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MEMORANDUM

TO: South Dakota Investment Council

FROM: Matthew L. Clark, CFA, State Investment Officer
Tammy V. Otten, CPA, CFA, Assistant Investment Officer

DATE: May 19, 2022

RE: Investment Performance Incentive Plan change effective for Fiscal Year 2023 –
Zach Nipp

This memo provides an overview and the calculation details effective for the fiscal year 2023 (payable in fiscal year 2024) incentive plan for **Zach Nipp**.

All incentives sum to 200% of base pay as follows: The first 100% of base pay is one-third on the one-year regular and two-thirds on the four-year regular. The second 100% of base pay is one-third on the ten-year regular, one-half on the four-year stretch and one-sixth on the ten-year stretch. All returns are time weighted.

On May 1, 2022, Zach changed portfolio management responsibilities from managing an individual high yield fixed income portfolio to a small/midcap equity portfolio. Refer to Zach's FY 2022 revised incentive memo dated March 25, 2022, for information on adjustments for the FY 2022 components that carryover to future incentive calculations.

The incentive calculation for fiscal year 2023 for the one-year return component will be based 40% on the individual small/midcap portfolio, 20% on the small/midcap composite, 20% on the total public equity composite and 20% on the SDRS total fund net rate of return. The prior history for the high yield component will be maintained and used for four and 10-year annualized calculations.

DETAILS:

The **one-year regular** incentive consists of four parts:

- 1) Forty percent is based on the individual small/midcap equity portfolio relative to the small/midcap equity benchmark with the difference applied to the public equity 1-3 years regular breakpoint schedule.
- 2) Twenty percent is based on the small/midcap composite relative to the small/midcap equity benchmark with the difference applied to the public equity 1-3 years regular breakpoint schedule.
- 3) Twenty percent is based on the total public equity composite relative to the total public equity benchmark with the difference applied to the public equity 1-3 years regular breakpoint schedule.

- 4) Twenty percent is based on the net rate of return of the SDRS total fund relative to the capital markets benchmark (CMB) with the difference applied to the total fund 1-3 years regular breakpoint schedule.

The **four-year regular** incentive consists of four parts:

- 1) Forty percent is based on the four-year annualized return that combines the returns of the individual high yield portfolio for fiscal years 2020 and 2021, the blended high yield/small/midcap one-year return for fiscal year 2022 and the fiscal year 2023 individual small/midcap return relative to the four-year annualized return of the high yield individual portfolio benchmark for fiscal years 2020 and 2021, the blended high yield/small/midcap individual benchmark return for fiscal year 2022 and the fiscal year 2023 individual small/midcap benchmark with the difference applied to the high yield/small/midcap custom blend 4&10 years regular breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.
- 2) Twenty percent is based on the four-year annualized return that combines the high yield composite return for fiscal year 2020-2022 and the fiscal year 2023 small/midcap composite return relative to the four-year annualized return that combines the high yield composite benchmark return for fiscal year 2020-2022 and the fiscal year 2023 small/midcap composite benchmark return with the difference applied to the high yield/small/midcap blended 4&10 years regular breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return after as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.
- 3) Twenty percent is based on two parts. **Part one:** Six and two-thirds percent is based on the four-year annualized return that combines the high yield composite return for fiscal year 2020-2022, and the fiscal year 2023 total public equity return relative to the four-year annualized return of the high yield composite benchmark for fiscal 2020-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended high yield/total public equity 4 & 10-years regular breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend. **Part two:** Thirteen and one-third percent is based on the four-year annualized return that combines the total fund return for fiscal year 2020-2022, and the fiscal year 2023 total public equity return relative to the four-year annualized return of the total fund benchmark for fiscal 2020-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended total fund/public equity 4 & 10-years regular breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.
- 4) Twenty percent is based on the four-year annualized net return of the SDRS total fund relative to the four-year annualized total fund benchmark return with the difference applied to the total fund 4&10 years regular breakpoint schedule.

