

Report to Members 2006



Value of Fund

The year's results: 2006

	£ million
Value of Fund at start of year	34,425
Contributions & Benefits:-	
Employers' contributions	897
Members' contributions	38
Benefits	(1,456)
Net transfers in/out	7
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Net Withdrawals	(514)
Returns on Investments:-	
Investment Income	1,422
Management expenses & interest paid	(391)
Increase in market values of investments during year	3,685
Minority interests	(234)
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Net Return on Investments	4,482
Resulting in a net increase in the Fund of	3,968
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Value of Fund at end of year	38,393

In 2006 over £1.4 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £517 million.

Financial Security

The BT Pension Scheme (BTPS) saw the market value of its investments increase significantly in 2006. Total income continues to exceed total expenditure, and with the increase in the value of the investments this has increased the fund value to £38.4 billion at 31 December 2006.

The last full actuarial valuation of BTPS was conducted as at 31 December 2005. This concluded that the funding level of BTPS (i.e. the ratio of assets to the Scheme Actuary's estimate of future liabilities) was 90.9%. The deficit was £3.4 billion.

In December 2006, the Trustee and BT signed a statutory Schedule of Contributions under which the Company agreed to additional contributions to restore the funding level to 100%. BT paid £500 million into the Scheme in December 2006, £20 million in March 2007 and £320 million in April 2007. The Company has committed to make seven annual payments of £280 million starting in December 2009, with the intention that the deficit will be cleared by December 2015. The funding level and BT's contributions will be reviewed at further full valuations every three years.

The Trustee and Company have also agreed some detailed true-up / true-down arrangements, which provide for BT to pay additional contributions if real investment returns are less than 3.2% per annum in the period between each actuarial valuation up to and including 31 December 2014. If the real returns are higher than 3.2% per annum in

those periods the Company's contributions may be reduced if the Trustee agrees. Should members' pensionable salary increases between the 2005 and 2008 valuations be more than assumed at the 2005 valuation, the Company will also pay the extra cost of this strain on the Scheme. These arrangements were covered in detail in the Summary Funding Statement sent out to all members in January 2007.

BT has also continued to pay special contributions in respect of redundancies and early leavers from participating companies. In 2006 these payments amounted to £4 million.

From 1 January 2007 the Company's normal contribution rate increased from 18.2% to 19.5% of Salaries, less members' mandatory contributions.

Crown Guarantee

Last year we referred to the Crown Guarantee, which was granted when BT was privatised in 1984. In the unlikely event that BT became insolvent, the Trustee believes that the Crown Guarantee would offer significant additional protection for the benefits payable to members who joined BTPS before 6 August 1984, and for payments to beneficiaries of such persons. The Trustee and Company are in discussion with their advisers and the government to obtain clarity on certain legal issues relating to the Guarantee. Secondly, the government has established a Pension Protection Fund (PPF), which may take over the Scheme and pay certain benefits to members. There are limits on the amounts paid by the PPF and this would not give exactly the same benefits as those provided by the Scheme.

Investment Returns

In 2006 equities again performed well, returning 13.7% in Sterling terms. UK property was the Scheme's best performing asset class returning 22% over the year. The total return on the Scheme's assets of 12.7% was well above the weighted average return of 10.7% for the 50 largest UK pension schemes, as measured by The WM Company (WM).

The Trustee has 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 Trustee's 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	+11.3%	+12.7%	+10.7%
3 years	+14.8%	+15.6%	+14.1%
10 years	+8.9%	+9.3%	+8.4%

Distribution of Investments

The chart of investments shows the distribution of the Scheme's investments at 31 December 2006 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

Key Facts

policy for BTPS is to seek good investment returns at relatively low risk. The Trustee's 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 2006 the Trustee increased the long-term target for 'alternatives' (hedge funds, commodities, private equity and infrastructure) from 7% to 15%, reducing the allocation to UK equities accordingly. The changes will be made over the next few years. It was also agreed that a 2% allocation would be made to overseas property.

Membership

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

Contributing Members	74,368
Deferred Beneficiaries	97,656
Current Pensioners	<u>177,388</u>
Total	349,412

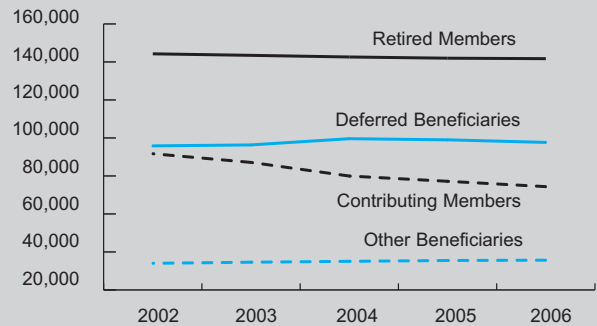
The figure in the table for Current Pensioners comprises 141,722 retired employees; 33,093 widows/widowers; 2,573 children/dependants.

Existing employees contributing to BTPS may continue to do so and accrue benefits but BTPS was closed to new members on 31 March 2001.

