



**BT Pension Scheme**  
Report to Members 2004

## Value of Fund

### The year's results: 2004

	£ million
<b>Value of Fund at start of year</b>	<b>26,295</b>
<b>Contributions &amp; Benefits:-</b>	
Employers' contributions	588
Members' contributions	99
Benefits	(1,355)
Net transfers in/out	(2)
Net Withdrawals	(670)
<b>Returns on Investments:-</b>	
Investment Income	1,164
Management expenses & interest paid	(214)
Increase in market values of investments during year	2,703
Minority interests	(101)
Net Return on Investments	3,552
<b>Resulting in a net increase in the Fund of</b>	<b>2,882</b>
<b>Value of Fund at end of year</b>	<b>29,177</b>

In 2004 almost £1.4 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £280 million.

### Financial Security

The BT Pension Scheme (BTPS) saw the market value of its investments increase significantly in 2004. Total income continues to exceed total expenditure, and with the increase in the value of the investments this has increased the fund value to £29.2 billion at 31 December 2004.

The last full actuarial valuation of BTPS was conducted as at 31 December 2002. This concluded that the funding level of BTPS (i.e. the ratio of assets to the Scheme Actuary's estimate of future liabilities) was 91.6%. The deficit was £2.1 billion.

From 1 April 2003 BT paid normal contributions of 12.2% of Salaries and agreed to increase its annual additional contributions to £232 million until the deficit is made good. The Company remains fully committed to reducing, and ultimately eliminating the deficit.

In March 2004, in a sign of the strength of its covenant, BT paid early the bulk (£380 million) of the 2004 and 2005 deficit payments.

BT has also continued to pay special contributions in respect of redundancies and early leavers from participating companies. In 2004 these payments amounted to £6 million.

From 1 June 2004 the Company's normal contribution rate increased from 12.2% to

18.2% of Salaries (less the members' mandatory contributions) as a result of the introduction of the salary sacrifice scheme Smart Pensions (see overleaf).

The Scheme Actuary is reviewing valuation scenarios between the three-yearly full valuations, so that the Trustees can continue to monitor the funding of the Scheme.

### New Pensions Legislation

In 2004 the Finance Act contained major reforms to simplify the tax treatment of registered pension schemes from April 2006. The Pensions Act 2004 was also another major milestone for pension schemes. It has introduced from 6 April 2005 a more powerful Pensions Regulator and a Pension Protection Fund. The Pension Protection Fund will start to provide some compensation to members of defined benefit pension schemes whose employers collapse leaving the scheme with insufficient money to meet the benefits members were expecting. Company defined benefit pension schemes, such as BTPS, will pay levies to the Pension Protection Fund.

### Investment Returns

2004 was a good year for equity markets and, once again, the total return on the Scheme's assets of +13.5% was above the weighted average return of +11.5% for the 50 largest UK pension schemes, as measured by The WM Company (WM).

The Trustees have set a demanding target for the total return over three years (from capital appreciation and investment income) on the assets of the Scheme. This requires that the Scheme return exceeds a return that would theoretically be available if the Scheme assets had been invested according to the Trustees'

long-term target distribution, and the returns in each asset class had been the average return for the 50 largest UK pension funds, as calculated by WM. This is the investment performance benchmark shown in the table below.

	Benchmark	Actual BTPS	Average for WM50
1 year	+12.7%	+13.5%	+11.5%
3 years	+5.1%	+6.1%	+4.4%
10 years	+8.7%	+9.0%	+8.2%

### Distribution of Investments

The chart of investments shows the distribution of the Scheme's investments at 31 December 2004 between the main types of assets. Any investment involves some level of risk that returns will be poor at times. Higher "risk" investments, such as equities (i.e. company shares), have greater volatility of good or bad returns, but are also expected to generate higher long-term returns than other investments such as bonds and property. The investment policy for BTPS is to seek good investment returns at relatively low risk. The Trustees' Statement of Investment Principles is available by sending a self-addressed envelope to the Scheme Address at the end of this Report.

