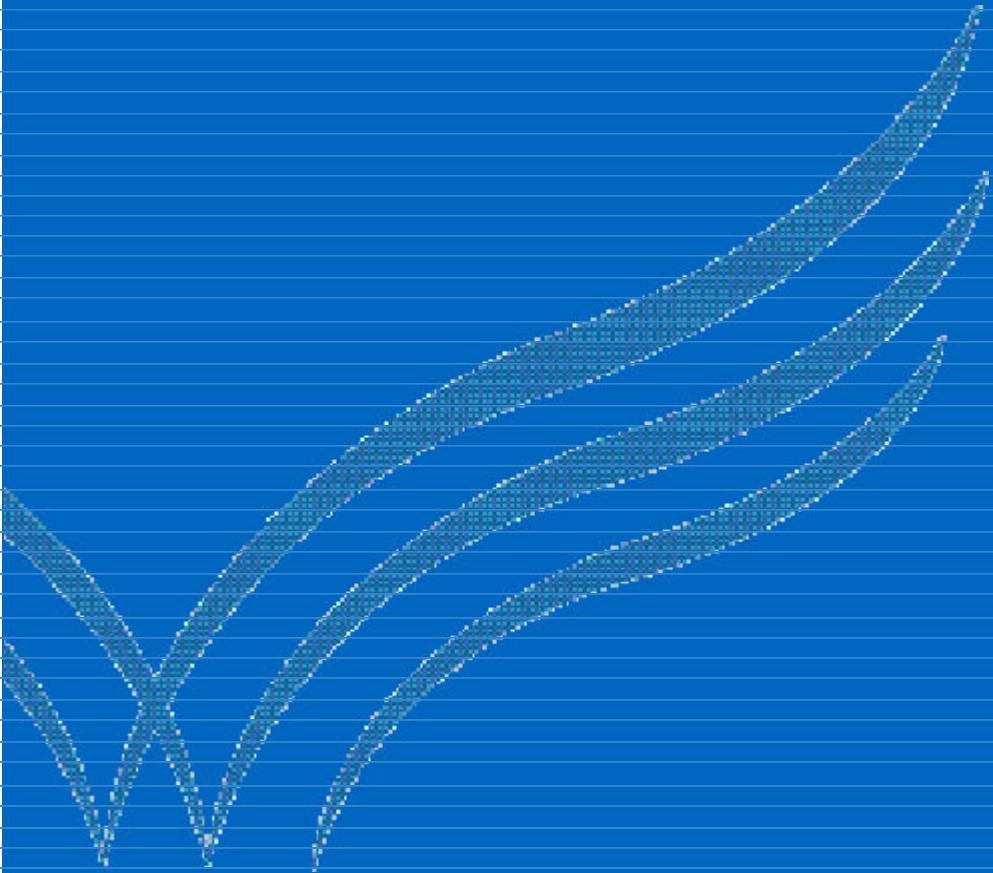




Report to Members 2002



**BT PENSION
SCHEME**





Sir Tim Chessells



Brian Birkenhead



David Davies



Howard Marchant



Bill McClory



Andrew Longden



Donald MacDonald



Chris Long



Larry Stone

At 31 December 2002 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

Managing Director and
Chief Executive Officer
of Sun Life Assurance
Company of Canada
(UK) Limited.

Chris Long

Formerly Chairman,
Union of
Communication
Workers

Andrew Longden

Group Treasurer, BT
Group plc

Donald MacDonald

Telecom Recruitment
Officer,
Communication
Workers Union.

Howard Marchant

Formerly Deputy
General Secretary,
Society of Telecom
Executives

Bill McClory

Assistant Secretary,
Communication
Workers Union.

Larry Stone

Company Secretary, BT
Group plc.

Colin Hartridge-Price
is Secretary to the
Trustees and
Chris Symonds is
Deputy Secretary.

On 8 April 2002, Colin Green resigned after eight years as a Trustee, having taken early retirement from BT. He was replaced by Larry Stone, who also took over Colin's role as Company Secretary in BT. On 25 September 2002 Ian Knight retired as Deputy Secretary to the BTPS Trustees and was replaced by Chris Symonds (formerly Assistant Secretary). We are extremely grateful for the wisdom and dedication that both Colin Green and Ian Knight displayed during their involvement with the BTPS.

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 3.3% in April 2001, 1.7% in April 2002 and 1.7% in April 2003. The corresponding increases for Section C are 2.9%, 0.7% and 2.9%. The Trustees do not have discretion to pay pension increases above the level required by the Scheme Rules.

Changes in Scheme Rules

On 1 May 2002 BT and the Trustees executed a new Trust Deed written in 'plain-English'. The new Deed did not change Scheme benefits but presented the Rules in a clearer fashion.

Hermes Pensions Management Limited

Hermes Pensions Management Limited is wholly owned by BTPS and at 31 December 2002 was directly responsible for the investment of almost 94% of the £22.8 billion assets of the Scheme.

On 24 January 2003 BTPS completed the acquisition of Schroder Hermes Limited for £4.9 million. The company has since been renamed Hermes Assured Limited. As well as investing about £1.5 billion of the assets of BTPS, Hermes Assured also provides unithed 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 (£470,000 in 2002) helps to reduce the cost to BTPS of the Hermes' investment and accounting services.

Action as Shareholders

"Corporate governance" is the term for the system by which companies are directed and controlled. Hermes, on behalf of the Trustees, encourages good corporate governance in the companies in which BTPS is a shareholder, so as to maximise long-term returns. Hermes is recognised as a leader in promoting corporate governance and companies, as well as other organisations such as the National Association of Pension Funds, often ask Hermes for views on corporate governance issues. The Scheme's

voting rights in UK and most overseas companies are nearly always exercised.

