Re-energising DC

To encourage recruitment and retention for its DC scheme, oil company Total UK implemented an age-related contribution system that aims to provide members with a pension pot similar to what they would have received in DB. Laura Blows finds out more

The concept of 'defined ambition'- the blending of defined benefit-style returns with the less-onerous regulatory burden for sponsors that defined contribution provides – has been seen as a pet project for Pensions Minister Steve Webb.

But while there are debates about how this ambition could be achieved ('DB-lite' or 'collective DC' being two suggestions) with sufficient ease, one company quietly and successfully solved this dilemma back in 2007.

Total, the world's fourth largest oil company, employs 97,000 people in over 130 countries. The complicated nature of the company's various business units means that in the UK alone, Total has 12 distinct DB sections with assets of £2.7 billion, and 12 different DC sections with a combined fund value of £75 million, from 12 business units taking part in the Total UK Pension Plan.

One such business was Upstream, Total's Aberdeen-based company for the drilling and exploration of the North Sea. In 2007 the decision was made to close its DB section to new hires and replace it with a new defined contribution-based pension offering.

Surprisingly, the main driver for this, Total's UK group pensions manager Lester Farrant explains, was not to reduce costs for the company.

"The company wanted to move from DB to DC for new hires not to control costs, but to control risks such as investment risk and longevity risk," he says. "We were just trying to manage the wild fluctuation on the balance sheet."

However, Upstream was aware of the highly competitive labour market in which it operates and that closing the DB scheme may have a negative effect on recruitment and retention rates, particularly as at the time it was one of the first in its sector to move over to DC for new hires.

To counter this, and as Upstream's aim was not to reduce costs, the new DB scheme was created to still potentially offer members a pension that roughly equivalent to that which the defined benefit section might have provided.

Scheme structure

To achieve this, the Upstream DC pension section features an age-related employer contribution structure. Under this system, a member aged under 24 would receive an employer contribution worth 10 per cent of their pensionable salary into their DC pension scheme. For members aged 25-29, this employer contribution would be 12.5 per cent. For those between 30-34 years, the employer contribution rises to 15 per cent. The employer contribution rises by 2.5 per cent every five years, culminating at 30 per cent for members aged 60 or over. The member's contribution remains at 6 per cent regardless of age.

"Even though we were not bound by it, our aim was to try and mirror the DB scheme structure, for instance by ensuring that the member pays one contribution rate for the rest of their working life," Farrant says. "We wanted to ensure that people would still get a decent pension pot, as they would have with DB, so we undertook a lot of modelling to ensure this would be the case."

The age element mirrors what happens in DB, he explains, and helps to retain people as it is never too long before they are offered an increasing rate. This age-related structure is also particularly suitable for Upstream, as long service is the norm for its employees. It was also necessary to make the contribution levels generous enough to effectively compete for industry staff.

"We did a lot of work with our actuaries to check that increasing contributions based upon age was legal," Farrant adds, "as we did not think it would legally work if we only had two age structures for instance."

Other structures were considered prior to the decision to implement an age-related contribution structure, such as a career average model, "but we thought if we were going to take risk off the table we were going to do it properly".

Investment strategies

The Upstream DC scheme provides members with the choice of six white-labelled passive funds, offered throughout Total UK's DC sections, of which L&G is the investment manager. The white-labelling is because "we wanted people to buy into the Total UK Pension Plan," Farrant explains, "and if we wanted to change any funds we would be able to do so without complication and red tape."

It also provides trustees with much greater control and flexibility in the event of poor performance, which in turn provides greater protection to the member.

The six choices consist of a global equity fund, a UK-only fund, a global excluding UK fund, a corporate bond fund, an index-linked gilt fund and a cash fund. Charges for each of the six funds range from 0.025 per cent to 0.125 per cent.

These six were viewed by the company as providing an effective mix, giving members access to the major asset classes whilst keeping the choice at a level that can be clearly described and does not form a barrier to entry by being too complex.

Despite this choice, unsurprisingly the vast majority of members – 90 per cent – are in the default lifestyle strategy. This moves people into the gilts and cash funds from five years before normal retirement age.

Even though the budget changes to DC allow members to do what they wish with their pension pot at retirement instead of purchasing an annuity, Farrant believes that the lifestyle strategy still has merit. "I expect there will still be a majority of members that would want an annuity, especially once they realise that they cannot simply take all their savings as cash, but would have to give up to 40 per cent to the tax man," he explains.

