

BT Pension Scheme

Pensions Update 2007

BT PENSION
SCHEME



The Trustee

The current directors of BT Pension Scheme Trustees Limited are:-



Rod Kent
Chairman

Chairman of Bradford and Bingley, Chairman of Grosvenor Limited and a Governor of the Wellcome Trust.



David Barford
Employer-nominated Director

Formerly Chairman and Chief Executive Officer of Mercer Human Resource Consulting Limited.



Les Cullen
Employer-nominated Director

Non-executive director of Avis Europe plc, DTZ Holdings plc, Interserve plc and F&C Global Smaller Companies plc.



Chris Long
Member-nominated Director

Formerly Chairman Union of Communication Workers. A BTPS deferred pensioner.



Donald MacDonald
Member-nominated Director

Formerly President Communication Workers Union. Chairman of United Nations Principles for Responsible Investment. A BTPS pensioner.



Howard Marchant
Member-nominated Director

Formerly Deputy General Secretary Society of Telecom Executives. A BTPS pensioner.



Bill McClory
Member-nominated Director

Assistant Secretary Communication Workers Union.



Andrew Parker
Employer-nominated Director

Company Secretary of BT Group plc. An active member of BTPS.



John Wroe
Employer-nominated Director

Director Group Financial Control & Treasury of BT Group plc. An active member of BTPS.

Peter Cross retired as a Trustee Director on 30 June 2007 and was replaced by John Wroe. Sir Tim Chessells retired as Chairman on 31 December 2007 and was replaced by Rod Kent. Larry Stone retired on 8 April 2008 and was replaced by Andrew Parker. We are grateful to Peter, Sir Tim and Larry for the significant contribution they made to BTPS.

Value of Fund

The information below provides an overview of the Scheme's financial results in 2007.

The year's results: 2007	
	£million
Value of Fund at start of year	38,379
Contributions & benefits:	
Employers' contributions	831
Members' contributions	26
Benefits	(1,554)
Net Transfers in/out	4
Net Withdrawals	(693)
Returns on investments	
Investment income	1,336
Management expenses & interest paid	(558)
Increase in market values of Investments during year	1,266
Minority interests	(56)
Net return on investments	1,988
Resulting in a net increase in the Fund of	1,295
Value of Fund at end of year	39,674

Value of Fund - continued

In 2007 over £1.5 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £85 million.

Financial Security

The BT Pension Scheme (BTPS) saw the market value of its investments increase again in 2007. Total income continues to exceed total expenditure, and with the increase in the value of the investments this has increased the fund value to £39.7 billion at 31 December 2007.

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, followed by two payments totalling £340 million during 2007. The Company has also 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 at 31 December 2008 and every three years subsequently.

As reported previously, the Trustee and Company also agreed some detailed true-up / true-down arrangements, which provide for BT to pay additional contributions if real investment returns are less than assumed in the period between each actuarial valuation up to and including 31 December 2014. If the real returns are higher than assumed 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 are covered in detail in the Summary Funding Statements sent out to all members annually.

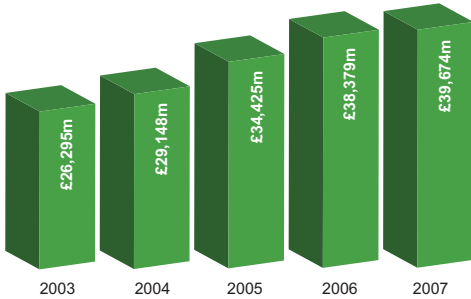
From 1 January 2007 the Company's normal contribution rate increased from 18.2% to 19.5% of Salaries, less members' mandatory contributions.

Hermes and the Actuary also work together to provide the Trustee with regular rough estimates of the change in the funding position and monthly information is now provided. It has helped the Trustee understand better the issues affecting the funding level and monitor it more closely. The Trustee is also being provided regularly now with more detailed information on the factors affecting the Scheme's liabilities to add to the regular information received on the assets. The Summary Funding Statement sent to members early in 2008 provided an update on the funding position at 31 December 2006, and another statement is being sent to members with an update to 31 December 2007.

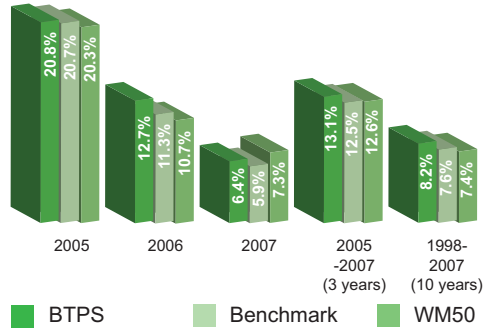
In the unlikely event that BT became insolvent, the Trustee believes there are a number of additional protections which may be available to members – i.e. a guarantee from the government granted when BT was privatised in 1984, and the Pension Protection Fund (PPF) which the government has established.

