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.

2007 Annual Report

Office of the State Treasurer

State of Vermont

Issued January 2008

Jeb Spaulding
State Treasurer

109 State Street
Montpelier, Vermont
www.VermontTreasurer.gov

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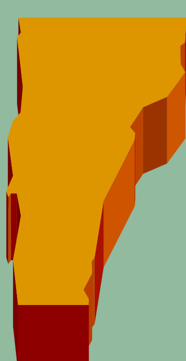
Our Commitment to Vermonters

The State Treasurer's Office manages money that belongs to all citizens of Vermont. The Treasurer and staff are committed to doing this honestly, 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.



Letter of Transmittal

TO: Members of the General Assembly
Honorable James H. Douglas, Governor
Citizens of Vermont

I feel privileged to serve as Vermont's State Treasurer and am proud of the work my office has accomplished during the past year. As the cover of this report highlights, we strive to provide Vermont taxpayers an excellent value, offer the best customer service possible, and deliver the highest quality treasury services. The 2007 Annual Report for the Office of the State Treasurer focuses on the results of our work for the fiscal year ending June 30, 2007, and also includes relevant information on activities through December 31, 2007.

The significant accomplishments in 2007 by the Office of the State Treasurer would not have been possible without a dedicated and professional staff. Below are just a few of the highlights.

Key Accomplishments

The State of Vermont achieved a very significant milestone in February. For the first time since the early1970s, Vermont received a triple-A bond rating from Moody's Investors Service. Vermont is one of only nine states rated triple-A by Moody's and maintains the best credit ratings in New England. This highest and most coveted rating lowers the cost of capital for the State and its municipalities and enhances our reputation as a good place to do business. (See *Achieving Triple-A* at left.)

Vermont's three state-level pension funds were all funded at the actuarially recommended level for fiscal year 2007 and also for fiscal year 2008. Overall, "funded ratios" were 100.8 percent for the Vermont State Employees' Retirement System, 105.1 percent for the Vermont Municipal Employees' Retirement System, and 84.9 percent for the Vermont State Teachers' Retirement System.

The State of Vermont avoided the losses you may have read about related to the sub-prime mortgage loan crisis. Principally, we did not experience losses related to structured investment vehicles (SIVs) and collateralized debt obligations (CDOs) carrying sub-prime mortgage loans as assets. We avoided those kinds of securities completely in our short-term and medium-term investments and experienced no loss of principal on any Vermont State Treasury investments. By policy, treasury investing ranks safety of principal first, followed by liquidity and return on investment, in that order. Vermont's investment returns in 2007 were strong. Our pension funds returned approximately 17 percent. We beefed up our due diligence and evaluation of all investment strategies in the face of the meltdown in the national credit market and the losses sustained in certain investment vehicles by large investment banks.

Achieving Triple-A

Moody's recognized our credit strengths as follows:

Aaa

- **Sound financial management and fiscal policies indicated by conservative budgeting practices.**
- **Prompt action and bipartisan willingness to reduce spending following revenue weakening during recession.**
- **Relatively rapid restoration of reserves used during period of revenue weakness.**
- **Steady progress in reducing previously high debt ratios and maintaining an affordable debt profile.**
- **Low unemployment and poverty rates.**

The challenge of finding new sources of return, while keeping risk at acceptable levels, has been a priority for the Vermont Pension Investment Committee this year. That commitment has required investment education and judgment relating to asset classes and investment options that may not have existed ten years ago. A softening housing market, much tighter credit conditions, spiraling energy costs, tightening government budgets, weakening economic indicators, and an increasing possibility of recession have increased risk to pension investment returns in the near term. The best protection against risk is portfolio diversification in non-correlating asset classes – when returns are down in one asset class, returns are often up in another class. We can expect some volatility over the next few years, but I am confident that decisions made by the Vermont Pension Investment Committee this year will result in favorable performance over the long term.

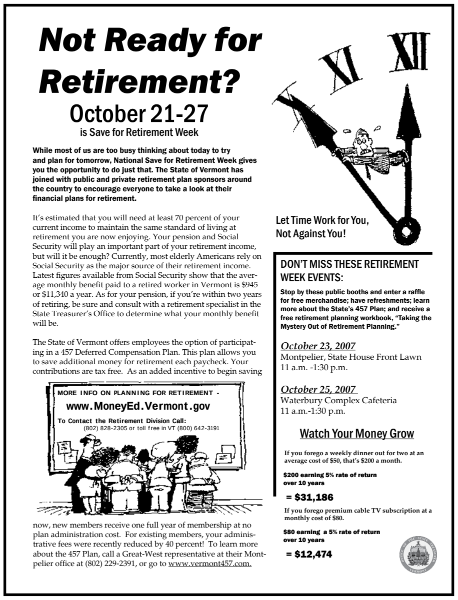
In 2006, the Vermont Legislature revised the statute permitting municipalities to pool their pension investments with the Vermont Pension Investment Committee. This change is intended to provide fee reductions, economies of scale, and the opportunity for enhanced returns to municipalities. This year, Burlington became the first municipality to take advantage of this opportunity, investing more than $100 million with the Vermont Pension Investment Committee.

The Treasurer's Office established a financial literacy effort aimed at developing, assessing and providing financial education programming to Vermont's citizens. In accordance with national trends that indicate a need for improved financial literacy, the office hired a director to manage the initiative. New web-based financial education resources were made live in September; two educational fact sheets were developed; and a retirement savings initiative was launched in October. My office also joined State Treasurers from throughout New England in the region-wide rollout of the NFL-themed money management video game, "Financial Football." Early in 2008, free copies of the game will be distributed to all high schools and middle schools in Vermont as part of a statewide effort to encourage financial education.

Stepped up outreach efforts for unclaimed property in 2007 greatly expanded Vermonters' knowledge of this important consumer function of the Treasurer's Office. Vermonters responded in the thousands to a new advertising initiative, "It's Your Money – Claim It!" The campaign included print, broadcast and web advertising, posters and direct-mail, and news releases aimed at motivating citizens to check the unclaimed property database to see if the State was holding financial property that belonged to them. As a result of these activities initiated in the fourth quarter of fiscal year 2007, the office saw a record-breaking response from the public in the first quarter of fiscal year 2008. From July 1 through September 30, 2007, the Unclaimed Property Division paid out 3,283 claims worth $1.28 million – a 250 percent increase in the average number of claims paid for that period. We also saw a record number of web searches in the first quarter with 110,964 searches, compared to 34,160 searches for the same period last year. We continue to see the number of claims filed rising. Please note the projected 2008 results in the charts found in the Unclaimed Property Division section of this report.

"Freedom and Unity"

The State motto, "Freedom and Unity," is a wonderful reflection of the cooperative spirit of Vermont. While we celebrate individual views and the right to express those opinions, Vermonters also work hard to create and sustain a sense of community. As our history has shown, it is not always easy to accomplish both ideals. However, we have not let the complexity of such issues deter us from continuing our pursuit of both concepts. In this review of the progress the Treasurer's Office has made during fiscal year 2007, I must acknowledge our ongoing concerted efforts to hear individual voices on how best to manage State resources, while at the same time working toward the greater good of all Vermonters. Without the teamwork of the Treasurer's Office staff, the many people who serve on the numerous boards that guide our investment policies, and the calls and suggestions we receive from individual Vermonters, we would not have accomplished so much. My thanks to everyone.



In October, the Retirement Division worked to encourage State employees to examine their future retirement needs.

It has been an exceptionally busy year for our Retirement Division. Individual counseling sessions were up 12 percent. The Vermont Municipal Employees' Retirement System Board of Trustees launched an innovative health savings plan for its members and made an initial distribution of approximately $5 million to more than 4,700 active and retired members. A new dental plan for retired State employees, authorized by legislation in 2006, was implemented and as of December 2007, more than 1,200 State retirees had enrolled. A similar dental plan was approved for Vermont's retired teachers and as of December 2007, the enrollment period was in process. Ten new entities joined the Vermont Municipal Employees' Retirement System. Development, testing, training, and debugging continued on the new data management system, with an expected completion date of 2009.

Looking Ahead to Fiscal Year 2008

Looking forward, I expect the next few years to be very challenging for Vermont from a financial perspective. Revenues are most likely going to slow significantly and this will make budget building very arduous. It will be difficult to maintain important, high-quality services that taxpayers can afford. At the same time, there are a number of longer-term budgetary challenges facing the State. These include a structural imbalance in the Transportation Fund and also between Medicaid revenues and spending; limited capital financing for demands such as a new State hospital and school buildings; unmet needs for highway and bridge infrastructure; and a continued need to sustain efforts to fund promised pension and retiree health benefits for State employees and teachers. We must be careful not to expand or start new programs which will make our budgetary situation worse. At the same time, we need to find ways to support essential services for our citizens and make investments that will improve our economy over time.

There are a number of budgetary challenges facing the State. We need to find ways to support essential services for our citizens and make investments that will improve our economy over time.

While we must continue our disciplined approach to debt financing of public infrastructure, the time is now right for a thorough review of whether Vermont's approach and policies of the past 20 years relating to debt management and infrastructure financing still make sense in light of current circumstances and remain appropriate for the future.

Another challenge will be the funding of post-employment benefits for Vermont teachers and State employees. Recently adopted standards by the Governmental Accounting Standards Board (GASB) covering non-pension post-employment benefits, primarily health insurance, will have major financial and disclosure ramifications for the State of Vermont beginning in fiscal year 2008. For the first time, public sector entities will be expected to report the future costs of these benefits on their balance sheets. These changes do not require pre-funding such benefits. However, the basis applied by the GASB standards for measurement of costs and liabilities for these benefits results in far larger yearly cost and liability accruals, if funded on a pay-as-you-go basis. Presently, in Vermont and many other states, such benefits are funded on a pay-as-you-go basis and not pre-funded in the same manner as traditional pension benefits.

In order to protect retirement benefits for current and future employees and to assure taxpayers that these benefits are affordable and fair to all parties, pension and retiree health benefits should be realigned in the very near future for new hires to reflect current and expected economic, demographic, and workforce trends. While significant over time, enactment of such changes will not solve the new GASB requirements just discussed. That means additional funding will be needed. I believe all states interested in maintaining a record of strong financial management will need to pre-fund their non-pension post-employment benefit commitments within a reasonable number of years.

Recently adopted standards covering non-pension post-employment benefits by the Governmental Accounting Standards Board will have major financial and disclosure ramifications for the State of Vermont beginning in fiscal year 2008.

I urge all parties not to dismiss out-of-hand the options available that might allow us to address the fiscal challenges that lie ahead, including carefully considered cost-reducing or revenue-raising options. Vermont is known for its ability to tackle and surmount challenges through collaborative efforts of the Governor's Office, the Legislature, and interested citizens. I stand ready to assist in any way possible.

My staff and I are available to discuss the information in this report, and welcome your inquiries and/or comments. You will find a great deal of additional information by visiting our web site at www.vermonttreasurer.gov.

Sincerely,

Jeb

Jeb Spaulding
State Treasurer

High school teams from each New England state participated in the December "Financial Football" event.

About the Treasurer's Office

Our Responsibilities

The State Treasurer's Office serves as the State's banker and chief investment officer. We handle money that belongs to all of the citizens of Vermont. We are committed to managing these funds honestly, 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.***
- ***Administration of three major pension plans, the deferred compensation plan, and the defined contribution plan for State employees, teachers, and participating municipalities.***

Executive Office
(802) 828-1452

Jeb Spaulding
State Treasurer

Beth Pearce
Deputy Treasurer

William Rice
Legal & Policy Director

Barbara Agnew
Executive Staff Assistant

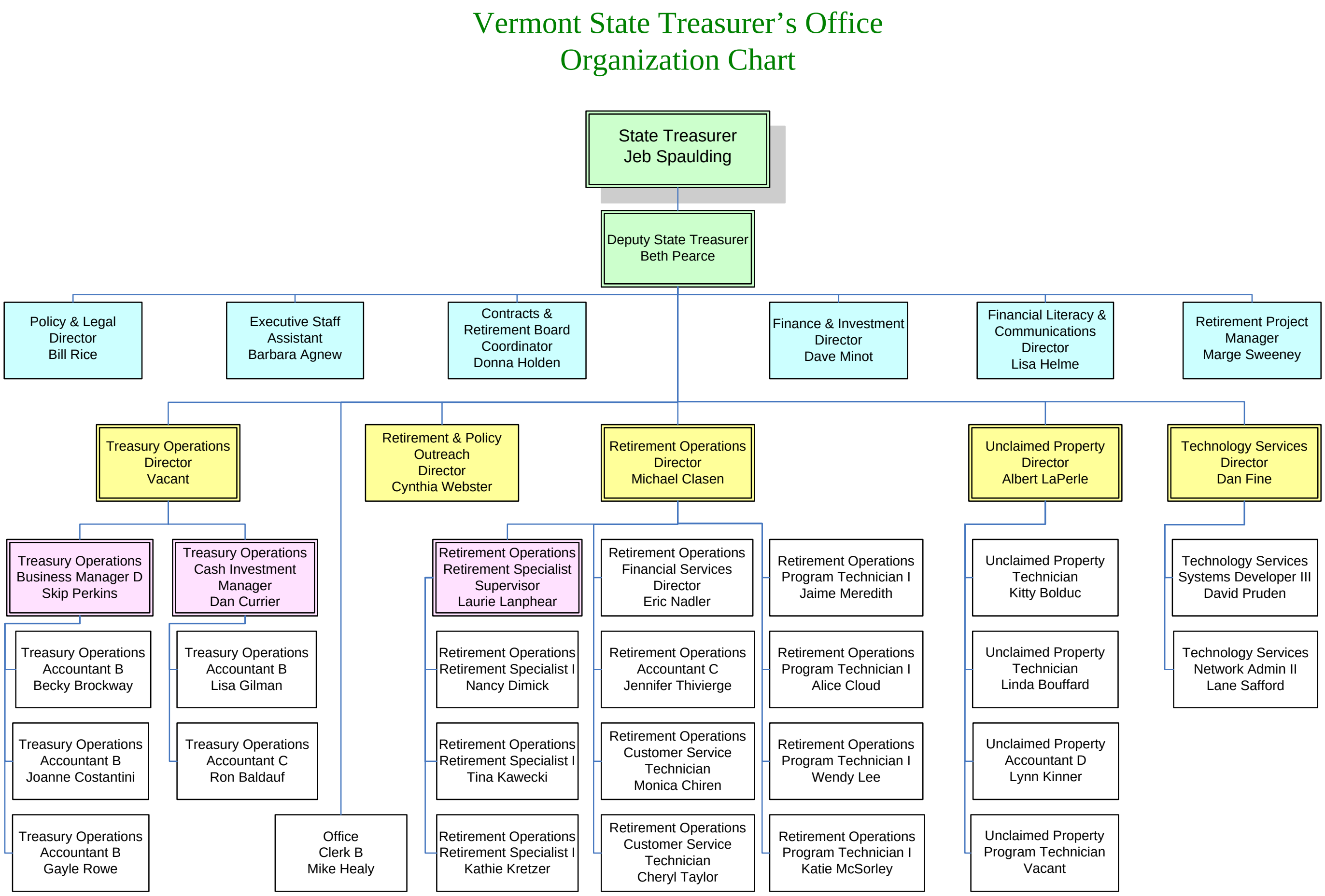
Administration & Organization

The State Treasurer's 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 System). Debt Management and Investment services provides cash, investment, and debt 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 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.

Organizational Chart

There are 38 staff members working within the State Treasurer's Office. Below is the office organizational chart.



Employee of the Year

Joanne Costantini is the Treasurer's Office lead staff member in the office's check processing function. Joanne was recognized as Employee of the Year in 2007 for demonstrating a high degree of professionalism, diligence and accuracy in processing more than 300,000 payments for the State's vendors, payees, and staff. She also acts as one of the office's "go-to" persons in an emergency and willingly works extra hours to get the task done. Recently, during the VISION Upgrade project, Joanne completed testing of the check cycle and ACH payment cycle functions and, in addition, worked many extra hours to assure critical payments such as foster care and day care were completed during the cut-over to the new system. She did this in a manner that demonstrated consideration and respect to our customers and to the Department of Finance and Management staff, who spearheaded this project, providing an excellent example of inter-agency cooperation.

Joanne Costantini
Accountant B

Above, Vermont State Teachers' Retirement System board members Vaughn Altemus and Board Chair Jon Harris participate in one of the group's quarterly business meetings.

Overview

The State Treasurer's Office administers a range of retirement plans that serve approximately 44,847 active and retired members. (See Retirement Division Operations section of this report.) 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).

The Boards of Trustees are statutorily charged with establishing rules and regulations for the administration of their system and for the transaction of its 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 a guideline. If questions arise, or if a member or retiree does not agree with a decision made by staff, they may appeal to the Board of Trustees for re-consideration. The board may seek legal counsel from the Attorney General's Office, when necessary. The boards also are charged with approving regular retirement applications, disability retirement applications, and withdrawals from membership. Each Board of Trustees acts a fiduciary of the funds held on behalf of its' members and retirees. The boards are required to keep a record if its proceedings which are open to the public. 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' Retirement System Boards of Trustees 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.

Board Administration
(802) 828-3708

Cynthia Webster
Executive Secretary of the Board and Director of Retirement Policy & Outreach

Donna Holden
Contracts & Retirement Board Coordinator

The boards meet a minimum of four times a year, some more frequently, to handle any business that may come before them for consideration.

Vermont State Employees' Retirement System

The Vermont State Employees' Retirement Board consists of eight members, including the State Treasurer, who serves an an *ex officio* member of the board. Pictured above (l to r) are Dick Johannesen, Governor's delegate; Bob Hooper, VSEA representative; Kevin Gaffney, VSEA representative; Joe Healy, VRSEA representative; David Herlihy, Commissioner of Human Resources; Jim Reardon, Commissioner of Finance & Management; and Jeb Spaulding, State Treasurer. Not pictured is Warren Whitney, Board Chair and VSEA representative.

Vermont State Teachers' Retirement System

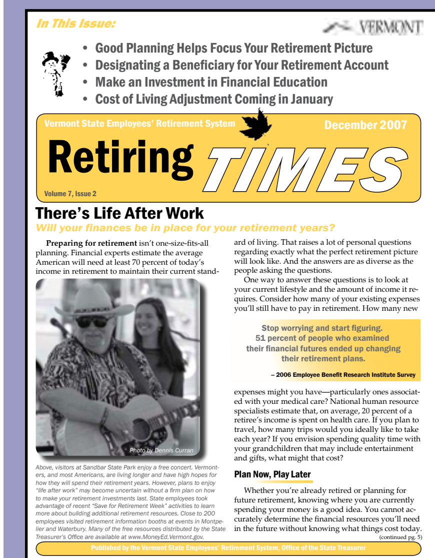
The Vermont State Teachers' Retirement System Board is comprised, by statute, by six members, of which three are *ex officio* members. Pictured above (l to r) are Jay Kaplan, VRTA representative; Jon Harris, Board Chair and active member representative; Vaughn Altemus, Department of Education representative and *ex officio* member; Jeb Spaulding, State Treasurer and *ex officio* member; Joe Mackey, Vice Chair and active member representative; and Tom Candon, Banking, Insurance, Securities and Health Care Administration representative and *ex officio* member.

Vermont Municipal Employees' Retirement System

The Vermont Municipal Employees' Retirement System Board is comprised of five members. Pictured above (l to r) are John "Jack" Mitchell, employee representative; Steven Jeffrey, Board Chair and employee representative; David Lewis, Vice Chair and employer representative; and Jeb Spaulding, State Treasurer and *ex officio* member. Not pictured is Stephen Rauh, Governor's delegate.

Retirement Newsletter Redesigned in 2007

Twice a year, a customized newsletter for each system is mailed to all active and retired members. In 2007 the newsletter was redesigned to encourage greater readership of the publication. Major thematic



In This Issue:

VERMONT

- Good Planning Helps Focus Your Retirement Picture
- Designating a Beneficiary for Your Retirement Account
- Make an Investment in Financial Education
- Cost of Living Adjustment Coming in January

Vermont State Employees' Retirement System

December 2007

Retiring TIMES

Volume 7, Issue 2

There's Life After Work

Will your finances be in place for your retirement years?

Preparing for retirement isn't one-size-fits-all planning. Financial experts estimate the average American will need at least 70 percent of today's income in retirement to maintain their current standard of living. That raises a lot of personal questions regarding exactly what the perfect retirement picture will look like. And the answers are as diverse as the people asking the questions.

One way to answer these questions is to look at your current lifestyle and the amount of income it requires. Consider how many of your existing expenses you'll still have to pay in retirement. How many new

Stop worrying and start figuring. 51 percent of people who examined their financial futures ended up changing their retirement plans.

-- 2006 Employee Benefit Research Institute Survey

expenses might you have—particularly ones associated with your medical care? National human resource specialists estimate that, on average, 20 percent of a retiree's income is spent on health care. If you plan to travel, how many trips would you ideally like to take each year? If you envision spending quality time with your grandchildren that may include entertainment and gifts, what might that cost?

Photo by Dennis Curran

Above, visitors at Sandbar State Park enjoy a free concert. Vermonters, and most Americans, are living longer and have high hopes for how they will spend their retirement years. However, plans to enjoy "life after work" may become uncertain without a firm plan on how to make your retirement investments last. State employees took advantage of recent "Save for Retirement Week" activities to learn more about building additional retirement resources. Close to 200 employees visited retirement information booths at events in Montpelier and Waterbury. Many of the free resources distributed by the State Treasurer's Office are available at www.MoneyEd.Vermont.gov.

Plan Now, Play Later

Whether you're already retired or planning for future retirement, knowing where you are currently spending your money is a good idea. You cannot accurately determine the financial resources you'll need in the future without knowing what things cost today.

