



# Report and Accounts

for the year ended 30 June **2017**

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# Management and advisers

## **Scheme registration number**

10085003

## **Trustee**

BT Pension Scheme Trustees Limited

## **Trustee Directors**

Paul Spencer CBE (Chairman)

Adrian Askew

The Law Debenture Pension Trust Corporation plc  
(represented by David Felder)

Ben Marshall (appointed 11 January 2017)

Billy McClory

Jim McInally

Keith Nichols (appointed 15 May 2017)

Beryl Shepherd

John Wroe

Catherine Claydon (resigned 31 December 2016)

Donald MacDonald (resigned 10 January 2017)

## **Scheme Secretary**

Susan Welch

## **Actuary**

Michael Pardoe FIA, Towers Watson Limited  
(a Willis Towers Watson Company)

## **Auditor**

KPMG LLP

15 Canada Square

Canary Wharf

London E14 5GL

## **Pensions administrator**

Accenture

Venture House

Venture Way

Chesterfield S41 8NR

## **Banker**

The Northern Trust Company

## **Executive arm of the Trustee and principal investment adviser**

BT Pension Scheme Management Limited (BTPSM)

## **Primary investment managers**

BlackRock Investment Management (UK) Limited

Hermes Fund Managers Limited

M&G Investment Management Limited

Magellan Asset Management Limited

Wellington Management International Limited

## **Master custodian of assets**

The Northern Trust Company

## **Principal sponsoring employer**

British Telecommunications plc (BT)

81 Newgate Street

London EC1A 7AJ

## **If you require further information regarding this report, please contact:**

Scheme Secretary

BT Pension Scheme Management Limited

One America Square

17 Crosswall

London EC3N 2LB

# Chairman's statement

## Introduction

On behalf of the Trustee of the BT Pension Scheme (the Scheme) I am pleased to present the Report and Accounts of the Scheme for the year ended 30 June 2017.

The Scheme is a pension scheme for employees, former employees, and their dependants, of BT and some of its associated companies. The Scheme was closed to new members on 31 March 2001. There were 297,454 members of the Scheme at 30 June 2017.

## Investment performance

During the year ended 30 June 2017, in the aftermath of the EU referendum, the Scheme was able to realise gains from large movements in Sterling following extensive contingency planning carried out ahead of the vote. Interest rates hedging was instrumental in mitigating some of the adverse impact to the Scheme from a further fall in yields as the Bank of England cut the base rate by 0.25% in August 2016.

The Scheme produced an investment return of 11.2% for the year, being 7.7% and 8.5% ahead of the Retail Prices Index and Consumer Prices Index respectively. This brought the return over the past three years to 10.5% per annum. A more detailed analysis of the performance of the investments is provided in the Investment report.

## Funding update

The Scheme Actuary provides an interim report on funding to the Trustee each year between full actuarial valuations. The most recent report following completion of the 2014 valuation was carried out at 30 June 2016 and the deficit was £13.9 billion. Details of the results were sent out to members in 2017. The Scheme is undertaking a full triennial valuation at 30 June 2017, which will provide an updated funded position, following which the Trustee in conjunction with BT will put in place revised funding measures to address the outcome. The results of the full valuation will be provided in the next Summary Funding Statement which is expected to be published in 2018.

## Sponsor update

In March 2017 Ofcom concluded their review of the digital communications sector, which included the ownership and governance of Openreach. Openreach is a business division of BT, the sponsoring employer of the



Scheme. BT has agreed that Openreach will be legally separated from BT following recommendations made by Ofcom.

To safeguard the interests of members the Trustee was actively engaged in the process and will continue to actively engage with Ofcom and BT to ensure that members' interests are safeguarded on the implementation of the agreement that BT has reached with Ofcom.

## Trustee website

In May 2017 the Trustee launched the new Scheme website ([www.btpensions.net](http://www.btpensions.net)). The new look site includes dedicated sections for each category of member, enabling users to more easily locate the information that is most relevant to them. The site has also been designed to be compatible with both tablets and smart phones, further enhancing the accessibility of this information to members.

## People update

I am delighted to welcome Ben Marshall and Keith Nichols, who have joined the Trustee Board in January and May 2017 respectively. I would also like to express my thanks to Catherine Claydon and Donald MacDonald, who have stepped down from the Trustee Board during the year.

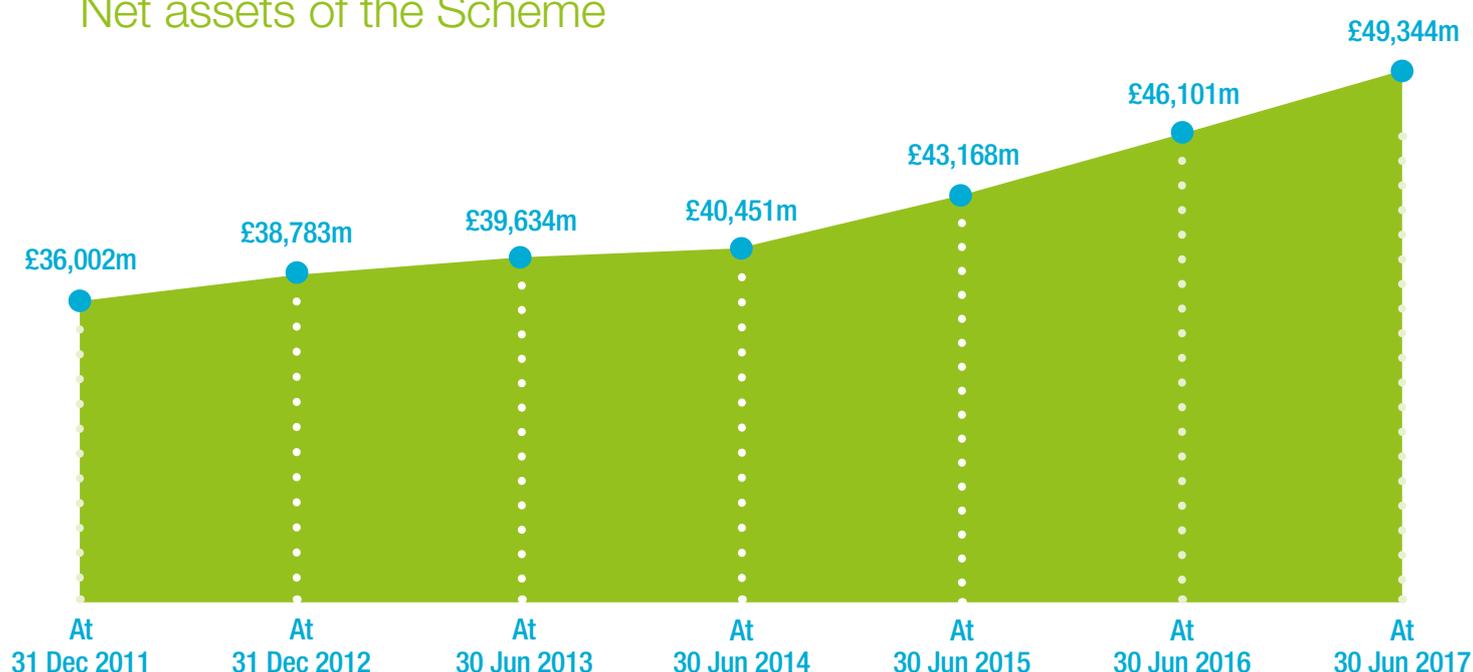
## Paul Spencer CBE

Chairman  
19 October 2017

# Key facts

“ The overall investment return on the Scheme’s assets was 11.2% for the year to 30 June 2017. This represents a real return of 8.5% above inflation measured by CPI. ”

## Net assets of the Scheme



## Allocation of investments

	30 June 2017
Equities	20.7%
Government bonds and cash	35.3%
Investment grade credit	19.0%
Other growth assets	14.3%
Property	10.7%
<b>Total</b>	<b>100.0%</b>

Information about the asset allocation of the Scheme at 30 June 2017 is given in Understanding the financial statements.

## Key facts

### Annualised investment returns

	2017	2016	2015	3 years	5 years	10 years	15 years
BTPS Actual	11.2%	11.9%	8.3%	10.5%	9.3%	5.4%	7.7%
BTPS Real <sup>1</sup> – Adjusted RPI <sup>2</sup>	7.7%	10.3%	7.3%	8.4%	6.9%	2.7%	4.7%
BTPS Real <sup>1</sup> – Adjusted CPI <sup>2</sup>	8.5%	11.5%	8.4%	9.5%	7.7%	3.1%	5.5%

<sup>1</sup> Scheme real adjusted equals Scheme actual less RPI and CPI respectively.

<sup>2</sup> Retail Prices Index (RPI) and Consumer Prices Index (CPI) are measures of UK inflation.

### Scheme membership



# Report by the Trustee

## Scheme funding

A full actuarial valuation of the Scheme is undertaken at least once every three years based on a range of assumptions including future inflation, pensions increases, salary increases, investment returns and life expectancy.

