-related trusts including the state and municipal defined contribution plans, a single deposit investment account or SDIA (State and teachers), a deferred compensation fund (open to teachers, municipal, and State members, with the State Retirement Board acting as trustee), and a Municipal Employees' Health Benefit Fund. All employ outside managers.

UPDATES

Pension Fund Investments

The State employees', teachers' and municipal employees' retirement plans had combined assets of approximately $3.3 billion on June 30, 2012. In addition, the Burlington Employees' Retirement System, which became a participating investor with the VPIC at the end of October 2007, had assets of approximately $124 million as of the same date.

The VPIC portfolio produced attractive investment performance relative to other public pension funds--ranking in the top 15 percent of public funds.

The charts on page 43 outline the long-term and 10-year investment performance of Vermont's retirement systems. These numbers are heavily impacted by the Great Recession. Prior to the Great Recession, the rolling 10-year average returns exceeded 8 percent. These were significantly impacted by market performance in 2008-2009. The 10-year rolling averages for subsequent years reflect this, but have begun to exhibit an upward trend. In fiscal year 2012, one-year investment returns were 2.4 percent for VSERS, 2.2 percent for VSTRS, and 2.4 percent for VMERS versus the median public fund return of 1.2 percent. The relatively low absolute return level should be viewed in light of the fact that this performance was in the top-third of public plan returns. Also note that the 30-

VPIC Membership

The Vermont Pension Investment Committee is responsible for the investment of almost $3.3 billion in assets for the three state-level retirement systems as of June 30, 2012. Act 100, which became effective July 1, 2008, redefined the membership of VPIC to six voting members and four alternates (from seventeen members previously). Act 139, which became effective July 1, 2010, established the VPIC Chair as a seventh, non-voting member elected by the six voting VPIC members. The active and retired employee members of the Vermont State Employees' Retirement System and Vermont State Teachers' Retirement System boards of trustees each appoint one member and one alternate. The employee and municipal official members of the board of the Vermont Municipal Employees' Retirement System appoint one member and one alternate. In addition, two members and one alternate are appointed to the VPIC by the Governor. The sixth member is the State Treasurer or designee. In considering appointments, the legislation directs that the experience and knowledge of potential appointees be considered in light of the purposes of the committee. The members serve staggered four-year terms with no term limits.

As of December 2012, individuals appointed to the committee are: Stephen Rauh, chair; Robert Hooper, VSERS voting member; Kevin Gaffney, VSERS alternate; Steven Jeffrey, VMERS voting member; Tom Golonka, VMERS alternate; Joseph Mackey, VSTRS voting member; Tom McConnell, VSTRS alternate; Richard Johannesen, Governor's appointee; Vaughn Altemus, Governor's appointee; Karen Paul, Governor's alternate appointee; and Beth Pearce, State Treasurer.

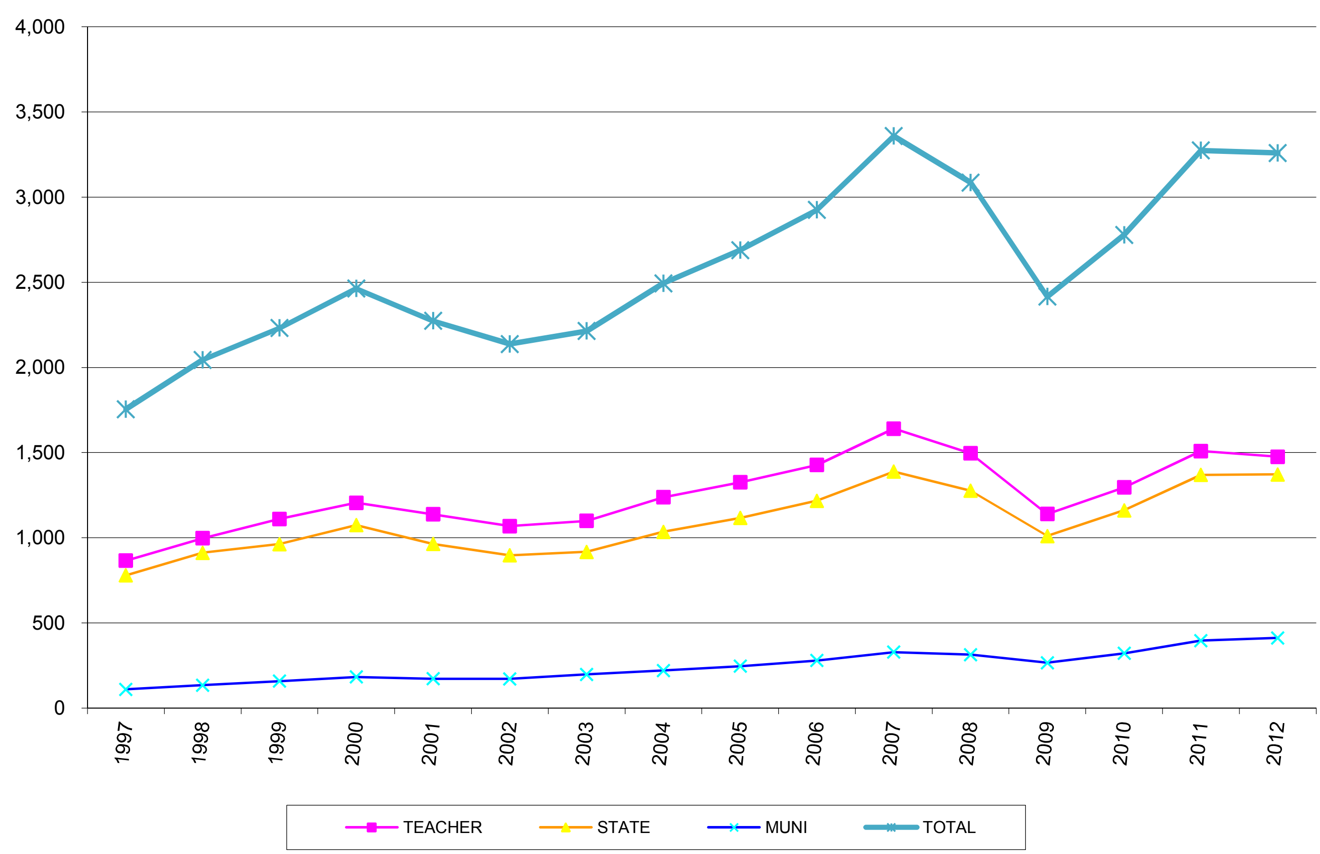
year expected returns for the portfolio are 6.8 percent, based upon current asset allocations, as determined by our independent investment consultants.

In 2012 we saw the continued benefits of portfolio restructuring efforts that were begun in 2009, with reduced portfolio risk and improved performance in the most recent three years. While longer term returns until fiscal year 2008 were well above the assumed actuarial rate of return (For example, 1.2 percent five-year returns for VSERS versus an 8 percent actuarial rate.), the financial crisis in 2008 and subsequent Great Recession have posed challenges for all retirement plans. In this context, the three-year annualized returns of 13.5 percent seen in fiscal year 2012 for the VSERS, accompanied by a reduction in annualized risk by approximately one-third, suggests significant progress has been made in adjustment of the portfolio. Part of this diversification has been achieved by incorporating a number of additional investment strategies, but a reduction in the exposure to equity risk also has contributed to recent improvements. As a result, the "capture" of performance in up and down markets has improved. Recent months' portfolio performance show more resiliency than in months prior to 2010. The current asset allocation is summarized on the chart on page 44.

Through a competitive process, in fiscal year 2008 the VPIC selected a consultant and advisor to assist with its previously adopted policy relating to investing in companies involved in genocidal or terrorist states. With assistance from this advisor, the VPIC has the tools required to identify issuers that may be

Growth of Pension Assets -- Fiscal Year 1997-2012

(Amount in $Millions)



in conflict with its policy and proceed with engagement or divestiture as appropriate. In 2010, VPIC expanded the list to include 25 companies and continues to discuss both the policy and ways of enhancing its efficacy in engaging or divesting companies found to be in conflict with it. Furthermore, the switch in investment custodians at the end of 2012 expands the ability and capacity to monitor managers' adherence to investment guidelines on a higher-frequency basis than in prior years.

In 2012 we saw the continued benefits of portfolio restructuring efforts that were begun in 2009, with reduced portfolio risk and improved performance in the most recent three years.

In 2011, VPIC continued its review of its domestic and international proxy voting policies. Corporate responsibility and accountability guidelines in these policies include voting policies on environmental issues such as global warming-related initiatives, environmental reporting, and executive compensation, as well as workplace issues such as equal employment opportunities, human rights, and labor codes. These policies can be viewed on the State Treasurer's web site.

Long-Term Investment Performance of Vermont's Retirement Systems - As of June 30, 2012

Gross of Fees

Retirement System:	Last 1 Year	Last 3 Years	Last 5 Years	Last 7 Years	Last 10 Years
Teachers Composite	2.2%	13.2%	1.7%	5.0%	6.6%
State Composite	2.4%	13.5%	2.3%	5.4%	6.6%
Municipal Composite	2.4%	13.6%	2.4%	5.6%	6.4%
Median Public Fund	1.2%	11.5%	2.0%	5.1%	6.4%

10-Year Investment Performance of Vermont's Retirement Systems - As of June 30 of Each Fiscal Year

Gross of Fees

Retirement System:	2012	2011	2010	2009	2008	2007	2006
Teachers Composite	6.6%	5.8%	3.7%	2.9%	6.3%	8.7%	9.1%
State Composite	6.6%	5.8%	3.1%	2.5%	5.6%	8.1%	8.6%
Municipal Composite	6.4%	5.9%	4.0%	2.8%	6.3%	9.1%	9.5%
Median Public Fund	6.4%	5.7%	3.4%	2.9%	6.1%	8.3%	8.5%

Source for tables above: New England Pension Consultants

Asset Allocation of Pension Funds as of June 30, 2012

Investment Category	Allocation
Equity	
Domestic Large Cap	11%
Domestic Mid Cap	3%
Domestic Small Cap	4%
International Established	10%
Emerging Market	6%
Total Equity	**33%**
Fixed Income	
Diversified Bonds	19%
High Yield Bonds	6%
Global Bonds	3%
Emerging Market Debt	5%
TIPS	3%
Total Fixed Income	**36%**
Alternatives	
Real Estate	5%
Hedge Fund-of-Funds	5%
Commodities	2%
Total Alternatives	**11%**
Multi-Strategy	
Risk Parity	8%
Global Asset Allocation	11%
Total Multi-Strategy	**20%**
Cash	**0%**
Grand Total	**100%**

Note for table above: To streamline administration and ensure greater consistency of returns across the three systems, VPIC migrated all three Vermont Retirement systems to the same asset allocation.

Trust Investment Account

The 2000 State Legislature authorized the establishment of a trust investment account (TIA) administered by the State Treasurer for purposes of investing restricted funds with non-expendable principal balances and other long-term funds. As of June 30, 2012, the fund had a principal balance of approximately $69.7 million, of which $30.5 million was allocated to the Higher Education Endowment Trust Fund, $17.8 million to the Tobacco Trust Fund, and the remainder to various smaller trust funds.

The current target allocation of the Trust Investment Account is 70 percent fixed-income securities and 30 percent equities. For fiscal year 2012, the fund had a dollar weighted total return of 4.1 percent versus the target return of 7.65 percent, which is based on actual asset allocation, and the performance of the S&P 500 Stock Index (5.45 percent) and the Barclays (formerly Lehman) Aggregate Bond Index (7.47 percent). The lag was due primarily to mortgage backed securities underperforming Treasuries and broader fixed income classes, as well as underperformance in equities. Since inception in 2000, the TIA fund has earned 7.77 percent, exceeding its benchmark of 6.3 percent.

It is important to note that TIA funds are invested with Vermont investment managers, including Hanson & Doremus Investment Management and Prentiss Smith & Co. on the domestic equity front and Sentinel Asset Management, Inc. for the fixed income portion. The only portion not invested with a local Vermont manager is used to assist Vermont housing. Beginning in fiscal year 2008, the Treasurer's office invested $2.5 million of TIA assets in a mutual fund that invests in public housing and other fixed-income securities throughout the United States. The

(continued next page)

Short-Term Investments

The Office of the State Treasurer is committed to meeting the cash needs of State operations while protecting the value of its assets, and approaches these responsibilities using a prudent and deliberative process. This past fiscal year presented a number of challenges, most notably a continuation of the Federal Reserve's "ZIRP" or zero interest rate policy for short-term investment rates, continued political uncertainty, and economic volatility.

