

The Trustees

At 31 December 2003 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
Telecom Recruitment
Officer, Communication
Workers Union



Howard Marchant
Formerly Deputy
General Secretary,
Society of Telecom
Executives



Bill McClory
Assistant Secretary,
Communication
Workers Union

On 24 October 2003, Andy Longden resigned after eight years as a Trustee. He was replaced by Peter Cross, who is BT's Director of Corporate Finance. We are grateful for Mr Longden's sterling service as a Trustee.

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 1.7% in April 2002, 1.7% in April 2003 and 2.8% in April 2004. The corresponding increases for Section C are 0.7%, 2.9% and 2.8%. The Trustees do not have discretion to pay pension increases above the level required by the Scheme Rules.

Pension Fund Award

BTPS won the "2003 Best European Corporate Pension Fund Award" by the Investment and Pensions Europe publication. In large part, this was in recognition of the BTPS leadership on corporate governance and shareholder engagement issues. BTPS has been promoting and encouraging good corporate governance for over a decade. The judges also recognised the good investment returns BTPS has achieved relative to other pension funds.

Changes in Scheme Rules

On 18 July 2003 an amending deed was executed by BT and the Trustees which made minor changes to the Scheme Rules. They included a provision for Sections A and B members of the Scheme to convert some or all of their lump sum retirement benefit to pension.

Hermes Pensions Management Limited

Hermes Pensions Management Limited (HPM) is wholly owned by BTPS and at 31 December 2003 was directly responsible for the investment of about 94% of the £26.3 billion assets of the Scheme.

Hermes owns a subsidiary company, Hermes Assured Limited. As well as investing about £5.9 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 (£586,000 in 2003) helps to reduce the cost to BTPS of 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 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).

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

The year's results: 2003

| | £ million |
|--|---------------|
| Value of Fund at start of year | 22,757 |
| Contributions & Benefits:- | |
| Employers' contributions | 649 |
| Members' contributions | 156 |
| Benefits | (1,254) |
| Net transfers in/out | (197) |
| Net Withdrawals | (646) |
| Returns on Investments:- | |
| Investment Income | 1,005 |
| Management expenses & interest paid | (150) |
| Increase in market values of investments during year | 3,422 |
| Minority interests | (93) |
| Net Return on Investments | 4,184 |
| Resulting in a net increase in the Fund of | 3,538 |
| Value of Fund at end of year | 26,295 |

In 2003 almost £1.3 billion was paid to Scheme members and other beneficiaries. Total income exceeded total expenditure by £209 million, even after allowing for a net outflow on transfer payments of £197 million.

Financial Security

The BT Pension Scheme (BTPS) saw the market value of its investments increase significantly in 2003, reversing partly the falls over the previous three calendar years. Total income continues to exceed total expenditure, and with the increase in the value of the investments this has increased the fund value to £26.3 billion at 31 December 2003.

A 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.

Despite the significant additional contributions that BT had paid since the previous valuation at the end of 1999, the deficit had increased mainly due to three years of falling equity markets. BT had paid £200 million in additional contributions in each of 2000, 2001 and 2002 to help reduce the deficit. Following the latest valuation BT agreed to increase its annual additional payments until the deficit is made good. The Company remains fully committed to reducing, and ultimately eliminating, the deficit.

In December 2003 BT paid an additional £232 million towards the deficit and in March 2004, in a sign of the strength of its covenant, paid early the bulk (£380 million) of the 2004 and 2005 payments.

BT has also continued to pay special contributions in respect of redundancies and early leavers from participating companies. In 2003 these payments amounted to £131 million.

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.

Investment Returns

2003 was a good year for equity markets and, once again, the total return on the Scheme's assets of +19.8% was above the weighted average return of +17.0% 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 top right.

| | Benchmark | Actual BTPS | Average for WM50 |
|----------|------------------|------------------------|-----------------------------|
| 1 year | +17.7% | +19.8% | +17.0% |
| 3 years | -2.2% | -1.0% | -2.2% |
| 10 years | +7.0% | +7.3% | +6.7% |

Distribution of Investments

The chart of investments shows the distribution of the Scheme's investments at 31 December 2003 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 changes were subject to timing and by the end of 2003 they had not been implemented. The switch from equities to index-linked and fixed interest bonds commenced in early 2004. The new allocation to hedge funds is being spread over 2004 and 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 2003 the membership was as follows:

| | |
|------------------------|----------------|
| Contributing Members | 87,123 |
| Deferred Beneficiaries | 96,333 |
| Current Pensioners | 178,070 |
| Total | 361,526 |

The figure in the table for Current Pensioners comprises 143,469 retired employees; 31,991 widows/widowers; 2,610 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.

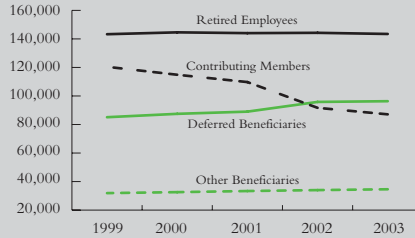
Benefits Administration

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 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

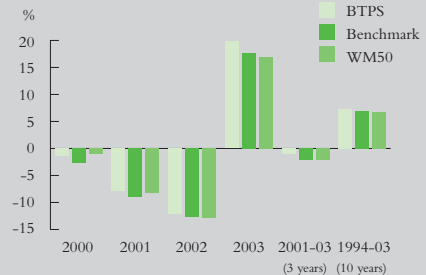
Membership



Value of Fund



Annualised Investment Returns



Investment of Fund

| | £m |
|--------------------------|-----------------|
| UK Equities | 10,121.6 |
| Overseas Equities | 8,176.6 |
| Property | 3,950.9 |
| Fixed Interest | 3,841.4 |
| Index-linked Investments | 2,133.2 |
| Deposits etc | (1,928.4) |
| Total | 26,295.3 |