(continued pg. 5)

Published by the Vermont State Employees' Retirement System, Office of the State Treasurer

Above is the front page for the December issue of the VSERS Retiring Times.

stories are carried in all three versions of the newsletter. However, stories reflecting the unique informational needs of each membership group are also included in the publications. The newsletter for VSERS members is yellow. The VSTRS newsletter is green and the VMERS newsletter is brown.

Retirement Division Operations

Above, municipal retiree Wayne Kathan, his wife Fay, and fellow retiree Rebecca Peatman leave an informational session on health savings accounts.

Background

The State Treasurer's Office Retirement Division administers a range of defined benefit pension and defined contribution retirement plans. The three defined benefit plans are statutorily defined. These plans are the State Teachers' Retirement System of Vermont, the Vermont State Employees' Retirement System, and the Vermont Municipal Employees' Retirement System. Charts 1-3 on page 12 show comparative membership information on the three defined pension benefit plans. In addition, the office also administers two defined contribution plans that are offered as an alternative to the defined benefit plans for certain employee groups.

ACCOMPLISHMENTS IN 2007

- **The Retirement Division staff conducted 1,173 individual counseling sessions during fiscal year 2007, a 12 percent increase over the prior year. The staff also calculated more than 8,213 retirement estimates at the request of prospective retirees and conducted 88 member informational sessions across the state with 1,881 individuals in attendance.**

- **Ten new entities joined the Vermont Municipal Employees' Retirement System.**

- **Legislation passed in 2006 allowed the office to offer a dental insurance plan to retired State employees, provided the retirees paid the full cost associated with the premiums and administration of the plan. Following the development of a Request for Proposals, a competitive bid process was conducted, and Northeast Delta Dental was selected as the insurance provider. Enrollment began in December 2006 and as of December 2007, more than 1,200 State retirees signed up for coverage with approximately 1,800 covered lives. Due to the larger than expected number of retirees who enrolled in the plan, the office lowered the administrative fee associated with the plan from eight to three percent.**

- **The Vermont Municipal Employee's Retirement System Board of Trustees launched a new retirement health savings (RHS) plan on July 1, 2007, resulting in a distribution of approximately $5 million to more than 4,700 active and retired members. The tax-advantaged savings plan is designed to assist retirees in paying for healthcare costs after retirement. The money goes into the RHS plan, accumulates interest and is drawn out during retirement, all on a tax-free basis. ICMA-RC was selected to administer the plan. In the future, the board will re-allocate surplus employer contributions, when available, to distribute into the RHS accounts. Future deposits will be made if and when the system's funding position is more than is actuarially needed to fund current and future pension obligations.**

- **The Treasurer's Office negotiated lower administrative fees for the State's 457 deferred compensation plan. Effective October 1, 2007, the previous 25 basis point plan administration fees for all accounts was reduced to 15 basis points--a 40 percent savings on administrative fees. New plan members also received one full year with no plan administrative cost.**

Retirement Operations
(802) 828-2305
(800) 642-3191

Michael Clasen, Retirement Operations Director

Marge Sweeney, Retirement Project Manager

Eric Nadler, Financial Services Director

Jennifer Thivierge, Accountant C

Katherine McSorley, Program Technician I

Wendy Lee, Program Technician I

Alice Cloud, Program Technician I

Jaime Meredith, Program Technician I

Laurie Lanphear, Retirement Specialist Supervisor

Kathleen Kretzer, Retirement Specialist I

Nancy Dimick, Retirement Specialist I

Tina Kawecki, Retirement Specialist I

Cheryl Taylor, Customer Service Technician

Monica Chiren, Customer Service Technician

Retirement Division Performance Indicators					
					Percent Change
Activity	2007	2006	2005	2004	2006 - 2007
Estimates	8,213	8,672	7,031	4,700	-5%
Individual Counseling	1,173	1,050	1,216	1,070	12%
Retirements	788	785	716	655	0%
Withdrawals	1,507	1,485	2,816	3,072	1%
Deaths	333	278	279	265	20%
Seminars	88	51	53	57	73%
Seminar Attendance	1,881	1,381	1,386	1,749	36%

There is also a 457 deferred compensation program for State and municipal employees and a single deposit investment account (SDIA) for State employees and teachers. SDIA is a tax-sheltered account funded through employee transfers from a contributory plan that was in existence in 1981.

Although the Retirement Division contracts with third-party administrators to manage the investment options for the defined contribution plans, the office is responsible for providing new hires with information and comparisons of projected benefits, and also conducts one-on-one counseling to assist in the election process. Staff members process all transfers between the plans, and receive and transmit all contributions on behalf of the retirement plans.

The primary function of the Retirement Division staff is to serve the needs of the active contributing members and retired members receiving benefit payments. On the active member side, the Retirement Division oversees enrollments, transfers, refunds, processing of employee and employer contributions, and adjustments to members' accounts. On the retiree side, the division oversees the issuance of the payroll, changes to dependents, adjustments to payments, and replacement checks. Other responsibilities include employee re-instatements, calculation of buybacks and refunds, disability retirements, and determination of survivor benefits.

UPDATES

Retirement Re-engineering Project

The Retirement Division is now testing the State's new Vermont Pension Administration System (VPAS). The new software system will replace the current pension data management system that has been in place for more than 25 years. VPAS features a fully integrated browser-based pension system. The new system will allow members access to their information via the web.

Work now underway includes a "cleaning" of the data to ensure the accuracy and the performance of the new system. The first phase of a two-phased approach to install the pension software is expected to "go live" in 2008. Phase one, the active members phase, involves the activities dealing with a member prior to retirement and includes employer reporting, annual statements, estimates and retirement planning, and purchases of service credit. The second phase, the retired member phase, deals with the activities of members once retired and includes pension payments, tax withholdings, and insurance deductions. The benefit phase is expected to "go live" in 2009. It's estimated that web-based access also will become available in 2009.

Retirement Division staff began training on the system in November 2007. Next, staff will operationally test VPAS using a wide-range of user scenarios.

With the implementation of VPAS, every aspect of the daily business of the division will be affected. This solution will provide the State of Vermont with

Comparative Membership Information--Vermont Retirement System

1

Vermont State Employees' Retirement System	June 30, 2007	June 30, 2006	Percent Change
Active Members			
Vested	5,709	5,652	1.01%
Not Vested	2,702	2,636	2.50%
Total Active Members	8,411	8,288	1.48%
Average Age	46.21	46.15	0.13%
Average Service	12.06	12.09	-0.25%
Average Compensation	$ 46,001	$ 44,560	3.23%
Retired Members and Beneficiaries			
Number	4,399	4,173	5.42%
Annual Retirement Allowances	$ 61,403,641	$ 55,043,322	11.56%
Inactive Members	935	1,111	-15.84%
Terminated Vested Members	790	805	-1.86%

2

State Teachers' Retirement System of Vermont	June 30, 2007	June 30, 2006	Percent Change
Active Members			
Vested	7,977	8,020	-0.54%
Not Vested	2,698	2,676	0.82%
Total Active Members	10,675	10,696	-0.20%
Average Age	46.88	46.73	0.32%
Average Service	13.66	13.58	0.59%
Average Compensation	$ 48,297	$ 46,657	3.52%
Retired Members and Beneficiaries			
Number	5,192	4,879	6.42%
Annual Retirement Allowances	$ 74,726,093	$ 66,776,433	11.90%
Inactive Members	2,901	2,777	4.47%
Terminated Vested Members	741	759	-2.37%

3

Vermont Municipal Employees' Retirement System	June 30, 2007	June 30, 2006	Percent Change
Active Members			
Vested	3,249	3,037	6.98%
Not Vested	2,917	2,912	0.17%
Total Active Members	6,166	5,949	3.65%
Average Age	47.01	46.77	0.51%
Average Service	6.79	6.57	3.35%
Average Compensation	$ 26,325	$ 25,015	5.24%
Retired Members and Beneficiaries			
Number	1,309	1,241	5.48%
Annual Retirement Allowances	$ 7,804,774	$ 6,997,737	11.53%
Inactive Members	2,064	2,075	-0.53%
Terminated Vested Members	432	418	3.35%

The Vermont State Employees' Board approved five new investment options for the 457 deferred compensation program in 2007. More details on page 13 of this report.

a stable, state-of-the-industry, fully-integrated pension administration solution that will allow the division to operate its business more efficiently and effectively. The system also will meet the customers' needs for increased access to services and more timely information.

457 Deferred Compensation Program

The deferred compensation program has been available since 1973 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 portion of salary that is deferred is not taxed at the time of deferral. On June 30, 2007, the plan had 6,320 participants. Total assets in the plan were valued at $255.02 million. Participating employees made contributions in the amount of $18.33 million to the plan during fiscal year 2007.

The Treasurer's Office negotiated lower administrative fees that resulted in a 40 percent savings on such fees for members.

The Treasurer's Office regularly reviews 457 plan mutual fund investment options in order to make available funds that have shown superior investment performance, favorable costs and continuity in management. As a result of such reviews, in 2007 three funds in two separate asset classes were replaced. The Templeton Foreign A Fund was replaced with the Lazard Emerging Markets Institutional Fund. Also, the Domini Social Equity Fund was replaced with the Vanguard FTSE Social Index Fund. Costs on two existing investment options, the Calvert Income Fund and the Vanguard Mid-Cap Index Fund, also were reduced. Two new socially responsible investment options were added from SRI categories not previously available: the Pax World Balanced Fund and the Calvert Social Investment Bond A Fund. All five new funds became available July 2, 2007.

As noted in the accomplishments box on page 10 of this report, the Treasurer's Office also negotiated lower administrative fees for existing plan members and no administrative fees for one year for new members.

Defined Contribution Plan

Established in 1999, the State's defined contribution plan had 589 participants and net assets of $41,402,234 as of June 30, 2007. 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 admnistratior, 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 State's defined contribution 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

Summer Study Committee Work

A bill was introduced in the 2007 legislative session to increase the annual cost-of-living adjustment (COLA) for group F retirees to equal the full amount of the Consumer Price Index (CPI) up to 5 percent. The bill failed due to concern regarding the significant increase in the group F active member retirement contribution rate necessary to fund the cost of the full COLA. In order to move this initiative forward, the Legislature created a Summer Study Committee and charged the group with developing recommendations for funding a full COLA. The committee was to report its recommendations to the General Assembly by December 15, 2007. The State Treasurer and the office's Director of Retirement Policy and Outreach served on the committee. The committee met six times over the summer and fall and is expected to file the required report. It's anticipated the report will iclude an option for a self-funded full COLA to begin five years after passage of the enabling legislation, as well as an option for a comprehensive package to include a full COLA, plus revisions to pension and retiree medical insurance benefits for future new employees of the State of Vermont. The Legislature will have the opportunity to act upon the committee's recommendations during the 2008 session.

SERVICE FIRST

The Retirement Division manages an extremely high volume of inquiries by phone, e-mail, and face-to-face appointments or walk-ins which are directed through the front office staff. The retirement counselors provide one-on-one counseling to prospective retirees.

Counselors provide estimates of pension and beneficiary payments by verifying a member's creditable service, salaries, and personal information (i.e., date of birth, beneficiary date of birth, etc.). Counselors and supervisory staff also conduct informational seminars throughout the state. Program technicians in the employer reporting unit provide daily support and technical assistance to the more than 700 reporting entities in the Teacher and Municipal systems. The Retirement Division's accountant maintains all retiree data and ensures the timely processing of over 11,000 pension payments each month.

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.

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 July 31, 2007, there were 77 contributing municipalities with 560 participants and net assets of $13,163,965.

Single Deposit Investment Account

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, 2007, the SDIA plan had 2,336 members and beneficiaries and has approximately $89.3 million in net assets.

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.

Pension Funding

The VSERS, VSTRS and VMERS are defined benefit systems funded by employee contributions, employer or State contributions, and interest earnings on the assets of the fund. These funds are used to pay current benefit payments, health care (VSERS and VSTRS), investment manager expenses, and the retirement office expenditures. The results of operations for the three systems are reported in detail in the Appendices, page 52 of this report. The chart on page 16 provide a synopsis of operations at a higher level. Over the year ending June 30, 2007, $443.5 million was added to the pension fund assets on a net basis. As defined benefit plans, there is a promise to provide its members with a monthly benefit beginning at each member's retirement for the rest of his/her life (or beneficiary, depending on retirement options selected). In order to meet these obligations, each plan has developed a funding plan to accumulate monies, which, properly invested, will fund member retirements.

Employee Contributions: There are various group plans within the retirement system with varying contribution rates and benefits. During the fiscal year ending June 30, 2007, plan members made approximately $15.5 million in contributions in VSERS, $22.5 million in VSTRS, and $9.8 million in VMERS.

Employer Contributions: In fiscal year 2007, the VSERS received $39.3 million in employer contributions. These included an amount set by the State's independent actuary for pension benefits, and for various expenses of the fund.

The VSTRS system received $37.3 million in State contributions. In addition, the VSTRS system received approximately $1.2 million from the federal Medicare D program. Local school system employees remit the employee contributions, but the "employer contribution" is made through State appropriation rather than as an expense of the local school or district. The State's contributions to each system are based on percentage rates of each member's annual earnable compensation. These rates include a "normal contribution" rate and an "accrued liability contribution" rate and are fixed on the basis of the liabilities of the systems as shown by actuarial valuations.

In the case of VMERS, local employers pay monthly into the pension fund based on fixed percentage of salary on a schedule approved by the Board of Trustees after a review of actuarial data. No state appropriations are used to fund VMERS.

Investments: Accumulated funds are invested by the Vermont Pension Investment Committee (VPIC) on behalf of each retirement system. Over time, interest on investments is the largest source of funds to pay benefits. In fiscal year 2007, the funds earned $483.7 million (net of investment expenses). The investments will vary from year to year, based on market conditions, but over time they consistently produce income to fund future retirement benefits. The investments section of this report provides extensive information on pension investment performance.

Actuarial Funding

Each year, employer contribution rates are determined based on an actuarial valuation. The employers' annual normal cost represents the present value of benefits that have accrued on behalf of the members during the valuation year. In addition to an annual normal cost, an employer may also be required to make payments toward the pension system's unfunded actuarial liability. An employer accrued liability contribution consists of the employer's share of the pension system's total unfunded actuarial liability amortized over a period set by statute, no more than 30 years. The unfunded actuarial liability of a retirement system at any time is the excess of the system's actuarial liability over the value of its assets.

The actuarial method for both the VSTRS and the VSERS plans are set by State statute. Through fiscal year 2005 the method used was the entry age normal (EAN) with frozen initial liability (FIL). The Legislature has enacted a statutory change revising the method to entry age normal without FIL for the actuarial valuation for the year ending June 30, 2006, which effectively restated the starting balance. Under the previous method, 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 VSTRS, where there had been substantial underfunding of the actuarially-determined annual required contribution (ARC), the EAN-FIL method had the effect of creating an improving funding ratio—although the total required contribution rapidly escalated (sum of the amortized unfunded actuarial accrued liability and normal). The unfunded actuarial accrued liability is amortized in a deterministic manner under the FIL method, making it easy for the ratio to rise from one year to the next even in the presence of substantial underfunding. The shift to the EAN method, therefore, has had the effect of increasing the actuarially unfunded liability and reducing the normal contribution. The State believes

Benefits & Other Expenses

The largest expenditure for all three systems is the retirement benefit. During fiscal year 2007, the three retirement systems paid out more than $141 million in monthly benefit payments. As noted in the Appendices, page 54, 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 VSERS and VSTRS 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 2007, these health care expenses for the two retirement systems totaled more than $25.5 million. VMERS does not offer a health insurance plan. In an effort to provide some assistance to members in health care without undue burden to local municipalities, the VMERS board established a new health retirement savings plan, distributing approximately $5 million into Internal Revenue Service-approved retirement health savings accounts on July 1, 2007. Each vested active and retired member will receive a share of the total amount to be distributed based on the number of years they contributed to the system. Future additions to these accounts will be made if and when the actuarial funding status of the VMERS fund supports such additions.

that the EAN method is a more accurate indicator of actuarial funding progress and it is, in fact, the predominant method used by public retirement systems.

The VSERS and VMERS system are both fully funded at 100.8 percent and 105.1 percent respectively (see charts page 17). The VSERS system reached the full funding milestone for the first time in fiscal year 2007.

In the case of VSTRS, there was a historical pattern of underfunding of the State contributions paid into the fund. The 2005 General Assembly created the Commission on Funding the State Teachers' Retirement System, chaired by the State Treasurer, to address underfunding and to make recommendations to ensure an adequate, sustainable, and actuarially sound retirement benefit plan. The Commission published its recommendations in December 2005 for consideration by the Legislature in the session beginning in 2006. The Legislature largely adopted the recommendation, including the above referenced change in actuarial method. In addition, the Governor recommended, and the Legislature appropriated, full funding of the actuarial recommendation in the fiscal year 2007 and 2008 budgets. As of June 30, 2007, the VSTRS was 84.9 percent funded.

Vermont Retirement Systems -- Year Ended June 30, 2007

Category	Vermont State Employees' Retirement System	State Teachers' Retirement Fund	Municipal Employees' Retirement Fund
SOURCES OF FUNDS			
Employee Contributions	$ 15,456,692	$ 22,533,479	$ 9,769,882
Employer Contributions	39,297,002	37,341,609	8,535,396
Other Income	205,321	2,093,219	206,101
Investment Income	192,625,279	244,437,213	46,637,360
APPLICATION OF FUNDS			
Retirement Benefits	58,859,659	74,368,306	7,969,703
Refunds	1,526,140	1,625,140	1,389,583
Health/Life Insurance Expenses	13,541,092	13,040,783	0
Administrative Expenses	511,434	817,051	687,382
Other Expenses	344,721	203,445	560,473
Addition to Net Assets Held In Trust for Pension Benefits	$ 172,801,248	$ 216,350,795	$ 54,541,598

Other Post-Employment Benefits (OPEB)

One of the major budgetary, fiscal and managerial challenges facing the State and its employees over the next few years is the funding of post-employment benefits, called OPEBs. These are primarily the accrued health benefits for current and future retirees. Recently adopted accounting rules at the national level will take effect in fiscal year 2008. For the first time, public sector entities will be expected to report the future costs of these benefits on their balance sheets. Most governments, including Vermont, have not historically recognized a liability for OPEBs and simply budget a year of premiums. Now, an "annual required contribution" (ARC) will have to be calculated using actuarial standards. The new accounting standards do not mandate funding. However, failure to pre-fund these benefits will necessitate the use of a very low interest rate in the actuarial calculation, which will result in much higher values for the ARC than would occur under the higher interest rates that apply if benefits are pre-funded. As a result, unfunded plans will generate greater liabilities than identical funded plans to maintain funding in the future. This necessitates that a plan be developed to budget and fund

FUNDING PROGRESS OF THE RETIREMENT SYSTEMS

VSERS

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)
2007	$1,318,687	$1,307,643	($11,044)	100.8%	$386,917	-2.9%
2006[1]	1,223,323	1,232,367	$9,044	99.3%	369,310	2.4%
2005	1,148,908	1,174,796	25,889	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	91.9%	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%

[1]The system's funding method was changed from Entry Age Normal with Frozen Initial Liability to Entry Age Normal effective with the 2006 actuarial valuation.

VSTRS

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)
2007	$1,541,860	$1,816,650	$274,790	84.9%	$515,573	53.3%
2006[1]	1,427,393	1,686,502	259,108	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	1,424,662	139,829	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	137,496	89.0%	403,258	34.1%
2000	1,037,466	1,174,087	136,621	88.4%	387,999	35.2%
1999	931,056	1,066,400	135,343	87.3%	372,299	36.4%
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%
1996	570,776	700,377	129,601	81.5%	355,895	36.4%
1995	520,850	648,052	127,202	80.4%	346,975	36.7%
1994	473,229	597,851	124,622	79.2%	335,155	37.2%

[1]The System's funding method was changed from Entry Age Normal with Frozen Initial Liability to Entry Age Normal effective with the 2006 actuarial valuation.

VMERS

Year Ended 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)
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)	124.6%	70,808	- 32.4%
1998	113,678	102,005	(11,673)	111.4%	87,328	- 17.3%
1997	96,196	85,686	(10,510)	112.3%	70,800	-14.8%
1996	81,396	73,401	(7,995)	110.9%	68,700	-11.6%

the actuarially required contribution. Lack of funding may have a detrimental impact on retiree health care financials and the State's bond ratings, which will ultimately increase the cost associated with both.

The State's independent actuary has prepared valuations of the OPEB liabilities for VSERS and VSTRS as of June 30, 2007. This is the fourth 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.

For VSERS, assuming no prefunding, the actuarial accrued liability for OPEB obligations earned through June 30, 2007 is $606.5 million, with an unfunded actuarial liability of $604.3 million. To fully amortize this liability over a 30-year period would require an annual contribution commencing at $47.3 million for fiscal year 2008. If, however, prefunding is assumed, the actuarial accrued liability is reduced to $316.8 million, with an unfunded actuarial liability of $314.6 million. The ARC is calculated to commence at $27.1 million for fiscal year 2008.

For the first time, public sector entities will be expected to report the future costs of other post-employment benefits on their balance sheets.

For VSTRS, assuming no prefunding, the actuarial accrued liability and the unfunded actuarial liability for OPEB obligations earned through June 30, 2007 is $820.2 million. This is a reduction compared to the previous year due to a change in assumption for the percentage of current active employees electing retiree medical coverage. To fully amortize this liability over a 30-year period would require an annual required contribution of $60.2 million for fiscal year 2008. If, however, prefunding is assumed, the actuarial accrued liability and the unfunded actuarial liability is reduced to $373.6 million and the ARC is calculated to commence at $29.8 million for fiscal year 2008.