The **ten-year regular** incentive consists of four parts:

- 1) Forty percent is based on the annualized return that combines the returns of the individual high yield portfolio for fiscal years 2018-2021, the blended high yield/small/midcap one-year return for fiscal year 2022 and the fiscal year 2023 individual small/midcap return relative to the annualized return of the high yield individual portfolio benchmark for

fiscal years 2018-2021, the blended high yield/small/midcap individual benchmark return for fiscal year 2022 and the fiscal year 2023 individual small/midcap benchmark with the difference applied to the high yield/small/midcap custom blend 4&10 years regular breakpoint schedule. For FY 23 the six-year annualized return will be used which is how long Zach has received an incentive on the individual portfolio. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.

- 2) Twenty percent is based on the annualized return that combines the high yield composite return for fiscal year 2017-2022 and the fiscal year 2023 small/midcap composite return relative to the annualized return that combines the high yield composite benchmark return for fiscal year 2017-2022 and the fiscal year 2023 small/midcap composite benchmark return with the difference applied to the high yield/small/midcap blended 4&10 years regular breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on the composite. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.
- 3) Twenty percent is based on two parts. **Part one:** Six and two-thirds percent is based on the annualized return that combines the high yield composite return for fiscal year 2017-2022, and the fiscal year 2023 total public equity return relative to the four-year annualized return of the high yield composite benchmark for fiscal 2017-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended high yield/total public equity 4 & 10-years regular breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on this component. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend. **Part two:** Thirteen and one-third percent is based on the annualized return that combines the total fund return for fiscal year 2017-2022, and the fiscal year 2023 total public equity return relative to the annualized return of the total fund benchmark for fiscal 2017-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended total fund/public equity 4 & 10-years regular breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on the composite. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.
- 4) Twenty percent is based on the annualized net return of the SDRS total fund relative to the annualized total fund benchmark return with the difference applied to the total fund 4&10 years regular breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on total fund. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.

The **four-year stretch** incentive consists of four parts:

- 1) Forty percent is based on the four-year annualized return that combines the returns of the individual high yield portfolio for fiscal years 2020 and 2021, the blended high

yield/small/midcap one-year return for fiscal year 2022 and the fiscal year 2023 individual small/midcap return relative to the four-year annualized return of the high yield individual portfolio benchmark for fiscal years 2020 and 2021, the blended high yield/small/midcap individual benchmark return for fiscal year 2022 and the fiscal year 2023 individual small/midcap benchmark with the difference applied to the high yield/small/midcap custom blend 4&10 years stretch breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.

- 2) Twenty percent is based on the four-year annualized return that combines the high yield composite return for fiscal year 2020-2022 and the fiscal year 2023 small/midcap composite return relative to the four-year annualized return that combines the high yield composite benchmark return for fiscal year 2020-2022 and the fiscal year 2023 small/midcap composite benchmark return with the difference applied to the high yield/small/midcap blended 4&10 years stretch breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added with the breakpoint schedule adjusted to that fiscal year's relevant blend.
- 3) Twenty percent is based on two parts. **Part one:** Six and two-thirds percent is based on the four-year annualized return that combines the high yield composite return for fiscal year 2020-2022, and the fiscal year 2023 total public equity return relative to the four-year annualized return of the high yield composite benchmark for fiscal 2020-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended high yield/total public equity 4 & 10-years stretch breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.
Part two: Thirteen and one-third percent is based on the four-year annualized return that combines the total fund return for fiscal year 2020-2022, and the fiscal year 2023 total public equity return relative to the four-year annualized return of the total fund benchmark for fiscal 2020-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended total fund/public equity 4 & 10-years stretch breakpoint schedule. In future fiscal years, the oldest year will drop off the annualized return as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.
- 4) Twenty percent is based on the four-year annualized net return of the SDRS total fund relative to the four-year annualized total fund benchmark return with the difference applied to the total fund 4&10 years stretch breakpoint schedule.