In 2003 after consulting BT, the Trustees agreed some changes, in principle, to their investment strategy. It was agreed that the target allocation to index-linked bonds and fixed interest bonds should be increased by 2% at the expense of UK equities. The Trustees also agreed to a 2% allocation to hedge funds out of UK equities. The switch from equities to index-linked and fixed interest bonds took place in 2004. The new allocation to hedge funds commenced in late 2004 and is continuing through 2005.

## Membership

### Membership

The graph on the right shows changes in the composition of the membership of the Scheme over the last 5 years. As at 31 December 2004 the membership was as follows:

Contributing Members	79,955
Deferred Beneficiaries	99,605
Current Pensioners	177,670
<b>Total</b>	<b>357,230</b>

The figure in the table for Current Pensioners comprises 142,609 retired employees; 32,384 widows/widowers; 2,677 children/dependants.

Existing employees contributing to BTPS may continue to do so and accrue benefits but BTPS was closed to new members on 31 March 2001. From 1 April 2001 new employees in the BT Group have only been able to contribute to a new "defined contribution" arrangement - the BT Retirement Plan.

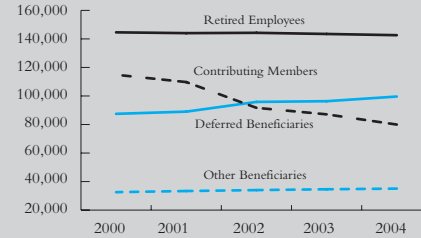
### Benefits Administration

Accenture HR Services at Chesterfield continues to undertake the essential work of keeping membership records and calculating and paying benefits. The Trustees receive a quarterly report on the service levels achieved against the agreed targets, and are pleased that service levels remain very high. Random surveys among newly retired, and other members have also indicated a high level of satisfaction.

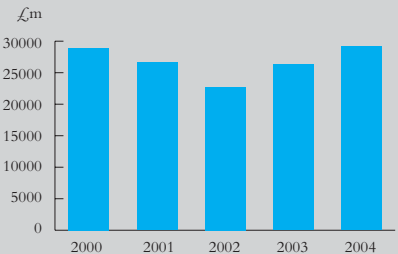
All the costs of Accenture HR Services incurred in administering BTPS are paid by BT Group plc.

## Key Facts

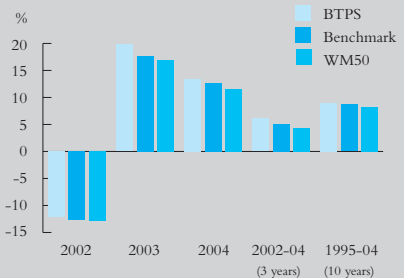
### Membership



### Value of Fund

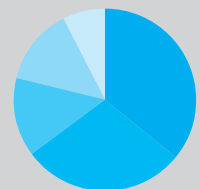


### Annualised Investment Returns



### Investment of Fund

	£m
UK Equities	10,836
Overseas Equities	9,274
Property	4,516
Fixed Interest	4,416
Index-linked Investments	2,728
Deposits etc	(2,593)
<b>Total</b>	<b>29,177</b>



## The Trustees

At 31 December 2004 the Trustees were:



**Sir Tim Chessells**  
*Chairman*  
Formerly Chairman,  
Legal Aid Board



**Brian Birkenhead**  
Formerly Group  
Finance Director,  
National Power plc and  
Chairman of The  
Hundred Group of  
Finance Directors



**David Davies FIA**  
Chairman of Sun Life  
Assurance Company of  
Canada (UK) Limited



**Peter Cross**  
Director of Corporate  
Finance, BT Group plc



**Larry Stone**  
Company Secretary,  
BT Group plc



**Chris Long**  
Formerly Chairman,  
Union of  
Communication  
Workers



**Donald MacDonald**  
Formerly President,  
Communication  
Workers Union



**Howard Marchant**  
Formerly Deputy  
General Secretary,  
Society of Telecom  
Executives



**Bill McClory**  
Assistant Secretary,  
Communication  
Workers Union

There were no changes to the Trustees in 2004.

### Pension Increases

The Scheme Rules currently result in the rates of increase for Section A/B and Section C pensions being based on the annual rise in the Retail Prices Index (RPI) to each September and December respectively.