The fiscal year 2008 State budget funds the current year expected pay-as-you go benefit payments of approximately $16.4 million for VSERS and $14.8 million for VSTRS, which is less than the ARC applicable under either funding basis for either system. The difference represents underfunding of this liability. The State has not yet made any decision on when or how it will fund the full ARC, although it has taken several steps. The Legislature positively responded to the Treasurer's proposal in fiscal year 2007 to establish an irrevocable trust. The purpose of the trust is to accumulate and provide reserves to fund retiree post-employment benefits for members of the VSERS. Additionally, all federal reimbursements to the State for employees choosing the State's prescription drug plan over the Medicare D Prescription Drug Program also are deposited into this trust.

As of June 30, 2007, the fund had assets of $2.2 million. All Medicare D subsidy payments for the VSERS will continue to be deposited into this fund in fiscal year 2008 and subsequent years. The State Treasurer also was authorized by the Legislature to contract with an independent expert to review, evaluate, and make recommendations on pension and retiree health plan provisions. This report has been submitted to the Legislature for consideration, and action by the Legislature is expected this year.

VSERS -- Other Post-Employment Benefits Funding Analysis

	PRE-FUNDING BASIS	PAY-AS-YOU-GO BASIS
Assumed Discount Rate	8.25%	3.75%
Actuarial Value of Assets	$2,210,874	$2,210,874
Actuarial Accrued Liability		
- Active Participants	$165,647,834	$376,919,766
- Retired Participants	151,129,166	229,579,164
- TOTAL	$316,777,000	$606,498,930
Unfunded Actuarial Liability	$314,566,126	$604,288,056
Funded Ratio	0.7%	0.4%
Annual Covered Payroll	$386,916,939	$386,916,939
Unfunded Actuarial Liability (as % of covered payroll)	81.3%	156.2%
Normal Cost for FY 2008	$11,336,486	$30,443,640
Amortization of Unfunded Actuarial Liability (for FY 2008-30 yr)	$15,759,345	$16,841,263
Annual Required Contribution (ARC) FY 2008 *	$27,095,831	$47,284,903
Expected Benefit Payments	$16,390,080	$16,390,080
Increase in Annual Cost to Fund Plan	$10,705,751	N/A

** 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	8.25%	3.75%
Actuarial Value of Assets	$0	$0
Actuarial Accrued Liability		
- Active Participants	$192,959,264	$520,968,301
- Retired Participants	180,678,133	299,243,545
- TOTAL	$373,637,397	$820,211,846
Unfunded Actuarial Liability	$373,637,397	$820,211,846
Funded Ratio	0%	0%
Annual Covered Payroll	$515,572,694	$515,572,694
Unfunded Actuarial Liability (as % of covered payroll)	72.5%	159.1%
Normal Cost for FY 2008	$11,074,293	$37,362,018
Amortization of Unfunded Actuarial Liability (for FY 2008-30 yr)	$18,718,737	$22,858,971
Annual Required Contribution (ARC) FY 2008 *	$29,793,030	$60,220,989
Expected Benefit Payments	$14,756,425	$14,756,425
Increase in Annual Cost to Fund Plan	$15,036,605	N/A

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

Financial Literacy

Above, twenty-one student athletes from U-32 High School participated in Financial Football at Gillette Stadium. Pictured here from left to right: (front row) Kelly Whitcomb, Sam Graves, Ali Freeman, Katie Joly, Kristen Cowens, Cy Carey (mid row) Patriots wide receiver Wes Welker, Liz Watson, Abbey Allen, Cat Jaworski, Cody Cacicco, Ellen Heitman, Lexi Hall, Kyle Lawson, Marc Trollinger, U32 Head Football Coach Mike Law (back row) Patriots center Dan Koppen, John Helme, Phil Hall, Anna Scribner, Ricky Hall, Luke Hadden, Tucker LaClair, MJ Rus, and State Treasurer Jeb Spaulding.

Financial Literacy
(802) 828-3706

Lisa Helme
Financial Literacy & Communications Director

Background

Being financially literate means having the knowledge, skills and habits to successfully manage personal finances. Such skills include using a budget or plan for monthly spending; regularly saving some of today's money for tomorrow's needs; managing personal credit; and investing funds to allow for reasonable growth. However, national trends indicate that many people struggle with the issue of personal financial literacy (see appendix item). The nation's personal savings rate is now at its lowest rate since the Great Depression – a negative one percent. Household debt as a percentage of income hovers at record levels. The ratio of household debt to personal income has risen from 60 percent of personal income to 100 percent. Bankruptcy rates have more than quadrupled in the past 20 years. National studies and surveys indicate that Americans from their teen years to retirement need to enhance their knowledge of personal finance.

Responding to this need, the Vermont State Treasurer's Office created the new position of Director of Financial Literacy and Communications. The position is charged with the development, assessment, management and delivery of innovative financial literacy programming to Vermont citizens. A director was hired in April of 2007. Vermont's establishment of a financial literacy effort reflects a

ACCOMPLISHMENTS IN 2007

- **Created the new position of Director of Financial Literacy & Communications and hired a director in April of 2007.**

- **Redesigned and expanded financial literacy web resources on the Treasurer's web site, including the creation of a web-based financial literacy clearinghouse of service providers. Secured new url for site: www.MoneyEd.Vermont.gov.**

- **Developed, printed and distributed the first of two in a series of new educational fact sheets on financial literacy topics. Topics completed were "Saving for Retirement" and "Selecting a Retirement Plan Provider."**

- **Initiated a pilot project on business retirement savings plans. A training meeting was held in October with 19 Bennington County small businesses to share information on establishing a workplace retirement savings plan and receive feedback on the State's role in helping to facilitate access to such plans.**

- **Developed and sponsored "Save for Retirement Week" observance October 21-27 to encourage Vermonters to save for their retirement.**

- **Participated and organized Vermont representation at a Financial Football event held at Gillette Stadium in Foxborough, Massauchesetts. The State Treasurer joined with state treasurers from throughout New England to announce the region-wide rollout of the NFL-themed, money management video game.**

nationwide trend among State Treasurers to implement financial literacy programs. There are now 36 Treasurer's Offices in the country offering financial literacy programs.

UPDATES

Web Resources

In September of 2007, the Treasurer's Office debut a new series of web-based resources for Vermonters. The new Financial Literacy section is accessible through the Treasurer's web site or by going to a unique url: www.MoneyEd.Vermont.gov. The section is composed of six key pages: Teacher & Community Resources; Saving for Retirement; Retirement Plan Resources for Businesses; For Parents & Kids; Manage Your Money; and Investment Resources. The Treasurer's Office worked to organize on these pages financial education resources for Vermonters in order to facilitate and encourage access to these materials.

The Treasurer's Office developed two new resources to support this effort. The Vermont Financial Education Resource Clearinghouse is a web-based service provider network with more than 40 different agencies and organizations listed that offer free or low-cost classes and educational resources to Vermonters. Visitors to the clearinghouse can search by county to identify those services closest to them. The aim of the clearinghouse is to aid the Vermont groups already providing financial education services by helping them share resources, make referrals and, ultimately, result in these groups serving more Vermonters.

The second new web-based resource was developed in cooperation with the State's Department of Banking, Insurance, Securities and Health Care Administration (BISCHA). As the Treasurer's Office worked to develop its web page on retirement savings resources, office personnel sought an easy on-line tool for Vermonters to use to identify retirement savings plan providers. BISCHA responded to the Treasurer's Office inquiry by creating a new on-line tool that allows people to search through a list of Vermont-domiciled businesses working within the retirement savings field. The Treasurer's Office greatly appreciated the innovation and speed of service provided by BISCHA. Vermonters may now access this resource through the Treasurer's financial literacy web pages or BISCHA's web site.

Finally, the Treasurer's Office now offers free retirement planning resources for Vermonters through its web site. Among the resources available is a 60-page workbook titled, "Taking the Mystery Out of Retirement Planning," created by the U.S. Department of Labor.

A new web page for teachers and community educators is part of an updated financial literacy section on the Treasurer's web site.

Educational Fact Sheets

Development of a series of financial education fact sheets is underway. The purpose of the fact sheets is to educate and motivate readers to act on the content within each educational piece. Fact sheets under development include information on the personal use of credit, budgeting, and teaching kids about money management. Completed in 2007 were two fact sheets—both on retirement savings—to complement other outreach efforts on this topic. Fact sheets completed are: "Retirement Goals: Plan Now, Play Later" and "Retirement Plans: Evaluating a Provider." The office has distributed the fact sheets through its free retirement planning packets, at information booths, in its retirement division offices, and via the financial literacy web pages. Individual requests for the fact sheets include a request from the Lamoille North Supervisory Union for 170 copies of the retirement goals fact sheet to distribute to employees.

In 2007, the Treasurer's Office began development of a new series of financial education fact sheets.

Commitment to Financial Literacy

As Vermont citizens increase their understanding and practice of sound money management skills, the individual financial well-being of both the individual and the state will improve. As the State of Vermont's banker and chief financial officer, the State Treasurer has a commitment to advocating for those practices that maintain Vermont's hard-earned reputation as a fiscally sound and disciplined state.

To that end, the State Treasurer participates and initiates actions in the following key areas:

Advocacy: **working to promote the adoption of fiscally sound money management practices by Vermonters through promotional efforts that raise awareness of the need for and benefits of practicing such skills;**

Collaboration: **working with local, state and national groups to build support for and participation in activities that promote and teach financial literacy to Vermont citizens; and**

Development: **creating avenues that encourage and build new financial literacy activities and educational products for Vermont citizens.**

Workplace Retirement Savings

On October 23, the Treasurer's Office partnered with the local Chambers of Commerce in Bennington and Manchester and the Vermont Small Business Development Corporation to sponsor a meeting with business owners in Bennington County about putting in place workplace retirement savings plans. National statistics indicate that 70 percent of businesses with fewer than 25 employees offer no formal retirement plans. In Vermont, 21 percent of the state's workforce is employed in small businesses. National surveys indicate that eight of ten people offered a retirement plan at work will participate. The Treasurer's Office hopes to initiate financial education efforts that will result in more Vermonters planning for their retirement and having access to workable plans to facilitate such advanced preparation.

There were 36 people in attendance, which included owners and managers from 19 separate local businesses. Feedback from the event was very positive. Meeting evaluations were received from 20 individuals. Those individuals characterized the meeting as either "Very Helpful" (12) or "Somewhat Helpful" (8). All of the evaluators thought the face-to-face meeting approach was a good way to communicate this information. Evaluators wanted more time spent on topics such as (1) information on specific retirement plans; (2) ideas on generating more employee participation in plans; and (3) concrete illustrations of workplace plans. Suggestions for improving the format of the meeting included less time on the interactive discussion and less use of retirement plan jargon. Additional topics evaluators would like to see covered include (1) how to research and select a plan advisor, and (2) specific tax advantages.

The Treasurer's Office hopes to hold additional retirement savings meetings with small businesses in 2008, continuing to develop useful resources for both business owners and their employees.

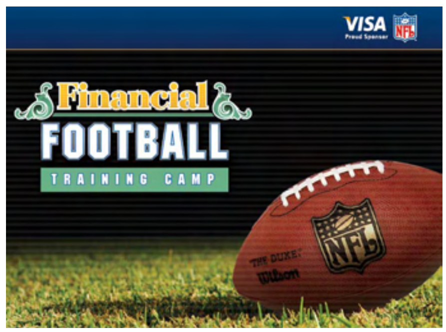
Save for Retirement Week

Capitalizing on the national observance of "Save for Retirement Week," October 21-27, the Treasurer's Office conducted a range of outreach and educational activities to encourage savings. To build awareness of the need to save for retirement, the Treasurer's Office distributed a flyer to all State employees in the October 11 paycheck mailer. On October 18, a press event was organized by the office in which State officials spoke on the need to save for retirement and the Governor signed a proclamation. The State Treasurer also participated in WCAX's "Across the Fence" program and discussed the need to begin saving. A notable increase was observed in visits to the Treasurer's Office new web pages on retirement savings following the press event. October 18, 215 visits were recorded. October 19 – 1,290 visits; and October 20 – 307 visits. Previously, daily hits to these pages averaged one hundred visitors or fewer. The office also received 33 requests for a free packet of retirement planning materials.

In addition to the workplace retirement savings meeting discussed previously, the office also organized and staffed two public information booths. The first was held October 23 in Montpelier and the second was held October 25 in Waterbury. The booths primarily were directed toward the State employees working in the two communities. Despite ongoing rain, the Montpelier booth located on the State House lawn attracted more than 80 people who stopped by and discussed retirement savings. Twenty-six individuals requested more information on the State's 457 plan. Five new 457 plan enrollments were received and 75 enrollment kits were distributed. Approximately 80 "Taking the Mystery Out of Retirement Planning" workbooks were given out, along with several dozen "Ready or Not" planning guides. In Waterbury, approximately 100 people stopped by the booth. Eighty "Mystery" books were distributed, along with 75 "Ready or Not" guides. Ten people requested more information on the 457 plan. Five new 457 plan enrollments were received.

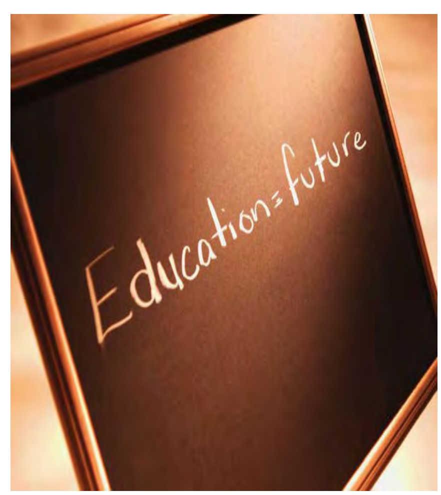
Financial Football

December 11, the State Treasurer's Office participated in a region-wide rollout of an NFL-themed, money management video game called "Financial Football." Treasurer Jeb Spaulding joined other State Treasurers at Gillette Stadium in Foxborough, Massachusetts. The event brought together high school teams from each New England state and their Treasurers with New England Patriots wide receiver Wes Welker and center Dan Koppen to demonstrate the game. "Financial Football" is part of a Visa/NFL financial education initiative. The event was the 12th stop of the 2007 national education campaign sponsored by Visa, the NFL and PLAYER INC. The National Jump$tart Coalition, including the Vermont Jump$tart Coalition, also supported the event.



Representing Vermont were student athletes from U-32 High School in East Montpelier, Vermont. The team competed against Bonny Eagle High School student athletes from Standish, Maine. To score points a team must answer a series of money management questions correctly. Wrong answers and penalties cost a team yardage. Questions cover topics such as budgeting, investment, retirement, student loans, and basic economics. The short demonstration game ended in a 7-7 tie.

In 2008, the State Treasurer's Office and Vermont Jump$tart will distribute free copies of the game to all high schools and middle schools in the state. The game is meant to act as an entertaining way for teachers and parents to introduce personal finance to teens.



Debt Management

Debt Management
(802) 828-5197

David Minot
Finance & Investment Director

Background

Historically, the State Treasurer's Office, in conjunction with the Administration and Legislature, has set a course of maintaining modest levels of new authorizations of long-term debt and net tax-supported debt outstanding. In prior years, the State's debt issuance and management process has been characterized by a conservative approach designed to reduce both the level and cost of debt. 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 have improved the State's debt ratios to those among the highest-rated states. In addition, the State's practice of issuing debt with level annual principal installments has resulted in a favorable amortization rate. At a rate of nearly 80 percent retirement within ten years, the State's bond payoff ratio continues to be favorably received by the rating agencies.

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

ACCOMPLISHMENTS IN 2007

- **For the first time since 1971, Vermont was awarded a triple-A bond rating from Moody's Investors Service. This highest and most coveted rating reflects years of sound debt and fiscal management in Vermont.**

- **Vermont ranked in the first or second tier in all four categories of the Moody's U.S. States Credit Scorecard, an analytical report that ranks states in four important categories of financial management: finance, economy, debt, and governance. Vermont's composite ranking is in the top tier (quintile), or in the top ten of all 50 states, for the second year in a row.**

- **The State Treasurer's Office issued $44.5 million aggregate principal amount of general obligation bonds in fiscal year 2007. This included a $30 million Series A competitive offering in February 2007 with a true interest cost of 4.09 percent and average life of 12.4 years, followed by a $14.5 million negotiated "Citizens Bond" offering Series B and C in March 2007 with a true interest cost of 3.65 percent and average life of 4.8 years. The State's bond ratings discussed above contributed to the favorable interest rates achieved in both offerings.**

- **The Capital Debt Affordability Advisory Committee (CDAAC) recommended increasing the State's annual bonding level to $54.65 million in fiscal year 2009. This 11.1 percent increase will allow for additional funding of capital projects without deterioration of key financial ratios used by rating agencies, and maintains the State's credit posture as a triple-A rated state.**

is advisory, but historically has been adopted by the State as a bonding limit. This legislative adherence to CDAAC recommendations is a major factor in the investment community's recognition of Vermont as a highly disciplined state in financial affairs. The CDAAC is made up of four *ex officio* members and one appointee of the Governor. The State Treasurer serves as chair of the committee.

In September 2004, the committee adopted new guidelines consistent with Vermont's stated objective of achieving and maintaining a triple-A rating from all bond agencies. A triple-A rating is attractive for a state because it offers a lower cost of capital to the state and favorably impacts the ratings and costs of borrowing for state agencies such as the Vermont Municipal Bond Bank, Vermont Housing Finance Authority, and Vermont Student Assistance Corporation.

The committee recommended an authorized debt issuance limit in fiscal 2007 at $45 million (level with fiscal year 2006), and increased the recommended amount by 9.3 percent to $49.2 million for fiscal year 2008. Continuing to use committee guidelines (see guideline chart below), while at the same time considering the State's need to fund essential capital projects, the committee unanimously voted to recommend that the fiscal year 2009 State General Obligation Debt bonding limit be set at $54.65 million. This 11.1 percent increase, while greater than in recent years, still allows for compliance with CDAAC target ratios allowing the State to continue its quest for all triple-A ratings.

The fiscal year 2009 recommended debt authorization of $54.65 million is the highest level that allows the State to maintain or improve critical ratings ratios, notwithstanding creation of modestly higher levels of debt outstanding. The committee continues to believe that debt issuance moderation is appropriate in uncertain economic times. Finally, the additional $5.45 million of debt authorization above debt authorized for fiscal year 2008 provides a substantial increase in capital projects funding.

UPDATES

Bond Issues

The State Treasurer's Office issued $44.5 million in aggregate principal amount of general obligation bonds in fiscal year 2007. This included a $30 million Series A competitive offering in February 2007 with a true interest cost of 4.09 percent and an average life of 12.4 years, followed by a $14.5 million negotiated "Citizens Bond" offering Series B and C in March 2007 with a true interest cost of 3.65 percent and average life of 4.8 years. Both issues achieved highly favorable interest rates. The Citizens Bonds, typically with shorter maturities more attractive to retail as opposed to institutional investors, were offered only to Vermont residents, in denominations as low as $1,000 instead of the more traditional $5,000 denominations.

Capital Debt Affordability Committee Target Guidelines

DEBT RATIOS	GUIDELINES
Debt per capita	Moody's Triple-A medians and means
Debt as Percent of Personal Income	Moody's Triple-A medians and means
Debt Service to Revenues	Six Percent or Less

Bond Rating

Vermont was assigned a triple-A rating by Moody's in February 2007. Vermont shares its Moody's triple-A rating with only eight other states. At the time of this upgrade, only 11 states had a triple-A rating from at least one rating agency. Combined with double-A plus bond ratings from both Standard & Poor's and Fitch Ratings, Vermont enjoys the highest general obligation bond ratings of any New England state (see bond rating chart below). With all three ratings carrying a "Stable" outlook, Vermont continues to work toward achieving a triple-A rating from Standard & Poor's and Fitch.

The rating upgrade by Moody's Investors Service and the excellent ratings by Fitch and Standard & Poor's is reflective of sound fiscal practices including budgetary discipline, an economy with significant breadth, strong debt management practices, and effective State governance reflecting sound statutes and legislative history.

Because a higher rating enhances the State's reputation in the municipal marketplace, it makes the bonds more attractive. 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 is applied to these bond issues. A high credit rating also is attractive to business development as it is a sign of economic and fiscal stability.