The **ten-year stretch** incentive consists of four parts:

- 1) Forty percent is based on the annualized return that combines the returns of the individual high yield portfolio for fiscal years 2018-2021, the blended high yield/small/midcap one-year return for fiscal year 2022 and the fiscal year 2023 individual small/midcap return relative to the annualized return of the high yield individual portfolio benchmark for fiscal years 2018-2021, the blended high yield/small/midcap individual benchmark return for fiscal year 2022 and the fiscal year 2023 individual small/midcap benchmark with the difference applied to the high yield/small/midcap custom blend 4&10 years stretch breakpoint schedule. For FY 23 the six-year annualized return will be used which is how long Zach has received an incentive on the individual portfolio. In future fiscal years, the

- oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added with the stretch breakpoint schedule adjusted to that fiscal year's relevant blend.
- 2) Twenty percent is based on the annualized return that combines the high yield composite return for fiscal year 2017-2022 and the fiscal year 2023 small/midcap composite return relative to the annualized return that combines the high yield composite benchmark return for fiscal year 2017-2022 and the fiscal year 2023 small/midcap composite benchmark return with the difference applied to the high yield/small/midcap blended 4&10 years stretch breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on the composite. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added with the stretch breakpoint schedule adjusted to that fiscal year's relevant blend.
 - 3) Twenty percent is based on two parts. **Part one:** Six and two-thirds percent is based on the annualized return that combines the high yield composite return for fiscal year 2017-2022, and the fiscal year 2023 total public equity return relative to the annualized return of the high yield composite benchmark for fiscal 2017-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended high yield/total public equity 4 & 10-years stretch breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on this component. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend. **Part two:** Thirteen and one-third percent is based on the annualized return that combines the total fund return for fiscal year 2017-2022, and the fiscal year 2023 total public equity return relative to the annualized return of the total fund benchmark for fiscal 2017-2022, and the fiscal year 2023 public equity benchmark return with the difference applied to the blended total fund/public equity 4 & 10-years stretch breakpoint schedule. For FY 23 the seven-year annualized return will be used which is how long Zach has received an incentive on the composite. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.
 - 4) Twenty percent is based on the annualized net return of the SDRS total fund relative to the annualized total fund benchmark return with the difference applied to the total fund 4 & 10 years stretch breakpoint schedule. For FY 23 the seven-year annualized return will be use which is how long Zach has received an incentive on total fund. In future fiscal years, the oldest year will drop off the annualized return once 10 years is met as a new fiscal year is added and the breakpoint schedule will adjust to that fiscal year's relevant blend.

Formula

One-year regular: Salary x ((1-year individual small/midcap incentive x 40%) + (1-year small/midcap composite incentive x 20%) + (1-year total public equity composite x 20%) + (1-year CMB total fund incentive x 20%)) x 33.333333% of first 100%

Four-year regular: Salary x ((4-year individual high yield & small/midcap incentive x 40%) + (4-year high yield & small/midcap composite incentive x 20%) + (4-year high yield composite & total public equity composite x 6 2/3%) + (4-year total fund & total public equity composite x 13 1/3%) + (4-year CMB total fund incentive x 20%)) x 66.666667% of first 100%

Ten-year regular: Salary x ((10-year individual high yield & small/midcap incentive x 40%) + (10-year high yield & small/midcap composite incentive x 20%) + (10-year high yield composite & total public equity composite x 6 2/3%) + (10-year total fund & total public equity composite x 13 1/3%) (10-year CMB total fund incentive x 20%)) x 33 1/3% of second 100%

Four-year stretch: Salary x ((4-year individual high yield & small/midcap stretch incentive x 40%) + (4-year high yield & small/midcap composite incentive x 20%) + (4-year high yield composite & total public equity composite x 6 2/3%) + (4-year total fund & total public equity composite x 13 1/3%) + (4-year CMB total fund incentive x 20%)) x 50% of second 100%

Ten-year stretch: Salary x ((10-year individual high yield & small/midcap stretch incentive x 40%) + (10-year high yield & small/midcap composite incentive x 20%) + (10-year high yield composite & total public equity composite x 6 2/3%) + (10-year total fund & total public equity composite x 13 1/3%) (10-year CMB total fund incentive x 20%)) x 16 2/3% of second 100%

***Sum of all parts for total earned incentive
Custom Blend Breakpoint Schedule attached***

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