Accordingly, Section A/B pensions in payment and deferred pensions (i.e. pensions that have not yet started to be paid) were increased by 2.8% in April 2004 and 3.1% in April 2005. The corresponding increases for Section C are 2.8% and 3.5%. The Trustees do not have discretion to pay pension increases above the level required by the Scheme Rules.

### Changes in Scheme Rules

On 1 June and 24 November 2004 BT and the Trustees agreed some changes to the Trust Deed and Rules for Section A, B and C members. The main changes introduced were related to BT's salary sacrifice schemes, in particular Smart Pensions, and the merger of the BT Supplementary Benefits Plan into BTPS.

Smart Pensions was introduced by BT on 1 June 2004 to provide an opportunity for employees and BT to save National Insurance contributions. Employees could cease their 6% basic contributions to BTPS and their gross pay would go down by the amount previously paid into BTPS. As their pay was reduced both the employees and BT saved on National Insurance contributions, and employees' take-home pay increased. However, the amendments to the BTPS Rules ensure that pension benefits are still calculated using members' 'Shadow Salary' i.e. before any reduction under Smart Pensions. BT has increased its contributions to BTPS so exactly the same amount of money goes into BTPS as before. This has not affected the benefits

of any employees not participating in Smart Pensions, or any ex-employees who left BT before 1 June 2004.

### **Hermes Pensions Management Limited**

Hermes Pensions Management Limited is wholly owned by BTPS and at 31 December 2004 was directly responsible for the investment of about 94% of the £29.2 billion assets of the Scheme.

Hermes owns a subsidiary company, Hermes Assured Limited. As well as investing about £7.6 billion of the assets of BTPS, Hermes Assured also provides unitised investment options for BTPS members paying additional voluntary contributions, and for members of the BT Retirement Plan. Hermes Assured also invests money for external clients, for which the fee income (£782,000 in 2004) helps to reduce the cost to BTPS of Hermes' investment and accounting services.

Hermes is recognised as a leader in promoting good corporate governance in the companies in which BTPS is a shareholder, in order to maximise long-term returns.

Towards the end of 2003 the Trustees appointed consultants Deloitte & Touche LLP to help them consider whether Hermes should continue to be wholly owned by BTPS. The conclusion reached by the Trustees in 2004 was that this ownership should continue, as any alternative was not in the best interest of members and BT.

During 2004 the Trustees and Deloitte & Touche LLP also considered how to further improve the governance of Hermes and BTPS. This reflected the commitment of the Trustees to maintain the highest standards of pension scheme governance and to be at the forefront

in the development of good practice in pension scheme administration and the safeguarding of scheme assets. The main decisions were as follows. The role of Chairman of Hermes and of the BTPS Trustees has now been split. Sir Tim Chessells continues as Chairman of the Trustees and Richard Bernays has replaced him as Chairman of Hermes. The Hermes Board is being restructured and will now comprise the independent non-executive Chairman, two non-executives (who will be BTPS representatives), one independent non-executive (additional to the Chairman) and five Hermes executives. Hermes is also establishing its own Committees: an Audit Committee, Nominations Committee and Remuneration Committee. The BTPS Trustees have agreed a revised investment management agreement with Hermes. Further information is in the BTPS Report & Accounts.

### **Scheme Address**

The address of the Trustees and the Secretariat of the Scheme is BT Pension Scheme, Lloyds Chambers, 1 Portsoken Street, London E1 8HZ. You should contact the Secretariat if you have any queries concerning the general management of the Scheme.

### **Members' Queries**

Anyone with queries about their Scheme benefits should contact BT Pension Scheme Administration, Accenture HR Services, Pioneer House, Chesterfield, S42 6NT. (Telephone 0800 731 4747 if you are a BT employee, or 0800 731 1919 if you are no longer employed by BT. Alternatively, e-mail [peopleline.hrservices@accenture.com](mailto:peopleline.hrservices@accenture.com)).

This Report to Members is a shortened version of the Annual Report and Accounts for BTPS which is available from Accenture HR Services at the above address. The full Report can also be accessed on the internet at [www.btpensions.net](http://www.btpensions.net), or BT employees can access it on the intranet at <http://humanresources.intra.bt.com>