The most recently completed full actuarial valuation was carried out at 30 June 2014. The valuation concluded that the funding level of the Scheme (i.e. the ratio of assets to the estimate of accrued liabilities at the date of the valuation) was 85.1%. The corresponding past service deficit was £7,044 million.

The Trustee and BT have agreed a recovery plan such that BT will pay additional contributions in order to return the Scheme to a fully funded position by 31 March 2030. Under this recovery plan, BT paid deficit funding contributions of £1,500 million during March and April 2015, £250 million in March 2016 and £250 million in March 2017. From 2018 to 2024, BT will make payments in line with the 2011 agreement (an average of £690 million per annum). After that, BT will pay £495 million per annum through to 2029 with a final payment of £289 million in 2030.

The deficit funding contributions are in addition to BT's normal contributions required to fund future benefits for current employees. As a result of the June 2014 full actuarial valuation, BT's regular contributions rate was increased from 13.5% to 16.0% of members' pensionable pay (less members' mandatory contributions) from April 2015. Furthermore, it is set to increase to 16.9% of members' pensionable pay (less members' mandatory contributions) from July 2017.

Legally binding agreements between the Trustee and BT, reached in 2011 to improve the security of members' benefits, were retained or improved as part of the 2014 agreement. These include:

- The 'negative pledge' provided by BT in 2010. This provides comfort to the Scheme that, within certain limits, future creditors will not be granted superior security. The negative pledge has been extended to cover BT, BT Group and their subsidiary undertakings, including any new companies that may be acquired and applies until the deficit reduces to below £2,000 million at any subsequent funding valuation.

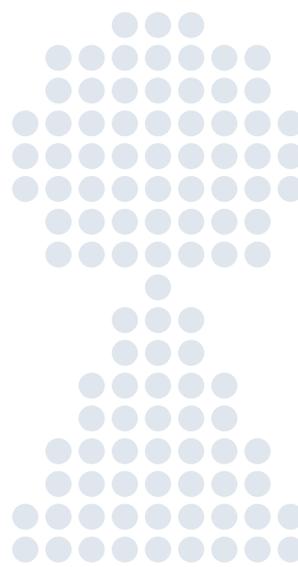
- BT has agreed that in the event that shareholder distributions exceed a threshold, then BT will make matching payments to the Scheme. The threshold allows for dividends per share to increase by 15% per annum and allows for share buybacks of £300 million per annum on a cumulative basis.
- BT has agreed that if it generates net cash proceeds greater than £1,000 million from disposals, net of acquisitions, in any twelve month period and certain conditions apply, then BT will make additional contributions to the Scheme equal to one third of those net cash proceeds.
- BT has also agreed to advise the Trustee should there be other material corporate events which may impact BT's covenant to the Scheme.

No account was taken of the Crown Guarantee in the actuarial valuation.

The Trustee received an interim report from the Actuary on the funding position of the Scheme at 30 June 2016.

This is an interim report provided each year between full actuarial valuations. It uses an approach that the Actuary regards as consistent with that adopted for the June 2014 valuation of the Scheme, allowing for changes in investment market conditions. Between 30 June 2014 and 30 June 2016 the funding shortfall increased from £7,044 million to £13,901 million.

The Scheme is currently undertaking a full actuarial valuation at 30 June 2017, the results of which are expected to be finalised in 2018.



## Report by the Trustee

### Scheme investment

#### Scheme investment strategy

The Trustee takes an integrated approach to the management of risk and return in the Scheme. The investment of the Scheme's assets is set to be consistent with funding a defined level of benefits within an acceptable level of risk, having regard to the covenant of BT, and the funding requirements in the Scheme Rules and relevant legislation.

The Trustee considers that a strong employer is the best support for the Scheme and it takes independent advice on the quality of the covenant of BT and its ability to meet its obligations.

Investment risks and returns are monitored by BTPSM on an ongoing basis and reviewed regularly by the Trustee. The Trustee also analyses the sensitivity of the Scheme to a wide range of factors including inflation, interest rates, currency, equity, credit and longevity in order to assess the potential impact on funding and the risks associated with different asset allocations.

The Scheme reached its targets for interest rates and inflation hedging of around 40% (on a solvency basis) in June 2017, reducing the volatility of the Scheme's funding position.

Over the life of the Scheme, and as the Scheme matures, the Trustee intends to reduce the level of growth assets (including equities and property) and increase the level of matching assets (including gilts and corporate bonds). On this basis the Trustee actively monitors the Scheme's assets and liabilities, with the assistance of BTPSM, and is well positioned to respond quickly to changes in markets and funding levels.

#### Statement of Investment Principles

A Statement of Investment Principles has been agreed by the Trustee following written advice from BTPSM and consultation with BT. The preparation of this statement complies with the requirements of Section 35 of the Pensions Act 1995 and sets out in general terms the policy of the Trustee on a number of investment issues. This statement is reviewed regularly and the Statement of Investment Principles (last revised April 2015) is reproduced in Appendix two.

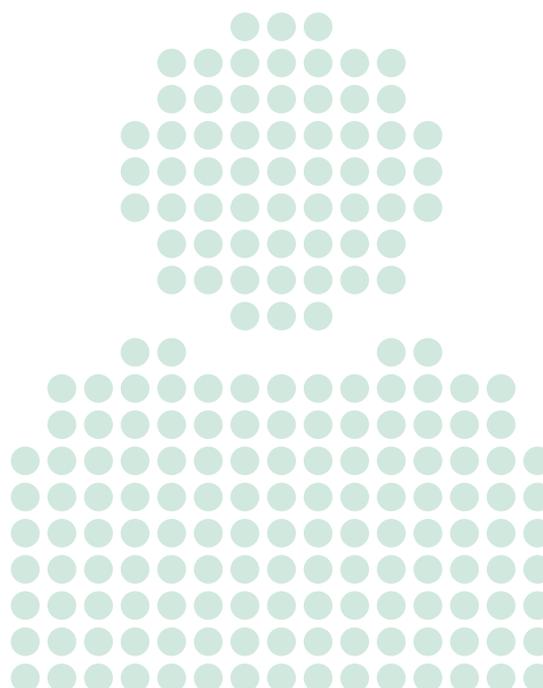
#### Measuring investment performance

The Trustee monitors investment performance against the Scheme's strategic investment objectives. Reports are provided regularly by BTPSM to the Trustee and include information on Scheme level risks, cash flows and the performance of underlying mandates against their respective benchmarks. Details of the annualised investment returns are given in the Key facts.

For the Trustee

#### Paul Spencer CBE

Chairman  
19 October 2017



# Trustee Board

The following are the Trustee Directors



## 1. Paul Spencer CBE, Chairman <sup>a</sup>

### Appointment

Paul was appointed as Chairman of the Trustee Board on 1 March 2011, having been a Trustee Director since 1 September 2009. He is chair of the Investment Committee, and was a member of the Audit Committee until 18 May 2017. He is also non-executive chair of BTPSM, and a member of its remuneration committee.

### Biography

Paul was appointed non-executive chair of the Prudential Assurance Company Limited, the UK subsidiary of Prudential plc, in January 2016. He is an independent trustee and chair of the Rolls-Royce Pension Fund, and a governor of Motability.

Paul was non-executive chair of Hermes Fund Managers Limited until 31 March 2016. He was formerly a non-executive director of WPP, NipponKoa Europe Insurance and TR Property Investment Trust and a former chair of State Street Managed Pension Funds. He is a past president of the Association of Corporate Treasurers and past chair of NS&I (National Savings and Investments).

Paul was appointed CBE in the 2010 New Year's Honours 'for services to financial services'.

## 2. Adrian Askew <sup>b</sup>

### Appointment

Adrian was appointed to the Trustee Board on 11 January 2011. He is chair of the Administration and Communications Committee and is a non-executive director of BTPSM and chair of its remuneration committee.

### Biography

Adrian became a national official of Connect (now the Bectu Sector of Prospect) in 1987 and retired as general secretary of Connect at the end of 2009. He was lead officer on pensions matters for the BT unions from 1997 to 2003 and was chair of the trustees for the Connect Pension and Life Assurance Scheme from 2003 to 2009. Adrian is a member of the National Federation of Occupational Pensioners (NFOP).

## 3. David Felder <sup>c</sup>

### Appointment

David represents, and is a director of The Law Debenture Pension Trust Corporation plc, a professional independent trustee of pension schemes. The Law Debenture Pension Trust Corporation plc was appointed to the Trustee Board on 15 September 2011. He is a member of the Investment Committee and the Responsible Investment Oversight Committee. He stepped down as a member of the AVC Committee on 18 May 2017. He is also a non-executive director of BTPSM.

### Biography

David has over thirty years of experience working with pension funds in both the public and private sectors, first at Morgan Grenfell as a fixed income fund manager and then at Kleinwort Benson where he was head of fixed income between 1992 and 1998. He is a fellow of the Chartered Institute for Securities and Investment.

## Trustee Board

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### 4. Ben Marshall <sup>b</sup>

#### Appointment

Ben was appointed to the Trustee Board on 11 January 2017. He was appointed as a member of the Audit Committee and the AVC Committee on 18 May 2017.