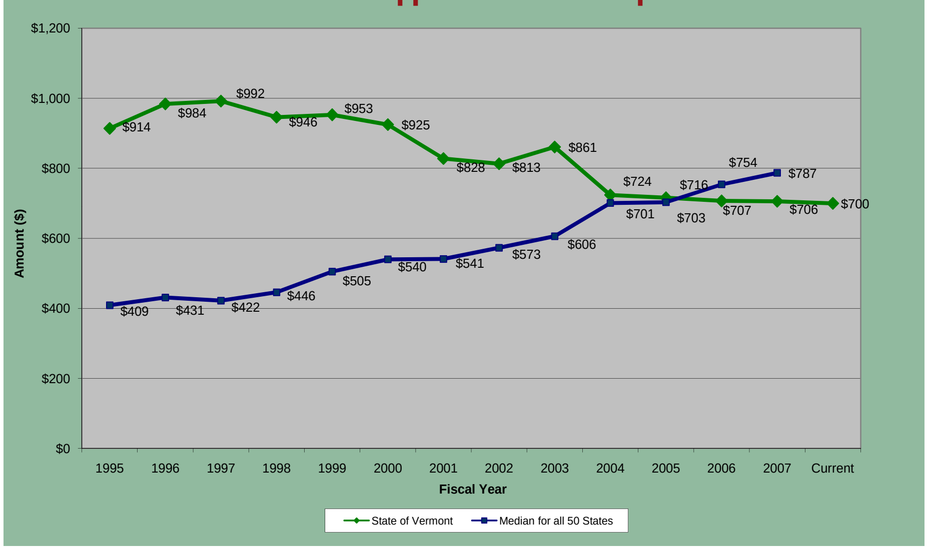
New England General Obligation Bond Ratings

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

Debt Ratios

The fiscal discipline of recent years has paid off as Vermont's debt ratios rank favorably among triple-A rated states. In fiscal year 2007, Moody's recog-

Net Tax Supported Debt Per Capita



nized this and upgraded Vermont from Aa+ to Aaa. 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: Medicaid funding, VSTRS pension funding, and the funding of other post-employment benefits (OPEBs). 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 ratio of the State's net tax-supported debt per capita. The guideline adopted by the CDAAC establishes a target ratio of debt per capita at Moody's median and means for triple-A rated states. In 2007, the State's debt per capita was $706 versus the Moody's five year triple-A median and mean of $691 and $838, respectively (see charts pages 26 and 27). The State's ranking versus all 50 states was 29th in 2006 and 28th in 2007. The higher the ranking figure, the lower a state's debt per capita is relative to all other states. While this ranking is better than average, 22 states have a higher (more favorable) ranking figure. Currently, the State's debt per capita is $700. Assuming a steady level of debt authorization

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

	July, 2007 Ratings							
Triple-A Rated States	**Moody's**	**S&P**	**Fitch**	**2003**	**2004**	**2005**	**2006**	**2007**
Delaware	Aaa/Stable	AAA/Stable	AAA/Stable	$1,599	$1,800	$1,865	$1,845	$1,998
Florida*	Aa1/Stable	AAA/Stable	AA+/Stable	985	1,023	1,008	976	1,020
Georgia	Aaa/Stable	AAA/Stable	AAA/Stable	802	827	803	784	916
Maryland	Aaa/Stable	AAA/Stable	AAA/Stable	977	1,077	1,064	1,169	1,171
Minnesota	Aa1/Stable	AAA/Stable	AAA/Stable	625	691	679	746	827
Missouri	Aaa/Stable	AAA/Stable	AAA/Stable	368	461	449	496	613
North Carolina	Aaa/Stable	AAA/Stable	AAA/Stable	429	556	682	804	728
South Carolina	Aaa/Negative	AA+/Stable	AAA/Stable	587	599	558	661	630
Utah	Aaa/Stable	AAA/Stable	AAA/Stable	682	846	792	707	621
Virginia	Aaa/Stable	AAA/Stable	AAA/Stable	546	546	589	601	692
MEAN**	________	________	________	**735**	**823**	**831**	**879**	**922**
MEDIAN**	________	________	________	**625**	**691**	**682**	**765**	**778**
VERMONT*	Aaa/Stable	AA+/Stable	AA+/Stable	861	724	716	707	706

* Florida raised to triple-A in 2005 and first reflected in 2006 numbers; Vermont raised to triple-A in 2007.
** These calculations include Florida for the years 2006 and 2007, and exclude Vermont numbers.

Triple-A Rated States
5-Year Mean and Median Including Florida and Excluding Vermont:
MEAN: $838 Vermont: $743
MEDIAN: $691 Vermont: $716

and issuance of $54.65 million in future years, and employing the population forecast developed by Economic Policy Resources, the State's net tax-supported debt per capita is forecast to grow to $798 by 2018. This modest increase over a significant period of time is expected to compare increasingly favorably to the State's debt per capita guideline (Aaa five year median) each year.

Debt as a Percentage of Personal Income

An even more important 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 new 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, and the State's ratio of debt to personal income for fiscal year 2007 dropped to 2.1 percent versus Moody's triple-A median and mean ratios of 2.4 percent and 2.7 percent, respectively. The State's ranking in its debt as a percentage of personal income improved from the 28th highest among all states in 2006 to 30th highest in 2007.

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

Triple-A Rated States	2003	2004	2005	2006	2007
Delaware	5.0%	5.6%	5.5%	5.3%	5.5%
Florida*	3.5	3.5	3.4	3.2	3.1
Georgia	2.9	2.9	2.8	2.7	3.0
Maryland	2.8	3.0	2.9	3.0	2.8
Minnesota	1.9	2.0	2.0	2.1	2.2
Missouri	1.3	1.6	1.5	1.6	1.9
North Carolina	1.6	2.0	2.5	2.8	2.4
South Carolina	2.4	2.4	2.2	2.5	2.3
Utah	2.9	3.5	3.2	2.7	2.3
Virginia	1.7	1.7	1.8	1.7	1.8
MEAN**	**2.5**	**2.7**	**2.7**	**2.8**	**2.7**
MEDIAN**	**2.4**	**2.4**	**2.5**	**2.7**	**2.3**
VERMONT*	3.0	2.5	2.3	2.2	2.1

* Florida raised to triple-A in 2005 and first reflected in 2006 numbers; Vermont raised to triple-A in 2007.

** These calculations include Florida for the years 2006 and 2007, and exclude Vermont numbers.

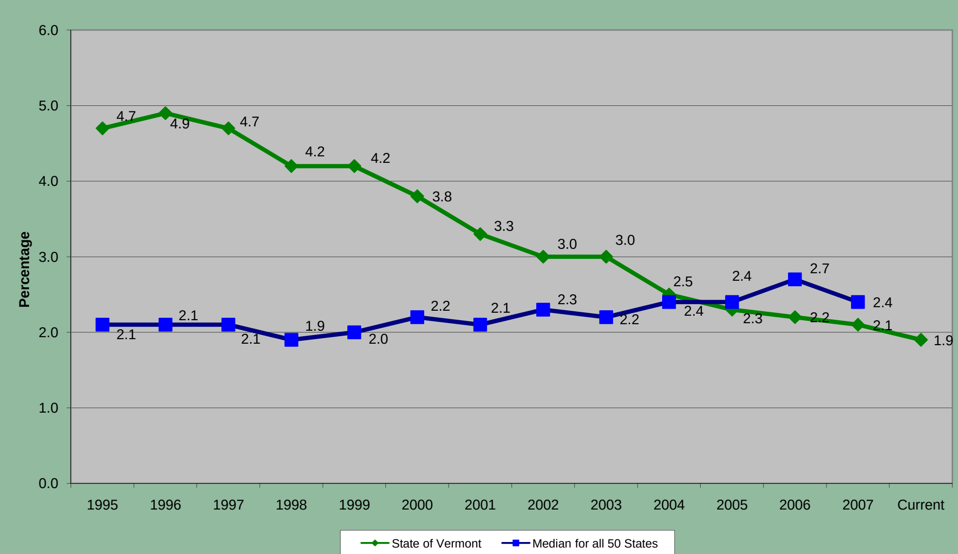
Triple-A Rated States

5-Year Mean and Median Including Florida and Excluding Vermont:

MEAN: 2.7% Vermont: 2.4%

MEDIAN: 2.4% Vermont: 2.3%

Net Tax Supported Debt as a Percent of Personal Income



Debt Service 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 5.1 percent for fiscal year 2007. This percentage is expected to decline through 2018, assuming the issuance of $54.65 million of debt from fiscal year 2009 through fiscal year 2018.

Additional Factors Affecting Bond Ratings

There are many other factors considered in a state's bond rating besides ratio analyses. 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 maximums. In addition, the State has human services caseload reserves which at June 30, 2007 were nearly $17 million. The combined effect of full reserves plus the caseload reserves is positive for the State's ratings.

The State's General Fund, Transportation Fund and Education Fund all carry reserves at State statutory maximums—a strong positive for the State's bond rating.

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. While the VSERS funding level is at 100.8 percent (slightly over-funded), the VSTRS funding level is 84.9 percent, indicating it is under-funded. The State plan is to amortize the VSTRS under-funded amount over a 30-year period and fully fund the annual actuarial recommended contributions in fiscal year 2008 and beyond. In the eyes of the rating agencies, such plans by the State are an important commitment to achieving the full funding of VSTRS. Other post-employment benefits (OPEBs), beyond pension benefits, to retired system participants also are of interest to the rating agencies. While Vermont's OPEBs have negligible funding for VSERS and none at present for VSTRS, the State has undertaken studies to analyze the size of these obligations and assess alternative funding strategies. This is recognized by the rating agencies.

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; 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. While the State has had a line of credit available to it during the last three years, it has not had to access it, a continuing sign of fiscal health. While the seasonal dip continues to occur, the overall healthy cash position has further reduced the likelihood of any short-term borrowing for the current fiscal year 2008.

While the State has had a line of credit available to it during the last three years, it has not had to access it, a continuing sign of fiscal health.

The State began fiscal year 2007 with approximately $259.1 million in unrestricted cash and investments on hand and ended the year with $261.2 million in unrestricted cash and investments. While these cash balances do not bear a direct one-to-one relationship to fund balance, it indicates a very positive position.

Approach Toward Establishing Debt Ratio Goals -- State of Vermont

Comparative Mean Debt Ratios*

Per Capita	2003	2004	2005	2006	2007
All States	$ 838	$ 944	$ 999	$1,060	$1,101
Triple-A**	735	823	831	879	922
VERMONT	**861**	**724**	**716**	**707**	**706**
% of Pers. Inc.	**2003**	**2004**	**2005**	**2006**	**2007**
All States	2.7%	3.1%	3.2%	3.2%	3.2%
Triple-A**	2.5	2.7	2.7	2.8	2.7
VERMONT	**3.0**	**2.5**	**2.3**	**2.2**	**2.1**

* Based on data provided by Moody's Investors Service and excluding Florida prior to 2006 and Vermont.

** See chart on "Debt Per Capita" for complete listing of triple-A states and respective ratings. Eleven states currently rated triple-A by one or more of the nationally recognized rating agencies: Delaware, Florida (in 2005), Georgia, Maryland, Minnesota, Missouri, North Carolina, South Carolina, Utah, Virginia and Vermont (in 2007).

Rating History -- State of Vermont

Rating Action	Date
STANDARD & POOR'S	
AAA	October 2, 1963
Rating Withdrawn	March 23, 1971
AA	February 28, 1973
Rating Withdrawn	October 16, 1973
AA	April 25, 1986
AA-	June 10, 1991
AA	October 14, 1998
AA+	September 11, 2000
MOODY'S	
Aaa	1971
Aa	September 20, 1972
Aa2*	October 20, 1997
Aa1	September 29, 1999
AAA	February 5, 2007
FITCH IBCA	
AA	August 18, 1992
AA+	October 25, 1999

** In 1997, Moody's began refining ratings with numerical modifiers. The shift to the "Aa2" rating was part of this refining process.*

Investments

Investments
(802) 828-5197

David Minot
Finance & Investment Director

Dan Currier
Cash Management & Investments Manager

Background

The State Treasurer's Office administers the investment policies and strategies adopted by the Vermont Pension Investment Committee (VPIC) which in-turn oversees all investment assets held by the Vermont State Employees' Retirement System, the State Teachers' Retirement System of Vermont, and the Vermont Municipal Employees' Retirement System. The three systems had combined assets of approximately $3.36 billion on June 30, 2007. Asset levels have continued to rise on a long-term trend consistent with national trends in pension portfolios. The growth in assets is displayed in the chart on the next page.

In fiscal year 2007, one-year investment returns remained well above actuarial targets of 8.25 percent for VSERS and VSTRS and 8.0 percent for VMERS. The return percentages were: 17.4 percent for the Vermont State Teachers' Retirement System, 16.5 percent for the Vermont State Employees' Retirement System, and 16.6 percent for the Vermont Municipal Employees' Retirement System (see chart

ACCOMPLISHMENTS IN 2007

- **Fiscal year 2007 marked the second year of pension investment oversight by the Vermont Pension Investment Committee (VPIC).**

- **Composite investment returns for the three State Systems for the year ending June 30, 2007 ranged from 16.5 percent to 17.4 percent, or twice the assumed actuarial rates of return.**

- **This past year, the legislature revised the VPIC statute to permit municipalities to pool their investments with the State plans. This will provide fee reductions, economies of scale and the opportunity for enhanced returns to municipalities. The first system to pool their assets with VPIC is the City of Burlington, pooling approximately $130 million in investments.**

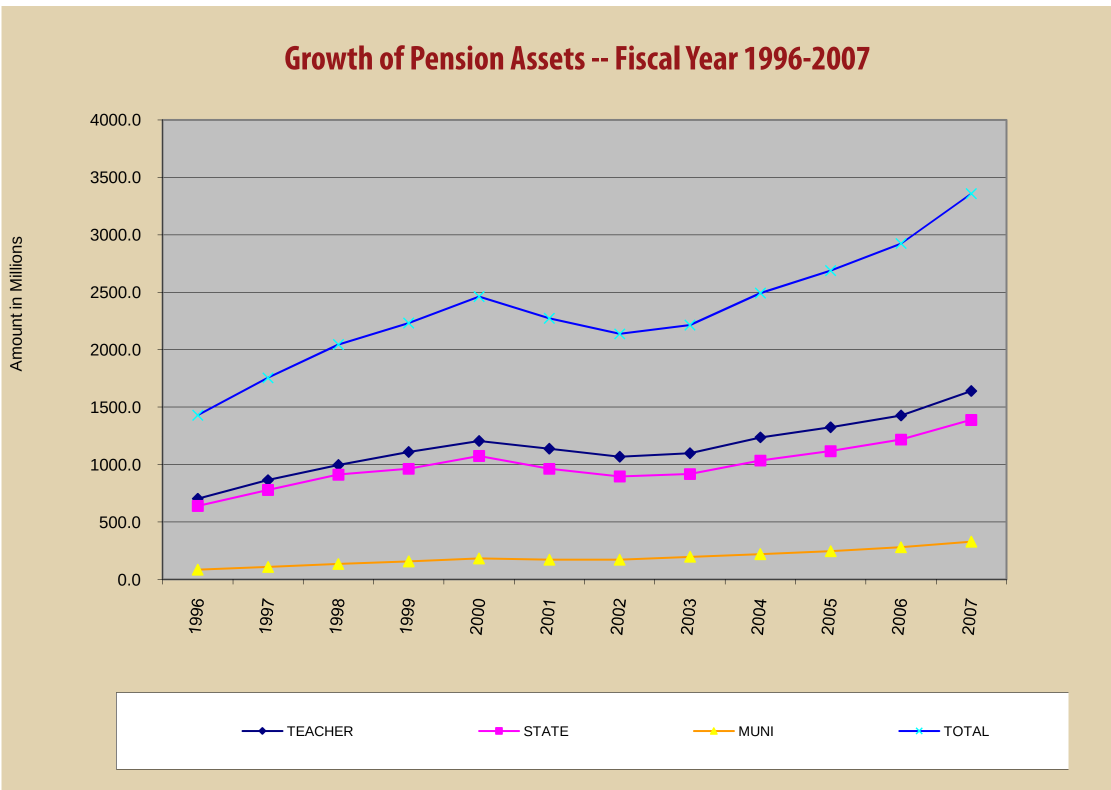
- **Having reached combined assets of $3 billion for the first time in August 2006, VPIC net assets grew to $3.39 billion at June 30, 2007.**

- **Significant improvements were made to the Vermont 457 Deferred Compensation Plan by remapping funds in three asset classes to new mutual funds with superior historical performance and adding two new socially responsible investment mutual funds. Administrative fees for this plan also were substantially reduced, making it an even more attractive vehicle for retirement savings and investment**

- **The VPIC added a policy on Investments in Terrorist or Genocide Link Countries that requires investment managers to report on holdings that may be linked to countries engaged in terrorist or genocidal activities. This policy led to divestiture of an equity security in fiscal year 2007. Also, VPIC created an Economically Targeted Investment Policy that opens the door to investments that fill housing, conservation and other capital gaps within the State and provides competitive investment returns. Proposals will be solicited annually.**

on page 34--*Long-term Investment Performance of Vermont's Retirement Systems*). For the ten years ending June 30, 2007, the median public retirement plan in the United States had an average annualized total return of 8.2 percent, compared with 8.7 percent for VSTRS, 8.1 percent for VSERS, and 9.1 percent for VMERS.

Asset allocation is essential to the investment performance of the plans. In order to insulate the portfolios from short-term market fluctuations, the three pension systems diversify assets across a broad group of asset classes, which enables each portfolio to maintain stability through market cycles of the different asset classes. VPIC asset allocations also are significantly diversified in order to maximize overall returns with acceptable portfolio risk. Each system's assets are invested in stocks, bonds, real estate, and global asset allocation strategies, with an additional small allocation to alternative investments, such as venture capital partnerships (see chart on page 35--*Asset Allocation of Pension Funds as of June 30, 2007*).



UPDATES

Pension Fund Investments

In 2007 important decisions were made in several asset classes. VPIC approved a 4 percent allocation to emerging markets equities to be funded equally from domestic large capitalization and international equities asset allo-cations. While some investment in emerging markets equities occurs in current VPIC international equities portfolios, this segment of global equities markets has become increasingly significant as measured by market capitalization and growth potential. The "BRIC" countries (Brazil, Russia, India and China) comprise a major portion of emerging markets equities and have become a significant portion of the world economy.

A decision was made to expand the core fixed income investment mandate to a core-plus fixed income mandate. Core-plus allows the manager on a discretionary basis to invest up to 20 percent of the portfolio in non-investment grade debt including high-yield bonds and non-dollar denominated emerging markets debt. Along with this decision, a new firm comprising individuals from the prior core fixed income manager was selected to manage this core-plus portfolio.

Associated with the above fixed income portfolio, VPIC approved allocation of fixed income assets to portfolios which capture fixed income markets performance ("Beta") and create the possibility of enhanced excess returns ("Alpha"). In addition to enhanced returns, these strategies offer advantages of non-correlated and diversifying Alpha components. In an effort to improve category performance, VPIC terminated a small capitalization equity investment manager and replaced it with an index fund.

In the past several years, VPIC has elected to engage in two relatively newer forms of investment that offer enhanced returns, one of which is mentioned above.

Long-term Investment Performance of Vermont's Retirement Systems (As of June 30, 2007)

Gross of Fees

Retirement System	Last 1 Year	Last 3 Years	Last 5 Years	Last 7 Years	Last 10 Years
Teachers Composite	17.4%	12.4%	11.7%	7.2%	8.7%
State Composite	16.5%	12.0%	11.2%	5.9%	8.1%
Municipal Composite	16.6%	12.0%	10.4%	7.2%	9.1%
Median Public Fund	16.8%	11.8%	10.9%	6.3%	8.2%

Global Asset Allocation: Investments within this class include index funds, index futures, mutual funds, and other vehicles which GAA managers use to take advantage of asset class pricing anomalies to create incremental returns. These assets are invested tactically on a daily basis, unlike traditional asset class portfolios which maintain investment in a class of assets irrespective of changes in daily market conditions.

Portable Alpha Strategies: Portable Alpha strategies mix asset class index performance (Beta) with non-correlated investments designed to generate a positive rate of return (Alpha) that is added to the index return. After careful consideration, in fiscal year 2006 VPIC added a portable Alpha strategy to its domestic large capitalization investments; this strategy employs Standard & Poor's 500 index futures to capture the Beta and invests in a short-term bond portfolio to generate Alpha. Following the end of fiscal year 2007, the VPIC considered and approved an investment in a portable Alpha strategy for the core fixed income asset allocation.

In fiscal year 2007, the VPIC approved an increased allocation to value-added real estate which will be invested with a current value-added real estate manager. Value-added managers purchase real estate properties considered to be sub-prime due to vacancy, physical condition or other factors. These properties are then released or otherwise improved to be later sold as prime properties. Following completion of a contract amendment with an existing value-added manager in fiscal year 2007, VPIC's commitment to such investments will be increased to approximately one-third of its real estate holdings.

In fiscal year 2007 the VPIC acted upon its previously adopted policy relating to investing in companies involved in genocidal or terrorist states by approving divestment of an equity investment that was categorized as a "highest offender" from an established source. Two of VPIC's large capitalization domestic equity accounts were impacted and investment managers were fully able to comply. This policy also generates quarterly reports from investment managers as to whether sources indicate that divestment should be considered. The VPIC continues to discuss this policy and ways of enhancing its efficacy in engaging companies found to be in conflict with it.

Proxy voting guidelines adopted in March 2004 continued to be in effect in fiscal year 2007. These guidelines were observed by investment managers through calendar 2006. In calendar 2007, VPIC engaged a proxy voting firm to vote its equity securities in accordance with these guidelines, in place of investment manager voting. The corporate governance guidelines include voting policies relating to boards of directors, auditors, shareholder rights, and executive and director compensation. The policy's corporate responsibility and accountability guidelines include voting policies on environmental issues such as global warming and environmental reporting, as well as workplace issues such as equal employment opportunities, human rights, and labor codes. A copy of this policy may be obtained on the Vermont Treasurer's web site.

Pursuant to Act 50 of the fiscal year 2005 legislative session, a report prepared by an independent consultant will be delivered to the Vermont General Assembly by January 15, 2008, that evaluates the effectiveness of having the VPIC oversee the funds of the three retirement systems. The report will include input from the three retirement boards and other directly affected groups. The report is expected to focus on committee governance, best practices in managing investment risk and performance, best use of available resources, and other matters to improve the efficacy of Vermont's pension investment management.

Asset Allocation of Pension Funds as of June 30, 2007

Investment Category	Teachers	State	Municipal
Domestic Equity			
Large Cap	30%	27%	26%
Small Cap	13%	12%	11%
Total	43%	39%	37%
Domestic Fixed Income			
Core	15%	20%	24%
High Yield	5%	5%	5%
Total	20%	25%	29%
International Equity	14%	14%	14%
Global Fixed Income	5%	5%	3%
Global Asset Allocation	10%	10%	10%
Real Estate	8%	6%	7%
Other	0%	1%	0%
Total	100%	100%	100%

Trust Investment Account

The 2000 Legislature authorized the establishment of a trust investment account administered by the State Treasurer for purposes of investing restricted funds with non-expendable principal balances. As of June 30, 2007, the fund had a principal balance of approximately $55.5 million, of which $33.6 million was allocated to the Tobacco Trust Fund, $18.3 million to the Higher Education Endowment 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 2007, the fund had a total return of 12.0 percent versus the target return of 10.6 percent, which is based on actual asset allocation, and the performance of the S&P 500 Stock Index (20.6 percent) and the Lehman Aggregate Bond Index (6.1 percent).