Fund statistics

Value of the Fund



Annualised investment returns

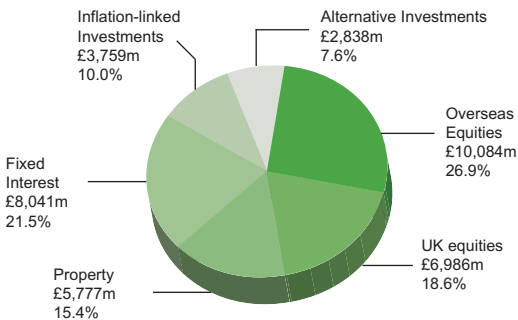


Fund membership

	2007	Change	2006
Pensioners	178,301	+913	177,388
Deferred Members	97,240	-416	97,656
Contributing Members	69,441	-4,927	74,368

The figure in the table for pensioners comprises 142,330 retired employees; 33,445 widows/widowers; 2,526 children/dependants.

Value of investments*



* Pooled investment vehicles, joint ventures and Hermes Commodities Umbrella Fund have been re-analysed into the appropriate investment class. The investments are presented on an economic exposure basis.

Investment update

Investment Returns

In 2007 the total return on the Scheme's assets of 6.4% was below the weighted average return of 7.3% for the 50 largest UK pension schemes, as measured by The WM Company (WM).

However, longer term performance has been good.

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	+5.9%	+6.4%	+7.3%
3 years	+12.5%	+13.1%	+12.6%
10 years	+7.6%	+8.2%	+7.4%

Distribution of Investments

The chart of investments on page 4 shows the distribution of the Scheme's investments at 31 December 2007 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 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. The Scheme's economic exposure to equities has been reduced significantly in 2007, through our de-risking strategy, from approximately 57% at the beginning of the year to around 44% of the Scheme's assets at 31 December 2007. This reduction has continued during the first quarter of 2008. In the short term this has turned out to be a prudent move.

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 in 2007 were paid by BT Group plc.

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 3.6% in April 2007 and 3.9% in April 2008. The corresponding increases for Section C are 4.4% and 4.0%. The Trustee does not have discretion to pay pension increases above the level required by the Scheme Rules.

Changes in Scheme Rules

On 28 November 2007 the Scheme Trust Deed was amended. The first amendment was a technical change to the powers of amendment by which BT and the Trustee can change the Trust Deed and Rules. This did not change the balance of powers between BT and the Trustee. The second change was to introduce a new section to the Scheme to admit to membership a small number of members of the Concert Retirement Benefits Plan and accept a transfer payment from that Plan in respect of some defined contribution benefits.

Hermes Fund Managers Limited

Hermes Fund Managers Limited is wholly owned by BTPS and at 31 December 2007 was directly responsible for the investment of 59.4% of the

£39.7 billion assets of the Scheme. It changed its name from Hermes Pensions Management Limited in March 2008. Hermes provides a range of investment, accounting and strategic and other advisory services to BTPS. After a comprehensive business review, it was agreed that Hermes would separate its investment management and advisory functions. Rupert Clarke was appointed Chief Executive of Hermes in December 2007; Nigel Labram was appointed head of the new specialist advisory team to service BTPS' needs. Hermes' plan is to increase its third party business and to deepen its fund management skills, to the benefit of BTPS and its other clients.

During 2007 the Trustee agreed to the transfer of its index tracking equities investments from Hermes Assured Limited to Legal & General Investment Management Limited (LGIM). This was because Hermes withdrew from the index tracking market and entered into a partnering agreement with LGIM.

The Hermes Group of companies also invests money for external clients, for which the fee income (£35 million in 2007) helps to reduce the cost to BTPS of Hermes' services.

Awards

We are very pleased to have won some awards over the last year. In May 2007 BTPS won the IPE Real Estate 'Best Pension Fund in the UK' award, and in April 2008 Hermes Real Estate won the Property Week award for Property Fund Manager of the Year 2008. In 2007 the UK Social Investment Forum Sustainable Pensions Report named BTPS as one of the top pension schemes in terms of corporate social responsibility, and BTPS was the only scheme to be ranked as 'Platinum'.

Your Contacts

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>.