



# BT Pension Scheme

Report to Members 2005

# Value of Fund

## The year's results: 2005

	£ million
<b>Value of Fund at start of year</b>	<b>29,148</b>
<b>Contributions &amp; Benefits:-</b>	
Employers' contributions	599
Members' contributions	39
Benefits	(1,386)
Net transfers in/out	11
Net Withdrawals	(737)
<b>Returns on Investments:-</b>	
Investment Income	1,274
Management expenses & interest paid	(325)
Increase in market values of investments during year	5,185
Minority interests	(120)
Net Return on Investments	6,014
<b>Resulting in a net increase in the Fund of</b>	<b>5,277</b>
<b>Value of Fund at end of year</b>	<b>34,425</b>

In 2005 almost £1.4 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £212 million.

## Financial Security

The BT Pension Scheme (BTPS) saw the market value of its investments increase significantly in 2005. Total income continues to exceed total expenditure, and with the increase in the value of the investments this has increased the fund value to £34.4 billion at 31 December 2005.

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. In view of the advance payment paid in 2004, and taking account of the earnings on that payment, BT paid £54 million in 2005.

BT has also continued to pay special contributions in respect of redundancies and early leavers from participating companies. In 2005 these payments amounted to £2 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.

A further valuation is being conducted as at 31 December 2005 and the Trustees are examining recent pensions legislation, regulations and draft guidelines for their implications on the Crown Guarantee given when BT was privatised on 6 August 1984. The Guarantee from the government applies, on a winding up of the Company, to pension entitlements for anyone who joined the Scheme before that date. It is in the interests of all BTPS members that we understand fully how the Guarantee, which is an important insurance policy for many members, interacts with the new laws.

### New Pensions Legislation

The Finance Act 2004 contained major reforms to simplify the tax treatment of registered pension schemes by replacing a multitude of regimes with a single basis where there is no limit on pension savings, only on the amount of tax relief available. The new regulations came into effect from April 2006 and BT and the Trustees have agreed the changes to be made to BTPS. They mainly affect members who are still contributing to the Scheme.

The Pensions Act 2004 was also another major milestone for pension schemes. It introduced from 6 April 2005 a more powerful Pensions Regulator and a Pension Protection Fund. The Pension Protection Fund provides 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, must pay levies to the Pension Protection Fund, but the levies set take account of any Crown Guarantee.

### Investment Returns

2005 was another good year for equity markets and, once again, the total return on the Scheme's assets of +20.8% was above the weighted average return of +20.3% 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	+20.7%	+20.8%	+20.3%
3 years	+17.0%	+18.0%	+16.2%
10 years	+8.8%	+9.2%	+8.3%

### Distribution of Investments

The chart of investments shows the distribution of the Scheme's investments at 31 December 2005 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

## Key Facts

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 contained in the full Report and Accounts, which is available from the address at the end of this Report.

In 2003 the Trustees agreed a 2% allocation to hedge funds out of UK equities. This new allocation commenced in 2004 and continued through 2005. In 2005 the Trustees have considered a higher allocation generally to 'alternative asset classes' such as hedge funds and commodities. They agreed a 3% allocation to commodities out of UK equities. This new allocation commenced towards the end of 2005 and is continuing through 2006.

### Membership

The graph on the right shows changes in the composition of the membership of the Scheme.

Contributing Members	77,184
Deferred Beneficiaries	99,010
Current Pensioners	<u>177,470</u>
<b>Total</b>	<b>353,664</b>

The figure in the table for Current Pensioners comprises 141,971 retired employees; 32,802 widows/widowers; 2,697 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.

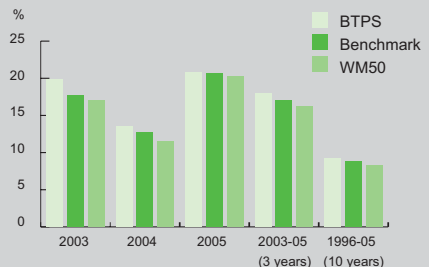
### Membership



### Value of Fund

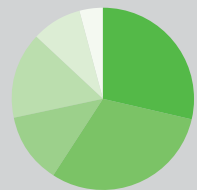


### Annualised Investment Returns



### Investment of Fund

	£m
UK Equities	10,049
Overseas Equities	10,684
Property	4,453
Fixed Interest	5,324
Index-linked Investments	3,131
Alternative Investments	1,373
Deposits etc	(589)
<b>Total</b>	<b>34,425</b>



# The Trustees

## At 1 January 2006 the Trustees were:



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



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



**David Barford**  
Formerly Chairman and  
Chief Executive Officer of  
Mercer Human Resource  
Consulting Ltd



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



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



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



**Peter Cross**  
Chief Financial Officer of  
Openreach, BT Group plc



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



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

David Davies retired as a Trustee on 31 December 2005. He was replaced by David Barford on 1 January 2006. We are grateful for Mr Davies' sterling service as a Trustee.

The Trustees were very pleased that in October 2005 they were awarded the prestigious Pensions Management Magazine Award for "Trustee Excellence". At the awards ceremony it was commented that both the composition of the Trustee body and the effort put into training were exemplary.

## 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 3.1% in April 2005 and 2.7% in April 2006. The corresponding increases for Section C are 3.5% and 2.2%. The Trustees do not have discretion to pay pension increases above the level required by the Scheme Rules.

## Changes in Scheme Rules

On 6 July 2005 some changes were made to the BTPS Trust Deed and Rules to make it clear that the Trustees may employ their own investment staff and delegate some matters to those staff.

On 12 October 2005 a further Amending Deed was executed, to allow members to provide additional life insurance through BTPS by salary sacrifice.

## Hermes Pensions Management Limited

Hermes Pensions Management Limited is wholly owned by BTPS and at 31 December 2005 was directly responsible for the investment

of about 94% of the £34.4 billion assets of the Scheme.

Hermes owns a subsidiary company, Hermes Assured Limited. As well as investing about £8.7 billion of the assets of BTPS, Hermes Assured also provides unitised investment options for BTPS members paying additional voluntary contributions, and for third party clients.

The Hermes Group of companies also invests money for external clients, for which the fee income (£33 million in 2005) 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.

As reported last year, the Trustees reviewed the governance of Hermes and BTPS in 2004. It was agreed that some changes should be made to the structure of the Hermes Board and its Committees, and to the relationship between Hermes and the Trustees. The changes were mainly introduced from 1 January 2005, and they are being reviewed again during 2006. The Hermes Board will normally comprise an independent non-executive Chairman, two non-executives (who are also BTPS Trustees), one independent non-executive (additional to the Chairman) and five Hermes executives.

### **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.

### **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.

### **Scheme Website**

In August 2005, the Scheme's own website was improved and relaunched. The site contains useful information, including past Annual Reports and Scheme documents such as the Rules and Members' booklets. The site does not hold any personal information. The website is at [www.btpensions.net](http://www.btpensions.net). BT employees can access pensions information on the intranet.

### **Members' Queries**

Anyone with queries about their Scheme benefits should contact BT Pension Scheme Administration, Accenture HR Services, Venture House, Venture Way, Dunston Technology Park, Chesterfield, S41 8NR. (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>