



SOUTH DAKOTA INVESTMENT COUNCIL

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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 20, 2020

RE: Investment Performance Incentive Plan changes effective Fiscal Year 2021

This memo provides an overview and calculation details effective for the Fiscal Year 2021 (payable in FY 2022) incentive plan program for **Katie Eliason**, who will be beginning high yield portfolio management responsibilities in FY 2021.

The incentive parts sum to 200% of base pay phased in per the plan implementation schedule. Incentives are earned on 1 year, 4-year annualized, and 10-year annualized returns. SDRS time-weighted rates of returns are used in the incentive calculations.

The incentive calculation will be based 40% on the individual high yield portfolio, 26 2/3% on the high yield composite, and 33 1/3% on the SDRS total fund net return. FY 21 will be the first year of managing an individual high yield portfolio so the one-year number will be used for the one, four and ten-year individual portfolio piece. FY 21 will be the second year for the high yield composite piece since she worked in the high yield group during FY 20 so the two-year number will be used in the four and ten-year composite piece. Each year thereafter an additional year will be added until there are four and ten years respectively. For FY 21 the SDRS total fund will be based on the two-year number for the four and ten-year piece. For each year after FY 21, an additional year will be added until there are four and ten years respectively.

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

- 1) Forty percent is based on the one-year return of the individual high yield fixed income portfolio relative to the one-year return of the individual high yield fixed income benchmark with the difference applied to the high yield fixed income (HY) 1-3 years regular breakpoint schedule.
- 2) Twenty-six and two-thirds percent is based on the one-year return of the high yield fixed income composite relative to the one-year return of the total high yield fixed income benchmark with the difference applied to the HY 1-3 years regular breakpoint schedule.

- 3) Thirty-three and one-third percent is based on the one-year net return of the SDRS total fund relative to the one-year return of the capital markets benchmark (CMB) with the difference applied to the CMB 1-3 years regular breakpoint schedule.

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

- 1) Forty percent is based on the four-year annualized return of the individual high yield fixed income portfolio relative to the four-year annualized return of the individual high yield fixed income benchmark with the difference applied to the HY 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the one-year number will be used. For each year after FY 21, an additional year will be added until there are four years.
- 2) Twenty-six and two-thirds percent is based on the four-year annualized return of the high yield fixed income composite relative to the four-year annualized return of the total high yield fixed income benchmark with the difference applied to the HY 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are four years.
- 3) Thirty-three and one-third percent is based on the four-year annualized net return of the SDRS total fund relative to the four-year annualized CMB return with the difference applied to the CMB 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are four years.

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

- 1) Forty percent is based on the ten-year annualized return of the individual high yield fixed income portfolio relative to the ten-year annualized return of the individual high yield fixed income benchmark with the difference applied to the HY 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the one-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.
- 2) Twenty-six and two-thirds percent is based on the ten-year annualized return of the high yield fixed income composite relative to the ten-year annualized return of the total high yield fixed income benchmark with the difference applied to the HY 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.
- 3) Thirty-three and one-third percent is based on the ten-year annualized return of the SDRS total fund relative to the ten-year annualized CMB return with the difference applied to the CMB 1-3 years regular breakpoint schedule and then the 4&10 years regular breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.

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

- 1) Forty percent is based on the four-year annualized return of the individual high yield fixed income portfolio relative to the four-year annualized return of the individual high yield fixed income benchmark with the difference applied to the HY 1-3 years stretch

- breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the one-year number will be used. For each year after FY 21, an additional year will be added until there are four years.
- 2) Twenty-six and two-thirds percent is based on the four-year annualized return of the high yield fixed income composite relative to the four-year annualized return of the total high yield fixed income benchmark with the difference applied to the HY 1-3 years stretch breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are four years.
 - 3) Thirty-three and one-third percent is based on the four-year annualized net return of the SDRS total fund relative to the four-year annualized CMB return with the difference applied to the CMB 1-3 years stretch breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are four years.

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

- 1) Forty percent is based on the ten-year annualized return of the individual high yield fixed income portfolio relative to the ten-year annualized return of the individual high yield fixed income benchmark with the difference applied to the HY 1-3 years stretch breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the one-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.
- 2) Twenty-six and two-thirds percent is based on the ten-year annualized return of the high yield fixed income composite relative to the ten-year annualized return of the total high yield fixed income benchmark with the difference applied to the HY 1-3 years stretch breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.
- 3) Thirty-three and one-third percent is based on the ten-year annualized return of the SDRS total fund relative to the ten-year annualized CMB return with the difference applied to the CMB 1-3 years stretch breakpoint schedule and then the 4&10 years stretch breakpoint schedule once four years has been reached. For FY 21 the two-year number will be used. For each year after FY 21, an additional year will be added until there are ten years.

Formula

One-year regular: Salary x ((1 yr individual high yield incentive x 40%) + (1 yr high yield composite incentive x 26 2/3%) + (1 yr CMB total fund incentive x 33 1/3%)) x 33 1/3% of first 100%

Four-year regular: Salary x ((4 yr individual high yield incentive x 40%) + (4 yr high yield composite incentive x 26 2/3%) + (4 yr CMB total fund incentive x 33 1/3%)) x 66 2/3% of first 100%

Ten-year regular: Salary x ((10 yr individual high yield incentive x 40%) + (10 yr high yield composite incentive x 26 2/3%) + (10 yr CMB total fund incentive x 33 1/3%)) x 33 1/3% of second 100%

Four-year stretch: Salary x ((4 yr individual high yield stretch incentive x 40%) + (4 yr high yield composite stretch incentive x 26 2/3%) + (4 yr CMB total fund stretch incentive x 33 1/3%)) x 50% of second 100%

Ten-year stretch: Salary x ((10 yr individual high yield stretch incentive x 40%) + (10 yr high yield composite stretch incentive x 26 2/3%) + (10 yr CMB total fund stretch incentive x 33 1/3%)) x 16 2/3% of second 100%

Plan Implementation Schedule:

Sum of all parts x 40% for total earned incentive for FY 21; x 50% for FY 22; x 70% for FY 23; x 90% for FY 24; x 100% for FY 25.

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