In response to continued slow economic growth and high unemployment, Federal Reserve Chairman Ben Bernanke and the Federal Open Market Committee (FOMC) have, since December 2008, targeted the federal funds rate to a range between 0 percent and 0.25 percent. In December 2012, Chairman Bernanke announced that the Federal Reserve would also employ unlimited quantitative easing (QE) until the unemployment rate falls below 6.5 percent, which was not expected until 2015. As a result, yields on high quality short-term fixed income securities maturing in three years or less are expected to remain near or below 0.25 percent. This limits the returns available on operating funds - including the general fund, transportation, and education fund - for which preservation of principal and daily liquidity are the most important objectives.

The short-term portfolio earned $917,500 in interest income in fiscal year 2012 on average daily available balances of $353.7 million.

The short-term portfolio earned $917,500 in interest income in fiscal year 2012 on average daily available balances of $353.7 million. Of this amount, $234,308 was credited to interest earning funds, and the balance of $683,192 remained in the general fund. The yield on the available cash in the portfolio was 0.26 percent for the year, which exceeded the average three-month Treasury Bill yield of 0.046 percent.

Extensive negotiations were completed with the State's bank of record, TD Bank, to increase the yield on overnight deposits, effective January 1, 2012.

Investments for operating funds and restricted funds and trusts, including the Trust Investment Account, but excluding pension and retirement trust funds, attained a combined interest rate return of 0.88 percent.

Higher Education Trust Fund

The 1999 State Legislature established the Vermont Higher Education Endowment Trust Fund and appropriated $6 million for the creation and management of the fund by the State Treasurer. An additional $22.5 million of contributions were added between fiscal years 2002 through 2012. On June 30, 2012, the fund had a market value of $30,495,227.22. In September of 2012, the State Treasurer authorized the distribution of 5 percent of the average market value of the assets over the prior 12 quarters equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation. Each entity received $377,409.25 to be applied as non-loan financial aid to Vermont students attending Vermont post-secondary institutions.

On June 30, 2012, the Vermont Higher Education Endowment Trust Fund had a market value of $30.4 million.

The Higher Education Endowment Trust Fund Act further provides that contributions shall include "… in any fiscal year in which a general fund surplus exists and the general fund stabilization reserve is funded to its required statutory level, funds raised by the estate tax under chapter 190 of Title 32 which are more than 125 percent of the amount projected by the emergency board in the July annual forecast made pursuant to section 305a of Title 32." In fiscal year 2008, a substantial contribution from this provision was made of $5,223,449, and in fiscal year 2010 the fund received an additional contribution of $1,521,871. At the end of fiscal year 2011, $11 million was received under this provision and reflected in the fiscal year 2012 balances. In addition, pursuant to legislation introduced by the Treasurer, all unclaimed property worth less than $100 that has been under State custody for ten years or longer is to be turned over to the Higher Education Trust Fund. Under this provision, $600,000 was added to the fund in fiscal year 2007, $51,586 in fiscal year 2009, $47,471 in fiscal year 2010, $30,026 in fiscal year 2011, and $60,675 in fiscal year 2012.

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balance continues to be invested and earning interest and has grown to approximately $3.2 million. The fund manager, RBC Global Asset Management (formerly Access Capital), has an equal investment in high-grade Vermont securities that address principally underserved segments of the housing market, such as affordable housing. The aim of the investment was to increase the pool of available capital funds for affordable housing in Vermont. RBC invests in mortgages to homebuyers making less than 80 percent of an area's median income. The fund invests primarily in AAA/credit quality community economic development investments, usually specially created mortgage-backed securities.

In addition to the above disbursements from the fund, the Vermont Commission on Higher Education Funding authorized the Treasurer to make available the additional 2 percent distribution of $364,817 to be divided equally between the University of Vermont and the Vermont State Colleges for application to their respective permanent endowments. In fiscal year 2013, the additional endowment allocation will be $226,445 for each institution, provided that it is matched on a two-to-one basis by external donations for endowment purposes by the end of the fiscal year and subject to statutory limitations on distributions exceeding contributions. A copy of the State Treasurer's Annual Report to the Commission is attached at the back of this report in the appendix section.

Trust Litigation Settlement Fund & the Tobacco Trust Fund

In November 1998, Vermont was one of 46 states to enter into a settlement agreement with four major tobacco companies. The State's estimated share of settlement payments at that time was expected to total $806 million over the first 25 years of payment, with an additional $156 million of strategic contribution payments to be paid between 2008 and 2017. Through fiscal year 2012, the State has received payments totaling $405.7 million. Fiscal year 2008 marked the first year of receipt of strategic payments, which were $14.4 million and are also included in the fiscal year 2010 total. Pursuant to the agreement, the expected settlement amounts are adjusted for inflation and the effect of any decreases in the sale of tobacco products to the base year. As of January 1, 2009, these have accounted for an 11.5 percent decrease. It remains difficult, therefore, to predict the amount of the future payments due from the tobacco settlement that will be received by the State.

The balance of the Tobacco Trust Fund investments on June 30, 2012 was $17.8 million and $24.96 million at the end of fiscal year 2011.

In fiscal year 2000, the Vermont State Legislature established a Tobacco Litigation Settlement Fund ("Settlement Fund") to be administered by the State Treasurer and subject to further appropriations. In fiscal year 2012, $36.98 million from the settlement fund was directed to healthcare services (Medicaid; includes funds redirected to the Medicaid Global Commitment Fund). A total of $3.65 million was spent on programs in various departments for tobacco enforcement, prevention, and education programs. Additionally, $1.98 million funded substance abuse and youth protection programs in the Agency of Human Services. In fiscal year 2013, the legislature has appropriated $31.3 million for Medicaid health services; $3.6 million for enforcement, prevention, and education; and $1.4 million for substance abuse and youth protection programs. Any remainder of the settlement fund receipts is to remain in the fund for appropriation in fiscal year 2014. In fiscal year 2012, $8.8 million was transferred from the Tobacco Trust Fund to the Tobacco Litigation Settlement Fund per Act 156 of 2010 sec D.103 amended by Act 3 of 2011 sec 58. The balance of the Tobacco Trust Fund investments at June 30, 2012, was $17.8 million and $24.96 million at the end of fiscal year 2011. Of the $17.8 million invested, $7.6 million is committed to the above mentioned transfer to cover the deficit in the tobacco Litigation Settlement Fund as in past years.

Vermont's Expected and Actual Receipt of Tobacco Settlement Funds

FISCAL YEAR	MASTER SETTLEMENT AMOUNT* ($ millions)	Expected* ($ millions)	Actual* ($ millions)
2000	$36.23	$36.23	$33.22
2001	28.47	28.47	24.68
2002	34.18	34.18	31
2003	34.51	34.51	30.55
2004	28.8	28.8	25.82
2005	28.8	26.1	26.21
2006	28.8	24.5	24.06
2007	28.8	22.6	24.99
2008	29.37	39.5	39.91
2009	29.37	39.91	40.66
2010	29.37	36	36.21
2011	29.37	33	33.86
2012	29.37	31	34.52

* Source: JFO. Master Settlement amounts shown are at time of initial settlement. Expected amount determined third quarter of each fiscal year unless noted. Actual excludes Settlement Fund Account performance.

Single Deposit Investment Account

The State Treasurer's Office, in concert with the State and teachers' retirement boards, made a significant change to the structure of the Single Deposit Investment Account (SDIA) two years ago. The SDIA is a non-contributory defined contribution plan. The fund was formed in 1981 and is closed to new membership and funds are not available to the members until they retire or terminate employment. Until fiscal year 2011 it was invested in two intermediate term bond portfolios managed by two different investment managers. The investment policy governing those portfolios included a minimum average credit quality of double-A, no bonds rated below investment grade, and limitations on asset-backed, mortgage-backed, collateralized Mortgage Obligations, corporate bonds, and single issuers of non-treasury/government agency backed bonds. The bonds were "wrapped" by an insurance policy guaranteeing the book principal value of investment to SDIA participants. This insurance wrapper required monthly adjustments of participant crediting rates based on the changing market value of the portfolio.

In response to a limited wrap environment and rising fees, the Treasurer's office undertook a Request for Proposals (RFP) to identify potential wrap providers and/or explore alternate delivery mechanisms. There is concern that continued use of this investment model would be difficult to support in light of a number of SDIA members nearing retirement and the resulting significant increases in the disbursement of funds. As a result of the RFP process, the State opted to transition to a new investment model. That model is a commingled stable value fund designed to combine the assets of unrelated plans, with resulting diversity economies of scale, within a single stable value strategy. This strategy also has the advantage of multiple wrap providers, thus, providing improved security to fund participants. The fund has demonstrated improved investment performance since that time (3.02 percent), while still meeting its stated objectives to provide a relatively

Bank in Vermont

The Treasurer's office continues to maintain its Bank in Vermont program to invest State funds on a predictable basis through certificates of deposit (CDs) via a competitive bidding process in banks with branches in Vermont. The program is designed to be attractive to the wide range of banking institutions in Vermont, and is predicated on the belief that investing Vermont funds in Vermont, consistent with earning a competitive rate of return, is a good policy. A block of funds is set aside for the scheduled bid in specified time frames. The CDs may be short duration, or have longer maturities, depending on the yield curve and cash management requirements. Between its inception in August, 2004, and December, 2012, $688.95 million in CDs have been awarded. As of December 31, 2012, there was one CD outstanding. During 2012, a total of $9.3 million was invested in CDs with varying maturities and rates well above comparable maturity Treasury rates. There have been no losses associated with this program.

high fixed income yield with little market-related risk. Of primary importance is the preservation of principal and earned interest. Secondary to the preservation of capital is the need to generate, over time, a composite yield in excess of short-term yields available in the fixed income money market marketplace.

Other Retirement Trusts/Funds

In 2012, the Treasurer's office issued requests for proposals (RFPs) for a Stable Value Fund manager for the 457 Deferred Compensation Plan and for a Plan Administrator for the State and Municipal Defined Contribution Plans. The State received seven proposals for the Stable Value Fund and awarded the contract to ICMA-RC. The State also received eight proposals for the Defined Contribution Plans and awarded the contracts to the incumbent, Fidelity Workplace Services LLC.

Vermont Veterans' Home

By legislative act in fiscal year 2001, the Vermont Veterans' Home was required to transfer its endowment fund to the State for administration by the State Treasurer. The legislation allows the State Treasurer to invest these funds, if appropriate, with the long-term investments in the Investment Trust Account. The funds were invested with the State's short-term investments, until a spending policy for these funds was established by the Board of Trustees for the Vermont Veterans' Home. At the board's September 2002 meeting, a spending policy was adopted that allowed for transfer of the funds to a fund in the State's Trust Investment Account ("TIA"). Of the amount transferred, $400,000 was deposited in the TIA fund as of October 1, 2002. In November and December of 2002, the Vermont Veterans' Home received a bequest of $410,000 that was deposited into the TIA fund as a second, separately-named fund pursuant to the terms of the bequest. On July 1, 2004, an additional contribution of $75,000 was credited to this second fund.

During fiscal year 2012, there were no withdrawals from the Vermont Veterans' Home TIA. As of June 30, 2012, the balance of the fund first contributed to the TIA was $530,889, and the balance of the second (later) fund was $641,851, for a combined total of $1,172,740.

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Unclaimed Property Division

Overview

The primary goal of the Unclaimed Property Division is to reunite citizens and their unclaimed financial property. Unclaimed property is any financial asset that has been unclaimed by the owner for one or more years, usually after a business or non-profit entity loses contact with a customer for a period of years. Vermont's unclaimed property law requires financial institutions, businesses, and government entities to report to the State personal property they are holding that is considered abandoned or unclaimed. The Unclaimed Property Division is responsible for administering the unclaimed property program. Property is turned over to the office annually when the owner's whereabouts are unknown and the property has been inactive on the books of the reporting company after the appropriate abandonment period has expired. Some examples of property that can become unclaimed are:

- **Savings Accounts**
- **Checking Accounts**
- **Uncashed Checks**
- **Telephone/Utility Deposits**
- **Rental Security Deposits**
- **Wages**
- **Insurance Benefits/Policies**
- **Safe Deposit Box Contents**
- **Mortgage Insurance Refunds**
- **Stocks and Dividends**
- **Mutual Funds**
- **Certificates of Deposit**

ACCOMPLISHMENTS IN 2012

- A historic milestone was reached in 2012 when the division paid a record number of 14,536 claimants approximately $4.28 million with an average claim of $294.70. This represents a 23.4 percent increase in the number of claims paid over fiscal year 2011.

- Worked with Verus Financial LLC, as part of a national multi-state initiative, to require life insurance companies to pay out on old, sometimes forgotten, policies of people who have died. As of January 8, 2013, the division had received approximately $1.9 million in insurance funds. As a result of this work, the Treasurer's office is working with the Department of Financial Regulation to require insurance companies to check death master lists quarterly and stop charging premiums again the account. The Treasurer's office views this as a proactive approach to consumer protection.