Scheme Address

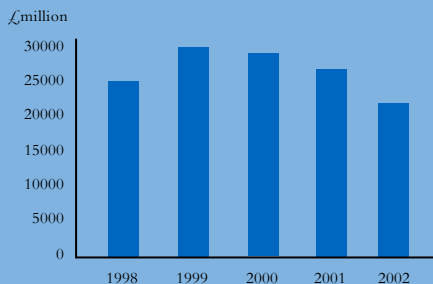
The address of the Trustees and the Secretariat of the Scheme is BT Pension Scheme, Lloyds Chambers, 1 Portsoken Street, London E1 8HZ. You should contact the Secretariat if you have any queries concerning the general management of the Scheme.

Members' Queries

Anyone with queries about their Scheme benefits should contact Pensions Services, Accenture HR Services Limited, Pioneer House, Mill Lane, Chesterfield, Derbyshire 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 e-peopleserve.pensions.services.01@e-peopleserve.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>

Value of Fund as at 31 December



The year's results: 2002

	£ million
Value of Fund at start of year	26,590
Contributions & Benefits:-	
Employers' contributions	634
Members' contributions	177
Benefits	(1,298)
Net transfers in/out	(51)
	<hr/>
Net Withdrawals	(538)
Returns on Investments:-	
Investment Income	848
Management expenses & interest paid	(100)
Decrease in market values of investments during year	(4,105)
Minority interests	62
	<hr/>
Net Return on Investments	(3,295)
Resulting in a net decrease in the Fund of	(3,833)
	<hr/>
Value of Fund at end of year	22,757

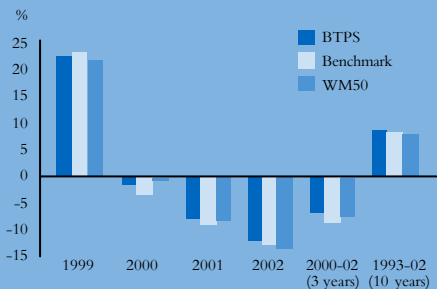
In 2002 almost £1.3 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £210 million, even after allowing for a net outflow on transfer payments of £51 million.

Financial Security

Like almost every other UK pension fund, the BT Pension Scheme (BTPS) has seen the market value of its investments fall in each of the last three calendar years. For BTPS the three-year fall has totalled £8.2 billion, resulting in a fund value at 31 December 2002 of £22.8 billion, despite total income continuing to significantly exceed total expenditure.

The results of the latest actuarial valuation of the assets and liabilities of BTPS as at 31 December 2002 will be available in May 2003. BT has confirmed that the likely deficit is entirely manageable in the context of the expected cash flows of the BT Group. It is also worth noting that the assumptions (on future investment returns, inflation etc) by the independent Actuary deliberately include a built-in cushion. On what he would regard as more realistic assumptions, it is likely that the BTPS deficit is less than 1.5%.

Annualised Investment Returns



Investment of Fund as at 31 December

	£ million
UK Equities	8,606
Overseas Equities	6,648
Fixed Interest	3,279
Property	3,376
Index-linked Investments	1,740
Deposits etc	(892)
	22,757



Since December 2000 BT has made an additional annual payment into BTPS of £200 million, specifically to reduce the Scheme deficit. BT remains financially strong and is fully committed to reducing, and ultimately eliminating, the deficit. In 2002 BT paid £634 million into BTPS, including £139 million in respect of redundancy costs incurred by the Scheme in 2001.

Investment Returns

2002 was another disappointing year for equity markets but, once again, the total return on the Scheme's assets of -12.2% was above the weighted average return of -12.9% 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 above right.

	Benchmark	Actual BTPS	Average for WM50
1 year	-12.6%	-12.2%	-12.9%
3 years	-8.2%	-7.2%	-7.5%
10 years	+7.8%	+7.9%	+7.6%

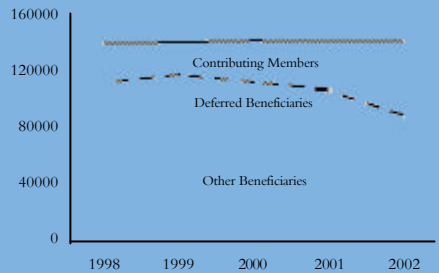
Distribution of Investments

The chart of investments shows the distribution of the Scheme's investments at 31 December 2002 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.

MEPC

At 31 December 2002 BTPS held a 50% interest in the issued share capital of MEPC Limited, a UK property company. On 17 February 2003 the Scheme acquired the remaining 50% interest in MEPC Limited, thereby taking full control of the property portfolio of the company.

Membership as at 31 December



Membership

The graph above shows changes in the composition of the membership of the Scheme over the last 5 years. As at 31 December 2002 the membership was as follows.

Contributing Members	91,692
Deferred Beneficiaries	95,829
Current Pensioners	<u>178,290</u>
Total	365,811

The figure in the table for Current Pensioners comprises 144,277 retired employees; 31,313 widows/widowers; 2,706 children/dependants.

Existing employees contributing to BTPS may continue to do so and accrue benefits, but 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

The Pensions Centre 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 high. Random surveys among newly retired, and other, members have also indicated a high level of satisfaction.

The administration is carried out by Accenture HR Services (formerly e-peopleserve Limited). This was originally a joint venture in which BT Group plc held a 50% interest, but BT Group disposed of its interest on 28 February 2002. All the costs of Accenture HR Services incurred in administering BTPS are paid by BT Group plc.