

# Appendix Eight

## Statement of Investment Principles

### Introduction

This Statement of Investment Principles has been agreed by the Trustee of the BT Pension Scheme (BTPS) to comply with Section 35 of the Pensions Act 1995. It has been prepared following written advice from Hermes Pension Fund Management Limited (HPFM) and consultation with the Principal Employer of BTPS, British Telecommunications plc (BT). No amendment to this Statement will be made without written advice from a suitably qualified person and in consultation with BT.

### Investment Managers

At 31 December 2008 the assets of the Scheme were managed by a total of seven investment managers with three managers each managing over 10% of Scheme assets:

Manager (mandate)	£ million	%
Hermes Investment Management Ltd (global securities)	18,618	59.4
Legal & General Investment Management Ltd (global equities)	7,743	24.7
Hermes Real Estate Investment Management Ltd (global property)	3,481	11.1
A further four managers (various)	1,502	4.8
<b>Total</b>	<b>31,344</b>	<b>100.0</b>

### Distribution of Investments

Targets set for the strategic allocation of assets between different classes of investment reflect the Trustee's views on the appropriate balance to be struck between returns and risk, and on the extent to which the Scheme's assets should be distributed so as to match its liabilities.

At 31 December 2008 the target strategic allocation and projected long-term real (i.e. excess of retail price inflation) investment return for each asset class is shown in the table below:

	Target Allocation %	Expected Real Return %
Equities	33	5.1
Fixed interest	20	2.4
Inflation-linked	15	1.0
Property	12	3.8
Alternatives	20	3.2
	<b>100</b>	

50% of the exposure to foreign currencies embedded in the overseas equities and overseas property allocations is hedged back into sterling to remove some of the currency risk. HPFM continually assesses current market conditions and trends and has defined latitude to implement tactical adjustments around the strategic asset allocation target.

### Investment Objective and Funding Requirements

The main investment objective is to ensure that over the long-term, and after allowing for all future income, the Scheme will always have enough money to meet the cost of the payments to be made.

The investment of the assets of the Scheme should be consistent with funding a defined level of benefits within an acceptable level

of risk, while trying to minimise the cash cost to BT over the long term, having regard to the funding requirements of the Pensions Act 2004 and an acceptable level of risk of significant cash injections being required from BT. The Trustee acknowledges that, in particular, the level of investment in risky assets might, over the short to medium-term, influence the volatility of the funding level of the Scheme, and hence may influence the volatility of the employer balancing contribution rate. The Trustee takes independent advice on the quality of the covenant of BT and thus its ability to meet its obligations. The estimated relative values of the Scheme's assets and liabilities are regularly monitored and currently considered formally on a monthly basis.

As part of achieving the Scheme's objective, the Trustee periodically sets a target for the total real investment return (from both capital appreciation and investment income) on the assets of the Scheme. Currently, this target is a real return of 3.5% per annum.

### Investment Strategy

The Scheme's investments are highly diversified by asset class, geographical area, sector and industry. Part of each asset class and geographical diversification is invested in smaller, more volatile and less marketable assets, but the total of such assets is limited by the Trustee. Hermes is the Scheme's principal investment manager. However, the Trustee has appointed other investment managers to manage some portfolios.

Investments are made on the expectation that greater long-term returns will be achieved through a prudent but generally high exposure to real assets. Tactical reallocation of individual investments are made by HPFM, under delegated authority by the Trustee.

During 2008, the Scheme's exposure to equities, having been reduced in 2007 from approximately 50% to close to 40% of the Scheme's assets through a de-risking strategy, were further reduced to 33%. This revised equity allocation is now in line with the Scheme's target allocation set out above under the Distribution of Investments section.

HPFM and certain of the investment managers are permitted to use derivative contracts for efficient portfolio management as in some cases they have advantages including lower overall costs and greater liquidity. Derivative contracts are financial instruments that derive their value from another reference asset class.

### Socially Responsible Investment

BTPS is a founder member and provides the current chairman of the board of the United Nations Principles for Responsible Investment, which acts as a framework for investors to take environmental, social and governance issues fully into account.

When appointing managers of segregated portfolios on behalf of the Scheme, the appointee is instructed, when selecting investments for the Scheme, to be prepared to account for the following:

- that companies are run in the long-term interests of shareholders and that this requires them to effectively manage relationships with employees, suppliers and customers;
- that companies behave ethically and to have regard for the environment and society as a whole;

The letters of appointment request that the manager uses its best endeavours to exercise the ownership rights associated with shares.

Hermes, the Scheme's principal investment manager, has issued Statements on Corporate Governance both in the UK and internationally, which are published on its website [www.hermes.co.uk](http://www.hermes.co.uk).

### **Performance Measurement**

The Trustee receives monthly reports on investment performance from HPFM. This includes an update on Scheme performance and funding, Scheme level risks, a breakdown of assets by asset type, Scheme level cash flows and a review of the performance of the individual portfolios managed by Hermes and other investment managers.

Any managers demonstrating consistent or extreme under performance will be subject to a detailed review, undertaken by HPFM on behalf of the Trustee.

### **Mandates for Advisers and Managers**

All investment advisers and managers have agreed in writing with HPFM, on behalf of the Trustee, the services to be provided and, where appropriate, the performance target and how it will be measured.

The fees paid to investment managers for these active mandates may comprise a base fee plus an additional fee calculated as a proportion of the amount by which the manager exceeds a performance target. Linking fees to performance in this way is felt to encourage outperformance, whilst ensuring fees do not vary purely due to changes in underlying market values.

Advisers, other than HPFM, are normally paid a fixed fee for a specific role, as here a performance-related fee is most unlikely to improve the quality of the advice and will probably result in an overall increase in the total fee paid.

### **Taking Decisions**

The Trustee is responsible for the stewardship of the assets of the Scheme. All the Trustee Directors are therefore involved in decisions on the strategic target for the distribution of assets between different classes. In making these decisions the Trustee is assisted by HPFM and other advisers. Training is undertaken where appropriate so that all Trustee Directors have the necessary expertise to take the decisions required of them and to evaluate critically the advice received. The Trustee has an Investment Committee, which has delegated authority for tactical asset allocation. It also oversees the appointment and removal of investment managers and the performance of HPFM.