- Holders of unclaimed property reported $10.3 million worth of unclaimed funds to the State in fiscal year 2012.

- In fiscal year 2012, there were 306,993 web searches for unclaimed property on the Vermont State Treasurer's web site. This is a growth of more than 15 percent over the same period last year.

- Managed the unclaimed property database of more than $57 million and 300,000 properties.

Unclaimed Property Division

(802) 828-2407
(800) 642-3191

Al LaPerle
Unclaimed Property Director

Nancy Scribner
Business Administrator

Linda Bouffard
Program Technician I

Charles Ryerson
Program Technician I

The Office of State Treasurer acts only as custodian for the missing owners, holding the property in trust until it is claimed. Vermont never takes legal ownership of the property; there is no time limit for filing a claim, and never a fee to claim the property.

UPDATES

Claims Processing

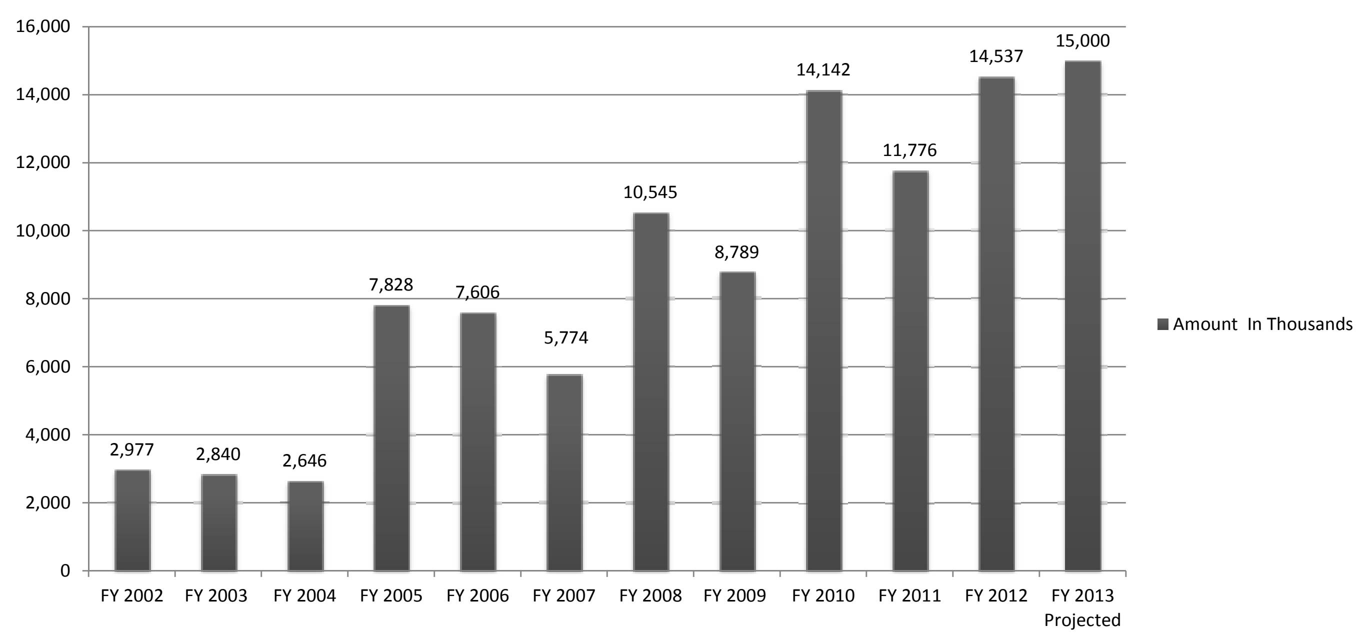
Fiscal year 2012 marked a historic accomplishment for Vermont's unclaimed property program. The division paid more claims than in any previous year since the program's inception. The office paid 14,537 claims with an average claim amount of $294.70. In total, the State Treasurer's Office returned more than $4.2 million.

In fiscal year 2012, the division paid more claims than in any previous year since the program's inception.

The division uses a proven system of outreach efforts to reunite owners with their property, such as a publication of our annual list of names in daily newspapers; a spring and fall advertising campaign; staffing a booth at the Champlain Valley Exposition; distribution of local listings to town clerks and legislators; cross-matching our database with the Department of Taxes; and our annual postcard mailing. Enhancing our ability to return property, the division uses the Unclaimed Property Management System 2000. This is the most advanced, secure and reliable unclaimed property management systems available to the State.

Fiscal year 2013 claims processing is currently on pace to match last fiscal year's record total. Claim information for the past nine fiscal years is shown in the chart below and on page 53.

Unclaimed Property Number of Claimants Paid



Reporting and Compliance

The Unclaimed Property Division actively works to promote the program to all Vermonters, urging everyone to check the database once a year. Above is one of the ads used in the fall 2012 campaign. The division annually publishes a list of names in daily newspaper, conducts spring and fall advertising campaigns, staffs a booth at the Champlain Valley Exposition, and distributes local listings to town clerks and legislators.

Property is sent to the Treasurer's office to protect the funds and centralize search efforts to locate property owners. The Unclaimed Property Division's primary goal is to reunite individuals with their unclaimed financial property. To accomplish this goal, the division uses a variety of tools. Foremost, the division must ensure that holders of the property file their annual unclaimed property report.

Nationally, in fiscal year 2012 Vermont was one of the first states in the nation to initiate audits of insurance companies. As part of a multi-state initiative, the State Treasurer's Office joined other states in reaching an agreement with several national life insurance companies to facilitate the surrender of funds from old, sometimes forgotten, policies of people who have died. Working on behalf of Vermont and dozens of other states, Verus Financial LLC conducted reviews of several national companies resulting in the transfer of more than $1.9 million to the State's unclaimed property program. It is anticipated that the program will receive an additional $1.5 million in funds through this initiative. In the coming year, the Treasurer's office will work with the Department of Financial Regulation to require insurance companies to check death master lists on a quarterly basis and to stop charging customers premiums against accounts where the person is deceased. The Treasurer's office views this proactive approach as an important consumer protection measure.

Ther State currently is in possession of more than $57 million in unclaimed property that belongs to more than 300,000 individuals and organizations. Property becomes "lost" due to a company having no communication with the owner. This may be caused by an address change or change in marital status. In some cases, the owner dies and the heirs have no knowledge of the property. During fiscal year 2012, the State of Vermont received $8.4 million from holders of unclaimed property.

Holders of unclaimed property include business associations, banking and financial organizations, life insurance corporations, and other entities holding

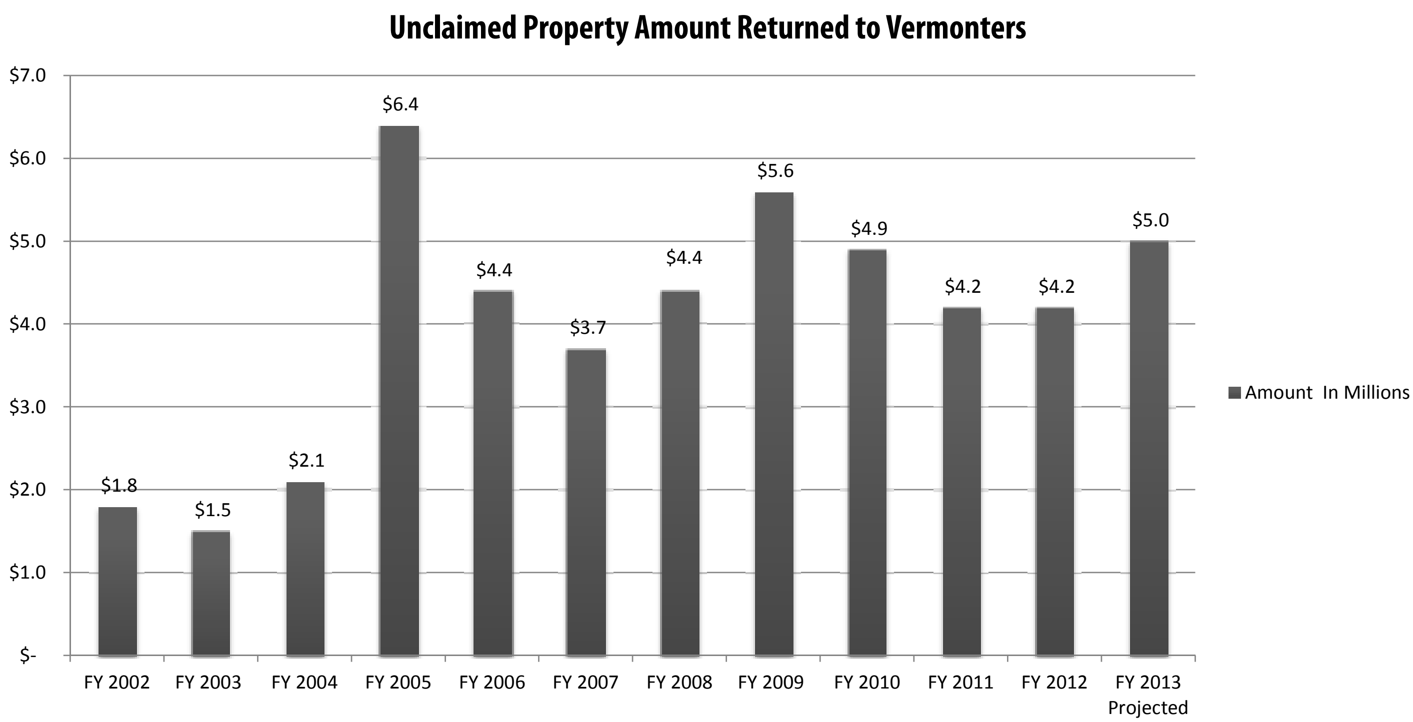
Vermont was one of the first states in the nation to initiate audits of insurance companies. In a national multi-state initiative, the Vermont State Treasurer's Office reached an agreement with several national life insurance companies to facilitate the surrender of funds from old, sometimes forgotten, policies of people who have died.

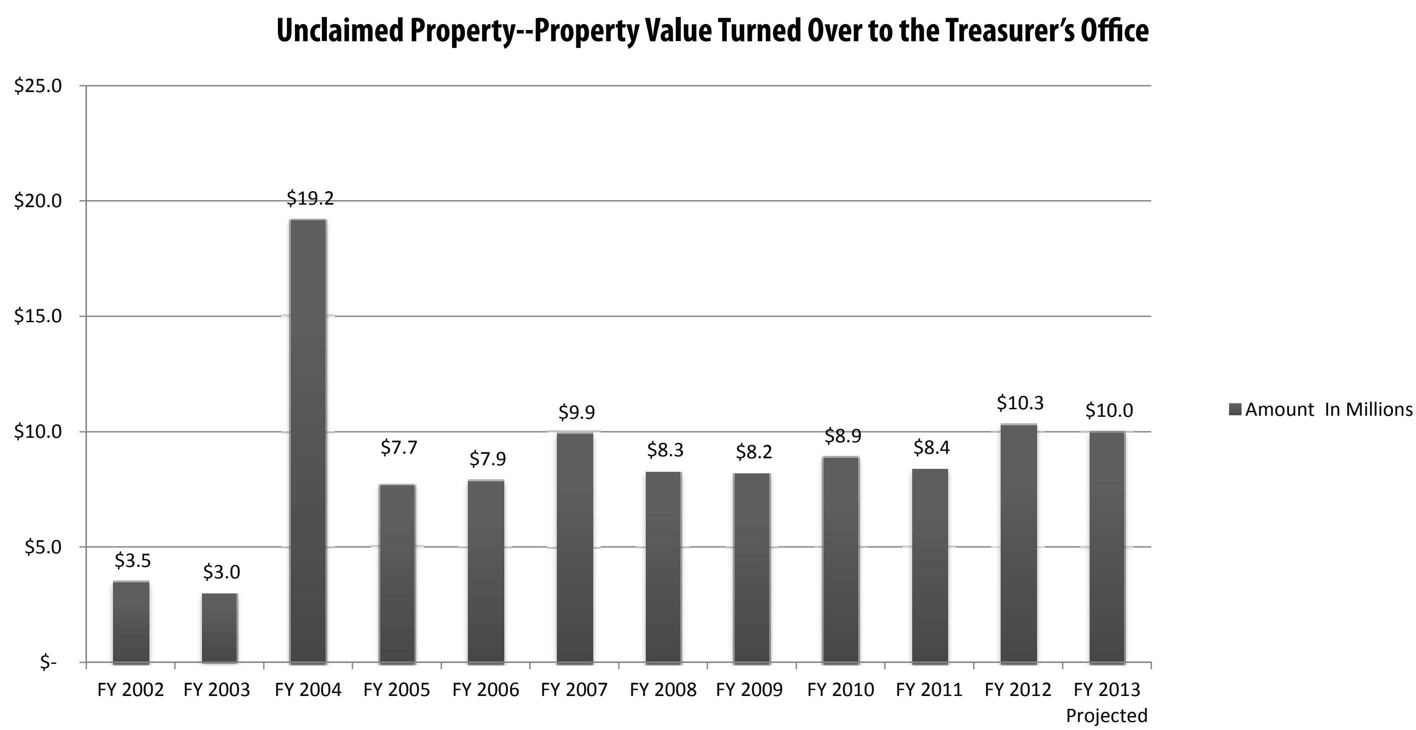
property belonging to another person. Vermont's Unclaimed Property Law states that holders are required to review their records each year to determine if they hold any property that has remained unclaimed for the required dormancy period. Once property has remained unclaimed for the required dormancy period, it becomes reportable. The State Treasurer serves as custodian of the funds until they can be returned to their rightful owners.

