INTEREST CREDITING AND RESERVE POLICY

I. PURPOSE AND INTENT

The purpose of this policy is to document the methodology used by the Sonoma County Employees' Retirement Association (SCERA) to credit interest to certain SCERA reserves in accordance with the County Employees Retirement Law of 1937 (CERL), track deficiencies in interest earnings, replenish shortfalls tracked in the Negative Contingency Reserve, maintain appropriate balances in the Interest Fluctuation Reserve, and define and administer Unapportioned Earnings of the Plan.

Reserves allow SCERA to track funds in the Plan. Reserves do not represent the present value of assets needed to satisfy retirement and other benefits as they become due. All assets are commingled for investment purposes regardless of source.

This policy is intended to comply with CERL (Gov. Code §§ 31472, 31591, 31592, 31592.2 and 31599) and other state and federal law.

II. DEFINITIONS

Reserves are created by statute or for actuarial or accounting purposes. Reserves can be either Valuation or Non-Valuation Reserves.

A. GENERAL DEFINITIONS

Actuarially Assumed Investment Rate of Return: The expected investment earnings rate of return used in the annual actuarial valuation of the plan, recommended to the SCERA Board by the Plan actuary in an experience study and set by the SCERA Board.

Actuarial Value of Assets: The Market Value of Assets less deferred investment gains or losses due to the Plan's five year smoothing policy.

Available Earnings: The net increase or decrease in Plan assets after accounting for Cash Flows, administrative expenses, and net investment income in the accounting period.

Board: The SCERA Board of Retirement.

Cash Flows: Employee and employer contributions paid into the Plan and benefit payments paid out of the Plan.

Earnings Allocations: Allocation of investment earnings at the interest crediting rate adopted by the Board.

Market Value of Assets: An asset value where the full value of investment earnings is recognized in a calendar year.

Member Reserve Interest Crediting Rate: The interest crediting rate for the Member Reserve which is equal to the current yield on the 10 Year Treasury Note as published by the U. S. Department of The Treasury Office on the last publishing date in June of the year in which the crediting takes place (for the June 30 crediting) or the last publishing date in December of the year in which interest crediting takes place (for the December 31 crediting). (Gov. Code § 31472 and Board action). In no event shall the interest crediting rate be less than zero or greater than the Plan's Actuarially Assumed Investment Rate of Return.

Non-Valuation Reserves: Reserves used by the Plan's actuary to develop the Actuarial Value of Assets. These reserves are excluded from the Valuation Value of Assets. These reserves include the Interest Fluctuation Reserve and the Market Stabilization Reserve.

Plan: The Sonoma County Employees' Retirement Association defined benefit plan.

Unapportioned Earnings: The earnings remaining after Available Earnings exceed the amount credited to the Valuation Reserves, the balance of the Negative Contingency Reserve reaches zero, and the Interest Fluctuation Reserve reaches 3% of the Plan's Market Value of Assets.

Valuation Reserves: Reserves used by the Plan's actuary to develop the Valuation Value of Assets. These include the Member Reserve, Employer Reserve, Annuitant Reserve, Cost of Living Reserve – Current, Cost of Living Reserve – Future, and the Negative Contingency Reserve.

Valuation Value of Assets: The Actuarial Value of Assets excluding any Non-Valuation reserves.

B. RESERVE DEFINITIONS:

1. Valuation Reserves:

Member Reserve: The Member Reserve is funded by active member payroll contributions, service purchases and Earnings Allocations. Active member contributions are used to fund the annuity portion of the retirement benefit and may also be paid to a member upon termination from SCERA covered employment and withdrawal. When a member retires and begins receiving a retirement allowance, funds in this reserve associated with the retiring member are moved to the Annuitant Reserve. (Gov. Code § 31599 (a))

Employer Reserve: The Employer Reserve is funded by employer contributions for active members and Earnings Allocations. Employer contributions are used to fund the pension portion of the retirement benefit. When a member retires and begins receiving a retirement allowance, funds in this reserve associated with the retiring member are moved to the Annuitant Reserve. (Gov. Code § 31599 (c))

Annuitant Reserve: The Annuitant Reserve is used to pay retirement and disability benefits to members and beneficiaries. The Annuitant Reserve is funded by transfers from the Member Reserve and Employer Reserve and Earnings Allocations less amounts paid out as annuitant benefits. (Gov. Code § 31599 (b))

Cost of Living Reserve – Current: The Cost of Living Reserve (Current) is the amount set aside in the Plan to pay COLA increases that have already been granted to retirees by the Board of Supervisors. It is funded from past Unapportioned Earnings and the Employer Reserve in amounts determined by the Plan's actuary and Earnings Allocations.