After the close of fiscal year 2007, the Treasurer's Office invested $2.5 million of Trust Investment Account (TIA) assets in a mutual fund that invests in public housing and other fixed income securities throughout the United States. The fund manager, Access Capital, will make an equal investment in high-grade Vermont securities that address principally underserved segments of the housing market, such as affordable housing. The aim is to increase the pool of available capital funds for affordable housing in Vermont. As Access Capital seeks investment opportunities for these funds, it will create new lending opportunities for local banks which, in turn, will make available more mortgage loans for low- to moderate-income homebuyers.

Access Capital will make an equal investment in high-grade Vermont securities that address principally underserved segments of the housing market, such as affordable housing. The aim is to increase the pool of available capital funds for affordable housing in Vermont.

Access Capital invests in mortgages to homebuyers making less than 80 percent of an area's median income. With the median income reported for all Vermont households now at approximately $48,500, the investments would expand home mortgage loan opportunities for households making, on average, less than $39,000 a year. The recent loan default problems in the sub-prime mortgage lending market have tightened the availability of funds for home loans to low-income households. However, unlike in the sub-prime lending market, potential homebuyers must go through a tougher loan approval process before being granted a federally-qualified mortgage. Since the loans structured and purchased by Access Capital are federally-qualified mortgages, the investments are more secure.

The fund invests primarily in AAA/credit quality community economic development investments, usually specially created mortgage-backed securities (MBS). Just as with VPIC ETI investments, it is required that the TIA economically targeted investment program target risk-adjusted, market-rate returns and provide net returns equivalent to or higher than other available investments, at commensurate levels of risk. The Treasurer's Office will be able to consider future ETI's annually in conjunction with the VPIC's annual RFP solicitations.

Higher Education Trust Fund

The 1999 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 $1 million was added to the fund in fiscal year 2001--$635,881 at the end of fiscal year 2002, $2,363,355 in fiscal year 2006, and $5,823,450 in fiscal year 2007. On June 30, 2007, the fund had a market value of $18,269,599. In August of 2007, 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 $206,860.67 to be applied as non-loan financial aid to Vermont students attending Vermont post-secondary institutions.

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." For the second straight year a substantial contribution from this provision was made: $5,223,449.94 derives from fiscal year 2006, and this contribution became part of the Higher Education Trust Fund early in fiscal year 2007. 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. In the first year of this provision deriving from fiscal year 2006, $600,000 was added to the fund in fiscal year 2007. Thus, the fund's investment base was significantly increased for fiscal year 2007 from a combination of both contributions and strong investment performance.

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 $248,232 to be divided equally between the University of Vermont and the Vermont State Colleges for application to their respective permanent endowments. In fiscal year 2007, the additional endowment allocation will be $124,116 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. A copy of the State Treasurer's Annual Report to the Commission is attached at the back of this report in the appendix section.

Tobacco 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 the 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 2007, the State has received payments that total $220.4 million.

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. To date, these have accounted for an 11.3 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.

In fiscal year 2000, the Vermont Legislature established a Tobacco Litigation Settlement Fund ("Settlement Fund") to be administered by the State Treasurer and to be subject to further appropriations. In fiscal year 2007, $19.8 million from the Settlement Fund was directed to healthcare services (Medicaid;

includes funds redirected to the Medicaid Global Commitment Fund). A total of $4.4 million was spent on programs in various departments for tobacco enforcement, prevention, and education programs. Additionally, $3.1 million funded substance abuse and youth protection programs in the Agency of Human Services. In fiscal year 2008, the legislature has appropriated $29.6 million for Medicaid health services; $4.4 million for enforcement, prevention, and education; and $3.2 million for substance abuse and youth protection programs.

Any remainder of the Settlement Fund receipts is earmarked for the separately established Tobacco Trust Fund, a trust established to eventually endow the education and prevention programs. In fiscal year 2007, there was a shortfall in funds received by the Settlement Fund due to an amount withheld by tobacco companies. This required a withdrawal from the Tobacco Trust Fund of $2.86 million. The balance of the Tobacco Trust Fund net of this withdrawal at June 30, 2007, was $30.9 million versus $30.2 million at the end of FY 2006. The increased net of the withdrawal in the Tobacco Trust Fund was due to much better-than-expected Trust Investment Account performance.

Vermont's Expected and Actual Receipt of Tobacco Settlement Funds

Fiscal Year	Master Settlement Amt*	Expected* ($ millions)	Actual* ($ millions)
2001	$28.47	$28.47	$24.68
2002	34.18	34.18	30.92
2003	34.51	34.51	30.55
2004	28.80	28.80	25.82
2005	28.80	26.10	26.21
2006	28.80	24.50	24.06
2007	28.80	22.60	24.99
2008	29.37	39.50 **	na
2009	29.37	40.20 ***	na
2010	29.37	40.69 ***	na

* Source: F&M. Master Settlement amounts shown are at time of initial settlement. Expected Amount determined third quarter of each fiscal year. Actual excludes Settlement Fund Account performance.

**Expected payments include $29.37 million in Master Settlement Payments less expected witholding, plus estimated $13 million in Strategic Contribution Payments which are subject to an unknown amount of withholding.

***Estimated including estimated Strategic Contribution payments of $13,000,000.

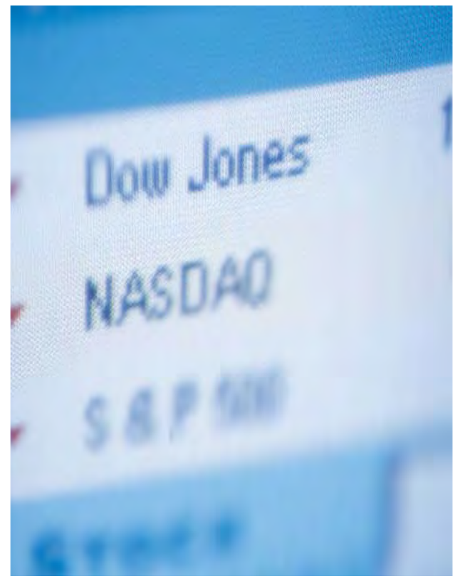
Vermont Veterans' Home

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. In the fall of 2001, the home transferred $455,441.85 into the trust to the State. 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 2007, withdrawals from the Vermont Veterans' Home TIA Funds totaled $50,000. As of June 30, 2007, the balance of the fund first contributed to the TIA was $500,502.71, and the balance of the second (later) fund was $591,178.65, for a combined total of $1,091,681.36.

Short-Term Investing

The State Treasurer's Office manages the investment of the State's cash in its short-term investment program. The short-term portfolio earned $9.51 million in interest income in fiscal year 2007 on average daily available balances of $180.51 million. Of this amount, $3,079,976.25 was credited to interest earning funds, and the balance of $6,426,514.41 remained in the general fund. The yield on the available cash in the portfolio was 5.27 percent for the year, which exceeded the average three-month treasury bill auction rate of 4.87 percent. The Treasurer's Office solicits offerings daily from the institutional trading desks of a number of national and local brokers in order to achieve maximum rate of return and diversification in the portfolio.



Recently, there have been reports of other (outside of Vermont) state treasuries and state-sponsored short-term investment vehicles experiencing losses in value. These losses have been principally related to structured investment vehicles (SIVs) and collateralized debt obligations (CDOs) carrying sub-prime mortgage loans as assets. The Treasurer's Office by policy and practice does not seek to increase return on treasury short-term investments by investing in less than upper-tier credit securities or by investing in non-traditional investments. By policy, treasury investing ranks safety of principal first, followed by liquidity and return on investment, in that order. In particular, SIVs and CDOs have been completely avoided as have all other forms of asset backed securities. As a result, there has been no loss of principal on any Vermont State Treasury investments.

Bank in Vermont Initiative

The Treasurer's Office continues to maintain its Bank in Vermont Program to invest State funds on a predictable basis through 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. Banking institutions that wish to be placed on a list of eligible institutions must complete an application/questionnaire. The responses are used to evaluate prospective candidates wishing to provide investment services for CDs, and to determine maximum levels of participation based on the bank's size, financial health, risk factors, credit ratings, and capital levels.

Since the program's inception in August 2004, $336.8 million in Certificates of Deposit has been awarded through December 2007.

Banks so pre-qualified are then eligible to participate in a monthly competitive bidding process for certificates of deposit. Banks that have been pre-qualified are notified in writing and/or e-mail in advance of this schedule, and bidding is done on a web site designed by the Treasurer's Office. A block of funds is set aside for the scheduled bid in specified time frames. Some of the funds may be short duration, while a portion is set aside for longer maturities, depending on the yield curve.

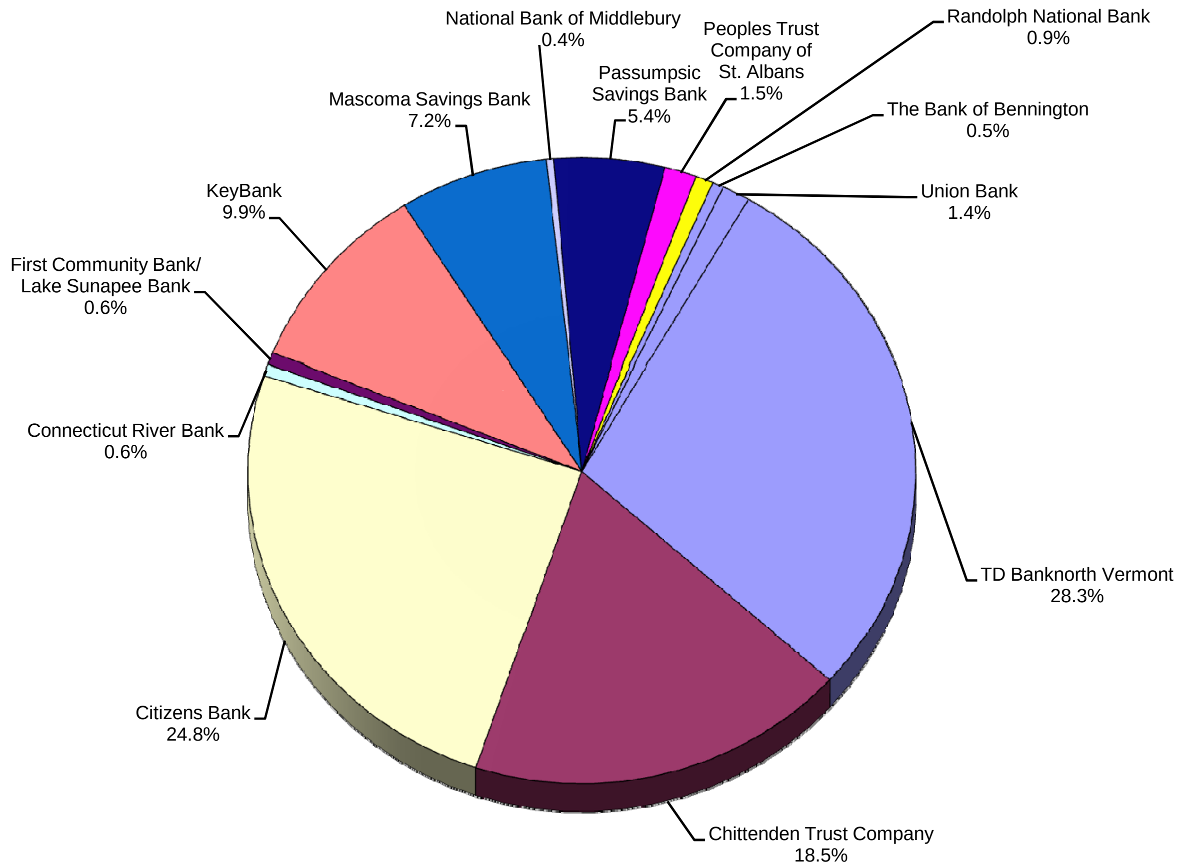
As of December 31, 2007, these 19 banks have been pre-qualified to participate:

Citizens Bank
Chittenden Trust Company
Connecticut River Bank
Factory Point National Bank NA *
First Brandon National Bank**
First Community Bank **
First National Bank of Orwell
Key Bank
Lyndonville Savings Bank and Trust Company***
Mascoma Savings Bank
Merchants Bank
National Bank of Middlebury
Northfield Savings Bank
Passumpsic Savings Bank
Peoples Trust Company of St. Albans
Randolph National Bank
TD Banknorth Vermont
The Bank of Bennington
Union Bank

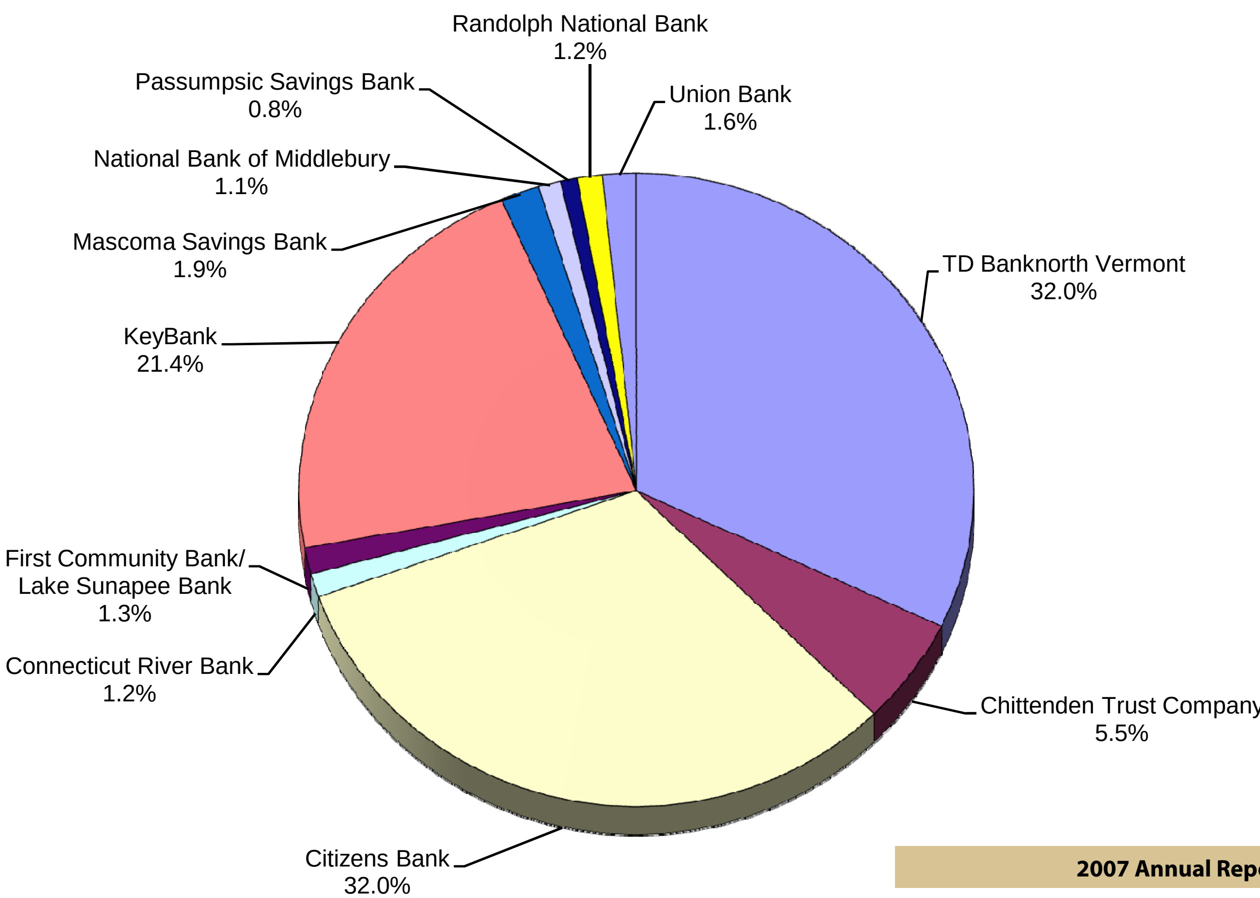
now part of Berkshire Hills Bancorp, Inc.
** *First Brandon National Bank and First Community Bank were prequalified and were acquired by Lake Sunapee Bank*
*** *merged with Community National Bank in January 2008*

Since its inception in August 2004, $336.8 million in Certificates of Deposit (CDs) has been awarded through December 2007. As of December 31, 2007, $37.45 million is invested in certificates of deposit of varying maturities with rates well above comparable maturity Treasury rates.

Bank in Vermont--CDs Awarded Through 12/31/07



Bank in Vermont--CDs Outstanding as of 12/31/07



Unclaimed Property Division

Background

The primary function of the Unclaimed Property Division is to locate and return various forms of unclaimed financial property to the rightful owners or their heirs. This property includes forgotten bank accounts, uncashed pay checks, unclaimed security deposits, and unused gift certificates. It is most often in the form of money, but it also can be stocks, mutual funds, or contents of safe deposit boxes. The property comes from many sources including banks, credit unions, corporations, utilities, insurance agencies, retailers, and governmental agencies throughout the United States. The Vermont State Treasurer's Office acts as custodian to safeguard the assets until they can be claimed by the rightful owners or heirs.

Unclaimed Property Division
(802) 828-2407
(800) 642-3191

Al LaPerle
Unclaimed Property Director

Linda Bouffard
Unclaimed Property Technician

Kitty Bolduc
Unclaimed Property Technician

Lynn Kinner
Accountant D

UPDATES

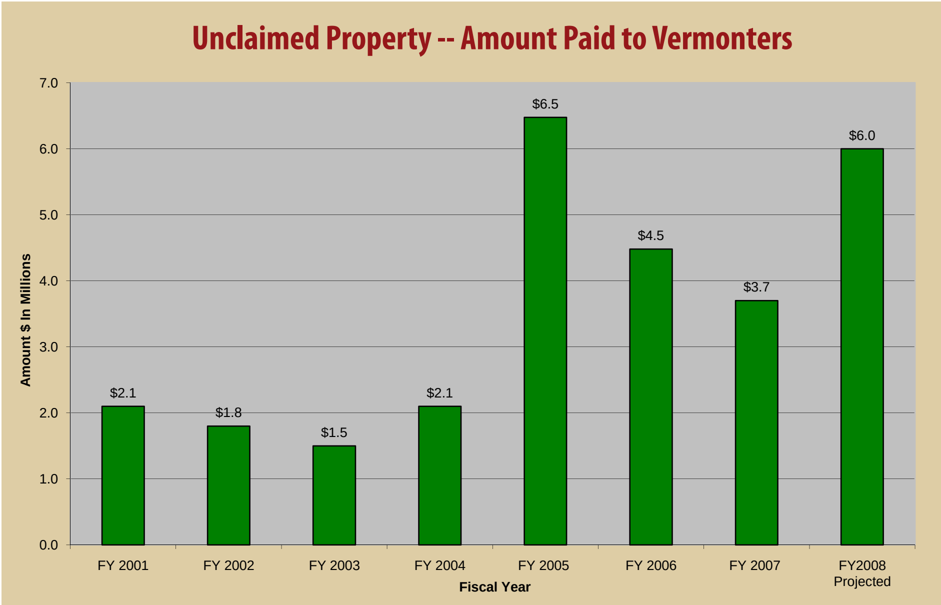
Claims Paid in 2007

In fiscal year 2007, $3.7 million in claims (see chart next page) was paid to 5,774 claimants (see chart page 44—*Unclaimed Property: Number of Claims Paid*). The average claim paid was $640. The Unclaimed Property Division has continued to expand our "express claim service." The express claim service is an expedited option for claims of $200 or less where the original owner is making the claim which permits claims payment in five workdays or less. During fiscal year 2007, the division processed 2,678 express claims.

The expansion of the express claim service is part of a larger initiative to reach potential claimants and streamline the application process. In addition to the more traditional methods of outreach, including informational displays at events such as the Champlain Valley Exposition and the Vermont League of Cities and Towns, the division has utilized a number of public service announcements, advertising through various media and targeted ads to reach Vermonters.

ACCOMPLISHMENTS IN 2007

- **Returned $3.7 million to 5,774 claimants.**
- **Developed an audit compliance program to assure holder compliance with the statutes.**
- **Collected $9.92 million in unclaimed property in fiscal year 2007.**
- **Continued to expand the office's expedited "express claims service." The current average processing time is four days, as compared to the goal of 5 days.**
- **Increased outreach to potential claimants. As a result, over 261,855 web searches were initiated by potential claimants over the past year.**
- **Managed a database of 215,289 properties totaling more than $42 million of unclaimed financial property in Vermont.**



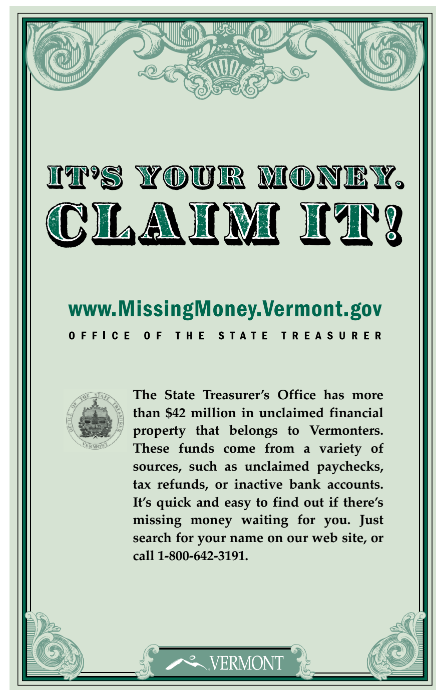
Improved web access has facilitated customer access to information. We continue to work with town and city clerks as a tool to reach citizens.