#### Biography

Ben has been a trustee of a number of pension schemes continuously for over thirty years, and until his recent retirement was both chair of the General Federation of Trade Unions Pension Scheme and a member of the board of governance of the Steria Defined Contribution Scheme since its creation in 2010. He has also been a trustee of the BT Retirement Plan (now the BTRSS and now a GPP) and the Accenture AHRS DC scheme.

Ben was National Secretary of the Prospect Communications, Media and Digital Sector until May 2017. In that role, he was responsible for leading all negotiations with BT (and many other telecoms employers) on pensions on behalf of Prospect members. Before becoming a union official in 1984, he worked for the Post Office as an engineer. He has a pension from the Post Office Statutory Pension Scheme and is a member of the NFOP.

### 5. Billy McClory <sup>b</sup>

#### Appointment

Billy was appointed to the Trustee Board on 1 September 1997. He is a member of the Investment Committee and the Responsible Investment Oversight Committee, and was a member of the Audit Committee until 18 May 2017. He is also the senior non-executive director of Hermes Fund Managers Limited.

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### Biography

Billy was employed by Post Office Telecommunications from 1968 to 1978. He is a former national officer of the CWU and its predecessor unions the Civil and Public Services Association and the National Communications Union (NCU). He was responsible for negotiations on pensions matters in the telecommunications and financial services sector and was the lead officer for pensions matters for the BT unions. He is a trustee of the NCU Staff Superannuation Scheme and was chair of its trustee board until 2011. He is a former trustee of the BT Retirement Plan. Billy is a member of the NFOP.

### 6. Jim McNally <sup>c</sup>

#### Appointment

Jim was appointed to the Trustee Board on 26 November 2012. He is a member of the Administration and Communications Committee, the Responsible Investment Oversight Committee and the AVC Committee. He is also an independent adviser to the BTPSM remuneration committee.

#### Biography

Jim is HR director for BT Group. He is a member of BT's senior leadership team, a trustee of the BT Healthcare Trust and the BT Rehabilitation Trust. Jim has extensive experience in remuneration and benefits and has held senior remuneration and benefits director roles at four FTSE100 companies. He read Economics & Industrial Relations at the London School of Economics & Political Science, and Social Studies & Quantitative Methods at the University of Oxford. He has further qualifications in Theology, Moral Philosophy & Social Ethics and in Electrical & Electronic Engineering.

## Trustee Board

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### 7. Keith Nichols <sup>c</sup>

#### Appointment

Keith was appointed to the Trustee Board on 15 May 2017. He was appointed a member of the Investment Committee, the Administration and Communications Committee and the Audit Committee on 18 May 2017.

#### Biography

Keith was recently chief financial officer and member of the board of management at AkzoNobel N.V., where he played a key role in the sale of Organon BioSciences to Schering Plough and in the acquisition of ICI plc and its related pension liabilities. Prior to joining AkzoNobel in 2005, he held various senior finance positions across a number of industrial sectors for companies such as Corus Group plc, TPG N.V., WPP plc and BET plc. He is a Fellow of the Association of Corporate Treasurers.

### 8. Beryl Shepherd <sup>b</sup>

#### Appointment

Beryl was appointed to the Trustee Board on 1 June 2009. She is chair of the AVC Committee and a member of the Administration and Communications Committee.

#### Biography

Beryl has been employed by BT since 1978 and is currently a member of the National Executive Committee of the CWU, a position that she has held since 2002. Since 2011 she has held the position of chair of the Telecoms & Financial Services Executive of the CWU. She is an active member of the Scheme and a member of the NFOP.

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### 9. John Wroe <sup>c</sup>

#### Appointment

John was appointed to the Trustee Board on 1 July 2007. He is chair of the Audit Committee, a member of the Investment Committee, and was appointed chair of the Responsible Investment Oversight Committee on 18 May 2017.

#### Biography

John joined BT Group in 1992 and held a number of senior finance roles until his retirement from his executive role in May 2017. Immediately prior to retirement, he was group director of treasury for BT Group, responsible for BT's worldwide treasury and insurance activities. He was a member of BT's senior leadership team. Prior to joining BT he worked for Coopers & Lybrand (now part of PricewaterhouseCoopers). He is a Chartered Accountant. John is a deferred member of the Scheme.

<sup>a</sup> Chairman appointed by BT with the agreement of the recognised trade unions.

<sup>b</sup> Member-nominated Trustee Director selected by the recognised trade unions and NFOP.

<sup>c</sup> Employer-nominated Trustee Director.

# Governance of the Scheme

## Introduction

The Scheme is managed and administered by the Trustee, BT Pension Scheme Trustees Limited, on behalf of members and in accordance with the terms of the Scheme Rules and relevant legislation. Details of the Trustee Directors are given on pages 9 to 11.

The governance arrangements for the Scheme take account of the recommendations and Codes of Practice of The Pensions Regulator and best practice, and are kept under continuous review. The governance of the Scheme is described in the following sections:

- Appointment and removal of Trustee Directors
- Trustee Knowledge and Understanding (TKU)
- Conflicts of interest
- Anti-corruption and bribery
- The Trustee Board
- Trustee Board Committees
  - Audit Committee
  - Investment Committee
  - Responsible Investment Oversight Committee
  - Administration and Communications Committee
  - AVC Committee
- Other Committees
- Attendance at Trustee Board and Committee meetings
- Role and governance of BTPSM
- Internal control and risk management
- Security of assets
- Recovery in the event of a disaster
- Membership
- Pensions increases



## Governance of the Scheme

### Appointment and removal of Trustee Directors

There is a robust process in place for the appointment, removal and ongoing appraisal of Trustee Directors. In accordance with the Trustee's Articles of Association and the Trust Deed and Rules, nine Trustee Directors are appointed by BT, recognised trade unions representing BT's employees, and the National Federation of Occupational Pensioners (NFOP).

### Appointment of the Chairman

The Chairman of the Trustee Board is appointed by BT after consultation with and agreement of the recognised trade unions. BT will fix the Chairman's period of office.

### Employer-nominated Trustee Directors

BT also appoints four employer-nominated Trustee Directors. An employer-nominated Trustee Director can be removed from office by BT.

### Member-nominated Trustee Directors

The Trustee's Articles of Association require that four member-nominated Trustee Directors are appointed. A member-nominated Trustee Director selection and nomination procedure is in place whereby member-nominated Trustee Directors are appointed by BT after being selected by the recognised trade unions and NFOP. In the event of a vacancy, the recognised trade unions and NFOP will convene a selection panel to fill that vacancy. Candidates from each constituent organisation will be considered by the selection panel. Existing member-nominated Trustee Directors will be re-nominated at the end of their term of office unless one of the constituent organisations represented on the selection panel disagrees. Additional nominations may be considered.

On request by the recognised trade unions and the NFOP, BT will, unless it considers the request to be unreasonable, remove a member-nominated Trustee Director from office.

### Trustee Directors term of appointment

At the end of a term of appointment, Trustee Directors are eligible for re-appointment. Unanticipated vacancies, for example as a result of death or resignation, are normally filled within six months. The Scheme Rules do not provide guidance on the length of service of Trustee Directors.

If a Trustee Director fails to attend any meeting of the Trustee Directors for a period of six months, the remaining Trustee Directors or a majority of them may send a request to BT to remove that person from office.

### Time requirement

Trustee Directors are expected to devote sufficient time as necessary to carry out their duties. This is expected to be around twenty five to thirty days a year. The time commitment in the first year following their appointment may be higher as the Trustee Director requires time to familiarise himself or herself with the rules and operation of the Scheme.

### Performance

The Chairman carries out an annual appraisal of performance of individual Trustee Directors. This includes an assessment of their role as Trustee Directors, their views on how well the Trustee Board is working and the need for any specific training. The Board also reviews the performance of the Chairman. In addition, the Trustee undertakes periodic external independent evaluations of the Board.

## Governance of the Scheme

### Trustee Knowledge and Understanding (TKU)

All of the Trustee Directors have the relevant skills and knowledge necessary to carry out their roles effectively. The Trustee Directors are required within six months of their appointment to have knowledge and understanding of the laws relating to pensions and trusts, and the principles relating to scheme funding and investment of assets on behalf of members. They are also required to be familiar with how the Scheme operates and its governing documents.

On appointment, a new Trustee Director receives a full induction including meetings with senior managers of BTPSM, and an induction pack containing information regarding the Scheme. The pack includes governing documentation, key funding documents, an overview of the pensions legislative and regulatory regimes and details of functions delegated to BTPSM. New Trustee Directors are also asked to identify any training needs which they think they require in order to fulfil their duties. Relevant initial and ongoing training is then provided and records of training are kept for each Trustee Director.

Trustee Directors are requested on an annual basis to consider whether they may benefit from additional training, and training sessions can be tailored and provided to meet the requirements of individual Trustee Directors.

Some Trustee Directors have experience of working at other pension schemes and some bring specialist knowledge to the Trustee Board. The overall result is that the Board as a whole has the right mix of skills and experience, and there is a balanced and diverse Board.