Cost of Living Reserve – Future: The Cost of Living Reserve (Future) is the amount set aside from Unapportioned Earnings, if any, for future COLA increases as determined by the Plan's actuary, recommended by the Board of Retirement, and granted by the Board of Supervisors. Pursuant to the SCERA COLA Policy, a COLA granted from this reserve should be fully funded on an actuarial basis prior to being granted. If funded, this reserve is credited with Earnings Allocations.

Negative Contingency Reserve: The Negative Contingency Reserve tracks Available Earnings shortfalls due to investment returns less than the Actuarially Assumed Investment Rate of Return as well as truing-up reserves upon the completion of the annual valuation. The balance reflects the amount of shortfall between the interest that has been credited to the Member Reserve, Employer Reserve, Annuitant Reserve, Cost of Living Reserve – Current and Cost of Living Reserve - Future and Available Earnings after accounting for changes to the Market Stabilization Reserve. The Negative Contingency Reserve is not credited with interest.

2. Non-Valuation Reserves:

Interest Fluctuation Reserve: The Interest Fluctuation Reserve is a statutory reserve in accordance with Government Code section 31592 that is used to offset future deficiencies in interest earnings, investment returns, or other contingencies. Only amounts in excess of 1% of the Plan's Market Value of Assets can be used for benefits. (Gov. Code § 31592.2) The Board has determined that Unapportioned Earnings up to 3% of the Plan's Market Value of Assets shall remain in this reserve.

Market Stabilization Reserve: The Market Stabilization Reserve represents the difference between the current fair market value of fund assets and the actuarially smoothed value of assets. SCERA smooths actuarial gains and losses over a five year period pursuant to SCERA Board of Retirement Policy. The Market Stabilization Reserve is not credited with interest.

Unreserved: Unapportioned Earnings above 3% of the Plan's Market Value of Assets are held as unreserved.

III. INTEREST CREDITING PROCEDURE

A. First, determine Available Earnings for the accounting period.

B. Credit interest semiannually on June 30 and December 31 to all funds that have been in the Valuation Reserves for the entire six months prior to June 30 and December 31 at the interest crediting rates and dollar amounts set forth below:

1. Member Reserve: The annual interest crediting rate is equal to the Member Interest Crediting Rate. Semiannual interest is credited as of June 30 to all funds that were on deposit as of December 31 of the prior year at half of the Member Interest Crediting Rate, and on December 31 to all funds that were on deposit as of June 30 of the current year at one-half of the Member Interest Crediting Rate.

2. Employer Reserve: The annual interest crediting rate on the Employer Reserve is the full Actuarially Assumed Investment Rate of Return. The Employer Reserve is also credited with the dollar difference between the Actuarially Assumed Investment Rate of Return on the Member Reserve and the Member Reserve Interest Crediting Rate. Semiannual interest is credited on June 30 to all funds that were on deposit as of December 31 of the prior year and on December 31 to all funds that were on deposit as of June 30 of the current year at one-half of the Actuarially Assumed Rate of Return. The Employer Reserve is also credited, on June 30 and December 31, with the dollar difference between one-half of the Actuarially Assumed Investment Rate of Return on the Member Reserve and one-half of the Member Reserve Interest Crediting Rate.

3. Remaining Valuation Reserves: The annual interest crediting rate is the full Actuarially Assumed Investment Rate of Return. Semiannual interest is

credited on June 30 and December 31 to all funds that have been on deposit for the entire six months prior to June 30 and December 31 at one-half of the Actuarially Assumed Investment Rate of Return.

C. If there are insufficient Available Earnings to fully credit the Valuation Reserves, the shortfall, after accounting for changes to the Market Stabilization Reserve and reversing Cash Flows, will be tracked in the Negative Contingency Reserve.

D. When the Negative Contingency Reserve balance reaches zero, remaining Available Earnings shall be credited to the Interest Fluctuation Reserve.

E. When Available Earnings exceed the amount credited to the Valuation Reserves, the balance of the Available Earnings after interest crediting, accounting for changes in the Market Stabilization Reserve and reversing Cash Flows shall be applied to the Negative Contingency Reserve until that balance reaches zero. Once the balance reaches zero, excess Available Earnings shall be credited to the Interest Fluctuation Reserve.

F. When the Interest Fluctuation Reserve balance reaches 3% of the Plan's Market Value of Assets, the Board has discretion to place Unapportioned Earnings into the Cost of Living Reserve – Future, provide other discretionary benefits, or maintain them as unreserved.

IV. NOTICE REQUIREMENTS

The Plan will provide reasonable advanced notice of any proposed use of Unapportioned Earnings to a recognized retiree organization prior to such use. The organization shall have a reasonable opportunity to comment prior to any formal action by the Plan on the proposed use. (Gov. Code § 31592.5)

V. EFFECTIVE DATE

This policy is effective beginning on January 1st of the year subsequent to the date of adoption.

VI. HISTORY

The Board adopted this policy on _______________.