Statute Compliance Activities

The Treasurer's Office could not return the funds to the rightful owner if it did not receive lost or abandoned property from the holders of the property. Typical holders of unclaimed property include financial institutions, employers, utility companies, and other firms. Vermont's firms have largely complied, on a voluntary basis, with State statutes relative to escheatment of property. Yet, while most companies comply, others do not. Increased education and compliance efforts are being undertaken to assure that all holders and rightful owners are treated in a fair and equitable manner. As in past years, we have disseminated educational materials and hosted training seminars to educate holders about the unclaimed property law. As a result of this and other holder outreach activities, we have added 1,173 new holders to the system in the past year.

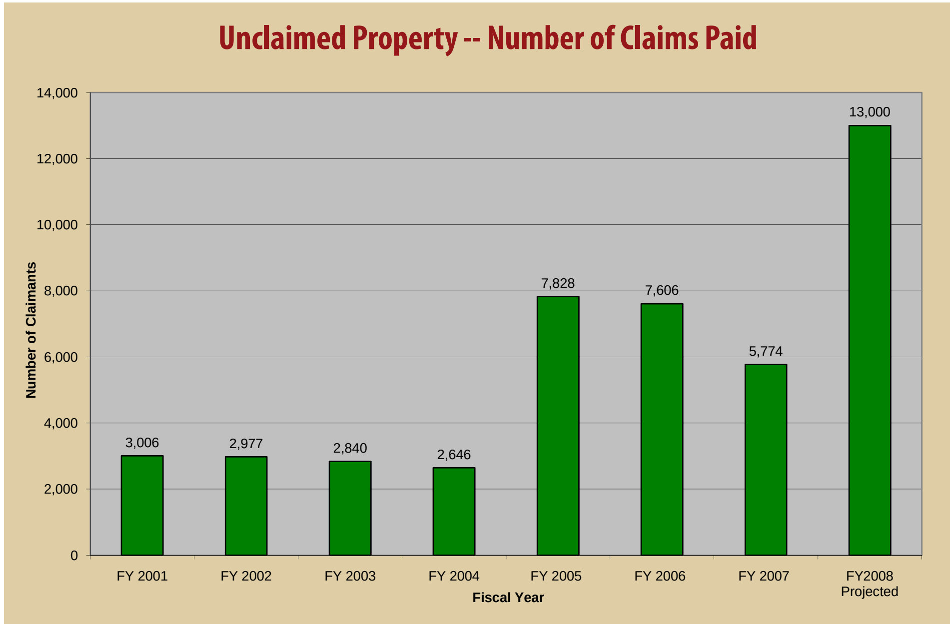
The office also instituted a Voluntary Compliance Program which has permitted holders to come forward and voluntarily submit to a process of disclosing and remitting unclaimed property funds—avoiding costly audits, fines and penalties. This incentive to voluntarily comply has been quite successful, with 27 additional holders signing agreements with the Unclaimed Property Division. This is in addition to the 18 that had signed agreements prior to the 2007 fiscal year. To date, an estimated $247,000 has been remitted to the State as a result of these agreements. A review of a large holder is expected to be completed in December 2007; preliminary estimates are that more than $545,000 will be remitted in the next few months. The final stage in this program is enforcement. This past

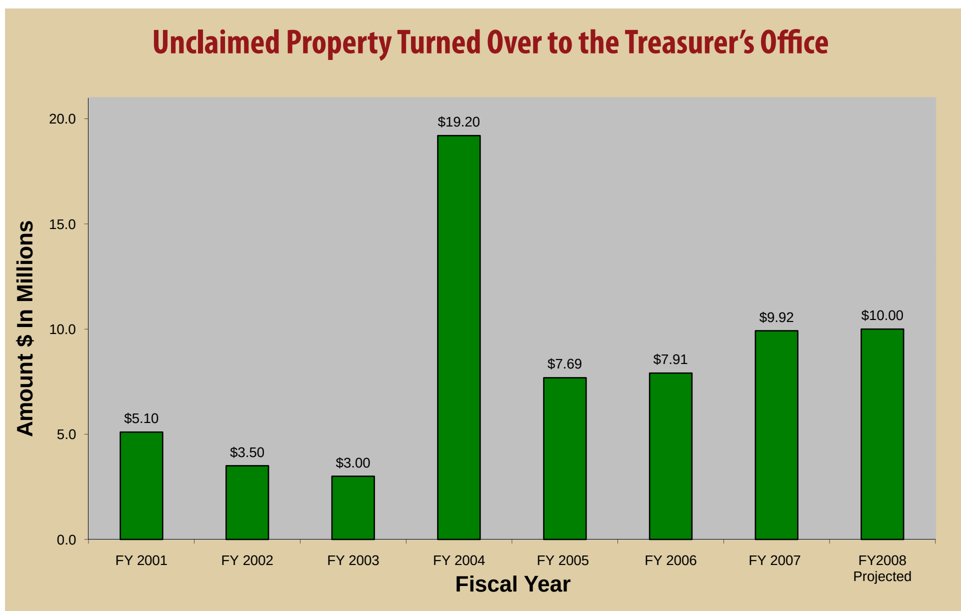
The expansion of the express claim service is part of a larger initiative to reach potential claimants and streamline the application process. In fiscal year 2007, there were 2,678 express claims processed.



Vermonters responded in the thousands to the Treasurer Office's new outreach campaign, "It's Your Money — Claim It." The office implemented an aggressive advertising plan in June aimed at building awareness of the unclaimed property program and directing individuals to the Missing Money web site. As a result, the division recorded 110,964 web searches for first quarter, compared to 34,160 searches for the same period last year.

year we selected two firms who will work with Treasurer's Office staff to perform unclaimed property audits. The enforcement phase will begin in January 2008.





Treasury Operations Division

Treasury Operations Division: (802) 828-5193

Skip Perkins
Business Manager D

Dan Currier
Cash Management & Investments Manager

Ron Baldauf
Accountant C

Gayle Rowe
Accountant B

Becky Brockway
Accountant B

Lisa Gilman
Accountant B

Joanne Costantini
Accountant B

Michael Healy
Clerk B

Background

The Treasury Operations Division is the core operation for all money movement within the State. This division is responsible for banking and cash management for more than $4 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 receipts, including those related to Act 68; and the recording of accounting transactions associated with the above activities in the State's general ledger accounting system (VISION). 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, the municipal equipment loan fund, and assisting Retirement Operations in the preparation of the pension trust fund financial statements.

The Treasury Operations Division processes approximately two million payments each year. More than half of those are conducted electronically, and the division's goal is to continue increasing the proportion of transactions that occur electronically.

The division's workload involves extensive interaction with the commercial banks that maintain accounts on behalf of the State, the various agencies involved with the disbursement and collection of funds, and the Department of Finance and Management.

The reconciliation of internal and external accounts comprises a major portion of the office's staff time, in addition to the proper reporting and recording on the State's books for financial reporting.

UPDATES

Reconciliations

The Treasurer's Office staff reconciles approximately 31 State core bank accounts. In the 2007 fiscal year, 79,532 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. On the disbursement side, 1,590,683 payments were processed, either through paper

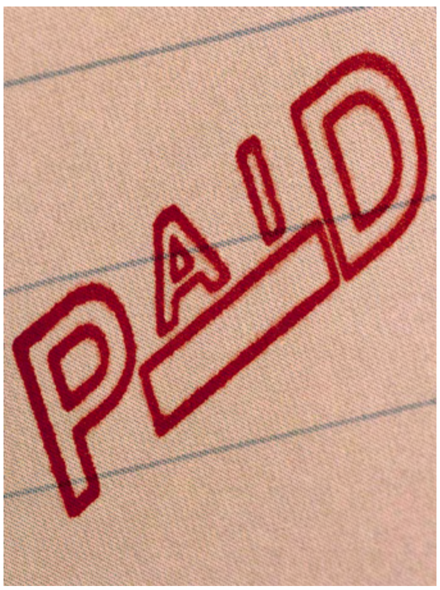
ACCOMPLISHMENTS IN 2007

- **Established a central and convenient manner in which our customers—State agencies and departments—can request information from the Treasury Operations Division, enabling staff to monitor the requests and respond in a more timely and orderly manner. Since May 1, more than 800 requests have been efficiently handled in this manner.**

- **Completed all reconciliations within 30 days of the monthly close of the State's books for nearly four consecutive years, reducing reconciling items and improving the reliability of financial data.**

checks or electronic payments. Reconciliation procedures implemented by the State Treasurer's Office have significantly reduced the likelihood of fraud, thereby protecting the State's assets. No one individual has control of all tasks associated with a transaction from start to finish. Staff activities are segregated and provide numerous checks and balances, involving multiple supervisory chains. This significantly reduces the risk of error associated with no one individual controlling a function. Reconciliation is separate from cash management and investment transactions (wire initiation and approval) as well as revenue receipt and payment. Joint reviews of outstanding reconciling items with agencies/departments state-wide have resulted in the resolution of important procedural and system issues, thereby significantly reducing the amount of aged items on the reconciliations.

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, and that reporting/review processes are in place to continually approve the accuracy and timeliness of financial reports and the supporting data. The Treasury has completed all bank reconciliations within 30 days of the monthly close of the State's books for nearly four consecutive years.



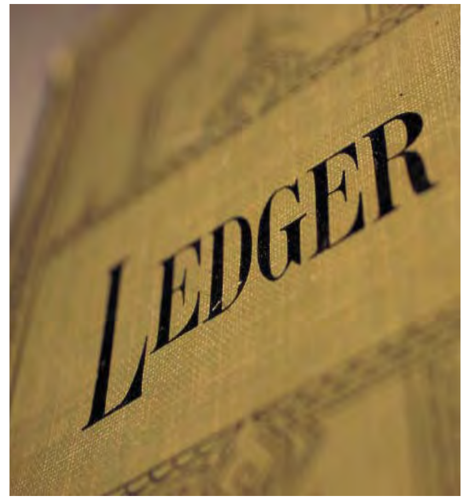
Electronic Payments

The issuance of paper checks is labor-intensive and costly. Electronic payments reduce bank fees, printing costs, fraud, and postage, fees that the banks charge, and staff time to reconcile bank accounts. In addition, there are added costs for reconciliation. Tracking of lost checks is time-consuming and can be largely eliminated through electronic 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. This past year 1,376 replacement checks were issued because payees misplaced or lost the original checks. While this is down from 1,700 the prior fiscal year, this task still involves extensive research and reconciliation work on the part of division staff, and is also an inconvenience to the customer.

Considerable efforts will be made in early 2008 to roll out a new web portal for vendors of the State to enable the electronic tracking of payments.

One of the major impediments to the use of automated clearing-house payments by vendors is the lack of payment remittance information in the file addenda. The State currently issues and mails a remittance advice when the electronic payment is made. Of the more than 1.5 million payments processed in 2007, 49 percent were electronic transfers. Considerable efforts will be made in early 2008 to roll out a new web portal for vendors of the State to track their payments, significantly reducing the costs associated with mailing an advice to those who currently do receive their payments electronically. The ultimate goal is to encourage more vendors who currently receive their payments for goods and services by check to switch to electronic transfers of funds directly to their bank accounts. Moving further from a paper-based payment system to electronic forms would provide increased safety, while at the same time reducing many operational costs.

In December of 2007, 86.3 percent of retired municipal employees, 92.6 percent of retired State employees, and 94.8 percent of retired teachers received their monthly benefit payments via direct deposit. This is an increase from the December 2006 percentages of 85.5 percent, 91.5 percent, and 94 percent respectively. Currently, 8,287 State employees, or 86 percent of the work force, have their biweekly pay deposited directly to their bank accounts. This is up from 7,982 the prior year, a 3 percent increase.



Banking Services

TD Banknorth serves as the State's master banking contractor. Bank personnel and Treasury staff are continuously working together to provide new, improved services and processes, with the goal of greater efficiency. Treasury personnel have secure access to up-to-the-minute account information; are able to initiate wire transfers and automated transfers of funds; can process stop-payments; utilize reporting functions; and access check services. They are assured of secure messaging. All of these features complement efforts by the Treasurer's Office to improve cash-flow forecasting and funds management.

Act 68 Receipts

Notification and initial invoicing of the municipalities for the principal payment is completed by the Department of Education. Per statute, the Treasury Operations Division monitors the receipt of payments mandated by Act 68. In fiscal year 2007, all municipalities made their Act 68 principal payments.

As of December 31, 2007, one principal receivable for the payment due on December 1 was outstanding, approximating $10,600. This was paid prior to publication of this report. The Treasurer's Office is seeking collection of interest, calculated at 8 percent per annum, for this account and for any other payments made after the due date.

The Act 68 receipts currently approximate $83 million for each semi-annual billing cycle.

Reorganization of the Division

In order to meet the challenges of increased on-going operational demands, centralize cash management and banking operations, and streamline financial management processes, the Treasurer's Office recently reorganized the division. Using existing resources, some of the staff positions were re-structured, and the workload re-distributed. No additional staff were added to the Treasurer's Office as a result of these changes. An audit compliance position was eliminated in order to dedicate additional resources to these core functions. Recognizing the continued need for an internal audit function, an Internal Audit Committee, composed of members from all relevant divisions, was created. The committee reviews treasury operations, recommends business process improvements, and identifies, implements and tests appropriate internal controls. This team approach has generated increased efficiencies and has the added benefit of cross-training.

The financial statement functions for non-pension related accounts are now centralized in the Treasury Operations Division. Pension accounting functions were transferred to the Retirement Operations Division. In both cases the effect has been to better link the day-to-day accounting to the larger financial management reporting function. Investment of short-term cash, banking, and cash projection functions have been consolidated in this division. Over the next year, a number of initiatives are expected to be completed and include a comprehensive review of the banking operations, creation of a banking RFP, initiation of a project to increase use of electronic transactions instead of paper, and a review of the cost allocation/budgeting model.

Legislative Reporting Requirements

Brandon Training School

Section 23 of Act 62 of the Public Acts of 1995 specifies that the State Treasurer shall notify the chairs of the Senate and House Institutions committees upon receipt of monies from the sale of the Brandon Training School property, as well as certain federal receipts associated with the Vermont Veterans' Home. For fiscal year ending June 30, 2007, the State has timely received amounts due from the federal government associated with the Vermont Veterans' Home. There were no sales of property belonging to the Brandon Training School in fiscal year 2007.

MacBride Principles

Act 50 of the Public Acts of 1989 specifies that the State Treasurer and the Retirement 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.

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.

Survivors of Emergency Personnel

Originally established by the Legislature in 2002 as the Firefighters' Survivors Benefit Fund, it 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 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. The board met once during the year. Thankfully, no benefit awards were required to be paid out to survivors this past year. As of November 30, 2007, the fund has assets of $230,656.

Credit Card Payments

The Treasurer's Office contracts with TD Banknorth Merchant Services Group, a division of TD Banknorth, to provide credit and bank card services. Acceptance of credit and debit card payments is broadly practiced in many agencies and departments as a method of payment of registration fees, licenses, penalties, fines, durable goods, park reservations, interest, and payment of taxes. Credit and debit card acceptance provides our customers, the citizens of Vermont, with a more convenient method of payment. In addition to public convenience, electronic processing of consumer and business purchases improves governmental cash flows, offers greater financial security, and reduces the overhead costs associated with the handling of currency.

Act 51 permits the Court Administrator to contract with a third party to collect fines, penalties, and fees by credit/debit card and to add on a processing charge for credit/debit payments. During January 2007, the Court Administrator contracted with the Vermont Information Consortium (VIC) to build a web site that is used to process credit/debit card payments. Two web sites were developed. The first is a password-protected site used by court staff only; the second is accessible to the public for on-line payment of judgments. The Judicial Bureau has used the staff web site since February 2007 to process payments and generate reports. The District Court is currently piloting the program in Washington County with rollout to the remaining courts in December, 2007. The public interface has been accepting online payments for Judicial Bureau since July 2007. As of November 30, 2007, they collected $1,747,179 in credit/debit card payment through this portal. During October 2007, over 20 percent of the payments received at the Judicial Bureau were processed by credit/debit cards.

Credit Card Accounts Summary

CREDIT CARD ACCOUNTS	SALES	FEES
VT Dept. of Liquor Control	$15,569,013.84	$313,197.07
VT Dept. of Motor Vehicles	10,134,977.59	171,575.20
VT Dept. of Taxes	3,486,796.86	8,160.05
VT Dept. of Fish & Wildlife	705,119.05	13,928.82
VT Dept. of Forest, Parks & Recreation	2,330,921.81	48,426.28
VT Dept. of Health	180,184.00	4,181.66
Vermont Life Magazine	471,149.34	10,198.07
Vermont Judicial / Courts	1,747,178.64	12,407.10
ACCD - Historic Preservation	134,562.54	10,430.56
Center for Crime Victims Services	132,477.00	2,490.22
Secretary of State	682,265.00	14,712.58
Environmental Conservation	625.00	225.95
Department of Children & Families	282,648.00	5,930.85
Total	35,857,918.67	615,864.41

Technology & Legal Updates

Legal Services

The position of legal and policy director was created in 2005. The purpose of the position is to provide legal and policy advice to the Treasurer's Office in the areas of investments, contracting, debt, access to records, retirement benefits, retirement administration and unclaimed property. The director conducts policy and legal research for the office, drafts procedures and legislative proposals, serves as liaison to the Attorney General's Office and coordinates litigation. Further, the director provides general counsel services to the Treasurer's Office.

UPDATES

In fiscal year 2007, the omnibus retirement legislation, Act 13, was a significant achievement for this office. It had three primary purposes: (1) To reduce the number of funds referenced in the three chapters—inserted at the request of the Attorney General's Office; these changes made up the largest part of the bill, because there are so many fund references in the retirement statutes; (2) To codify federal requirements for public retirement systems; and (3) To complete largely technical changes that will enhance the operation of the three retirement systems.

Technical changes aimed at enhancing operation of the Vermont Retirement System addressed the following issues:

1. Defined how average final compensation is calculated when determining retirement benefits.

2. Defined retirement allowance to equate to maximum retirement option.

3. Established language to ensure no loss of creditable service if a member goes on a leave of absence as a result of a work-related injury.

4. Defined how disability benefit will be calculated when service has been accrued in more than one group plan.

5. Established guidelines for payment of benefits under and over $1,000 for active and retiree deaths.

6. Established maximum of five years over which equal annual payments for purchase of eligible credit may be made.

7. Removed sections of respective statutes that are no longer relevant to plans.

8. Established penalties for employers who file delinquent or willfully erroneous retirement reports.

9. Clarified early retirement penalties in the Municipal System.

10. Eliminated restrictions that prohibit more than one membership in a Vermont public retirement system at the same time.

11. Established death-in-service benefit for members of the Municipal Group D plan.

Legal & Policy
(802) 828-5505

William Rice
Legal & Policy Director

Technology Services

The Technology Services Division is committed to providing programming and technical support services to the Treasurer's Office. Office personnel in this area provide support to 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 various programs supporting the retirement services for the State's approximately 44,000 active, vested, and retired members.

UPDATES

The Technology Services staff continued to implement important upgrades to the Treasurer's Office's infrastructure to improve the speed and dependability of its systems during 2007. This work included:

- Implementation of the Treasurer's Office disaster recovery and business continuity plan at the off-site facility during the spring flood warning and test of emergency systems (while emergency action was not required in spring 2007, the Treasurer's Office contingency planning started in 2005 has helped prepare the operations to respond to a emergency event);

- In coordination with DII, implementation of a new Enterprise-wide backup application that will also help improve business continuity;

- Deployment of Microsoft Office 2007 to the entire Treasurer's Office staff and testing Vista for phase-in use in 2008;

- VPAS (Vermont Pension Administration System) implementation—continuing the second phase scheduled to be rolled out in 2008; and

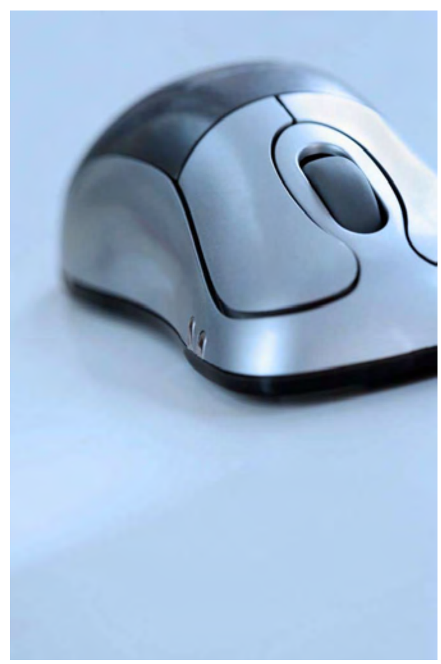
- Working closely with various Treasurer's Office operations staff and other departments to enhance existing services—such as the development of a web-based Vendor Advice Portal, deployment of a new Financial Literacy web site, and planning for a comprehensive check printing solution.