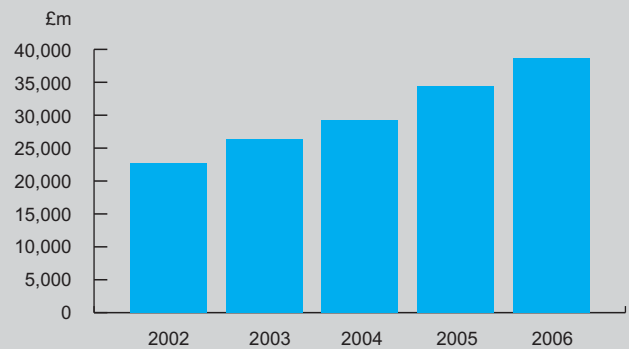
Corporate Governance Award

BTPS won the Corporate Governance Award at the Professional Pensions Pension Scheme of the Year Awards 2006.

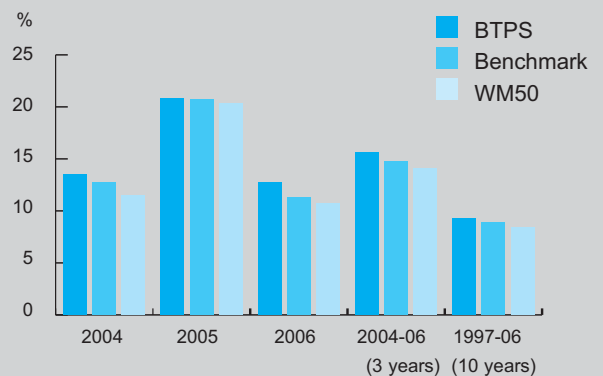
Membership



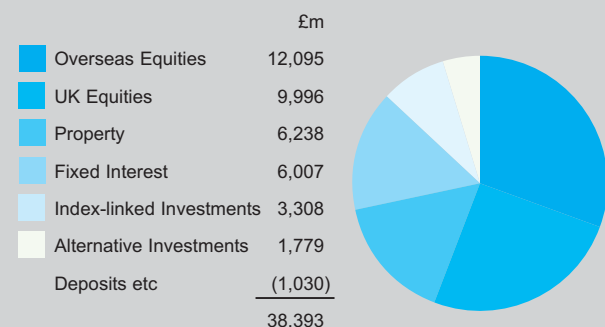
Value of Fund



Annualised Investment Returns



Investment of Fund



The Trustee

At 31 December 2006 the Directors of the Trustee Company 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



Peter Cross
Director of Strategic
Planning, BT Group plc



Bill McClory
Assistant Secretary,
Communication
Workers Union



Les Cullen
Formerly Finance Director
of Prudential plc and
Inchcape plc. Chairman of
the BTPS Audit
Committee.



Larry Stone
Company Secretary,
BT Group plc



Chris Long
Formerly Chairman,
Union of Communication
Workers

Brian Birkenhead retired as a Trustee on 30 April 2006. He was replaced by Les Cullen on 1 May 2006. We are grateful to Mr Birkenhead for his years of sterling service as a Trustee.

From 14 December 2006, BT Pension Scheme Trustees Limited was appointed as the Trustee of BTPS replacing the nine serving individual Trustees, all of whom became directors of the Trustee company. This is in line with many other large pension schemes. The day-to-day running of the Scheme continued with the same people still responsible for managing the Scheme in the interests of all members and beneficiaries.

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 2.7% in April 2006 and 3.6% in April 2007. The corresponding increases for Section C are 2.2% and 4.4%. The Trustee does not have discretion to pay pension increases above the level required by the Scheme Rules.

Changes in Scheme Rules

On 5 April 2006 some minor changes were made to the BTPS Trust Deed in relation to changes in HM Revenue & Customs rules regarding contributions to and payments from pension schemes. From 6 April 2006 the Scheme introduced increased flexibility in the contributions that can be paid into the Scheme and the benefits that may be taken at retirement.

On 14 December 2006 changes were made to the Trust Deed in connection with the

appointment of BTPS Trustees Ltd as Trustee in place of the nine former individual Trustees.

Hermes Pensions Management Limited

Hermes Pensions Management Limited is wholly owned by BTPS and at 31 December 2006 was directly responsible for the investment of about 94.5% of the £38.4 billion assets of the Scheme.

Hermes owns a subsidiary company, Hermes Assured Limited. As well as investing about £8.5 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 (£40 million in 2006) 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.

The Trustee believes that, as a long-term shareholder, the Scheme has responsibilities as a joint owner of companies, to participate in their stewardship in order to maximise long-term returns. The Scheme has appointed Hermes Equity Ownership Service (EOS) to assist with these responsibilities.

Benefits Administration

Accenture HR Services at Chesterfield continues to undertake the essential work of keeping membership records and calculating and paying benefits. The Trustee receives a quarterly report on the service levels achieved against the agreed targets, and is pleased that service levels remain very high.

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

Scheme Address

The address of the Trustee 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

The Scheme has its own website: www.btpensions.net. 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. Current BT employees can access pensions information on BT's intranet.

Members' Queries

Anyone with queries about their Scheme benefits should contact BT Pension Scheme Administration, Accenture HR Services, Venture House, Venture Way, 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. If resident overseas, the contact number is +44(0)1908 358661. Alternatively, e-mail peopleline.pensions@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, or BT employees can access it on the intranet at <http://humanresources.intra.bt.com>