### Conflicts of interest

A conflicts of interest policy is in place to assist Trustee Directors in identifying, managing and monitoring any conflicts of interest which may arise in relation to the Scheme. The policy takes account of the guidance from The Pensions Regulator, the Scheme Rules, Articles of Association and the Companies Act 2006. On appointment, each Trustee Director completes a declaration of his or her conflicts of interest and these are recorded in a conflicts of interest register which is reviewed and approved at least annually by the Trustee Board. As an ongoing matter, conflicts of interest are also an agenda item at the beginning of each Board meeting and other Committee meetings to ensure that conflicts are noted, properly identified and managed appropriately as they arise.

### Anti-corruption and bribery

All Trustee Directors have received appropriate briefings in relation to the Bribery Act 2010, and an Anti Bribery and Corruption Policy and Gifts and Hospitality Policy are in place. If a Trustee Director suspects that there may have been a potential breach of the Bribery Act, he or she is required to report the breach to the chair of the Audit Committee or via the whistle-blowing procedure to the Chairman of the Trustee Board.

### The Trustee Board

The Trustee Board has ultimate authority for all aspects of the management and strategy of the Scheme, including audit, investment, policy, administration and communications. The Board discharges its responsibilities through an annual programme of meetings. During the year the Board met eleven times.

The Board has a forward agenda in place, for a rolling period of twelve months, to ensure that it meets its statutory obligations and has adequate time to prepare and plan for milestones in the management and operation of the Scheme. The forward agenda also ensures that matters requiring future approval or input of the Board are dealt with in a timely manner.

During the year, the Board considered a wide range of strategic and operational initiatives affecting the Scheme. Investment strategy has been a key focus as has overseeing the Scheme's administration activities. The Board has also spent significant time working with BT and Ofcom to ensure its views have been adequately factored into the DCR review process. Monitoring compliance against the continuing pipeline of legal and regulatory changes impacting the Scheme has been a regular agenda item for the Board. The Board continues to receive frequent advice from its Actuary and covenant advisor as required and it is periodically invited to attend the BT Pensions Committee.

In certain circumstances the Board is required to consult with BT. To facilitate this, joint meetings with the BT Pensions Committee take place. The Board also had regular presentations from BT on its financial results and business strategy.

## Governance of the Scheme

On 31 December 2016, Catherine Claydon resigned from the Board as an employer-nominated Trustee Director and on 10 January 2017, Donald MacDonald resigned from the Board as a member-nominated Trustee Director. Ben Marshall was appointed as a member-nominated Trustee Director to the Board on 11 January 2017 and Keith Nichols was appointed as an employer-nominated Trustee Director to the Board on 15 May 2017.

### Trustee Board Committees

The Trustee Board has delegated some powers and responsibilities for certain matters to five Board Committees. Where powers are delegated to a Committee, the Committee must act in the same manner and bear in mind the same considerations as the Board would have done had there not been any delegation. Terms of reference are in place for each Committee and these are reviewed annually to ensure that they remain relevant and fit for purpose.

In May 2017, following the appointment of two new Board members, a full review of the membership of the Board Committees was undertaken which resulted in revised membership for some of these Committees. Revised membership of the Committees was with effect from 18 May 2017.

Each Committee provides regular reporting to the Board on the key points raised and decisions taken at each meeting, and each Committee is required to escalate to the Board any matter for approval that is outside of its delegated powers and responsibility, or which requires special consideration by the Board.

Attendance by Trustee Directors at Board and Committee meetings are shown in the table on page 19.

### Audit Committee

#### Members

John Wroe – **Chair**  
Ben Marshall  
Keith Nichols

The Audit Committee is responsible for the integrity of the Scheme's annual report and accounts and the discharge of its duties, including maintenance of appropriate accounting records and review of financial controls. The Committee oversees Scheme governance and the effectiveness of risk management processes, the internal controls framework and internal audit function.

The Committee is responsible for recommending to the Trustee Board the appointment, reappointment and removal of the external auditor, monitoring of auditor independence and objectivity and approval of remuneration and engagement terms of the auditor.

A Verification working group oversees the disclosure and verification of information in the annual report which does not form part of the audited financial statements. The chair of the working group reports its findings to the Committee. The members of the working group include the BTPSM management committee and senior members of the finance and secretariat functions.

The Committee met four times during the year and subsequently one meeting was held up to the date of the approval of the annual report and accounts. During the year, the Committee oversaw the tender of audit services, resulting in the appointment of KPMG LLP as Scheme auditors and further details are provided in this report; reviewed and approved an initiative to reduce the Scheme's financial reporting cycle effective 30 June 2017; reviewed the process for preparing the Scheme's 2017/2018 cost budget; reviewed reports on operational due diligence of third party investment managers; received regular risk and compliance and internal audit reports; reviewed the Scheme's procurement plan; reviewed the security of Scheme assets; and reviewed cyber security.

## Governance of the Scheme

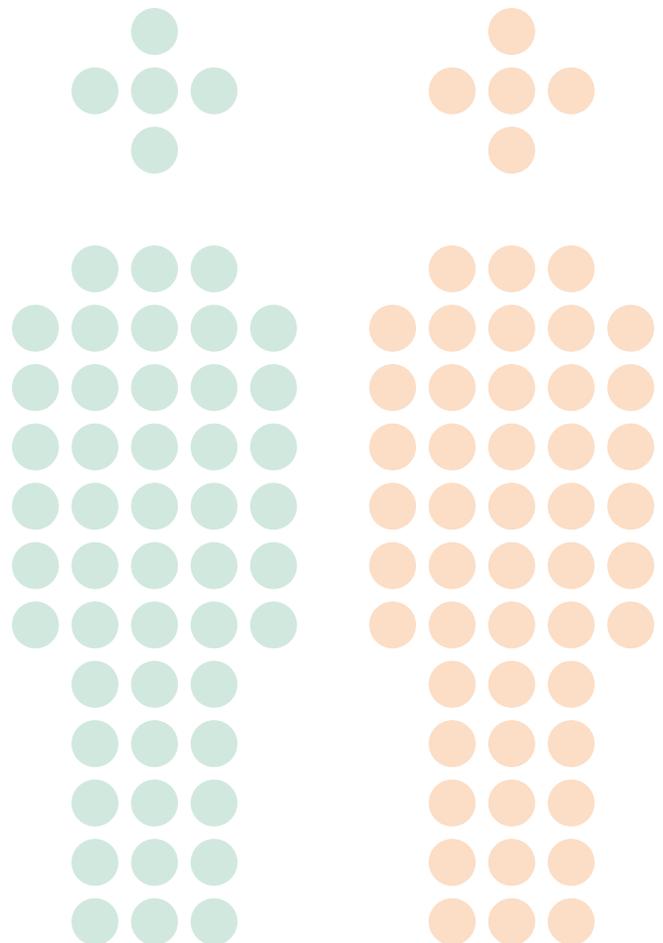
### Audit Tender

The Committee approved a proposal to tender audit services for the Scheme and group entities in September 2015. Deloitte LLP had been the auditor of the Scheme since 1993 and the last audit tender was performed in 2001 that had resulted in the retention of Deloitte. As a matter of good corporate governance the Committee approved an audit tender. Deloitte was not asked to tender for audit services.

KPMG LLP was identified as the preferred audit firm based on audit quality and significant experience of auditing pension schemes. The Committee recommended to the Trustee Board the appointment of KPMG as the new auditors of the Scheme and group entities. The appointment was then ratified by the Trustee Board. Deloitte resigned as the auditor of the Scheme on 6 April 2017, and on 7 April 2017 KPMG was appointed as auditor of the Scheme.

### Auditor Independence

To safeguard the auditor's independence, the Scheme has a policy on the provision of non-audit services by the auditors. From September 2016, the Committee required the orderly termination of non-audit services provided by KPMG to the Scheme and group entities that would be prohibited when they became the auditors. Furthermore, any new engagements with KPMG for non-audit services were to be considered based on this policy.



## Governance of the Scheme

### Investment Committee

#### Members

Paul Spencer CBE – **Chair**  
David Felder  
Billy McClory  
Keith Nichols  
John Wroe

The Investment Committee oversees the effectiveness of the Scheme's investment strategy. This includes oversight of investment performance, including the performance of investment allocations and sub-allocations. The Committee met seven times during the year and members also attended workshops and training sessions on specific matters of interest.

Reporting to the Committee included quarterly performance reports, regular updates on investment activity and oversight, an annual review of performance over the year and rolling three years, and the annual review of Scheme investment costs. The Committee also reviewed 'deep dive' reporting into each of the main asset classes including the distribution of assets within the asset class, key risk factors and manager allocations and performance.

A sub-committee, the Implementation Oversight Committee, is used from time-to-time to oversee the implementation of more complex investment activity. This sub-committee includes members of the Investment Committee with appropriate expertise in implementation issues and is also attended by senior managers from BTPSM.

