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, 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 as of December 31 of the current interest crediting year, 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.

Actuarial Value Investment Rate of Return: The investment earnings rate of return calculated on the Actuarial Value of Assets measured as of December 31 of the current interest crediting year.

Available Earnings: Net investment income as determined based on the Actuarial Value of Assets and funds previously set aside in the Interest Fluctuation Reserve.

Board: The SCERA Board of Retirement.

Cash Flows: Member 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 rates 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.

Net Investment Income: The net increase or decrease in Plan assets after accounting for Cash Flows and administrative expenses.

Non-Member Reserve Interest Crediting Rate: The interest crediting rate for the Employer Reserve, Annuitant Reserve, and Cost of Living Reserve which is the lesser of the Actuarial Value Investment Rate of Return as of December 31 of the year in which interest is being credited and the full Actuarially Assumed Investment Rate of Return. The Non-Member Reserve Interest Crediting Rate has a ceiling of the plan's Actuarially Assumed Investment Rate of Return and a floor of zero.

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. Only earnings exceeding 1% of the Plan's Market Value of Assets as of December 31 may be used to fund benefits.

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 and Cost of Living 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: The Cost of Living Reserve 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.

Negative Contingency Reserve: The Negative Contingency Reserve is a historical reserve that tracked 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 reflected the amount of shortfall between the interest that had been credited to the Member Reserve, Employer Reserve, Annuitant Reserve, and Cost of Living Reserves and Available Earnings after accounting for changes to the Market Stabilization Reserve. The Negative Contingency Reserve was not credited with interest. Effective March 21, 2024, the Negative Contingency Reserve was rendered obsolete due to the policy change to limit interest crediting on all valuation reserves except for the Member Reserve to the Actuarial Value Investment Rate of Return (capped at the Actuarially Assumed Investment Rate of Return) as of December 31 of the year in which interest is being credited. As a result of this policy change the Employer Reserve was adjusted to account for the Negative Contingency Reserve balance as of January 1, 2024, and future interest crediting shortfalls, if any exist after utilizing available Interest Fluctuation Reserve balances, will be tracked in the Interest Fluctuation Reserve.

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 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 had determined that Unapportioned Earnings up to 3% of the Plan's Market Value of Assets shall remain in this reserve. Effective March 21, 2024, the 3% threshold was reduced to 1% and the reserve was modified to hold all Unapportioned Earnings remaining after interest crediting.

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 investment gains and losses over a five year period pursuant to the SCERA Board of Retirement Actuarial Funding Policy. The Market Stabilization Reserve is not credited with interest.

III. INTEREST CREDITING PROCEDURE

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

B. Credit interest at the interest crediting rates and dollar amounts set forth below:

1. Member Reserve: The annual interest crediting rate is equal to the Member Reserve 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 Reserve 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 Reserve Interest Crediting Rate.

2. Employer Reserve: The Employer Reserve will be credited at the Non-Member Reserve Interest Crediting Rate annually. Crediting will be calculated as if it occurred semiannually 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. The annual interest crediting rate on the Employer Reserve is equal to the Non-Member Reserve Interest Crediting Rate. The Employer Reserve is also creditedwith the dollar difference between the Non Member Reserve Interest Crediting Rate and the Member Reserve Interest Crediting Rate. This crediting will also be calculated as if it occurred semiannually on June 30 to on 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.

3. Remaining Valuation Reserves: The annual interest crediting rate is the Non-Member Reserve Interest Crediting Rate .

C. When Available Earnings exceed the amount credited to the Valuation Reserves, the balance of the Available Earnings after interest crediting and accounting for changes in the Market Stabilization Reserve shall be credited to the Interest Fluctuation Reserve.

D. When the Interest Fluctuation Reserve balance reaches 1% of the Plan's Market Value of Assets, the Board has discretion to designate that all or a portion of the Unapportioned Earnings be used for payment of the cost of benefits described in the County Employees Retirement Law or maintained in the Interest Fluctuation Reserve.

IV. NOTICE REQUIREMENTS

With the exception of a COLA recommendation, which will be presented at a public Retirement Board meeting, 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. REVIEW

This policy will be reviewed at least every three (3) years to ensure it remains relevant and appropriate.

VI. HISTORY

The Board adopted this policy on October 25, 2018 and it became effective January 1, 2019.

Reviewed and revised on 6/16/2021, 4/20/2023 and 3/21/2024.