Before unclaimed funds are turned over to the State, all holders of property valued at $50 or more are mandated by law to notify the individual by mail at the last known address on record. Despite these efforts, many accounts remain unclaimed and are turned over to the State Treasurer.

Education continues to be an important part of the division's compliance effort. A division representative will visit a holder upon request to provide information on the program. Besides using staff to conduct audits within the State of Vermont, we also use three contract audit companies to assist us in the enforcement of the statute. These companies have enabled the division to touch base with a greater number of holders of unclaimed property.

The Treasurer's office continues to allow holders to enter into a voluntary compliance program to submit to a process of disclosing and remitting property and thereby avoiding costly audits, fines and penalties. As a result, since the program's inception, $2,655,496 has been turned over to the State. Since the beginning of fiscal year 2012, 300 holders have submitted more than $1,991,572 in financial property, an increase of 103 percent over the same time period last fiscal year.





Treasury Operations Division

Overview

The Treasury Operations Division is responsible for the banking and cash management of more than $4.7 billion annually in both receipts and disbursements; the establishment and maintenance of the State's banking network; the disbursement of the State's warranted payments and debt service; the collection of certain receipts, including those related education tax payments to the State; and the recording of accounting transactions associated with these activities. The reconciliation of internal and external accounts comprises a major portion of the division's staff time, in addition to the proper reporting and recording on the State's books for financial reporting.

In addition, the division is responsible for preparing financial statements and schedules for the annual audit of the State's books (as it relates to cash and investment disclosures), administering the Municipal Equipment Loan Fund, and the preparation of the pension trust fund financial statements for the pension systems managed by the State Treasurer's Office. TD Bank, N.A. serves as the State's master banking contractor. Bank personnel and Treasury staff work continuously together to provide new and improved services and processes.

Treasury Operations Division: (802) 828-2301

John Booth
Treasury Operations Director

Scott Baker
Financial Reporting Director

Dan Currier
Cash & Short-term Investments Manager

Ron Baldauf
Financial Specialist III

Lisa Gilman
Financial Specialist III

Joanne Costantini
Financial Specialist II

Wendy Dickinson
Financial Specialist II

Robyn Lambert
Financial Specialist II

UPDATES

Reconciliations

The Treasurer's office staff reconciles approximately 30 State core bank accounts. In fiscal year 2012, more than 111,000 deposits were processed to State accounts through a network designed to accelerate the collection of cash so that it may be used for operating needs or efficiently placed in short-term investments.

More than 111,000 deposits were processed to State accounts and 1.63 million payments were completed.

On the disbursement side, 1.63 million payments were processed, either through paper checks or electronic funds transfers (EFT). Working cooperatively with all of the Treasury's business partners, we have been able to assure that the number and duration of reconciling items from user department entries remains low.

ACCOMPLISHMENTS IN 2012

- In fiscal year 2012, more than 111,000 deposits were processed to State accounts and 1.63 million payments were processed, either through paper checks or electronic fund transfers.

- In response to ongoing fiscal challenges created by Hurricane Irene, the Treasury Operations Division facilitated and implemented actions aimed at aiding Vermont's impacted communities. As directed by the State Treasurer and the Administration, and as requested by specific municipalities and school districts, the division processed the acceleration of certain State payments.

- During fiscal year 2012 the division responded to more than 1,000 information requests received via the division's centralized email account.

Electronic Payments

The issuance of paper checks is labor-intensive and costly. Electronic payments reduce bank fees, printing and postage costs, the potential for fraud, as well as staff time to reconcile bank accounts. Tracking of lost checks is time-consuming and can be largely eliminated through electronic payment processing. Time spent searching for cleared payments is eliminated. Bank fees related to "stop payments" are eliminated, as are the costs associated with re-issuing payments, and inconvenience to the payees. This past year, 1,136 check payments were reissued because the original check was lost or was never received by the payee. The reissued payment may be made by check or by electronic payment. The Treasurer's office has an ongoing initiative to encourage State agencies and departments to use electronic payments whenever feasible.

Tracking of lost checks is time-consuming and can be largely eliminated through electronic payment processing.

One of the barriers to the use of electronic payments by vendors is the lack of payment remittance information received with the payment. The State currently issues and mails a remittance advice for each electronic payment. Of the more than 1.63 million payments processed during fiscal year 2012, approximately 64 percent were electronic transfers. The State Treasurer's Office rolled out a "Vendor Portal" secure web site during fiscal year 2009. This web site allows vendors that receive payments electronically to view payment information online, which reduces the number of information requests received.

In November of 2012, 96.8 percent of monthly benefit payments to retired State employees were made via direct deposit, for the retired teachers, the percentage of monthly benefit payments via direct deposit was 97.4 percent, and for retired municipal employees it was 93.4 percent. This is an increase from the November 2011 percentages of 96.4 percent-State; 97.2 percent-teachers; and 92.3 percent-municipal.

Act 68 Receipts

Per statute, the Treasury Operations Division monitors the receipt of education tax payments to the State mandated by Act 68. Notification and initial invoicing of the municipalities for the principal payment are completed by the Department of Education. In fiscal year 2012, all municipalities made their Act 68 principal payments.

Hurricane Irene Response Support

Recovering from the damage caused by Hurricane Irene has caused ongoing fiscal concerns and cash flow issues for some Vermont towns. The State Treasurer's Office continued work from 2011 aimed at helping towns manage municipal finances as they repaired damage from the storm. In 2011, towns were given a one-time payment deferral of the education tax payment, with the due date extended from December 1, 2011 to February 28, 2012. All 11 towns that requested a full or partial deferral made their education tax payment on time.

In 2012, the Treasurer's office, working cooperatively with the Administration, offered towns an additional opportunity to request early receipt of certain payments from the State. Through this initiative, six towns received a total of $1.47 million in payments prior to the regular payment dates. The State's cash position and cash flows allowed for the acceleration of these payments without placing strain on the State's cash position. These measures were intended to give towns financial relief and options as they continue the work of rebuilding.

Legislative Reporting Requirements

Burma (Myanmar)

Act 13 of the Public Acts of 1999 specifies that the Treasurer shall implement the purposes of the Act by voting in favor of shareholder resolutions concerning individual companies doing business with the government of Burma. In addition, the Treasurer shall separately notify the company that Vermont wishes to convey its grave concerns regarding the company's economic ties to the government of Burma. The Treasurer complies with this Act through measures including mandating compliance through VPIC investment guidelines that must be observed by investment managers and by the proxy voting firm engaged by VPIC to vote its proxies. Proxy voting guidelines adopted by the three Vermont Retirement Systems and the Treasurer's office for U.S. domestic equity managers also specify manager voting compliance including support of labor standards in connection with a company's involvement in Burma, and reporting on Burmese operations and activities.

Financial Literacy Trust Fund

The legislature authorized the establishment of a trust fund in 2008 to finance financial literacy in Vermont. According to the legislation, "the purpose of the fund is to promote the adoption of fiscally sound money management practices by Vermonters through education and outreach efforts that raise awareness of the need for and benefits of practicing such skills; and to create opportunities to build and encourage the development of new financial literacy activities and educational products for Vermont citizens." The Treasurer is authorized to collect money from a variety of sources to fund these activities. For fiscal year 2012, the fund received deposits of $15,000. The fund earned $22.03 in interest. There was $9,497.77 expended from the trust fund during fiscal year 2012. Of that amount, approximately $8,300 was expended in support of the second year of the Reading is an Investment program, $1,016 was expended for the state tournament of the Reserve Cup Challenge, and the remainder expended for the annual financial literacy poster competition.

MacBride Principles

Act 50 of the Public Acts of 1989 specifies that the State Treasurer and the tetirement boards compile a list of corporations that conduct business in Northern Ireland in which the State Treasurer and retirement boards have invested funds. Notifications from external investment managers listing such businesses are due in the Treasurer's office on January 1 of each year, and these notifications are kept on file in the Treasurer's office. The Act further requires that the Treasurer and the boards of the trustees of the Vermont State Employees' Retirement System and the Vermont State Teachers' Retirement System shall support the MacBride Principles addressing worker equality and security issues through support of shareholder issues. The Treasurer's office and the trustees comply with Act 50 by mandating MacBride Principles compliance through Vermont Pension Investment Committee (VPIC) investment guidelines to be observed by investment managers and by the proxy firm engaged by VPIC to vote its proxies. Proxy voting guidelines approved by the three Vermont Retirement Systems and the Treasurer's office for U.S. domestic equity managers also specify manager voting compliance with MacBride principles.

Emergency Personnel Survivors Benefit Special Fund

Originally established by the legislature in 2002 as the Firefighters' Survivors Benefit Fund, this fund was expanded during the 2005 legislative session to include not only firefighters, but ambulance service, emergency medical, first responder service and volunteer personnel. A review board administers the grant of a one-time monetary benefit to the survivor or survivors of emergency personnel

A review board administers the grant of a one-time monetary benefit to the survivor or survivors of emergency personnel.

employed by or who volunteer for the State of Vermont, a county or municipality of the state, or a nonprofit entity which provides services in the state, who die in the line of duty or of an occupational-related illness. From July 1, 2011 through November 30, 2012, there were no payments made related to the deaths of emergency personnel in the line-of-duty.

For both fiscal years 2011 and 2012, the Treasurer's office operating department had a surplus. As part of the State's budget adjustment act, the Treasurer requested that a portion of each surplus be dedicated to the Emergency Personnel Survivors Benefit Special Fund. In fiscal year 2011, an appropriation of $100,000 to the special fund was included as part of the fiscal year 2012 budget adjustment act. As of November 30, 2012, this fund had assets of $106,903.36.

The Treasurer has requested that $102,000 be transferred to the special fund as part of the fiscal year 2013 budget adjustment act. The Governor's office has indicated that they will include this appropriation in their budget adjustment request.

Technology Update

Technology Services

The Technology Services Division (TSD) is committed to providing technology support services to the Office of the State Treasurer. The technology support staff provides business analysis, system design, programming, help desk support, hardware maintenance, system and data security and project management support services. TSD administers and maintains the entire range of software and hardware facilitating the operations of the office, including banking reconciliation software, check and EFT issuance, unclaimed property, and the software applications that support the retirement services for Vermont's active, vested, and retired members across our State employee, municipal employee and teacher retirement funds.

UPDATES

The Technology Services staff continued to implement important upgrades to the office's infrastructure and applications suite to improve the speed, reliability and dependability of its systems during 2012. Listed below are some of our major accomplishments.

ACCOMPLISHMENTS IN 2012

- Our servers in our primary data center were upgraded this year and a new server added to further improve system capacity and reliability. The displaced servers from our primary data center were redeployed to our backup data center to increase system capacity and reliability in the event of a disaster. In fiscal year 2012, we successfully completed two disaster recovery tests to ensure that our current backup and recovery systems are functional. Further upgrades are planned for the coming year as advancements in technology become available that further improves system capacity and reliability in support of the Office of the State Treasurer and the citizens of Vermont. Additional disaster recovery tests will be executed in fiscal year 2013 to ensure our systems are adequately backed up and available at all times.

- A significant effort was completed this year to reconcile and update our retirement database now that our system of record is VPAS (Vermont Pension Administration System). A team of data cleansing specialists worked extensively for eight months to reconcile and update retirement data. This effort was significant as the data from VPAS was used for the actuarial reports for fiscal year 2012. The results significantly improved the actuarial reporting process and ensured accurate and complete information for the valuation of the retirement funds for the coming year.

