



11 February 2010

Dear Member

Following my report to you in August 2009, BT and the Trustee of BTPS today announced their agreement on the triennial actuarial valuation of BTPS as at 31st December 2008, details of a new recovery plan, and other agreements giving additional security for members.

The results of the actuarial valuation agreed with BT show that the Scheme's liabilities amounted to £40,387m as at 31st December 2008, which when measured against the Scheme's assets of £31,344m give an actuarial deficit of £9,043m. At the date of the last triennial valuation in December 2005, the actuarial deficit was £3,435m.

In due course, members will receive the Summary Funding Statement which will set out fuller details of the valuation results.

The Trustee and BT have agreed a detailed schedule of contributions to make good this deficit. As previously announced, under this recovery plan, BT will make deficit repair payments of £525m for the first three years, of which the first payment was made in December 2009.

In 2012, the annual deficit repair payment will amount to £583m, and will then increase each year by 3% per annum giving a final payment of £856m in 2025. The recovery plan includes an allowance for annual investment outperformance (over the prudent funding assumptions) of 0.5% in the first year, reducing uniformly to 0.3% over the term of the recovery plan.

These payments are in addition to the normal joint employer/employee annual contributions, which will reduce from 19.5% to 13.6% of salary with effect from 1st April 2009, as a result of the benefit review changes that were effective from that date.

We estimate that total contributions to the pension fund over the three years to December 2011 will amount to some £2.4bn.

Under the "Scheme-specific" funding framework, introduced by the Pensions Act 2004, the 2008 approach to the actuarial valuation of the Scheme's liabilities uses the same methodology as the previous triennial valuation in 2005. The valuation has been performed in accordance with the requirements of the Pensions Act 2004. All the Trustee's advisers supported the process carried out by the Trustee and its outcome. These advisers include Towers Watson as Scheme Actuary and adviser on longevity, investment returns and discount rates; Penfida Partners in respect of their reviews of covenant and affordability; telecom specialists in respect of BT's

long term strategic position in its core fixed line business; and Lovells in respect of legal advice and the framework underpinning the process. As in 2005, the Crown Guarantee given to BT on privatisation has not been taken into account in determining these valuation results. The Scheme's actuary took particular care in advising the Trustees on the mortality assumptions. These are based on a detailed review of the Scheme's actual mortality experience and include a prudent allowance for future improvements in mortality. Compared with the December 2005 valuation, this exercise represents on average some extra two years of life expectancy, with future improvements every 10 years of about 1 year. This increased the Scheme's liabilities by some £2.5bn.

In order to improve the security of members of the Scheme, the Trustee and BT have entered into legally binding agreements on several other matters.

- BT has provided the Scheme with a 'negative pledge'. In common with other lenders to BT, this provides comfort to the Scheme that, within certain limits, future creditors will not be granted superior security.
- BT have agreed that if over the period to the next triennial valuation, cumulative shareholder distributions exceed cumulative total pension contributions, then BT will make additional matching contributions to the Scheme.
- The parties have agreed that if BT generates net cash proceeds greater than £1bn from disposals, net of acquisitions, in any 12 month period until the next triennial valuation, then BT will make additional contributions to the Scheme equal to one third of the net cash proceeds.

In coming to these agreements with BT, the Trustee, with the help of its professional advisers, made a careful and prudent assessment of the strength of BT, its longer-term strategic position in its markets, the affordability of the recovery plan, and the appropriateness of the Scheme's investment strategy.

In line with the normal requirements, the results of the valuation and recovery plan will now be submitted by the Trustee to the Pensions Regulator for their review. The Pensions Regulator has been kept fully informed as discussions have developed, but has not yet had the opportunity to review the full detail of the agreement announced today. However, the Pensions Regulator's initial view is that they have substantial concerns with certain features of the agreement. BT and the Trustee will continue to work with the Pensions Regulator to help them complete their detailed review.

Members should take reassurance from the fact that whilst this valuation was carried out at a particularly difficult time for financial markets, the Scheme's investment strategy is firmly focused on providing appropriate returns over the longer term, and our sponsor enjoys a strong strategic market position.

Rod Kent
Chairman
BT Pension Scheme