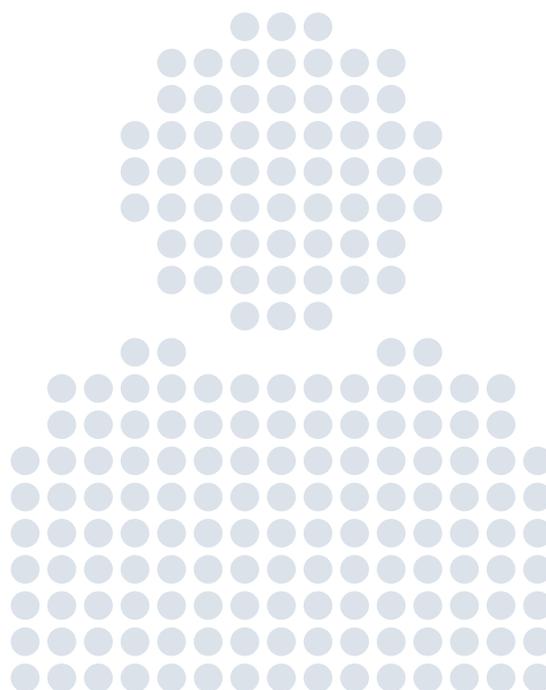
### Responsible Investment Oversight Committee

#### Members

John Wroe – **Chair**  
David Felder  
Billy McClory  
Jim McNally

The Responsible Investment Oversight Committee oversees the Scheme's responsible investment strategy with the objective of seeking the optimal long-term risk-adjusted return while limiting outcomes which may harm members' shared interests. It also has oversight of the implementation of this strategy and the consideration of financially relevant environmental, social and governance (ESG) factors within the Scheme's investment decision making and stewardship activities.

The Committee met once during the year. At this meeting the Committee agreed a single overarching responsible investment policy to consolidate all of the Scheme's policies relating to sustainability, stewardship and proxy voting. The Committee also reviewed and revised its Terms of Reference and received an update from Hermes Equity Ownership Services Limited on their stewardship activities, and a presentation from Hermes GPE LLP on their approach to responsible investment within private equity.



## Governance of the Scheme

### Administration and Communications Committee

#### Members

Adrian Askew – **Chair**

Jim McInally

Keith Nichols

Beryl Shepherd

The Administration and Communications Committee is responsible for overseeing administration services provided to the Scheme and its members. The Committee is responsible for monitoring and overseeing casework arising from the application of Scheme Rules involving discretions, as well as monitoring the development and implementation of an effective communications strategy. In addition, the Committee is responsible for making sure the Scheme's Trust Deed and Rules are up to date and reflect any changes arising from regulation and legislation.

The Committee met five times during the year and received and reviewed monthly reports from Accenture on the pensions administration of the Scheme. The Committee provided oversight on a number of pensions administration projects and also discussed and considered proposals for the redesign of the Scheme's website and the development of the pensions portal. The Committee was also provided with reports from the Discretions and IDRPs Committees.

### AVC Committee

#### Members

Beryl Shepherd – **Chair**

Ben Marshall

Jim McInally

The AVC Committee is responsible for overseeing the Scheme's Additional Voluntary Contributions (AVC) arrangements. This includes assessing the Scheme's AVC arrangements against the standards and quality features set out by The Pensions Regulator, in particular, Code of Practice 13, monitoring the overall effectiveness of AVC arrangements and reviewing the appropriateness of investment options.

The Committee met three times during the year and carried out a value for members assessment and security of assets review under the Code of Practice, both achieving positive results for the Scheme. Actions arising from these reviews are in progress with oversight by the Committee.

### Other Committees

#### Discretions Committee

##### Members

Beryl Shepherd – **Chair**

Adrian Askew

Keith Nichols

The Discretions Committee, which is a sub-committee of the Administration and Communications Committee, is responsible for considering and arriving at determinations where the Trustee is required by the Scheme Rules to exercise discretion, such as in the distribution of a lump sum death benefit or the payment of a pension to an adult dependant.

#### IDRP Stage 2 Appeals Panel

##### Panel members

Jim McInally – **Chair**

Ben Marshall

Billy McClory

The Internal Disputes Resolution Procedure (IDRP) Stage 2 Appeals Panel is a sub-committee of the Administration and Communications Committee. It is responsible for considering and arriving at determinations in respect of appeals by Scheme members or beneficiaries against a decision under Stage 1 of the IDRPs.

## Governance of the Scheme

### Attendance at Trustee Board and Committee meetings

The table below shows the attendance by Trustee Directors at Trustee Board and Committee meetings (where they are a member) during the year ended 30 June 2017.

Trustee Director	Main Board	Administration and Communications Committee	Audit Committee	Investment Committee	Responsible Investment Oversight Committee	AVC Committee
<b>Number of meetings</b>	<b>11</b>	<b>5</b>	<b>4</b>	<b>7</b>	<b>1</b>	<b>3</b>
P Spencer CBE	11	-	2 <sup>b</sup>	7	-	-
A Askew	11	5	-	-	-	-
C Claydon*	5	3	-	3	-	-
D Felder	11	-	-	7	1	2 <sup>b</sup>
D MacDonald**	4	-	-	-	-	-
B Marshall***	6	-	1 <sup>a</sup>	-	-	- <sup>a</sup>
B McClory	11	-	3 <sup>b</sup>	1 <sup>a</sup>	- <sup>a</sup>	-
J McNally	11	5	-	-	1	3
K Nichols****	2	- <sup>a</sup>	1 <sup>a</sup>	1 <sup>a</sup>	-	-
B Shepherd	11	4	-	-	-	3
J Wroe	11	-	4	7	1	-

\* Resigned as a Trustee Director with effect from 31 December 2016

\*\* Resigned as a Trustee Director with effect from 10 January 2017

\*\*\* Appointed as a Trustee Director with effect from 11 January 2017

\*\*\*\* Appointed as a Trustee Director with effect from 15 May 2017

<sup>a</sup> - New member of Committee with effect from 18 May 2017

<sup>b</sup> - Stepped down as a member of the Committee

## Governance of the Scheme

### Role and governance of BTPSM

BTPSM is a wholly-owned subsidiary of the Scheme. It was authorised by the Financial Conduct Authority (FCA) with effect from 13 February 2009.

BTPSM is the executive arm of the Trustee and provides investment, advisory, operational and secretariat services solely for the Scheme. This includes providing the Trustee with advice on asset allocation and risk management, advice on public policy issues and sustainability, acting as agent of the Trustee in appointing third parties to provide investment management, custodial, administration and operational services for the Scheme, monitoring the activities of third party service providers and reporting to the Trustee, and engaging in direct management of certain assets of the Scheme.

BTPSM has established its own operating and governance frameworks. The Chairman of the Trustee Board, Paul Spencer CBE, is also non-executive chair of BTPSM and two Trustee Directors, Adrian Askew and David Felder, are non-executive directors of the BTPSM board. The role of the BTPSM board is to ensure that BTPSM has the appropriate capability, skills and experience to effectively provide the Trustee with the required services.

BTPSM secretariat is responsible for providing secretarial services and also the Scheme Secretary to the Trustee. The secretariat is responsible for preparation of agendas and meeting papers, and ensuring decisions made at meetings are accurately recorded and implemented. In addition, secretariat is responsible for ensuring the Trustee is kept informed on pension consultation documents, legislation and general good practice, as well as on issues concerning Scheme governance, communications and administration. The performance of BTPSM is reviewed by the Trustee Board on an annual basis.

The BTPSM board has two principal committees:

- The management committee, comprising the Chief Executive Officer, Chief Operating Officer, Chief Investment Officer, Deputy Chief Investment Officer and Head of Legal, Risk and Compliance, implement the board's requirements and manages day-to-day operations.
- The remuneration committee, which determines the policy and framework for the remuneration of BTPSM employees and the remuneration of the management committee of BTPSM. The remuneration committee has been delegated responsibility for ensuring that the process for determining the remuneration of BTPSM employees is transparent, fair and compliant with relevant regulation and legislation, and that the remuneration processes encourage high performance with the right behaviours such as compliance with risk and regulatory frameworks, team behaviours and fiduciary responsibilities. Subsequent to the year end, it was agreed that the responsibilities of the remuneration committee should be undertaken by the BTPSM board.