Technology Services
(802) 828-2498

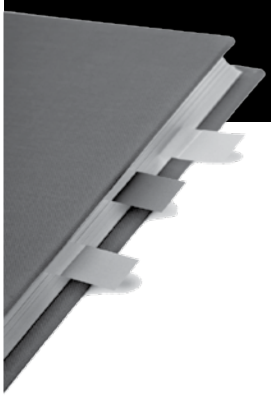
Ram Verma
Technology Services Director

Lane Safford
Network Administrator II

Steve Godin
System Developer III

Linda Vincent
Project Manager

Appendices



HISTORICAL SUMMARY OF OPERATIONS: *Pension Fund Operations*

State Employees' Retirement System -- Summary of Operations

Category	2004	2005	2006	2007	2008	2009	2010	2011	2012
SOURCE OF FUNDS									
Employee Contributions	$ 13,716,264	$ 15,112,105	$ 14,561,467	$ 15,456,691	$ 18,614,102	$ 22,148,754	$ 22,840,354	$ 22,269,041	$ 27,708,009
Employer Contributions	26,645,619	36,493,435	36,866,451	39,297,002	39,179,823	25,134,235	31,468,884	37,572,599	40,302,433
Other Income	695,397	777,792	1,171,516	205,321	169,984	1,041,870	227,524	743,172	377,562
Investment Income (Reduction)	138,426,552	90,452,723	115,146,415	192,625,279	(84,156,254)	(242,976,381)	182,593,261	238,386,383	23,604,774
APPLICATION OF FUNDS									
Retirement Benefits	44,637,116	48,893,673	53,435,617	58,859,659	64,060,488	70,043,119	79,001,908	84,716,513	90,170,209
Refunds	1,171,957	1,402,481	1,351,911	1,526,140	1,414,144	1,403,995	1,521,440	1,731,375	1,908,752
Health/Life Insurance Expenses	9,236,526	11,329,269	11,590,588	13,541,092	16,371,373	-	-	-	-
Administrative Expenses	659,447	1,255,852	1,329,081	511,435	1,254,577	1,219,287	891,477	1,147,576	1,328,919
Other Expenses	617,658	635,618	668,929	344,719	631,321	477,966	568,278	613,899	702,136
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 123,161,128	$ 79,319,162	$ 99,369,723	$ 172,801,248	$ (109,924,248)	$ (267,795,889)	$ 155,146,920	$ 210,761,832	$ (2,117,238)

State Employees' Retirement System -- (OPEB) Summary of Operations*

Category	2008	2009	2010	2011	2012
SOURCE OF FUNDS					
Employee Contributions	$ -	$ -	$ -	$ -	$ -
Employer Contributions	1,444,757	19,893,129	20,888,347	24,963,027	25,865,470
Other Income	-	-	1,640,420	2,431,447	1,786,719
Investment Income (Reduction)	7,886	86,454	480,064	802,020	375,423
APPLICATION OF FUNDS					
Retirement Benefits		-	-	-	-
Refunds		-	-	-	-
Health/Life Insurance Expenses		17,894,518	20,860,032	24,878,272	25,863,989
Administrative Expenses		-	-	68	275
Other Expenses		-	-	-	-
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 1,452,643	$ 2,085,065	$ 2,148,799	$ 3,318,154	$ 2,163,348

*** In 2008, changes made to the Government Accounting Standard Board requirements mandated that institutions report the future cost of other post-employment benefits (OPEB).**

Teachers' Retirement System -- Summary of Operations

Category	2004	2005	2006	2007	2008	2009	2010	2011	2012
SOURCE OF FUNDS									
Employee Contributions	$ 21,088,345	$ 21,158,452	$ 21,884,140	$ 22,533,479	$ 22,918,798	$ 20,937,686	$ 25,315,397	$ 32,062,253	$ 31,827,995
Employer Contributions	24,446,282	24,446,282	24,446,282	37,341,609	39,549,097	35,960,934	40,545,321	47,134,361	51,731,875
Other Income	267,330	373,705	1,180,606	2,093,219	1,628,242	3,754,020	1,817,540	3,341,877	4,505,246
Investment Income (Reduction)	166,325,045	115,058,694	130,835,585	244,437,213	(110,019,634)	(307,382,559)	208,723,610	261,886,311	24,726,665
APPLICATION OF FUNDS									
Retirement Benefits	55,246,342	60,147,731	66,272,471	74,368,306	82,157,642	89,825,986	96,448,102	106,930,467	117,801,002
Refunds	711,806	1,104,278	1,290,197	1,625,140	1,280,715	1,420,776	1,183,659	1,218,955	1,521,099
Health/Life Insurance Expenses	8,279,332	10,167,601	11,233,854	13,040,783	15,081,847	16,421,176	17,203,669	18,749,675	20,620,144
Administrative Expenses	805,495	1,052,772	1,679,883	817,052	866,473	1,249,774	1,078,762	1,399,732	1,604,735
Other Expenses	543,746	682,438	580,403	203,444	542,665	606,434	303,741	609,091	391,832
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 146,540,281	$ 87,882,313	$ 97,289,805	$ 216,350,795	$ (145,852,839)	$ (356,254,065)	$ 160,183,935	$ 215,516,882	$ (29,147,031)

Municipal Retirement System -- Summary of Operations

Category	2004	2005	2006	2007	2008	2009	2010	2011	2012
SOURCE OF FUNDS									
Employee Contributions	$ 6,507,268	$ 7,404,119	$ 8,744,718	$ 9,769,882	$ 9,906,709	$ 9,557,973	$ 10,711,600	$ 11,702,728	$ 11,337,926
Employer Contributions	7,114,813	8,058,810	7,926,436	8,535,396	-	8,008,862	10,592,919	11,117,363	11,532,230
Other Income	2,125,294	298,475	228,746	206,101	124,132	1,321,919	203,549	266,425	118,191
Investment Income (Reduction)	27,271,821	18,165,861	27,697,371	46,637,360	(19,472,654)	(56,937,342)	47,598,096	66,957,781	7,671,464
APPLICATION OF FUNDS									
Retirement Benefits	5,694,080	6,418,097	7,120,325	7,969,703	9,064,725	10,228,263	11,073,098	12,298,902	14,214,160
Refunds	1,110,243	1,140,245	1,102,940	1,389,583	1,143,397	1,223,465	1,127,574	1,275,979	1,664,687
Health/Life Insurance Expenses	-	-	-	-	-	-	-	-	-
Administrative Expenses	151,228	367,810	439,983	687,382	623,619	798,458	393,947	569,603	672,851
Other Expenses	668,624	423,937	1,101,883	560,473	506,817	588,899	795,522	886,709	469,599
Addition (Reduction) to Net Assets Held In Trust for Pension Benefits	$ 35,395,021	$ 25,577,176	$ 34,832,140	$ 54,541,598	$ (20,780,371)	$ (50,887,673)	$ 55,716,023	$ 75,013,104	$ 13,638,514

STATE OF VERMONT: *Pension Trust Funds—Combining Statement of Plan Net Assets—6/30/2012*

	Defined Benefit Plans			Defined Contribution Plans			Other Postemployment Benefit Funds			
	Vermont State Retirement Fund	State Teachers' Retirement Fund	Vermont Municipal Employees' Retirement Fund	Vermont State Defined Contribution Fund	Single Deposit Investment Account Fund	Vermont Municipal Employees' Defined Contribution Fund	Vermont State Postemployment Benefits Trust Fund	Municipal Employees' Health Benefit Fund	Eliminations	Total
ASSETS										
Cash and short-term investments	$ 4,858,969	$ 3,930,254	$ 428,733	$ 75,165	$ 1,020,170	$ 83,233	$ 2,756,174	$ 277,004	$ -	$ 13,429,702
Investments at fair value										
Pooled investments	1,370,104,804	1,483,892,279	410,258,890	-	-	-	-	-	-	3,264,255,973
Fixed income	-	-	-	-	-	-	7,177,476	-	-	7,177,476
Equities	-	-	-	-	-	-	3,051,156	-	-	3,051,156
Mutual funds	-	-	-	44,994,420	73,054,599	16,493,804	61,067	10,509,325	-	145,113,215
Total investments	1,370,104,804	1,483,892,279	410,258,890	44,994,420	73,054,599	16,493,804	10,289,699	10,509,325	-	3,419,597,820
Receivables										
Contributions - current	3,782,623	3,896,583	2,379,816	120,382	-	13,106	-	-	-	10,192,510
Contributions - non-current	-	-	6,774,199	-	-	-	-	-	-	6,774,199
Interest and dividends	2,430	4,702	343,349	-	125	-	-	-	-	350,606
Due from other funds	64,614	-	48,607	-	-	-	376,775	-	(113,221)	376,775
Other	729	491,774	58,583	-	-	-	-	-	-	551,086
Total receivables	3,850,396	4,393,059	9,604,554	120,382	125	13,106	376,775	-	(113,221)	18,245,176
Prepaid expenses	-	-	-	-	-	-	-	-	-	-
Capital assets										
Construction in progress	1,397,090	1,621,844	476,842	-	-	-	-	-	-	3,495,776
Capital assets being depreciated										
Equipment	804,568	975,979	392,836	-	-	-	-	-	-	2,173,383
Less accumulated depreciation	(295,172)	(354,771)	(146,568)	-	-	-	-	-	-	(796,511)
Total capital assets, net of depreciation	1,906,486	2,243,052	723,110	-	-	-	-	-	-	4,872,648
Total assets	1,380,720,655	1,494,458,644	421,015,287	45,189,967	74,074,894	16,590,143	13,422,648	10,786,329	(113,221)	3,456,145,346
LIABILITIES										
Accounts payable	2,007,016	2,561,646	362,881	4,266	-	563	29,197	-	-	4,965,569
Retainage payable	224,143	273,261	111,329	-	-	-	-	-	-	608,733
Due to other funds	-	3,836	1,007	45,204	-	48,607	14,567	-	(113,221)	-
Total liabilities	2,231,159	2,838,743	475,217	49,470	-	49,170	43,764	-	(113,221)	5,574,302
NET ASSETS HELD IN TRUST FOR EMPLOYEES' PENSION AND OTHER POSTEMPLOYMENT BENEFITS	$ 1,378,489,496	$ 1,491,619,901	$ 420,540,070	$ 45,140,497	$ 74,074,894	$ 16,540,973	$ 13,378,884	$ 10,786,329	$ -	$ 3,450,571,044

See Independent Auditors' Report.

STATE OF VERMONT: *Pension Trust Funds—Combining Statement of Changes in Plan Net Assets—Fiscal Year Ended 6/30/2012*

	Defined Benefit Plans			Defined Contribution Plans			Other Postemployment Benefit Funds			
	Vermont State Retirement Fund	State Teachers' Retirement Fund	Vermont Municipal Employees' Retirement Fund	Vermont State Defined Contribution Fund	Single Deposit Investment Account Fund	Vermont Municipal Employees' Defined Contribution Fund	Vermont State Postemployment Benefits Trust Fund	Municipal Employees' Health Benefit Fund	Eliminations	Total
ADDITIONS										
Contributions										
Employer - pension benefit	$ 40,302,433	$ 41,231,875	$ 11,532,230	$ 1,813,629	$ -	$ 659,609	$ -	$ -	$ -	$ 95,539,776
Employer - healthcare benefit	-	10,500,000	-	-	-	-	25,865,470	-	-	36,365,470
Plan member	27,708,009	31,827,995	11,337,926	694,488	-	605,657	-	-	-	72,174,075
Transfers from other pension trust funds	377,562	85,110	118,191	110,673	-	15,771	-	-	(707,307)	-
Transfers from non-state systems	-	-	-	5,009	-	14,485	-	-	-	19,494
Medicare part D drug subsidy	-	1,672,423	-	-	-	-	1,786,719	-	-	3,459,142
Early retiree reinsurance program	-	2,747,713	-	-	-	-	-	-	-	2,747,713
Total contributions	68,388,004	88,065,116	22,988,347	2,623,799	-	1,295,522	27,652,189	-	(707,307)	210,305,670
Investment Income										
Net appreciation (depreciation) in fair value of investments	251,957	11,718	-	(1,131,683)	1,040	(529,722)	37,144	62,552	-	(1,296,994)
Income from pooled investments	28,591,705	30,472,513	8,733,660	-	-	-	-	-	-	67,797,878
Dividends	-	5,194	-	1,151,379	2,414,165	453,412	98,868	-	-	4,123,018
Interest	13,702	20,304	453,851	124	862	335	239,411	938	-	729,527
Securities lending income	576,926	634,424	173,514	-	38	-	-	-	-	1,384,902
Other income	32,431	38,157	3,701	-	-	-	-	-	-	74,289
Total investment income	29,466,721	31,182,310	9,364,726	19,820	2,416,105	(75,975)	375,423	63,490	-	72,812,620
Less Investment Expenses										
Investment managers and consultants	5,726,752	6,305,871	1,652,847	-	234,679	-	-	58,490	-	13,978,639
Securities lending expenses	135,195	149,774	40,415	-	-	-	-	-	-	325,384
Total investment expenses	5,861,947	6,455,645	1,693,262	-	234,679	-	-	58,490	-	14,304,023
Net investment income	23,604,774	24,726,665	7,671,464	19,820	2,181,426	(75,975)	375,423	5,000	-	58,508,597
Total additions	91,992,778	112,791,782	30,659,811	2,643,619	2,181,426	1,219,547	28,027,612	5,000	(707,307)	268,814,267
DEDUCTIONS										
Retirement benefits	90,170,209	117,801,002	14,214,160	2,578,550	6,734,383	680,642	-	-	-	232,178,946
Other postemployment benefits	-	20,620,144	-	-	-	-	25,863,989	213,526	-	46,697,659
Refund of contributions	1,908,752	1,521,099	1,664,687	-	-	-	-	-	-	5,094,538
Death claims	482,483	186,384	187,393	-	-	-	-	-	-	856,260
Transfers to other pension trust funds	219,653	205,448	282,206	-	-	-	-	-	(707,307)	-
Depreciation	86,854	108,139	42,420	-	-	-	-	-	-	237,413
Operating expenses	1,242,065	1,496,596	630,431	46,432	-	81,025	275	-	-	3,496,824
Total deductions	94,110,016	141,938,812	17,021,297	2,624,982	6,734,383	761,667	25,864,264	213,526	(707,307)	288,561,640
Change in net assets	(2,117,238)	(29,147,030)	13,638,514	18,637	(4,552,957)	457,880	2,163,348	(208,526)	-	(19,747,373)
Net assets held in trust for employees' pension and postemployment benefits										
July 1	1,380,606,734	1,520,766,932	406,901,556	45,121,860	78,627,851	16,083,093	11,215,536	10,994,855	-	3,470,318,417
June 30	$ 1,378,489,496	$ 1,491,619,902	$ 420,540,070	$ 45,140,497	$ 74,074,894	$ 16,540,973	$ 13,378,884	$ 10,786,329	$ -	$ 3,450,571,044

See Independent Auditors' Report.