That said, Total UK has been reviewing the investment strategy of the scheme over the past 18 months, as the investment strategy was created back in 2002.

Farrant describes himself as "open-minded" about how the lifestyle investment strategy may evolve. One such idea, he suggests, may be to have three lifestyle strategies, with the standard accumulation strategy until approximately 10 years before normal retirement age, and then offer the member education and allow them to decide if they want to go down the investment route preparing for drawdown, or the investment strategy most suited for annuitisation. "But probably the biggest thing to do is to educate people about retirement choices sooner than we do currently," he adds.

Governance

Every month, the plan's governance committee receives a report that provides information such as how many people are in the scheme, who has left, how the contributions have been invested, the total returns in the pension pots and the level of annuities they may provide, all tracked using an in-house-developed governance database.

Total UK Pension Plan's Upstream defined contribution section

Formed in 2007, Upstream DC currently has 455 members - 370 male, 85 female - approximately half of Upstream's total employees. Ninety-six per cent of new hires have joined the scheme since its launch. Of these, 90 per cent have chosen the default lifestyle investment strategy.

Breakdown of Upstream DC's contribution structure:

Member's age	Member's contribution	Employer contribution
Under 24	6%	10%
25-29	6%	12.5%
30-34	6%	15%
35-39	6%	17.5%
40-44	6%	20%
45-49	6%	22.5%
50-54	6%	25%
55-59	6%	27.5%
60 and over	6%	30%

Breakdown of membership by age:	
20-25	5%
25-30	16%
30-35	14%
35-40	16%
40-45	15%
45-50	15%
50-55	12%
55-60	7%

Meanwhile, the trustees of the Total UK Pension Plan receive a 'DC Dashboard' at every quarterly meeting, which tracks the speed of investment and enables them to make appropriate changes.

A source of pride for Farrant is that DC issues are on the agenda for every trustee meeting, as "even though DC contains a much smaller amount of money compared to our DB sections, we still like to dedicate time and attention to DC".

Also, for the past two years the trustees have received an annual investment report purely for the DC sections.

Member communications

Just as the need for clear information is required for those running the scheme, Total UK recognises the importance of clear communications for its pension scheme members.

All new recruits receive a copy of the pension plan handbook and investment choices guide, and once they become a member, they gain access to their personal account online.

The pension scheme website allows a member to review their personal details, current fund values, contribution rate and investment choices. It also features a modeller that allows the member to see the effect of increasing/decreasing their contributions, along with the impact a different investment choice may have on their fund value.

According to Farrant, the company is currently working on automating member changes to investment choices and contribution levels through the website, "but while all the pension schemes sit under the one Total UK Pension Plan umbrella, we have 12 different business units with 12 different payrolls beneath it, making automation quite complex".

Annual benefit statements are issued each year, along with a letter from Farrant containing fund performance information and a general overview of the past year. A regular DC-focused newsletter is also issued at least annually. Total UK Pension Plan is currently in the process of 'revamping' these statements and newsletters, with the help of Ferrier Pearce.

Farrant and his team also regularly visit the various business sections of Total UK and speak to staff about pensions during 'lunch and learn' sessions, which discuss issues around ceasing work and lifestyle changes. Hargreaves Lansdown is used to provide an advisory service to members purchasing an annuity on the open market.

"We did struggle a bit with engagement," Farrant admits, "but we do now seem to be getting through to people a bit more." His team is currently running focus groups to receive feedback from members "instead of just assuming what we are doing is right".

Results

Total UK may be awaiting confirmation from members, but within the pensions industry it is clear that its Upstream business section is providing an exceptional DC arrangement, as proved by it being crowned the winner of the inaugural Pensions Age DC Pension Scheme of the Year 2014 award, and receiving a NAPF Pension Quality Mark three years ago.

The results are also apparent within Upstream, with 96 per cent of all new hires having made the active decision to join the scheme. Since its launch seven years ago, approximately half of Upstream's employees are now in the DC section, and there have been a number of retirees in this time that have managed to retire with a 'decent'-sized pension pot.

The company has also not noticed any detrimental impact upon the business's recruitment plans since launching the Upstream DC section, and has managed to realise its aim of being able to control its pension risks.

This, for Farrant, is the achievement he is most proud of. "I am very pleased that the company stuck by its ethos that the move to DC was not about reducing costs but reducing risks," he explains. "It is easy to say but not so easy to stick to, particularly in the current climate of cost constraints. I am pleased that we carried that philosophy through though."

Written by Laura Blows