## Governance of the Scheme

### Internal control and risk management

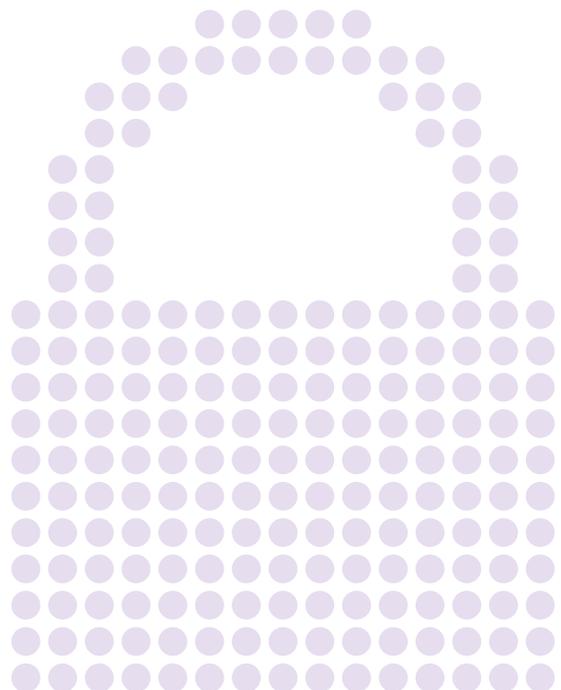
The Trustee Board is responsible for the Scheme's internal controls and risk management. The responsibility for monitoring risks has been delegated to the relevant Committees, and BTPSM who, in turn, provides escalation and assurance on the management of risks to the respective Committees and the Board. The Audit Committee provides an ongoing review of the adequacy of internal controls and assurance relating to the Scheme's risk register. The risk register has been further enhanced so that the Committee has greater visibility of the risks arising from the Scheme's operations and infrastructure as well as external factors which could have significant impact on the Scheme. This enables more effective risk management in considering existing and emerging risks coming across the governance structure.

BTPSM has a dedicated legal, risk and compliance function which reports to the Head of Legal, Risk and Compliance with responsibility for monitoring and providing advice to BTPSM and the Scheme on compliance with regulatory developments and the internal controls environment. This is in relation to both the investment advisory and pensions administration services provided by BTPSM to the Scheme.

The compliance function is responsible for providing advice on FCA regulations and requirements, pensions regulations as well as other relevant regulations. BTPSM and the Scheme have approved compliance monitoring plans which set out the key regulatory risks and the testing which will take place during the year.

The operational risk function provides challenge and advice on all aspects of the internal controls environment. It oversees and facilitates a rolling programme of risk and control self assessments carried out by the business for reviewing the effectiveness of the internal controls environment.

The internal audit function, under an outsourcing agreement with Hermes Fund Managers Limited, conducts a rolling programme of independent control reviews and investigations where necessary. It may use external professional firms to provide additional technical support on certain audits. In addition, internal audit reviews audited internal controls reports such as the ISAE 3402, SSAE 16 and SOC 1 reports, on the Scheme's investment managers and administrators.



## Governance of the Scheme

### Security of assets

The Scheme's assets are registered in the name of a custodian Trustee, Britel Fund Trustees Limited, through a deed of appointment on behalf of the Scheme or are held in safe-keeping with independent professional custodians, appointed by the Trustee. The Trustee's policy is to separate management and custody, which minimises the risk of misuse of Scheme assets. A small proportion of liquid Scheme assets are now held with a secondary custodian, to provide a prudent contingency in the unlikely event of short-term business continuity issues with the Scheme's master custodian. This additional capability is in line with regulatory recommendations. Custody arrangements are reviewed regularly by the Trustee, with the assistance of BTPSM, to ensure the custodial arrangements are appropriate. The Northern Trust Company has been master custodian since 18 November 2008 and JP Morgan Chase was appointed as secondary custodian on 18 December 2015.

### Recovery in the event of a disaster

BTPSM, The Northern Trust Company (as Scheme custodian) and Accenture (as Scheme pensions administrator), have documented plans for recovering from a disaster. This includes the use of alternative disaster recovery sites to which key staff can be relocated. All the main suppliers of services to the Scheme have disaster recovery plans that are regularly reviewed and tested.

### Membership

On 31 March 2001 the Scheme was closed to new entrants.

In the year to 30 June 2017, the number of active members fell from 33,871 to 31,432 while the number of pensions being paid rose from 201,261 to 202,439. The number of members with deferred rights fell from 67,766 to 63,583. A detailed analysis is given in Appendix one.

Membership of the Scheme falls into one of three 'sections': Section A, Section B and Section C. Details of these can be found on the website:

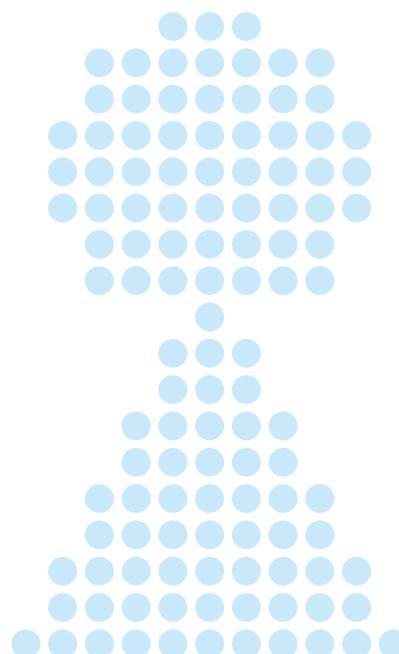
**[www.btpensions.net](http://www.btpensions.net)**.

### Pensions increases

The rate of pensions increases for Sections A and B is determined by reference to the Consumer Prices Index (CPI). For Section C, the rate of pensions increase reflects the annual rise in the Retail Prices Index (RPI) up to 5%.

In April 2017, the increase for Sections A and B pensions in payment was 1% and the increase for Section C pensions was 2.5%. The Trustee does not have the power to pay pension increases above the level required by the Scheme Rules without the agreement of BT.

For deferred beneficiaries for all sections, each member's pension is revalued for the period between the date of leaving service and the date the pension commences. Revaluation for each year the benefit was deferred before 2011 is calculated by reference to RPI, and revaluation from 2011 onwards is calculated by reference to CPI.



# Statement of Trustee's responsibilities

The audited financial statements, which are to be prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, are the responsibility of the Trustee.

Pension scheme regulations require the Trustee to make available to Scheme members, beneficiaries and certain other parties, audited financial statements for each Scheme year which:

- show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of the Scheme year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year; and
- contain the information specified in the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement whether the accounts have been prepared in accordance with the Statement of Recommended Practice *Financial Reports of Pension Schemes*.

The Trustee has supervised the preparation of the financial statements and have agreed suitable accounting policies, to be applied consistently, making estimates and judgements on a reasonable and prudent basis. They are also responsible for:

- assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern;
- using the going concern basis of accounting unless they either intend to wind up Scheme, or have no realistic alternative but to do so; and
- making available each year, commonly in the form of a Trustee's annual report, information about the Scheme prescribed by pensions legislation, which they should ensure is consistent with the financial statements it accompanies.

The Trustee also has certain responsibilities in respect of contributions which are set out in the statement of Trustee's responsibilities accompanying the Trustee's summary of contributions.

The Trustee is responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities.

# Investment report

“During the twelve months to 30 June 2017 there was a sharp upturn in market sentiment and fortunes as recessionary and populist fears gave way to wide spread optimism. The Scheme has been able to take advantage of this shift as highlighted by the positive performance of the assets across the board and particularly the growth portfolio.”

## Review of the year to 30 June 2017

The past year has seen markets go through a rollercoaster of intense moves and emotions. The contrast between the start and the end of the year could not have been sharper with excessive fear morphing into widespread complacency.

Early on, markets grappled with the aftermath of the European Union referendum in fear that it would be the first piece of a larger trend that would push the European project towards breaking point. During this period the Scheme was able to lock in significant foreign currency gains from large movements in Sterling thanks to the extensive contingency planning carried out ahead of the referendum. Interest rate hedging activity was also instrumental in mitigating the adverse impact to the Scheme from a further fall in yields as the Bank of England cut rates by 25bps to pre-emptively cushion any set backs from Brexit.

Beyond these short-term market moves, the gloomier economic projections over the impact of Brexit failed to materialise over the course of 2016 partly due to steadying economic activity in China, continued solid growth in the US and a much improved outlook for Europe. These strong and improving global fundamentals helped allay investors' lingering fear of the rise in populism and protectionism. Indeed, such fear was turned on its head by November with the election of President Trump in the United States of America. From one of the biggest political upsets of recent times, Trump's election almost instantaneously galvanised markets on promises of deregulation, fiscal reforms and more spending.

The mixture of buoyant market sentiment and strong fundamentals also allowed the Federal Reserve to raise rates for the first time since the financial crisis, a momentous event that nonetheless had little impact as investors started to look at 2017 with a level of optimism and hope not seen in over a decade. The positive outlook continued during 2017 as the Federal Reserve raised interest rates twice more, and the economic rebound in Europe and emerging markets gained pace. Fears over an implosion of the EU and populism more generally continued to recede with the election of the staunch pro-European and reformist Macron in France.

However, some clear signs of complacency have started to take hold of markets. In particular, volatility slumped to extremely low levels whilst valuations climbed to cyclical highs even as the prospects for a swift implementation of the Trump election agenda started to fade. More fundamentally, there remains a significant degree of uncertainty over the sustainability and strength in the current cyclical upswing. On a geopolitical front, risks remain numerous and have largely shifted eastwards from Europe towards Asia and the Middle East.

Going forward, we continue to see, along with the improvements in the global economy, a long and growing tail of downside risks of which the Scheme must remain mindful. We believe that vigilance of downside risks is particularly warranted given the current levels of complacency among investors.

## Investment report

### Investment performance

The objective of investing in growth assets, such as equities and property, is to produce an investment return that is expected to improve the funding position of the Scheme. At each triennial actuarial valuation of the Scheme the Trustee works with the Scheme's advisors to estimate the long-term returns that can be expected from investments in growth assets.