HIGHER EDUCATION TRUST FUND: *Annual Report—September 20, 2012*

ELIZABETH A. PEARCE
STATE TREASURER

RETIREMENT DIVISION
TEL: (802) 828-2305
FAX: (802) 828-5182

UNCLAIMED PROPERTY DIVISION
TEL: (802) 828-2407

ACCOUNTING DIVISION
TEL: (802) 828-2301
FAX: (802) 828-2884

STATE OF VERMONT
OFFICE OF THE STATE TREASURER

TO: Jeb Spaulding, Secretary of Administration, and the Higher Education Subcommittee of the Prekindergarten-16 Council

FROM: Elizabeth Pearce, State Treasurer

RE: Annual Report on the Higher Education Endowment Trust Fund

DATE: September 20, 2012

I am pleased to present the Secretary of Administration and the Higher Education Subcommittee (Subcommittee) of the Prekindergarten-16 Council with the State Treasurer's twelfth annual report on the Higher Education Endowment Trust Fund (Fund).

The General Assembly established the Fund in the Office of the State Treasurer in 1999 to provide non-loan financial aid to Vermont students attending the University of Vermont (UVM), the Vermont State Colleges, and other Vermont post-secondary institutions (16 V.S.A. § 2885).

Performance Summary

During Fiscal Year 2012, the Fund's dollar weighted investment return was 4.10% gross of fees. This return compares to the Barclays Aggregate Bond Index return of 7.47% and to the S&P 500 Stock Index return of 5.45% for the same period, and is less than the Fund's target allocation index rate (that is, the rate of return that would have been realized if 30% of the Fund was invested in the S&P 500 Index, and 70% in the Barclays Aggregate) of approximately 7.6%. It should be noted that the Fund has outperformed since its inception in 2000, returning 7.77% on an annualized basis against 6.30% for its benchmark. At the same time, the conservative positioning of the fund is consistent with the objective of providing a high likelihood of annual distributions from the Fund. While recent performance has not met expectations, the Fund has also outperformed its benchmark over the past seven and ten fiscal year periods. In the most recent fiscal year, underperformance relative to the target return can be attributed both to the lower performance of mortgage debt instruments as well as the overall weakness of equities in the early part of fiscal 2012. Going forward, the exposure to mortgage debt instruments would be expected to benefit from the recently announced efforts by the Federal Reserve (i.e. "QE3"). A detailed discussion of the Fund's performance is included in this report.

5% Distribution from Fiscal Year 2012

The statute provides that in August of each fiscal year, the State Treasurer is to withdraw 5% of up to a 12-quarter moving average of the Fund's assets and divide the amount equally among

UVM, the Vermont State Colleges, and the Vermont Student Assistance Corporation (VSAC). The amount appropriated, however, cannot exceed an amount that would bring the Fund balance below total contributions to principal. Total principal contributions through June 30, 2012 have been $28,537,615.38.

The 5% distribution available this year is $1,132,227.76 in total or $377,409.25 each for UVM, the Vermont State Colleges, and VSAC. This amount represents a 24.1% increase over the distribution made following Fiscal Year 2011 of $304,014.79 for each institution. **Appendix A** to this report includes quarterly market values and distributions for Fiscal Year 2012, and **Chart #1** shows principal contributions to date.

2% Distribution from Fiscal Year 2011

16 V.S.A. § 2885 further provides that during the first quarter of each fiscal year, the Secretary and the Subcommittee may authorize the State Treasurer to make an additional amount equal to up to 2% of the Fund's average assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. Similar to the 5% distribution, the amount appropriated cannot exceed an amount that would bring the Fund balance below total contributions to principal. Further, each institution is required to match the appropriation by raising private donations of at least twice the appropriated amount, to certify to the Commissioner of Finance and Management (Commissioner) that it received private donations in the requisite amount, and that the funds will be used to create or increase a permanent endowment at the respective institution.

At its meeting last year, Secretary Spaulding and the Subcommittee authorized this 2% appropriation in the amount of $364,817.75, or $182,408.87 each for distribution to UVM and the Vermont State Colleges, dependent upon a finding by the Commissioner that the terms of this appropriation were met. Each of these institutions is in the process of establishing the required certification. Due to the Fund's positive return in Fiscal Year 2012, the Fund will be able to make the full distribution amount.

After payments of $1,132,227.76 and $364,817.75, the Fund balance at the end of Fiscal Year 2012 totals $28,998,181.71. An accounting of the Fund balances is provided below:

Ending balance prior FY 2011			$19,739,011.70
	Contributions received FY 2012		11,036,791.72
Opening balance FY 2012			$30,739,011.70
	5% Distributions :	University of Vermont	(304,014.79)
		Vermont State Colleges	(304,014.79)
		Vermont Student Assistance Corp.	(304,014.79)
	2% Distributions :	University of Vermont	(177,917.90)

		Vermont State Colleges	(177,917.90)
	Income earned FY 2012		1,283,527.22
	Appreciation (Depreciation) FY 2012		(186,571.04)
	Fees and Other Charges FY 2012*		(109,652.22)
Balance June 30, 2012			$30,495,227.22
	5% of 12-Quarter Moving Average as of June 30, 2012		(1,132,227.76)
	Distributions :	University of Vermont	(377,409.25)
		Vermont State Colleges	(377,409.25)
		Vermont Student Assistance Corp.	(377,409.25)
	2% Income Available for Endowments from FY 2011		(364,817.75)
Balance after distributions			$28,998,181.71
Total contributions as of June 30, 2012			$28,537,615.38
	2% Income Available for Endowments from FY 2012 (requires institutional match in FY 2013)		$452,891.10

2% Distribution for Fiscal Year 2012

All principal contributions to the Fund through June 30, 2012 total $28,537,615.38, which also represents the minimum balance that must be maintained in the Fund. The 2% distribution proposed for this year of $452,891.10 would leave a balance of $28,545,290.61 excluding contributions to be received, the 5% distribution following FY 2013, and any gains from investment activity in FY 2013. If the Secretary and the Subcommittee authorize this distribution, each institution's share will be $226,445.55 with a required match to be raised by each entity in FY 2013 of $452,891.10. The attached **Chart #2** provides a graphical depiction of authorized distributions, including this 2% distribution subject to the Secretary's and the Subcommittee's approval.

Fund Balances

Appendix B to this report shows the total return of the entire Trust Investment Account, of which the Higher Education Endowment Trust Fund, with a balance of $30.5 million comprises approximately 44%. The Tobacco Trust Fund comprises 26% of the account, or $17.8 million, and the remaining 30% is made up of, in decreasing size, a State Employee's retirement benefit trust fund totaling $11.3 million, the ANR Stewardship Fund at $4.6 million, the Waterfowl Stamp Fund at $2.3 million, the Fish and Wildlife Trust Fund at $1.6 million, two Veterans' Home trusts totaling $1.2 million, and eight small trusts totaling just over $470,000. **Chart #3** displays the relative share of the Higher Education Endowment Trust Fund compared to the entire Trust Investment Account.

Chart #4 presents the Fund's balances, inclusive of distributions, for fiscal years 2000 through 2012. The balance increased significantly in FY 2007 due to Estate Tax receipts of $5,223,449.94, and a $600,000 contribution from the State's unclaimed property fund as a result of legislation proposed by the Treasurer in FY 2006. Assets decreased modestly in FY 2008 and FY 2009 due to low investment returns and minimal fund contributions, and benefitted in FY 2010 and FY2011 from a strong equity market and Estate Tax contributions in FY 2010 and FY2012.

Asset Allocation, Investment Managers and Performance

The Trust Investment Account's target asset allocation is 70% fixed income securities and 30% equities. As of June 30, 2012, the Account's actual allocation was 68.5% in fixed income securities and 31.5% in equities, versus 68.8% fixed income securities and 31.2% equities, respectively, on June 30, 2011. To minimize transaction costs, the Account is rebalanced annually in October, and other contributions and withdrawals from the various funds are used to "fine tune" the asset allocation during the year.

The Account achieved modest positive returns in both FY 2008 and FY 2009, during some of the worst financial market conditions since the 1930s, and has achieved sufficient returns to fully fund distributions in fiscal years 2010, 2011 and 2012. The Treasurer's Office has been mindful of the need to balance the allocations to equity and fixed-income assets given the expectation for annual distributions from the Fund and the asset allocation structure has enabled the Fund to perform in both adverse and positive markets, reinforcing the belief in the appropriateness of the allocations.

In FY 2012, the Account return underperformed its benchmark, due in part to conservative fixed income managers lagging their benchmark as well as to the equity markets being volatile during the year. The lag in the fixed income segment was due primarily to an underweight in Treasuries and Corporate credit compared to the benchmark, which outperformed mortgage-backed securities. The primary exposure of the Sentinel fund is mortgage-backed securities, which are expected to outperform in the upcoming year due to the Fed's QE3 program, but have lagged in the last year. Compared to a mortgage-backed index Sentinel outperformed by 4bps. Equity performance during the fiscal year was impacted primarily by underperformance stemming from investments in international stocks.

The Account has four investment managers, three of whom are Vermont-based and have managed Account assets for at least ten years: two equity managers, Prentiss Smith & Co. of Brattleboro, and Hanson & Doremus of Burlington, and fixed income manager Sentinel Asset Management (a National Life company), of Montpelier. The equity managers have outperformed their benchmark (gross of fees) for seven of the last twelve fiscal years. Sentinel has outperformed its benchmark (gross of fees) for eight of the last twelve fiscal years.