Technology Services
(802) 828-5192

Dan Fine
Technology Services Director

Lane Safford
Network Administrator II

David Pruden
Systems Developer III



Appendices

STATE OF VERMONT: *Pension Trust Funds—Combining Statements of Plan Net Assets—6/30/2007*

	Vermont State Retirement Fund	Vermont State Defined Contribution Fund	Vermont State Postemployment Benefits Trust Fund	State Teachers' Retirement Fund	Single Deposit Investment Account Fund	Vermont Municipal Employees' Retirement Fund	Municipal Employees' Defined Contribution Fund	Total Pension Trust Funds
Assets:								
Cash and short term investments	$ 112,032,818	$ 300,236	$ 1,890,996	$ 113,441,597	$ 10,107,757	$ 36,034,007	$ 51,091	$ 273,858,502
Receivables:								
Contributions - current	3,256,579	136,316	-	2,667,082	-	2,241,821	8,799	8,310,597
Contributions non-current	-	-	-	-	-	10,773,134	-	10,773,134
Interest and dividends	7,307,272	6,177	-	7,920,588	648,364	2,255,197	34	18,137,632
Investments sold	181,154,265	-	-	203,633,308	-	42,027,434	-	426,815,007
Due from other funds	26,384	-	319,878	-	-	-	-	346,262
Other	-	-	-	319,617	-	-	-	319,617
Total receivables	191,744,500	142,493	319,878	214,540,595	648,364	57,297,586	8,832	464,702,248
Investments at Fair value:								
Fixed income	509,727,481	-	-	515,883,494	96,816,009	126,027,558	-	1,248,454,542
Equities	592,290,513	-	-	763,708,294	-	132,151,845	-	1,488,150,652
Real estate and venture capital	86,958,042	-	-	129,764,068	-	22,505,574	-	239,227,684
Mutual funds	143,133,711	40,970,920	-	168,435,550	-	34,011,769	13,104,242	399,656,192
Total investments	1,332,109,747	40,970,920	0	1,577,791,406	96,816,009	314,696,746	13,104,242	3,375,489,070
Prepaid expenses	1,278,127	21,066	-	1,178,148	-	-	-	2,477,341
Capital Assets:								
Construction in progress	627,199	-	-	718,984	-	183,570	-	1,529,753
Total capital assets	627,199	-	-	718,984	-	183,570	-	1,529,753
Total assets	**1,637,792,391**	**41,434,715**	**2,210,874**	**1,907,670,730**	**107,572,130**	**408,211,909**	**13,164,166**	**4,118,056,915**
Liabilities:								
Payable for investments purchased	244,233,294	-	-	259,222,549	18,295,600	60,070,058	-	581,821,501
Accounts payable	1,060,475	6,097	-	1,176,797	-	259,693	201	2,503,263
Retainage payable	80,502	-	-	98,366		41,685	-	220,553
Due to other funds	-	26,384	-	-	-	-	-	26,384
Total liabilities	**245,374,271**	**32,481**	**0**	**260,497,712**	**18,295,600**	**60,371,436**	**201**	**584,571,701**
Net assets held in trust for employees' pension benefits	**$ 1,392,418,120**	**$ 41,402,234**	**$ 2,210,874**	**$ 1,647,173,018**	**$ 89,276,530**	**$ 347,840,473**	**$ 13,163,965**	**$ 3,533,485,214**

STATE OF VERMONT: *Pension Trust Funds—Combining Statements of Changes in Plan Net Assets—Fiscal Year Ended 6/30/2007*

	Vermont State Retirement System	Vermont State Defined Contribution Plan	Vermont State Postemployment Benefit Trust Plan	State Teachers' Retirement System	Single Deposit Investment Account	Vermont Municipal Employees' Retirement System	Vermont Municipal Employees' Defined Contribution Fund	Total Pension Funds
Additions :								
Contributions								
Employer	$ 39,297,002	$ 1,941,685	$ 2,209,843	$ 37,341,609	$ -	$ 8,535,396	$ 571,438	$ 89,896,973
Plan member	15,456,692	683,781	-	22,533,479	-	9,769,882	571,335	49,015,169
Transfers from other pension trust funds	199,993	152,965	-	544,849	-	206,101	4,731	1,108,639
Transfers from non-state systems	5,328	9,449	-	393,569	-	-	44,432	452,778
Medicare part D drug subsidy	-	-	-	1,154,801	-	-	-	1,154,801
Total contributions	**54,959,015**	**2,787,880**	**2,209,843**	**61,968,307**	**0**	**18,511,379**	**1,191,936**	**141,628,360**
Investment Income:								
Net appreciation (depreciation) in fair value of investments	150,144,794	3,577,166	-	197,150,904	667,890	35,623,661	1,159,839	388,324,254
Dividends	15,649,401	2,147,154	-	19,781,365	-	3,590,973	649,036	41,817,929
Interest income	30,068,619	14,467	1,031	30,913,355	4,895,955	8,393,540	3,131	74,290,098
Securities lending income	748,949	-	-	865,428	427,880	169,185	-	2,211,442
Other income	1,031,161	-	-	1,537,916	16,999	239,842	196,212	3,022,130
Total investment income	**197,642,924**	**5,738,787**	**1,031**	**250,248,968**	**6,008,724**	**48,017,201**	**2,008,218**	**509,665,853**
Less Investment Expenses								
Investment managers and consultants	4,802,825	554	-	5,563,372	355,119	1,331,293	-	12,053,163
Securities lending expenses	214,820	-	-	248,383	-	48,548	-	511,751
Total investment expenses	**5,017,645**	**554**	**0**	**5,811,755**	**355,119**	**1,379,841**	**0**	**12,564,914**
Net investment income	**192,625,279**	**5,738,233**	**1,031**	**244,437,213**	**5,653,605**	**46,637,360**	**2,008,218**	**497,100,939**
Total additions	**247,584,294**	**8,526,113**	**2,210,874**	**306,405,520**	**5,653,605**	**65,148,739**	**3,200,154**	**638,729,299**
Deductions:								
Retirement benefits	58,859,659	2,539,106	-	74,368,306	9,958,378	7,969,703	352,646	154,047,798
Refunds of contributions	1,229,497	-	-	1,287,544	-	1,186,942	-	3,703,983
Death claims	296,643	-	-	337,596	-	202,641	-	836,880
Transfers to other pension trust funds	344,721	-	-	203,445	-	560,473	-	1,108,639
Operating expenses	14,052,526	228,718	-	13,857,834	-	687,382	27,763	28,854,223
Total deductions	**74,783,046**	**2,767,824**	**0**	**90,054,725**	**9,958,378**	**10,607,141**	**380,409**	**188,551,523**
Change in net assets	**172,801,248**	**5,758,289**	**2,210,874**	**216,350,795**	**(4,304,773)**	**54,541,598**	**2,819,745**	**450,177,776**
Net assets held in trust for employees' pension benefits:								
July 1	**1,219,616,872**	**35,643,945**	**0**	**1,430,822,223**	**93,581,303**	**293,298,875**	**10,344,220**	**3,083,307,438**
June 30	**$ 1,392,418,120**	**$ 41,402,234**	**$ 2,210,874**	**$ 1,647,173,018**	**$ 89,276,530**	**$ 347,840,473**	**$ 13,163,965**	**$ 3,533,485,214**

HISTORICAL SUMMARY OF OPERATIONS: *Pension Fund Operations*

State Employees Retirement System
Summary of Operations

Category	2003	2004	2005	2006	2007
SOURCES OF FUNDS					
Employee Contributions	$ 12,171,186	$ 13,716,264	$ 15,112,105	$ 14,561,467	$ 15,456,692
Employer Contributions	24,394,933	26,645,619	36,493,435	36,866,451	39,297,002
Other Income	813,168	695,397	777,792	1,171,516	205,321
Investment Income	40,435,216	138,426,552	90,452,723	115,146,415	192,625,279
APPLICATION OF FUNDS					
Retirement Benefits	41,614,187	44,637,116	48,893,673	53,435,617	58,859,659
Refunds	923,964	1,171,957	1,402,481	1,351,911	1,526,140
Health/Life Insurance Expenses	9,916,398	9,236,526	11,329,269	11,590,588	13,541,092
Administrative Expenses	971,394	659,447	1,255,852	1,329,081	511,434
Other Expenses	369,383	617,658	635,618	668,929	344,721
Addition to Net Assets Held in Trust for Pension Benefits	$ 24,019,177	$ 123,161,128	$ 79,319,162	$ 99,369,723	$ 172,801,248

Teachers' Retirement System
Summary of Operations

Category	2003	2004	2005	2006	2007
SOURCES OF FUNDS					
Employee Contributions	$ 18,820,703	$ 21,088,345	$ 21,158,452	$ 21,884,140	$ 22,533,479
Employer Contributions	20,446,282	24,446,282	24,446,282	24,446,282	37,341,609
Other Income	438,166	267,330	373,705	1,180,606	2,093,219
Investment Income	52,506,838	166,325,045	115,058,694	130,835,585	244,437,213
APPLICATION OF FUNDS					
Retirement Benefits	50,409,313	55,246,342	60,147,731	66,272,471	74,368,306
Refunds	1,109,174	711,806	1,104,278	1,290,197	1,625,140
Health/Life Insurance Expenses	6,634,738	8,279,332	10,167,601	11,233,854	13,040,783
Administrative Expenses	763,527	805,495	1,052,772	1,679,883	817,051
Other Expenses	702,568	543,746	682,438	580,403	203,445
Addition to Net Assets Held in Trust for Pension Benefits	$ 32,592,669	$ 146,540,281	$ 87,882,313	$ 97,289,805	$ 216,350,795

Municipal Retirement System
Summary of Operations

Category	2003	2004	2005	2006	2007
SOURCES OF FUNDS					
Employee Contributions	$ 5,000,479	$ 6,507,268	$ 7,404,119	$ 8,744,718	$ 9,769,882
Employer Contributions	5,707,184	7,114,813	8,058,810	7,926,436	8,535,396
Other Income	17,855,452	2,125,294	298,475	228,746	206,101
Investment Income	2,630,247	27,271,821	18,165,861	27,697,371	46,637,360
APPLICATION OF FUNDS					
Retirement Benefits	4,929,747	5,694,080	6,418,097	7,120,325	7,969,703
Refunds	639,170	1,110,243	1,140,245	1,102,940	1,389,583
Health/Life Insurance Expenses	-	-	-	-	-
Administrative Expenses	118,038	151,228	367,810	439,983	687,382
Other Expenses	546,692	668,624	423,937	1,101,883	560,473
Addition to Net Assets Held in Trust for Pension Benefits	$ 24,959,715	$ 35,395,021	$ 25,577,176	$ 34,832,140	$ 54,541,598

TO: Commission on Higher Education Funding

FROM: Jeb Spaulding, State Treasurer

RE: Annual Report on the Higher Education Trust Fund

DATE: 29 August 2007

I am pleased to present the State Treasurer's eighth annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by the 1999 General Assembly (16 V.S.A. § 2885). Appropriations totaled $7,635,881.49 through Fiscal Year 2002, $2,363,355.61 in FY 2005, and $5,823,449.94 in FY 2006. The statute was amended in 2001 to provide that in August of each year, the State Treasurer shall withdraw 5% of up to a 12-quarter moving average of the fund's assets and divide the amount equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation.

During fiscal year 2007, the Higher Education Trust Fund dollar weighted return was 12.02%. This return compares to the Lehman Aggregate Bond Index return of 6.12% and to the S&P 500 Stock Index return of 20.60% for the same period, and exceeds the Fund's target rate (based on actual asset allocation and index returns) of 10.62%. The 5% distribution available this year is $620,582.02 in total, or $206,860.67 each for UVM, VSC, and VSAC; the distribution made following Fiscal Year 2006 was $156,365.08 for each institution. (See Appendix A for quarterly market values and distributions for fiscal year 2007.)

16 V.S.A. § 2885 further provides that in August of each year, the Commission on Higher Education Funding 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. The amount appropriated, however, cannot exceed an amount that would bring the fund balance below total contributions to principal.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of $187,638.09, or $93,819.05 each, for distribution to the University of Vermont and the Vermont State Colleges dependent upon a finding by the Commission that the terms of this appropriation have been met. Each institution is required to match the appropriation by raising twice that

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amount, or $187,638.09, and to certify to the Commissioner of Finance and Management 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. [Each of these institutions is in the process of establishing the required certification.]

After payments of $620,582.02 and $187,638.09, the balance in the fund at the beginning of fiscal year 2008 totals $17,461,379.61.

All principal contributions to June 30, 2007, total $15,822,687.04 (see Chart #1). This represents the current minimum balance that must be maintained in the fund. The 2% distribution proposed for this year of $248,232.81 would leave a balance of $17,213,146.80 excluding contributions to be received, 5% distribution, and any gains from investment activity in Fiscal Year 2008. If the committee authorizes this distribution, each institution's share will be $124,116.40 with a required match to be raised by each entity in Fiscal Year 2008 of $248,232.81. Chart #2 is a graphical depiction of distributions, including this 2% distribution subject to committee approval.

An accounting of the fund balances is provided below:

Ending balance FY 2006		$11,188,699.76
Contributions received FY 2007		5,823,449.94
Opening balance FY 2007		17,012,149.70
Distribution August 2006		(637,758.37)
Income earned FY 2007		813,667.62
Appreciation (Depreciation) FY 2007		1,149,774.90
Fees and Other Charges FY 2007		(68,234.56)
Balance June 30, 2007		18,269,599.72
5% of 12-Quarter Moving Average June 30, 2007		(620,582.02)
Distributions: University of Vermont	(206,860.67)	
Vermont State Colleges	(206,860.67)	
Vermont Student Assistance Corp.	(206,860.67)	
2% Income Available for Endowments from FY 2006		(187,638.09)
Balance after distributions		17,461,379.61
Total contributions as of 6/30/2006		15,822,687.04
2% Income Available for Endowments from FY 2007 (requires institutional match in FY 2008)		$248,232.81

I have attached a spreadsheet as Appendix B that shows the total return of the entire Trust Investment Account, of which the Higher Education Trust Fund at $18,269,599.72 (prior to cash distributions to be made in fiscal year 2008) comprises approximately 32.9%. The Tobacco Trust Fund comprises 60.6% of the account, or $33,621,059.32, and the remaining 6.5% is made

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up of eight small unexpendable trusts that total $545,197.25, the ANR Stewardship Fund at $680,300.10, two Veterans' Home trusts totaling $1,091,681.36, and the Fish and Wildlife Trust Fund at $1,241,773.90. Chart #3 displays the relative share of the Higher Education Trust Fund compared to the entire fund. Chart #4 identifies the major asset classes in the portfolio and their performance over the past seven years.

As noted in Chart #5, assets increased significantly due to receipt of funds raised by the Estate Tax in the amount of $5,223,449.94 and a $600,000 contribution form the State's unclaimed property fund as a result of legislation proposed by the Treasurer in FY 2006. Both of these amounts were derived from FY 2006 and were received into the fund in FY 2007. Assets also increased significantly as a result of favorable investments returns in FY 2007. Thus, the Fund's investment base significantly increased in fiscal year 2007, and depending upon investment market conditions can be expected to generate ongoing additional returns to the Fund.

In the past, fixed income investments have been the principal source of total return over the life of the Fund due to a combination of Fund asset allocation and market forces. However, in both fiscal years 2006 and 2007 equity investments have provided the majority of the contribution to the Fund's investment performance based on favorable market conditions and a combined above-benchmark performance by the equity managers. The asset allocation of the Fund at June 30, 2007, comprised 33.8 % equities and 66.2% fixed income securities versus 32.5% equities and 67.5% fixed income securities, respectively, at June 30, 2006.

Currently, allocations of contributions and sources of distributions in the Trust Investment Account are used to target a 30% - 70% ratio in favor of fixed income securities. This balance addresses joint investment objectives of investment return and capital preservation. During the FY 2007 legislative session, bill H.40 was introduced, calling for the removal of the restriction contained in 16 V.S.A. § 2885(c) that the 5% distribution withdrawals from the Higher Education Endowment Trust Fund not exceed the Fund's initial funding balance plus subsequent contributions. While H.40 did not progress beyond introduction during the 2007 session, it is likely to be taken up during the second half of the biennium. If the bill is passed, a more aggressive asset allocation increasing the equity allocation for the Higher Education Trust Fund would become appropriate, inasmuch as the risk of not being able to fully fund 5% distributions would be eliminated.

In summary, the investment performance of the Trust Investment Account once again exceeded its target return, and favorable market conditions combined with overall above-benchmark performance by the investment managers created a return well above a level fully supporting this year's distributions. Going forward, distributions will depend on the ongoing performance of the Fund, and will require continued monitoring of the Fund's investment performance, as well as ongoing consideration of optimal asset allocation in evolving investment marketplaces.

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

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HIGHER EDUCATION TRUST FUND: *Quarterly Market Values—June 30, 2007*

	Balance	Balance	Balance	Balance	
	9/30	12/31	3/31	6/30	
Education Trust					
FY2005	$8,241,108.63	$8,566,614.41	$8,617,473.66	$8,855,599.91	
FY2006	$10,849,205.23	$10,921,067.11	$11,272,112.39	$11,188,699.76	
FY 2007	$16,853,847.32	$17,407,882.23	$17,896,475.61	$18,269,599.72	
Twelve Quarter Average	**$12,411,640.50**				
5% Distribution 2007	**$620,582.02**				
VSAC		$206,860.67		Contributions	
UVM		$206,860.67			
VSC		$206,860.67		Initial	$6,000,000.00
				2001	$1,000,000.00
2% FY2006	**$187,638.09**			2002	$635,881.49
UVM		$93,819.05		2003	$0.00
VSC		$93,819.05		2004	$0.00
				2005	$2,363,355.61
				2006	$5,823,449.94
Balance after Distributions	**$17,461,379.61**			Total	**$15,822,687.04**
2% FY2007	$248,232.81				
UVM		$124,116.40			
VSC		$124,116.40			

VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance from 9/30/06 to 6/30/07*

MANAGER	Quarter Ended 9/30/2006	Quarter Ended 12/31/2006	**Calendar Year 2006**	Quarter Ended 3/31/2007	Quarter Ended 6/30/2007	**Fiscal Year 2007**	Portfolio Market 6/30/2007	Portfolio Percent 6/30/2007
DOMESTIC EQUITY								
Hanson Investment Management	2.70%	7.20%	**20.28%**	6.58%	10.05%	**29.13%**	$10,585,985	19.1%
Prentiss Smith & Co.	1.32%	8.28%	**16.61%**	1.60%	7.74%	**20.09%**	$8,139,800	14.7%
S&P 500	*5.67%*	*6.70%*	***15.80%***	*0.64%*	*6.28%*	***20.60%***	$18,725,785	33.8%
DOMESTIC FIXED INCOME								
NL Capital Management	3.43%	1.48%	**5.31%**	2.20%	-1.07%	**6.12%**	$36,723,827	66.2%
Lehman Aggregate	*3.81%*	*1.24%*	***4.33%***	*1.50%*	*-0.52%*	***6.12%***		
TOTAL FUND DOLLAR WEIGHTED RETURN	3.00%	3.39%	**9.48%**	2.88%	2.24%	**12.02%**		
Total Fund Target	4.39%	2.92%	**7.96%**	1.23%	1.71%	**10.62%**		
TOTAL FUND MARKET VALUE	**$53.8**	**$52.8**	**$52.8**	**$54.3**	**$55.5**	**$55.5**	$55,449,612	**100.0%**

VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance from Fiscal Year 2005 to 6/30/06*

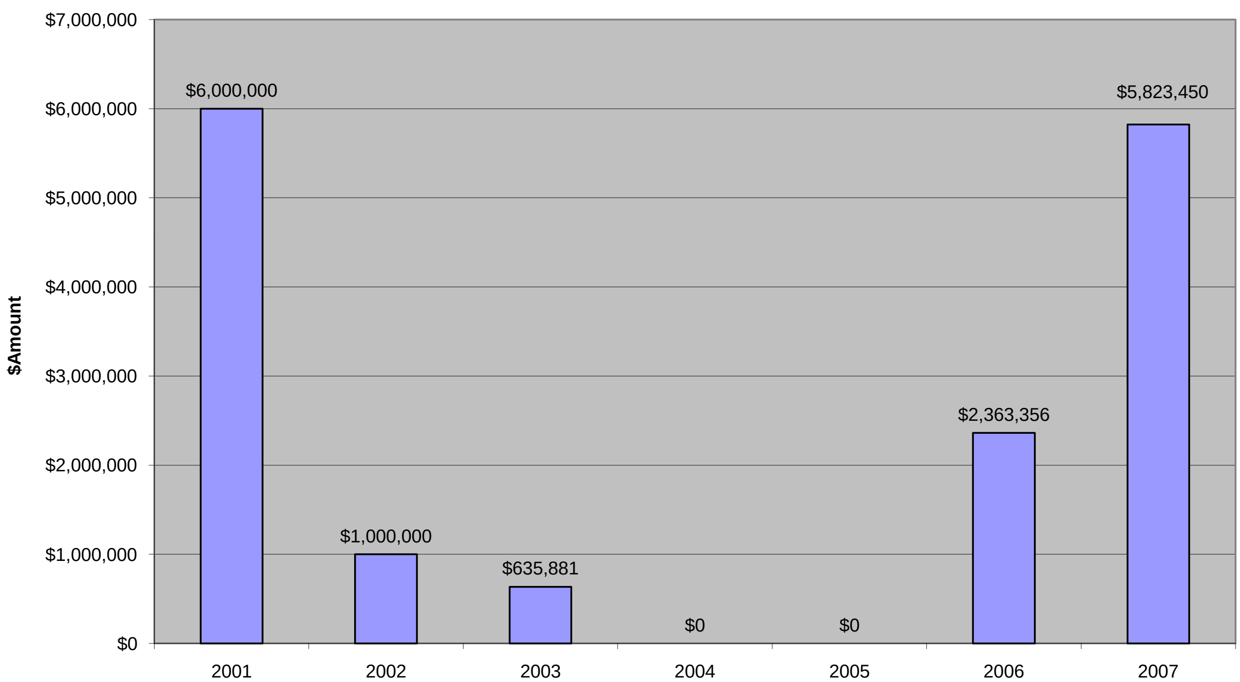
MANAGER	**Fiscal Year 2005**	Quarter Ended 9/30/2005	Quarter Ended 12/31/2005	**Calendar Year 2005**	Quarter Ended 3/31/2006	Quarter Ended 6/30/2006	**Fiscal Year 2006**	Portfolio Market 6/30/2006	Portfolio Percent 6/30/2006
DOMESTIC EQUITY									
Hanson Investment Management	**22.25%**	8.40%	2.26%	**19.18%**	13.33%	-3.60%	**21.10%**	$8,781,896	17.7%
Prentiss Smith & Co.	**11.00%**	7.92%	0.86%	**10.68%**	6.40%	-0.10%	**15.77%**	$7,369,828	14.8%
S&P 500	***6.32%***	*3.60%*	*2.09%*	***4.91%***	*4.21%*	*-1.44%*	***8.63%***		*32.5%*
DOMESTIC FIXED INCOME									
NL Capital Management	**7.42%**	-0.50%	0.44%	**3.07%**	0.16%	0.17%	**0.26%**	$33,529,229	67.5%
Lehman Aggregate	***6.80%***	*-0.67%*	*0.59%*	***2.43%***	*-0.65%*	*0.08%*	***-0.81%***		
TOTAL FUND DOLLAR WEIGHTED RETURN	**10.17%**	2.15%	0.80%	**6.64%**	3.37%	-0.55%	**5.86%**		
Total Fund Target	**6.76%**	0.64%	1.05%	**3.27%**	0.91%	-0.42%	**2.19%**		
TOTAL FUND MARKET VALUE ($mil)	**$43.5**	**$48.3**	**$48.6**	**$48.6**	**$50.1**	**$49.7**	**$49.7**	$49,680,953	**100.0%**