The objective of the liability hedging portfolio, which includes index-linked gilts alongside inflation and interest rate derivatives, is to produce an investment return that offsets a proportion of the effect on the value of the Scheme's liabilities due to changes in the level of interest rates and inflation. We call this proportion the "hedge ratio". For example, if inflation expectations rise so too does the value of index-linked gilts, helping to offset the increase in the Scheme's liabilities.

As a result, the Trustee identifies the Scheme assets as being part of either the growth asset portfolio or the liability hedging portfolio. The Trustee would consider the Scheme's investment performance to be acceptable if growth asset performance is in line with or better than the expected returns and the liability hedging portfolio has provided an effective hedge.

### Growth asset portfolio performance from June 2014 to June 2017

	From June 2016 (1 year)	From June 2014 (per annum over 3 years)
Actual return	16.9%	11.9%
Expected return	6.7%	6.7%
Outperformance	+10.2%	+5.2%

At the last triennial actuarial valuation at 30 June 2014 the Scheme's growth assets had an expected annual return of 6.7%. Since the last valuation the growth assets, including the effects of foreign currency movements, produced an actual annualised return of 11.9%. This outperformance of 5.2% has mainly been the result of the Scheme's foreign currency exposure, which benefited from a fall in the value of Sterling following the outcome of the EU referendum in 2016, coupled with strong performances from property, equities and infrastructure investments.

Over the past year, since the end of June 2016, the return from growth assets of 16.9% has been well ahead of expectation. The main contribution to this performance has been from the strong performance of equities.

Over both the one and three year time horizons the actual returns of the growth asset allocation have outperformed the expected returns over the periods.

### Liability hedging portfolio performance from June 2014 to June 2017

Since the last valuation the Trustee has steadily increased the hedge ratio from around 20% to 40% on a solvency basis to mitigate the effect of changes in interest rates and inflation expectations. This means that 40% of any change to the Scheme's liabilities due to changes in interest rate and inflation expectations is expected to be offset by the change in value of the liability hedging portfolio.

The Trustee has implemented this hedge incrementally over the last three years. A measured implementation approach has been required because of the large size of the Scheme and the desire not to have an adverse impact on market pricing.

Over the period, the liability hedging portfolio has performed in line with expectations, providing an effective hedge in the anticipated proportions.

### Total Scheme return

The total Scheme return, combining the growth asset portfolio and the liability hedging portfolio, over the period since June 2014 was 10.5% per annum. For comparison, the prudent discount rates adopted in the 2014 valuation, based on market conditions at that date, were broadly equivalent to an average long-term investment return of 4.5% per annum. The relatively high Scheme return was in the main due to the strong investment returns generated over the period by the majority of financial markets and was within the expected range taking into account the degree of investment risk within the Scheme's investment strategy.

## Investment report

### Scheme funding

Despite growth asset performance exceeding expected returns and the liability hedging portfolio performing in line with expectations, the Scheme's funding position is expected to have deteriorated over the period since the 30 June 2014 valuation. This is primarily due to the fall in long-term UK interest rates which has caused the value placed on the Scheme's liabilities to increase. This effect has been only partially offset by the performance of the liability hedging portfolio as this portfolio is not currently intended to offset the full effects of changes in interest rates on the value of the liabilities.

### Distribution of investments

The Trustee takes an integrated approach to the management of risk in the Scheme, setting an investment strategy that is consistent with funding a defined level of benefits within an acceptable level of risk while having regard to the quality of the covenant and the affordability to BT. The allocation of assets between different classes of investments is a key factor in delivering this investment strategy and is reviewed regularly by the Trustee.

The distribution of investments at 30 June 2017 is shown in the table below. Pooled investment vehicles, loans, derivatives, cash and borrowings have been re-allocated to the appropriate asset classes to reflect the underlying exposures. Further explanation of these re-allocations is given in Understanding the financial statements.

Asset class	30 June 2017
Equities	20.7%
Government bonds and cash	35.3%
Investment grade credit	19.0%
Other growth assets	14.3%
Property	10.7%
<b>Total</b>	<b>100.0%</b>

### Growth asset portfolio

As previously discussed, the Trustee invests in growth assets to improve the Scheme's funding position by out-performing liabilities. The allocation to growth assets includes investments in equities, property and other growth assets. The purpose of the equity allocation is to contribute to the Scheme's required return objective and to provide liquidity and income. The purpose of the property allocation is to provide returns, income and diversification from equity risk. Other growth assets, which include absolute return, non-core credit and mature infrastructure investments, are intended to deliver a similar return to equities without taking additional risk, and should provide better capital protection than equities during market downturns.

#### Equities

At 30 June 2017, approximately 85% of the Scheme's equity allocation was invested in publicly listed securities whilst approximately 15% was invested in private equities. Furthermore, the Scheme hedged part of its total equity exposure through a derivatives strategy.

#### Public equities

Approximately 55% of the listed equities exposure was allocated to a blend of "factor-weighted" mandates providing exposure to quality, low beta companies, companies which are assessed as offering good value based on profitability and other balance sheet metrics and mid and small cap companies. The quality, low beta and value mandates are passively managed. The other 45% of the listed equities exposure is allocated to active managers whose objectives are to outperform their respective listed equity benchmarks.

#### Private equities

The majority of the Scheme's private equity allocation is managed by Hermes GPE LLP with a global strategy deployed through a combination of private equity funds and co-investments. The private equity allocation is expected to outperform the MSCI World Index by 3% per annum, albeit with higher volatility.

## Investment report

### Property

The majority of the Scheme's property allocation is managed by Hermes Real Estate Investment Management Limited, and at 30 June 2017 was invested approximately 70% in the UK and 30% overseas. The portfolio is managed according to a strategy that balances exposure to growth with a consistent income return and prudent level of risk.

### Other growth assets

There are four different asset classes under the 'Other growth assets' umbrella: absolute return, non-core credit, mature infrastructure and commodities.

### Liability hedging portfolio

The Trustee invests in matching assets and liability overlays to provide a hedge against changes in the value of pension liabilities resulting from changes in interest and inflation rates. Matching assets include investment grade corporate bonds, government bonds, and liability overlays include interest rate and inflation swap contracts, and total return swaps.

### Investment grade corporate bonds

At 30 June 2017 approximately 19% of the Scheme's exposure to investment grade corporate bonds was allocated to UK corporate bonds and the remaining 81% was invested globally.

### Government bonds

100% of the Government bonds allocation was invested in index-linked gilts at 30 June 2017.

### Derivatives and other financial instruments

The Trustee has set objectives and constraints for the Scheme overall, and for the Scheme's investment managers containing restrictions on the use of derivatives and other financial instruments. The Trustee authorises the use of derivatives by BTPSM and certain investment managers.

BTPSM uses derivatives to manage the Scheme's risk profile; this includes their use to mitigate the impact on Scheme funding of changes in inflation and interest rates, and to limit downside risk on equities. Furthermore, derivatives are used to rebalance the Scheme's asset allocation and for reducing the risks associated with the Scheme's foreign currency exposure.

The Scheme's investment managers, where applicable, use derivatives for the efficient management of the portfolios they manage on behalf of the Scheme. The Scheme's subsidiary undertakings also use derivatives and other financial instruments to finance their operations and to manage interest rate and foreign currency risks arising from their operations and from their sources of finance.

### Self investment

Regulations require that the Scheme's investment in BT should not be more than 5% of net assets. At 30 June 2017, the total amount of self investment was £14 million (2016: £9 million), representing 0.03% (2016: 0.02%) of the net assets of the Scheme. There were no properties occupied by BT owned by the Scheme at 30 June 2017 and 30 June 2016.

# Responsible investment

The Trustee has articulated its commitment to investing the assets of the Scheme responsibly with the following Responsible Investment mission statement: “As a responsible investor we will best manage the Scheme’s assets by seeking the optimal long-term risk-adjusted return while limiting outcomes which may harm our beneficiaries, shared interests.” The implications of this statement in terms of governance, investment strategy, portfolio management and reporting are set out in the Responsible Investment policy, which can be found at [www.btpensions.net/assets/uploads/documents/BTPS-Responsible-Investment-Policy-April-2017.pdf](http://www.btpensions.net/assets/uploads/documents/BTPS-Responsible-Investment-Policy-April-2017.pdf).