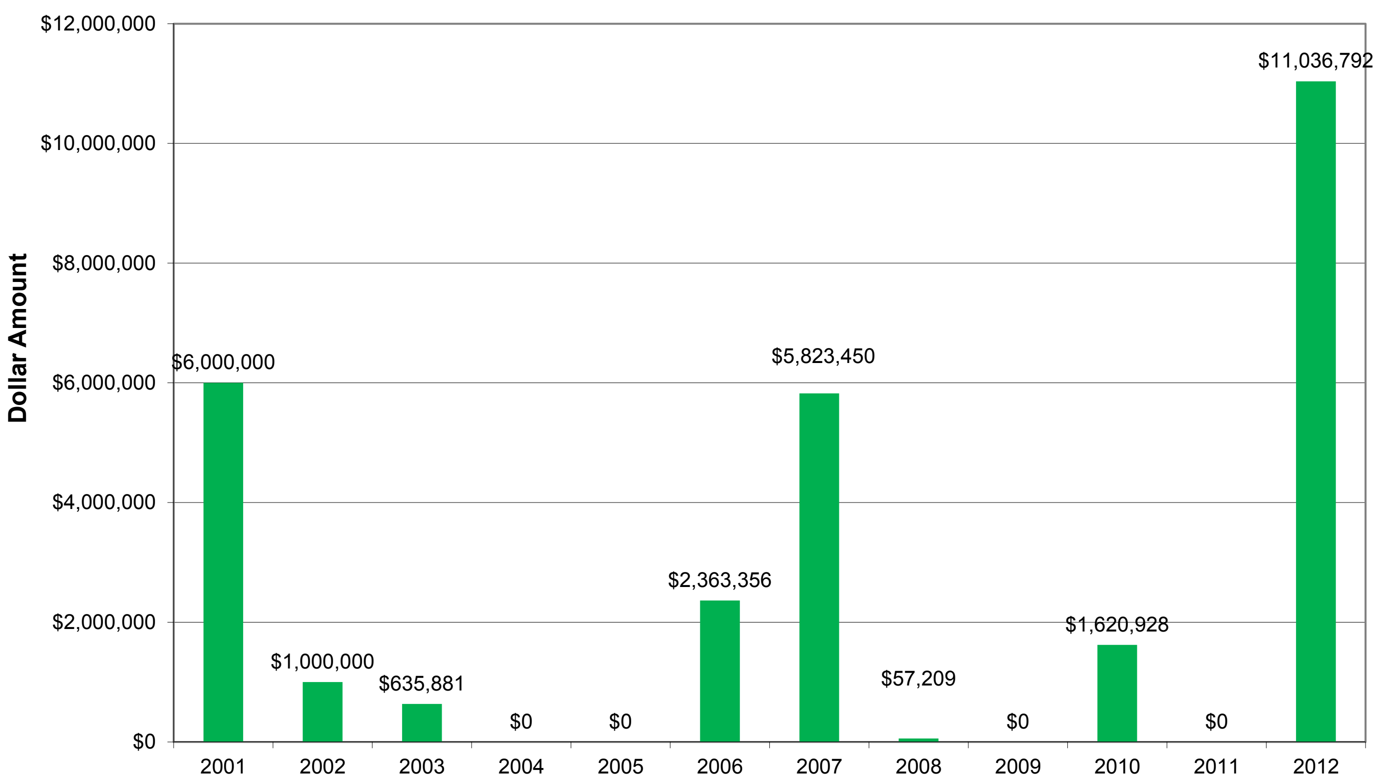
The fourth manager, Minnesota-based fixed income manager RBC Global Asset Management (formerly Access Capital), manages a fund that invests in debt securities that support affordable housing, job creation and community development for low- and moderate-income individuals and communities in Vermont. RBC underperformed in FY 2008, outperformed in FY 2009, and has lagged the benchmark in fiscal years 2010, 2011 and 2012 (but in those years has posted returns equal to or higher than Sentinel). As such, this investment is meeting its goals of capital preservation and investment return, along with providing benefits to Vermonters.

While the Treasurer's Office believes that the Fund's asset allocation has been appropriate to its goals of asset growth, capital preservation and supporting distributions, and that the investment managers have performed in a manner consistent with these goals, we believe a re-examination of the expected annual distribution rate may be appropriate. Expected returns over an intermediate term horizon for both equity and fixed-income classes have been reduced due to prospects for higher inflation, the likelihood of higher interest rates over time, expanded equity valuations and the dampening effect that higher debt burdens have on economic growth around the world. Similarly, we believe it would be prudent to reconsider the asset allocation and investments in light of asset class risk and return expectations that are markedly different from those that existed at the Fund's inception.

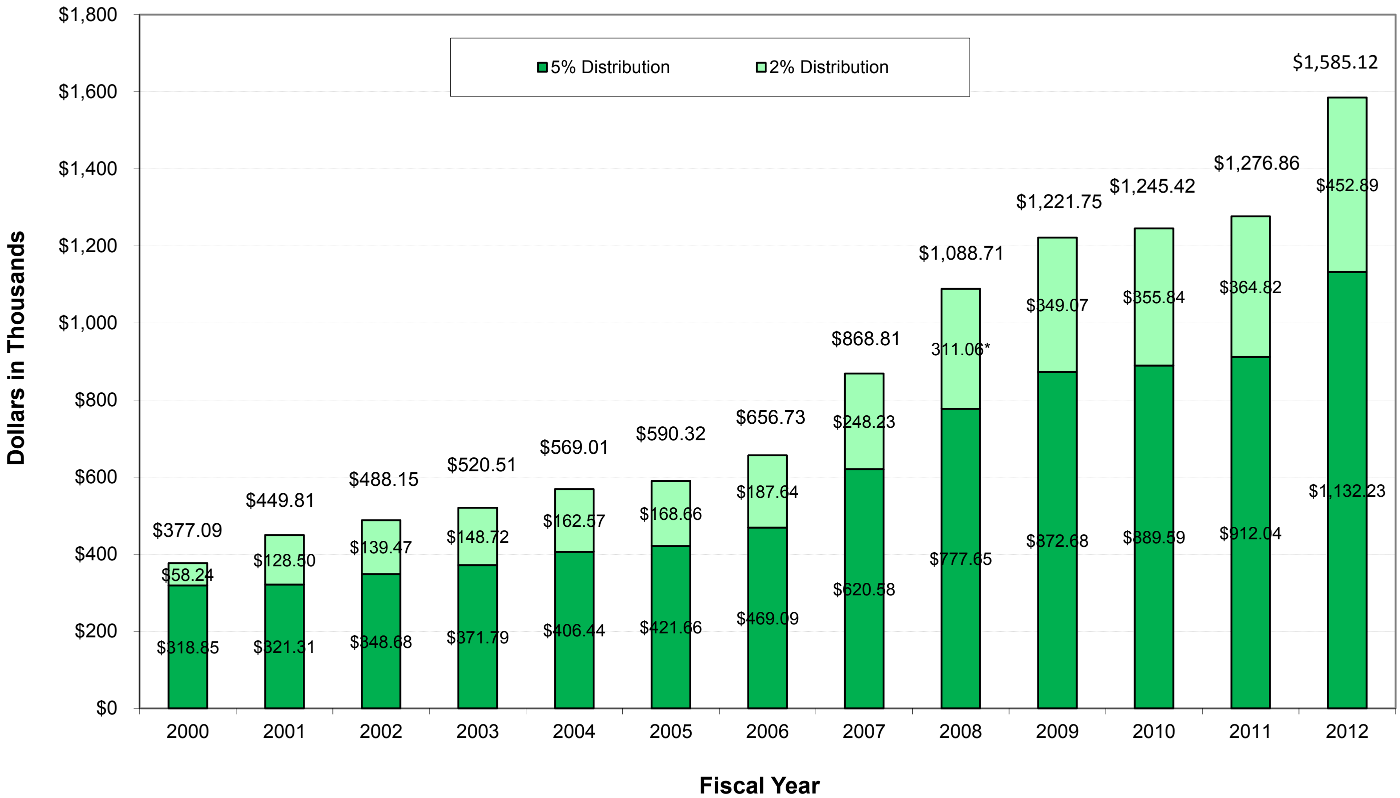
Please feel free to contact me if you have any questions or concerns regarding this report.

cc: James Reardon, Commissioner of Finance & Management
Donna Russo-Savage, Legislative Council

HIGHER EDUCATION TRUST FUND: *Fund Contributions—Fiscal Years*

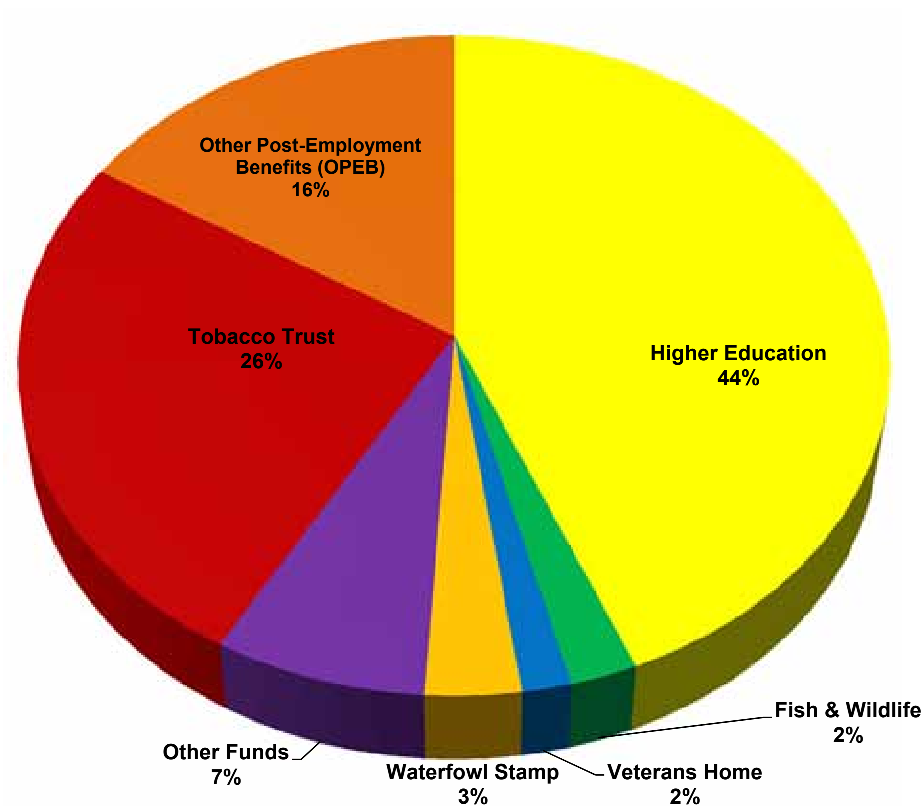


HIGHER EDUCATION TRUST FUND: *Authorized Distributions by Year and Type*

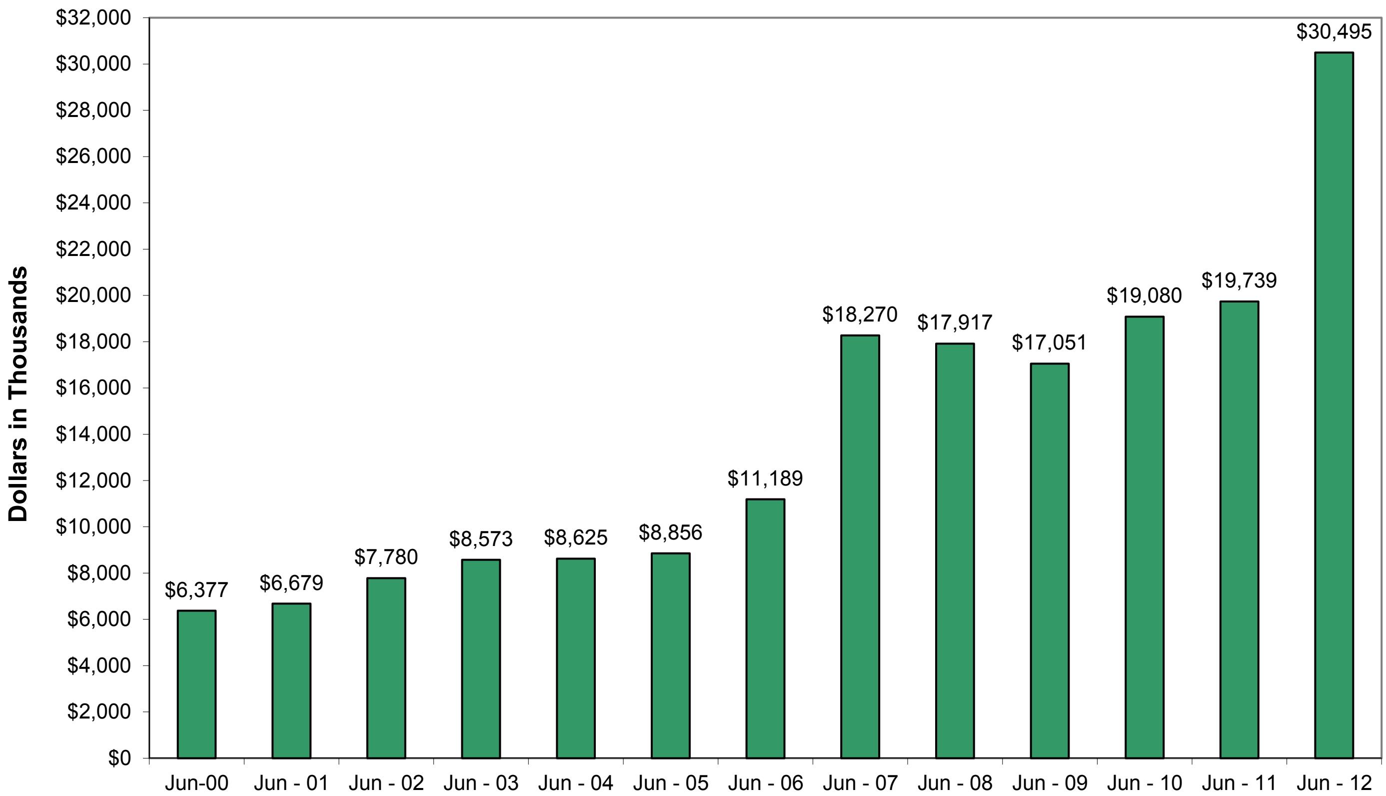


* Actual 2% distribution for 2008 was $298,227.18.