VERMONT COMMON TRUST FUND: *Total Return Analysis—Performance from Fiscal Year 2001 to Fiscal Year 2005**

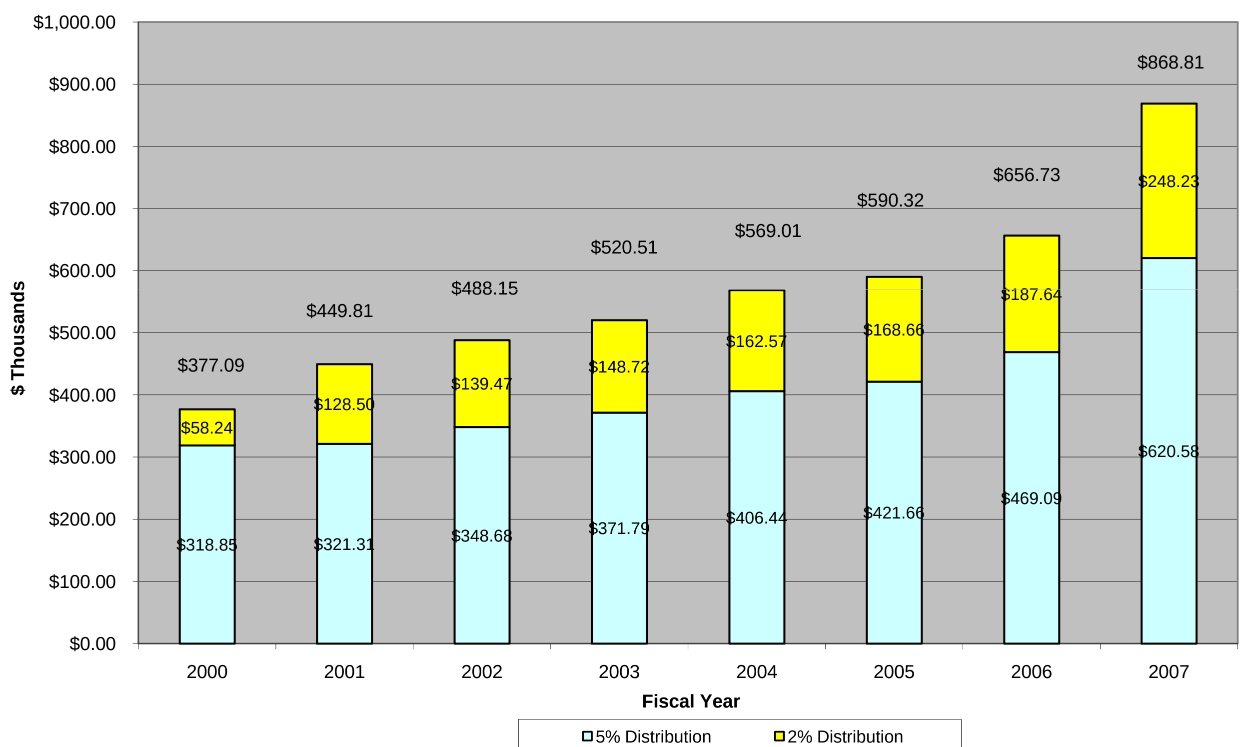
MANAGER	**Fiscal Year 2001**	**Calendar Year 2001**	**Fiscal Year 2002**	**Calendar Year 2002**	**Fiscal Year 2003**	**Calendar Year 2003**	**Fiscal Year 2004**	**Calendar Year 2004**	**Fiscal Year 2005**
DOMESTIC EQUITY									
Hanson Investment Management	**29.41%**	**17.41**	**(7.78)**	**(18.01)**	**-1.89%**	**42.55%**	**29.10%**	**15.92%**	**22.25%**
Prentiss Smith & Co.	**7.59%**	**13.69**	**3.60**	**(7.35)**	**7.70%**	**18.17%**	**11.47%**	**13.25%**	**11.00%**
S&P 500	***-13.56%***	***-11.89%***	***-17.99%***	***-22.11%***	***0.25%***	***28.69%***	***19.14%***	***10.90%***	***6.32%***
DOMESTIC FIXED INCOME									
NL Capital Management	**10.34%**	**10.07%**	**9.41%**	**9.48%**	**8.92%**	**5.43%**	**3.48%**	**5.56%**	**7.42%**
Lehman Aggregate	***10.23%***	***8.44%***	***8.63%***	***10.25%***	***10.40%***	***4.10%***	***0.32%***	***4.34%***	***6.80%***
TOTAL FUND DOLLAR WEIGHTED RETURN	**11.27%**	**11.62**	**7.94**	**5.15**	**8.59%**	**11.24%**	**7.59%**	**8.14%**	**10.17%**
Total Fund Target	**7.52%**	**6.57**	**3.94**	**3.29**	**9.23%**	**9.94%**	**4.96%**	**6.23%**	**6.76%**
TOTAL FUND MARKET VALUE ($mil)	**$26.5**	**$32.6**	**$33.3**	**$34.9**	**$37.3**	**$38.8**	**$39.3**	**$41.1**	**$43.5**

***inception date 7/15/00**

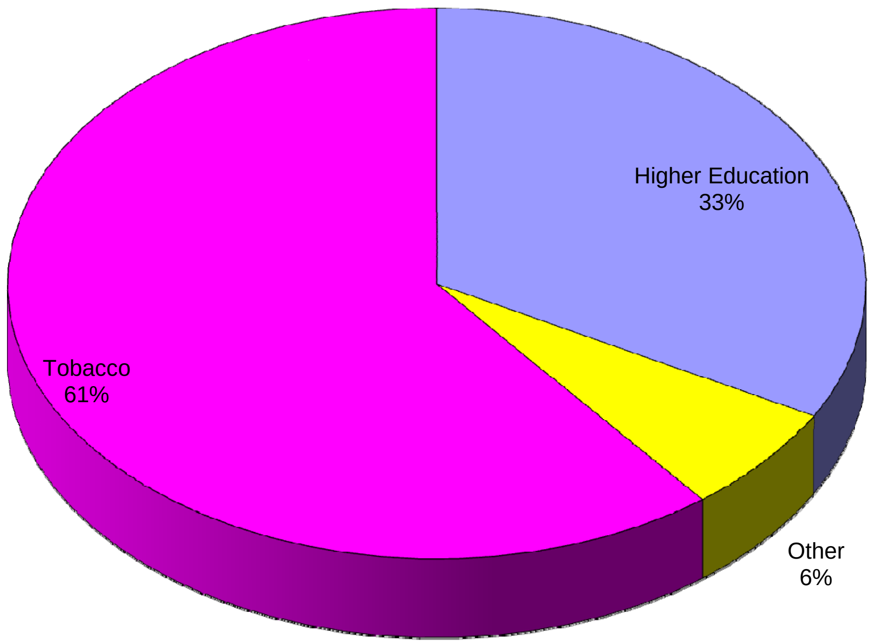
HIGHER EDUCATION TRUST FUND: *Fund Contributions—Fiscal Years*



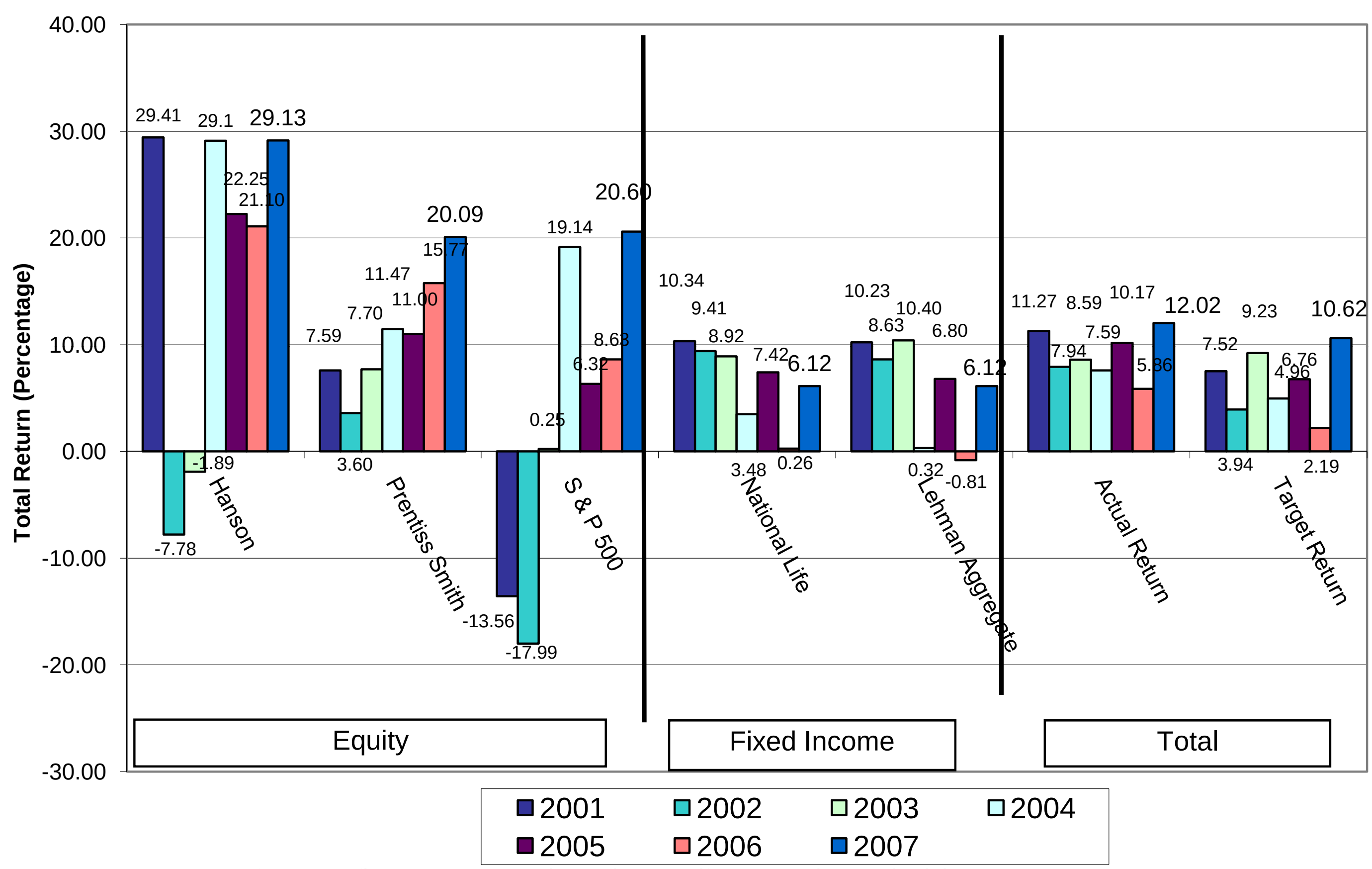
HIGHER EDUCATION TRUST FUND: *Authorized Distributions by Year and Type*



HIGHER EDUCATION TRUST FUND: *Common Trust Fund Breakdown as of June 30, 2007*

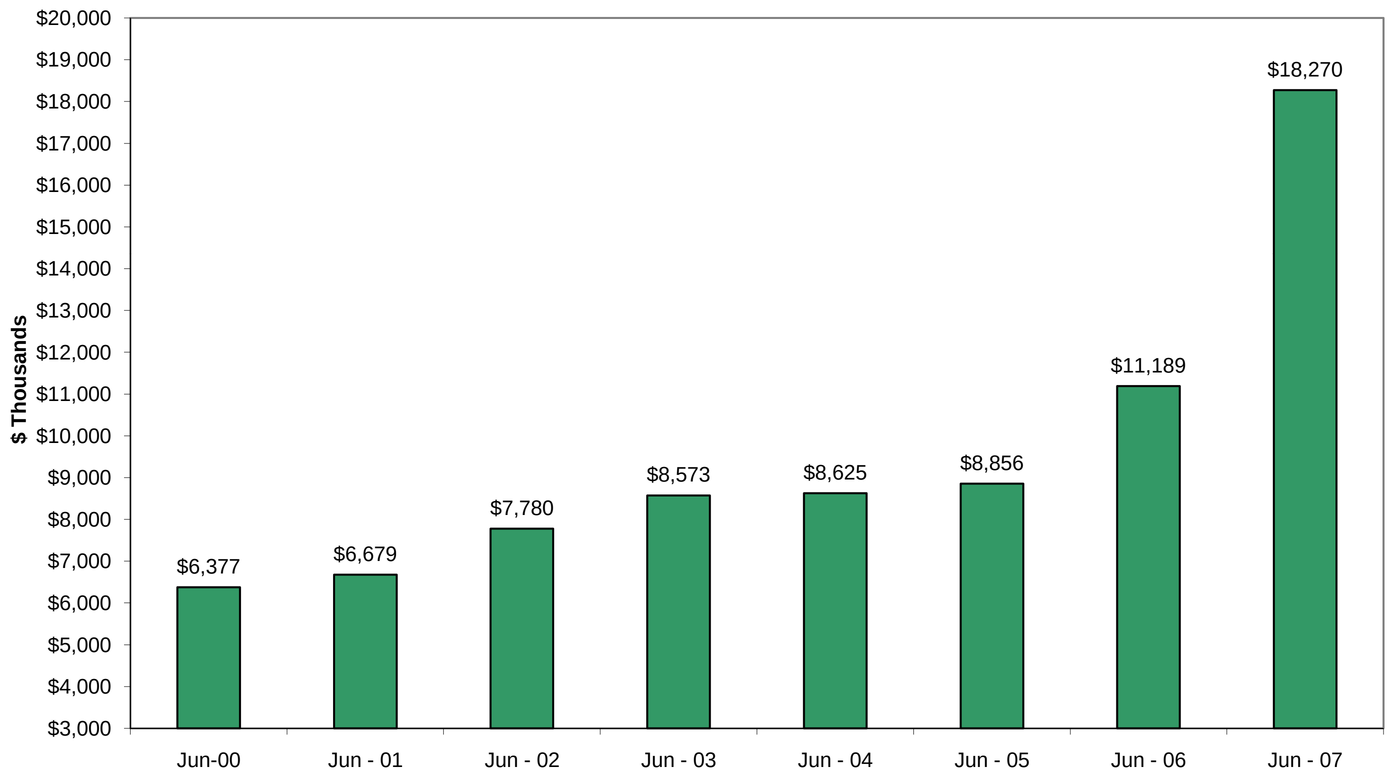


HIGHER EDUCATION TRUST FUND: *Total Return by Asset Class Fiscal Years 2001-2007*



Note: Some performance figures are restated to reflect a uniform reporting methodology.

HIGHER EDUCATION TRUST FUND: *Asset Growth—6/30/00 to 6/30/07, includes distributions*



FINANCIAL LITERACY: *Financial Literacy Facts*

Office of the State Treasurer

Financial Literacy Facts

Why is the Vermont Treasurer's Office engaged in financial literacy?

- Being financially literate means having the knowledge, skills and habits to successfully manage personal finances.
- As Vermont citizens increase their understanding and practice of sound money management skills, the financial well-being of both the individual and the State will improve.
- Financial systems and markets work best when consumers understand how financial service providers and products work.
- Vermont's financial literacy efforts are part of a nationwide trend among State Treasurers to implement financial literacy programs. There are now 36 Treasurer's Offices in the country offering financial literacy programs.

Financial Data Suggests a Problem

- Nation's overall **personal savings rate fell to negative one percent** in the first quarter of 2007. National savings rate consistently negative since the second quarter of 2005. *(Source: U.S. Department of Commerce, Bureau of Economic Analysis)*
- The negative 1 percent is **the lowest savings rate since 1933**, during the Great Depression. *(Source: U.S. Department of Commerce, Bureau of Economic Analysis)*
- **Household debt** as a percentage of income hovers **at record high levels**. The ratio of household debt to aggregate personal income has risen from 0.6 (60% of personal income) to 1.0 (100% of personal income). *(Source: Federal Reserve Board, working paper "The Rise in U.S. Household Indebtedness: Causes and Consequences, "Aug. 2007)*
- **Home foreclosures nationwide are up.** First quarter of 2007, an estimated 325,000 foreclosure proceedings were initiated, up from an average quarterly rate of 230,000 over the preceding two years. *(Source: First American Loan Performance, rates from the Mortgage Bankers Association)*
- **Bankruptcy rates** have more than **quadrupled** in the past 20 years. *(Source: Government Accountability Office report, "The Federal Government's Role in Improving Financial Literacy)*

Surveys Show a Lack of Financial Knowledge

- A comprehensive written survey of 5,775 high school students in 37 states measured 12th graders' knowledge of basic personal finances. The average score for the 2005-2006 survey was 52.4%--a failing grade. *(Source: Jump$tart Coalition of Personal Financial Literacy)*

- The majority of college students in a 2007 survey said they learn the most about personal finance from their parents, but less than half of the students said their parents make a consistent effort to teach them. *(Source: Feb. 2007, "New Survey by The Hartford Reveals Financial Literacy Communication Gap Among College Students and Parents")*

- A 2005 national survey found that while 65.1% of Americans consider themselves "very" or "highly" knowledgeable when it comes to personal finance, more than one-third (36.1%) report they do not use a budget to manage their family's expenses, a majority (52%) do not regularly review their credit report each year, and 23% have never reviewed their credit report. *(Source: "National Survey Shows Americans Need to Get Financially Fit; capital One and Consumer Action Find Majority of Americans Lack Basic Understanding of Credit Scores and the Fundamentals of Personal Finance" July 2005)*

- A 2003 national survey by AARP of consumers aged 45 and older found that they often lacked knowledge of basic financial and investment terms. Only about half of respondents reported knowing that diversification of investments reduces risk. *(Source: survey reported in Government Accountability Office report, "The Federal Government's Role in Improving Financial Literacy)*

Financial Education Positively Increases Knowledge and Changes Behavior

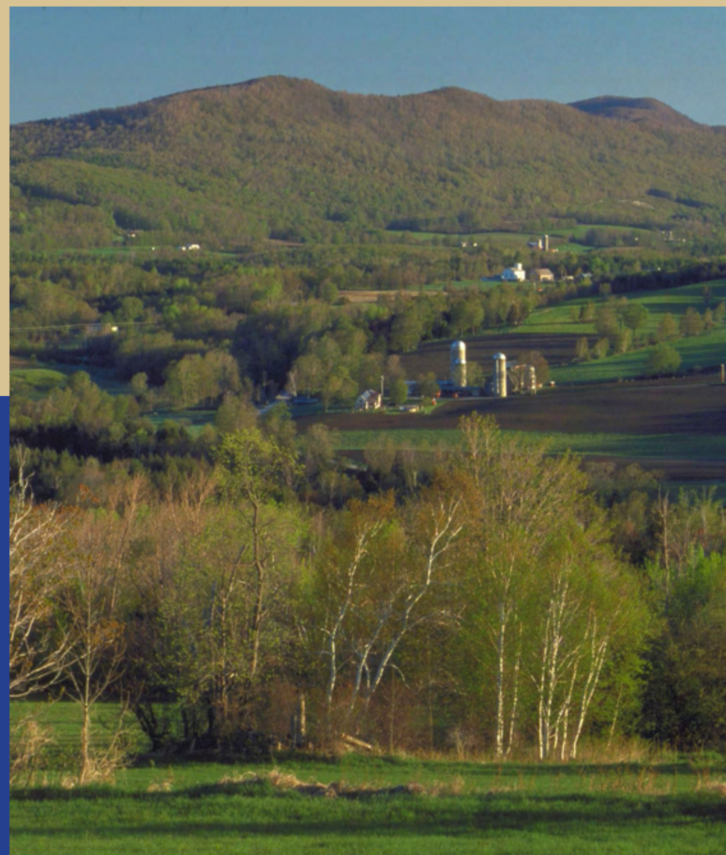
- Public school financial education mandates have been shown to be successful in increasing adult savings and net worth, while other targeted programs, such as the U.S. Cooperative Extension System's Money 2000, have seen participants decrease credit balances and increase savings accounts. *(Source: FDIC paper, Sept. 2004, "Delivery Systems for Financial Education in Theory and Practice")*

- Employees who attended training workshops about retirement savings options offered by their employers often increased participation in their companies' 401(k) plans. *(Source: "Impacts of Workplace Financial Education on Retirement Plans" Proceedings of the 2001 Annual conference of the Association for Financial Counseling and Planning Education)*

- Financial education can help prevent credit quality problems. A Federal Home Loan Mortgage Corporation (Freddie Mac) study found that individuals who had gone through homeownership counseling prior to purchasing a home had delinquency rates up to 34 percent lower than those who did not have such training. *(Source: Freddie Mac, May 2001 working paper, "A Little Knowledge is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling")*

- Financial Education helps correct past problems. Individuals who have undergone credit counseling after suffering financial difficulties experienced fewer delinquencies and have better credit risk scores over the three years following their counseling sessions than similar borrowers who did not seek counseling. *(Source: presentation at March 2003 Federal Reserve System Conference, "The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior")*

(2)



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 honestly, efficiently and responsibly, and to maintaining Vermont's hard-earned reputation as a fiscally sound and disciplined state.

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