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## MEMORANDUM

TO: South Dakota Investment Council

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

DATE: March 25, 2022

RE: Investment Performance Incentive Plan change effective for Fiscal Year 2022 –  
**REVISED for Zach Nipp**

This memo provides an overview and the calculation details effective for the fiscal year 2022 (payable in fiscal year 2023) 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.

### **Reassignment of portfolio management duties for Zach Nipp during fiscal year 2022**

On May 1, 2022, Zach will change portfolio management responsibilities from managing an individual high yield fixed income portfolio to a small/midcap equity portfolio.

To reflect the reassignment, the incentive calculation for fiscal year 2022 for the one-year return component will be based 40% on the individual high yield portfolio from July 1, 2021, to April 30, 2022 (first period), combined with the individual small/midcap portfolio from May 1, 2022, to June 30, 2022 (second period), 26 2/3% on the high yield composite, 33 1/3% on the SDRS total fund net return. The prior history for each piece will be maintained and used for four and 10-years calculations.

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

- 1) Forty percent is based on the individual high yield portfolio for the first period combined with the individual small/midcap portfolio for the second period compared to the combined first period and second period benchmarks with the difference applied to the custom blend of the high yield and small/midcap 1-3 years regular breakpoint schedule.
- 2) Twenty-six and two-thirds percent is based on the one-year return of the high yield composite relative to the one-year return of the high yield 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 total fund 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 that combines the individual high yield portfolio for the 3 years and 10 months with the individual small/midcap portfolio for 2 months relative to the combined annualized return of the high yield benchmark and small/midcap benchmark with the difference applied to the custom blend 4&10 years regular breakpoint schedule.
- 2) Twenty-six and two-thirds percent is based on the four-year annualized return of the high yield composite relative to the four-year annualized return of the high yield benchmark with the difference applied to the high yield 4&10 years regular breakpoint schedule.
- 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 total fund 4&10 years regular breakpoint schedule.

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

- 1) Forty percent is based on the ten-year annualized return that combines the individual high yield portfolio for the 9 years and 10 months with the individual small/midcap portfolio for 2 months relative to the combined annualized return of the high yield benchmark and small/midcap benchmark with the difference applied to the custom blend 4&10 years regular breakpoint schedule. For FY 22 the five-year annualized return will be used which is how long Zach has received an incentive on the individual portfolio.
- 2) Twenty-six and two-thirds percent is based on the ten-year annualized return of the high yield composite relative to the ten-year annualized return of the total high yield benchmark with the difference applied to the high yield 4&10 years regular breakpoint schedule. For FY 22 the six-year annualized return will be used which is how long Zach has received an incentive on the composite.
- 3) Thirty-three and one-third percent is based on the ten-year annualized net return of the SDRS total fund relative to the ten-year annualized CMB return with the difference applied to the total fund 4&10 years regular breakpoint schedule. For FY 22 the six-year annualized return will be use which is how long Zach has received an incentive on total fund.

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

- 1) Forty percent is based on the four-year annualized return that combines the individual high yield portfolio for the 3 years and 10 months with the individual small/midcap portfolio for 2 months relative to the combined annualized return of the high yield benchmark and small/midcap benchmark with the difference applied to the custom blend 4&10-years stretch breakpoint schedule.
- 2) Twenty-six and two-thirds percent is based on the four-year annualized return of the high yield composite relative to the four-year annualized return of the total high yield benchmark with the difference applied to the 4&10 years stretch breakpoint schedule.
- 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 total fund the 4&10 years stretch breakpoint schedule.

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

- 1) Forty percent is based on the ten-year annualized return that combines the individual high yield portfolio for the 9 years and 10 months with the individual small/midcap portfolio for 2 months relative to the combined annualized return of the high yield benchmark and small/midcap benchmark with the difference applied to the custom blend 4&10 years stretch breakpoint schedule. For FY 22 the five-year annualized return will be used which is how long Zach has received an incentive on the individual portfolio.
- 2) Twenty-six and two-thirds percent is based on the ten-year annualized return of the high yield composite relative to the ten-year annualized return of the total high yield benchmark with the difference applied to the high yield 4&10 years stretch breakpoint schedule. For FY 22 the six-year annualized return will be used which is how long Zach has received an incentive on the composite.
- 3) Thirty-three and one-third percent is based on the ten-year annualized net return of the SDRS total fund relative to the ten-year annualized CMB return with the difference applied to the total fund 4&10 years stretch breakpoint schedule. For FY 22 the six-year annualized return will be use which is how long Zach has received an incentive on total fund.

Formula

**One-year regular:** Salary x ((1-year individual high yield & small/midcap incentive x 40%) + (1-year high yield composite incentive x 26 2/3%) + (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 composite incentive x 26 2/3%) + (4-year CMB total fund incentive x 33 1/3%)) 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 composite incentive x 26 2/3%) + (10-year CMB total fund incentive x 33 1/3%)) 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 composite stretch incentive x 26 2/3%) + (4-year CMB total fund stretch incentive x 33 1/3%)) 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 composite stretch incentive x 26 2/3%) + (10-year CMB total fund stretch incentive x 33 1/3%)) x 16 2/3% of second 100%

**Sum of all parts for total earned incentive**

**Custom Blend Breakpoint Schedule attached**

Fiscal year 2023 incentive programs for Zach will be determined, with calculation and plan implementation details finalized and approved, prior to the beginning of fiscal year 2023.

# Breakpoint Schedule for Zack

Individual HY/SMID portfolio 40% (May 1, 2022 for FY 22)

HY composite mapped to SMID composite 20% (FY 23)

HY composite mapped to Total Public Equity for 6 2/3% (FY 23)

Total Fund mapped to Total Public Equity for 13 1/3% (FY 23)

Total Fund 20%

## HY breakpoints

	1-3	4 & 10	4 & 10
% of Pay	Years	Years	Stretch
30%	0	0	
40%	13	8	
50%	36	17	
60%	47	25	
75%	63	30	
90%	74	44	
100%	100	60	
			stretch
20%			65
40%			70
60%			80
80%			90
100%			100

## Public Equity (Global & SMID) breakpoints

	1-3	4 & 10	4 & 10
% of Pay	Years	Years	Stretch
30%	0	0	
40%	23	14	
50%	65	30	
60%	85	45	
75%	115	55	
90%	135	80	
100%	180	120	
			stretch
20%			130
40%			140
60%			160
80%			180
100%			200

## Total Fund breakpoints (20% of incentive)

	1-3	4 & 10	4 & 10
% of Pay	Years	Years	Stretch
30%	0	0	
40%	13	8	
50%	39	18	
60%	61	32	
75%	77	37	
90%	98	58	
100%	120	80	
			stretch
20%			90
40%			100
60%			110
80%			120
100%			140

## **FY 2022 breakpoints for 40% change from Individual portfolio HY to SMID May 1**

1-3 year: 10/12 HY/ 2/12 SMID 0.833333 0.166667

4 year: 3 10/12 HY/ 2/12 SMID 0.958333 0.041667

10 year: 9 10/12 HY/ 2/12 SMID 0.983333 0.016667

	1-3	4	10	4	10
% of Pay	Years	Years	Years	Stretch	Stretch
30%	0	0	0		
40%	15	8	8		
50%	41	18	17		
60%	53	26	25		
75%	72	31	30		
90%	84	46	45		
100%	113	63	61		
20%				68	66
40%				73	71
60%				83	81
80%				94	92
100%				104	102