HIGHER EDUCATION TRUST FUND: *Trust Investment Account Fund Composition as of June 30, 2012*



HIGHER EDUCATION TRUST FUND: *Asset Growth—6/30/00 to 6/30/12, includes distributions*



APPENDIX A: *Higher Education Endowment Trust Fund Distributions—Period Ending June 30, 2012*

APPENDIX A
HIGHER EDUCATION ENDOWMENT TRUST FUND - DISTRIBUTIONS
For Period Ending June 30, 2012

Quarter-End Balances	September 30	December 31	March 31	June 30
Fiscal Year 2010	$18,084,136.99	$18,649,777.82	$19,114,425.82	$19,080,449.90
Fiscal Year 2011	$19,046,186.38	$19,080,907.03	$19,442,411.23	$19,739,011.70
Fiscal Year 2012	$28,788,444.91	$29,571,316.31	$30,642,367.21	$30,495,227.22

Twelve Quarter Average	**$22,644,555.21**	
5% Distribution FY2011	**$1,132,227.76**	
VSAC		$377,409.25
UVM		$377,409.25
Vermont State Colleges		$377,409.25
2% FY2010 (Projected)	**$364,817.75**	
UVM		$182,408.87
Vermont State Colleges		$182,408.87
2% FY2010 (Actual)	**$364,817.75**	
UVM		$182,408.87
Vermont State Colleges		$182,408.87
Balance after Distributions	**$28,998,181.71**	
2% FY2012 (Projected)	**$452,891.10**	
UVM		$226,445.55
Vermont State Colleges		$226,445.55

Total Contributions	
2001	$6,000,000.00
2002	$1,000,000.00
2003	$635,881.49
2004	$0.00
2005	$0.00
2006	$2,363,355.61
2007	$5,823,449.94
2008	$57,208.95
2009	$0.00
2010	$1,620,927.67
2011	$0.00
2012	$11,036,791.72
Total:	**$28,537,615.38**

APPENDIX B—TRUST INVESTMENT ACCOUNT: *Total Return Analysis—Year Ended June 30, 2012*

APPENDIX B
TRUST INVESTMENT ACCOUNT - TOTAL RETURN ANALYSIS[1]
Period Ending June 30, 2012

MANAGER	Fiscal Year 2003	Calendar Year 2003	Fiscal Year 2004	Calendar Year 2004	Fiscal Year 2005	Calendar Year 2005	Fiscal Year 2006	Calendar Year 2006	Fiscal Year 2007	Calendar Year 2007
DOMESTIC EQUITY										
Hanson & Doremus Investment Management	-1.89%	42.55%	29.10%	15.92%	22.25%	19.18%	21.10%	20.28%	29.13%	14.32%
Prentiss Smith & Co.	7.70%	18.17%	11.47%	13.25%	11.00%	10.68%	15.77%	16.61%	20.09%	10.85%
S&P 500	*0.25%*	*28.69%*	*19.14%*	*10.90%*	*6.32%*	*4.91%*	*8.63%*	*15.80%*	*20.60%*	*5.50%*
DOMESTIC FIXED INCOME										
Sentinel Asset Management, Inc.	8.92%	5.43%	3.48%	5.56%	7.42%	3.07%	0.26%	5.31%	6.12%	7.61%
RBC Global Asset Management (Access Capital)[2]										2.83%
Barclays (formerly Lehman) Aggregate	*10.40%*	*4.10%*	*0.32%*	*4.34%*	*6.80%*	*2.43%*	*-0.81%*	*4.33%*	*6.12%*	*6.96%*
TOTAL FUND DOLLAR WEIGHTED RETURN	8.59%	11.24%	7.59%	8.14%	10.17%	6.64%	5.86%	9.48%	12.02%	9.47%
Total Fund Target	9.23%	9.94%	4.96%	6.23%	6.76%	3.27%	2.19%	7.96%	10.62%	6.80%
TOTAL FUND MARKET VALUE ($ million)	$37.3	$38.8	$39.3	$41.1	$43.5	$48.6	$49.7	$52.8	$55.5	$58.8

MANAGER	Fiscal Year 2008	Calendar Year 2008	Fiscal Year 2009	Calendar Year 2009	Fiscal Year 2010	Calendar Year 2010	Fiscal Year 2011	Calendar Year 2011	Fiscal Year 2012	Calendar Year 2012
DOMESTIC EQUITY										
Hanson & Doremus Investment Management	-14.64%	-38.44%	-28.04%	22.93%	10.42%	18.90%	32.15%	-6.02%	-0.85%	
Prentiss Smith & Co.	-4.96%	-23.98%	-9.34%	35.30%	12.30%	11.04%	26.57%	1.73%	-0.05%	
S&P 500	*-13.13%*	*-37.00%*	*-26.21%*	*26.42%*	*14.43%*	*15.16%*	*30.73%*	*2.09%*	*5.45%*	
DOMESTIC FIXED INCOME										
Sentinel Asset Management, Inc.	9.10%	7.81%	8.77%	5.03%	7.95%	6.67%	3.27%	6.26%	5.31%	
RBC Global Asset Management (Access Capital)[2]	3.52%	3.71%	8.72%	9.76%	8.67%	5.40%	3.80%	5.84%	5.31%	
Barclays (formerly Lehman) Aggregate	*7.12%*	*5.24%*	*6.06%*	*5.94%*	*9.49%*	*6.54%*	*3.90%*	*7.84%*	*7.47%*	
TOTAL FUND DOLLAR WEIGHTED RETURN	3.10%	-3.62%	2.40%	13.06%	9.93%	9.76%	10.79%	4.04%	4.10%	
Total Fund Target	1.14%	-6.59%	-1.19%	13.18%	12.06%	9.88%	11.68%	6.67%	7.65%	
TOTAL FUND MARKET VALUE ($ million)	$59.3	$55.7	$59.2	$66.1	$60.6	$61.2	$64.0	$67.2	$69.7	

MANAGER	Quarter Ended 9/30/2011	Quarter Ended 12/31/2011	Calendar Year 2011	Quarter Ended 3/31/2012	Quarter Ended 6/30/2012	Fiscal Year 2012	Portfolio Value 6/30/2012	Portfolio Percent 6/30/2012
DOMESTIC EQUITY								
Hanson & Doremus Investment Management	-14.82%	7.97%	**-6.02%**	12.75%	-4.38%	**-0.85%**	$11,011,081	15.8%
Prentiss Smith & Co.	-10.94%	7.87%	**1.73%**	8.22%	-3.86%	**-0.05%**	$10,930,225	15.7%
S&P 500	*-13.87%*	*11.82%*	***2.09%***	*12.59%*	*-2.75%*	***5.45%***		*31.5%*
DOMESTIC FIXED INCOME								
Sentinel Asset Management, Inc.	2.44%	0.80%	**6.26%**	0.49%	1.49%	**5.31%**	$44,541,679	63.9%
RBC Global Asset Management (Access Capital)[2]	1.81%	1.03%	**5.84%**	1.15%	1.22%	**5.31%**	$3,234,388	4.6%
Barclays (formerly Lehman) Aggregate	*3.82%*	*1.12%*	***7.84%***	*0.30%*	*2.06%*	***7.47%***		68.5%
TOTAL FUND DOLLAR WEIGHTED RETURN	-2.16%	2.94%	**4.04%**	3.70%	-0.32%	**4.10%**		
Total Fund Target	-1.48%	4.31%	**6.67%**	4.21%	0.52%	**7.65%**		
TOTAL FUND MARKET VALUE ($ million)	**$64.8**	**$67.2**	**$67.2**	**$70.0**	**$69.7**	**$69.7**	$69,717,372	**100.0%**

Notes:
1. Includes cash balances of: Hanson - $452K, Prentiss - $1.09M as of June 30, 2012.
2. Access Capital added to Trust Investment Account on October 12, 2007.

APPENDIX C—TRUST INVESTMENT ACCOUNT: *Account Performance*

APPENDIX C
TRUST INVESTMENT ACCOUNT PERFORMANCE [1]

MANAGER	Fiscal Year 2012	Calendar Year 2011	Last 3 Fiscal Years	Last 5 Fiscal Years	Last 7 Fiscal Years	Last 10 Fiscal Years	Since Inception in FY2000
DOMESTIC EQUITY							
Hanson & Doremus Investment Management	-0.85%	-6.02%	13.10%	-2.33%	4.81%	7.96%	8.18%
Prentiss Smith & Co.	-0.05%	1.73%	12.42%	4.13%	7.89%	8.53%	8.03%
S&P 500	*5.45%*	*2.09%*	*16.41%*	*0.22%*	*4.10%*	*5.34%*	*1.48%*
DOMESTIC FIXED INCOME							
Sentinel Asset Management, Inc.	5.31%	6.26%	5.49%	6.86%	5.78%	6.02%	6.66%
RBC Global Asset Management [2]	5.31%	5.84%	5.91%	5.98%	N/A	N/A	N/A
Barclays (formerly Lehman) Aggregate	7.47%	7.84%	6.93%	6.79%	5.58%	5.63%	6.25%
TOTAL FUND DOLLAR WEIGHTED RETURN	4.10%	4.04%	8.23%	6.01%	6.82%	7.41%	7.77%
Total Fund Target	7.65%	6.67%	10.45%	6.13%	6.19%	6.42%	6.30%
TOTAL FUND MARKET VALUE ($ millions)	**$69.7**	**$67.2**					

Notes:
1. Returns for periods longer than one year are annualized.
2. Formerly Access Capital Management, inception date of September 17, 2007.

OTHER POST-EMPLOYMENT BENEFITS FUNDING ANALYSIS—VSERS & VSTRS

VSERS -- Other Post-Employment Benefits Funding Analysis

	Pre-Funding Basis	Partial Funding
Assumed Discount Rate	8.10%	4.25%
Actuarial Value of Assets	$ 13,378,884	$ 13,378,884
Actuarial Accrued Liability		
- Active Participants	$ 292,233,106	$ 569,194,149
- Retired Participants	$ 313,516,917	$ 442,588,702
- TOTAL	$ 605,750,023	$ 1,011,782,851
Unfunded Actuarial Liability	$ 592,371,139	$ 998,403,967
Funded Ratio	2.2%	1.3%
Annual Covered Payroll	$ 406,929,339	$ 406,929,339
Unfunded Actuarial Liability (as % of covered payroll)	145.6%	245.4%
Normal Cost for FY 2013	$ 16,617,316	$ 38,040,233
Amortization of Unfunded Actuarial Liability for FY 2013 (30 yr)	$ 29,175,240	$ 29,936,946
Annual Required Contribution (ARC) for FY 2013 *	$ 45,792,556	$ 67,977,179
Expected Benefit Payments	$ 35,699,629	$ 35,699,629
Increase in Annual Cost to Fund Plan	$ 10,092,927	$ 32,277,550

* *Payment is assumed to be made at the beginning of the fiscal year.*

VSTRS -- Other Post-Employment Benefits Funding Analysis

	Pre-Funding Basis	Pay-As-You-Go Basis
Assumed Investment Return	7.9%	4.0%
Actuarial Value of Assets	$ -	$ -
Actuarial Accrued Liability		
- Active Participants	$ 159,280,970	$ 352,293,953
- Retired Participants	$ 303,745,975	$ 474,886,145
- TOTAL	$ 463,026,945	$ 827,180,098
Unfunded Actuarial Liability	$ 463,026,945	$ 827,180,098
Funded Ratio	0.0%	0.0%
Annual Covered Payroll	$ 561,025,964	$ 561,025,964
Unfunded Actuarial Liability (as % of covered payroll)	82.5%	147.4%
Normal Cost for FY 2013	$ 8,711,812	$ 21,540,147
Amortization of Unfunded Actuarial Liability for FY 2013 (30 yr)	$ 22,286,538	$ 23,918,211
Annual Required Contribution (ARC) for FY 2013 *	$ 30,998,350	$ 45,458,358
Expected Benefit Payments	$ 23,982,688	$ 23,982,688
Increase in Annual Cost to Fund Plan	$ 7,015,662	N/A

* *Payment is assumed to be made at the beginning of the fiscal year.*

The State Treasurer's Office serves as the State's banker and chief investment officer. The office handles money that belongs to all of the citizens of Vermont. The Treasurer's office is committed to managing these funds efficiently and responsibly, and to maintaining Vermont's hard-earned reputation as a fiscally sound and disciplined state.

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Phone: (802) 828-1452
Fax: (802) 828-2772