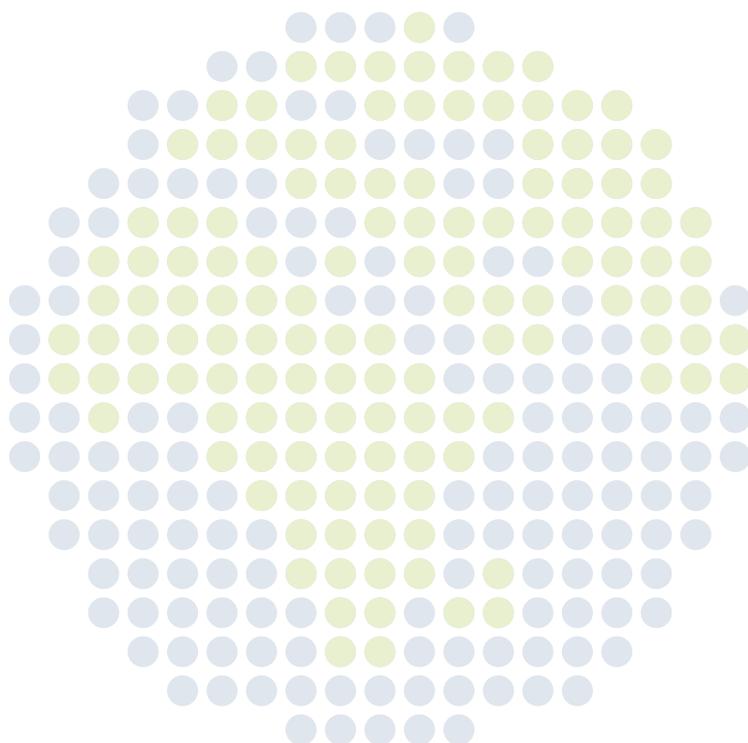
The Responsible Investment Oversight Committee (RIOCC) advises the Trustee Board on responsible investment matters and oversees the implementation of the Responsible Investment policy.

The day-to-day implementation of the responsible investment strategy has been delegated to BTPSM, with activity focused on the following three core areas:

**1.** Understanding the risks and opportunities that may face the Scheme because of its long-term investment horizon. For example, following an investigation into the Scheme’s potential exposure to climate-related risks and opportunities, an enhanced climate and carbon risk monitoring process was put in place.

**2.** Integrating financially material environmental, social and governance (ESG) factors into the Scheme’s investment process, including the design of investment mandates, new manager searches and ongoing monitoring of managers.

**3.** Ensuring that the Scheme is delivering long-term value through responsible ownership. The majority of the Scheme’s stewardship activities are undertaken by Hermes Equity Ownership Services Limited, one of the world’s foremost providers of collaborative stewardship services. This includes holding the management of companies in which the Scheme invests to account and proxy voting. A record of the Scheme’s voting and engagement activities can be found at [www.btpensions.net/information/investment/voting-disclosure](http://www.btpensions.net/information/investment/voting-disclosure) and [www.btpensions.net/information/investment/engagement-reports](http://www.btpensions.net/information/investment/engagement-reports).



# Understanding the financial statements

The disclosures in the financial statements are determined by pensions legislation, UK GAAP including the Financial Reporting Standard applicable in the UK and Republic of Ireland (“FRS 102”), and the guidelines in the Statement of Recommended Practice (SORP) revised November 2014 (“Pensions SORP”). These set out how the assets of the Scheme are to be presented in the Consolidated statement of net assets and the relevant notes. The Scheme can gain exposure to different asset classes by investing in pooled investment vehicles (“PIVs”), or by using derivatives as well as segregated mandates.

Investments in PIVs and derivatives are shown separately at fair value in the Consolidated statement of net assets. The presentation of these investments, as guided by the Pensions SORP, differs to the asset allocation of the Scheme as managed by the Trustee at 30 June 2017. The table below reclassifies assets such as PIVs, derivatives and loans into their appropriate asset classes so the asset allocation at 30 June 2017 can be observed.

Asset class	Value per Consolidated statement of net assets £ million	Reclassification				Managed value £ million	Managed allocation %
		PIVs £ million	Footnote	Other £ million	Footnote		
Equities	11,459	0		(11,459)	7	0	0.0%
Actively managed	0	378	1	1,759	4, 7, 9	2,137	4.3%
Passively managed	0	105	1	5,921	4, 7, 9	6,026	12.2%
Private equity	0	1,813	1	271	5, 9	2,084	4.2%
<b>Equities</b>	<b>11,459</b>	<b>2,296</b>		<b>(3,508)</b>		<b>10,247</b>	<b>20.7%</b>
Bonds	21,412	0		(21,412)	8	0	0.0%
Investment grade credit	0	686	1	8,672	3, 8, 9	9,358	19.0%
Government bonds and cash	0	2,456	1	14,984	3, 8, 9	17,440	35.3%
<b>Bonds and cash</b>	<b>21,412</b>	<b>3,142</b>		<b>2,244</b>		<b>26,798</b>	<b>54.3%</b>
<b>Property</b>	<b>1,432</b>	<b>3,613</b>	<b>1</b>	<b>245</b>	<b>5, 9</b>	<b>5,290</b>	<b>10.7%</b>
Absolute return	0	1,797	1	8	9	1,805	3.7%
Mature infrastructure	0	510	1	1,176	9	1,686	3.4%
Non-core credit	0	2,187	1	1,331	9	3,518	7.2%
<b>Other growth assets</b>	<b>0</b>	<b>4,494</b>		<b>2,515</b>		<b>7,009</b>	<b>14.3%</b>
<b>Other Categories</b>							
Pooled investment vehicles	13,545	(13,545)	1	0		0	0.0%
Loans	299	0		(299)	3	0	0.0%
Other net assets	1,197	0		(1,197)	2, 9	0	0.0%
	<b>49,344</b>	<b>0</b>		<b>0</b>		<b>49,344</b>	<b>100%</b>

## Understanding the financial statements

### Footnotes

- <sup>1</sup> Investments in pooled investment vehicles (PIVs) have been reclassified into the appropriate asset class.
- <sup>2</sup> Other net assets include deposit and short-term investments, derivatives contracts, AVC investments, other investment assets and liabilities, the longevity insurance contract and net current assets. These have been reclassified to their appropriate asset exposures.
- <sup>3</sup> Loans include investments in debt instruments and have been reclassified to the investment grade credit category within the bonds asset class.
- <sup>4</sup> Exposures to equities are obtained in part through the use of derivatives. It is therefore the notional amount of the derivative that will determine the Scheme's exposure.
- <sup>5</sup> The Scheme consolidates entities in accordance with FRS 102 and thus the underlying assets and liabilities of those entities are presented in the appropriate lines in the Consolidated statement of net assets where permitted by the Pensions SORP. Reclassifications between asset classes have therefore been applied so the managed asset exposure is adequately reflected.
- <sup>6</sup> The cash balance represents the value of cash and cash equivalents, net of the amount required to back open derivative contracts (refer to footnote 4 above).
- <sup>7</sup> Equities have been reclassified between those that are actively and passively managed.
- <sup>8</sup> Bonds have been reclassified between investment grade corporate bonds and government bonds.
- <sup>9</sup> Investments are classified according to the legal nature of the security or investment instrument within the Consolidated statement of net assets. Within the managed allocation, investments are classified according to the sector to which each investment mandate has exposure. Reclassifications between asset classes have therefore been applied so the managed asset exposure is adequately reflected.



# Independent auditor's report

## To the Trustee of the BT Pension Scheme

We have audited the financial statements of BT Pension Scheme ("the Scheme") for the year ended 30 June 2017, which comprise the Consolidated Fund Account and the Consolidated Statement of Net Assets (available for benefits) and related notes, including the accounting policies in note 2.

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the Scheme year ended 30 June 2017 and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- contain the information specified in Regulation 3 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Scheme in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

### Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate, or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

### Other information

The Trustee is responsible for the other information, which comprises the Report by the Trustee (including the Report on actuarial liabilities and the summary of contributions) and the actuarial certification of the Schedule of Contributions. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon in this report.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on this work we have not identified material misstatements in the other information.

## Independent auditor's report

### Trustee's responsibilities

As explained more fully in their statement set out on page 23, the Scheme Trustee is responsible for: supervising the preparation of financial statements which show a true and fair view; such internal controls as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Scheme's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to wind up the Scheme, or have no realistic alternative but to do so.

### Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at <http://www.frc.org.uk/auditorsresponsibilities>.

### The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Scheme Trustee in accordance with the Pensions Act 1995 and Regulations made thereunder. Our audit work has been undertaken so that we might state to the Scheme Trustee those matters we are required to state to it in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme Trustee, for our audit work, for this report, or for the opinions we have formed.

### KPMG LLP

Chartered Accountants and Statutory Auditor  
15 Canada Square  
Canary Wharf  
London, E14 5GL  
United Kingdom

19 October 2017

# Independent auditor's statement about contributions

## To the Trustee of the BT Pension Scheme

### Statement about contributions

We have examined the summary of contributions payable under the Schedule of Contributions to the BT Pension Scheme in respect of the Scheme year ended 30 June 2017 which is set out on page 34.

In our opinion contributions for the Scheme year ended 30 June 2017 as reported in the summary of contributions and payable under the Schedule of Contributions have in all material respects been paid at least in accordance with the Schedule of Contributions certified by the actuary on 29 January 2015.

### Scope of work on statement about contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the summary of contributions have in all material respects been paid at least in accordance with the Schedule of Contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the Schedule of Contributions.

### Respective responsibilities of the Trustee and the auditor

As explained more fully in the Statement of Trustee's responsibilities set out on page 23, the Scheme's Trustee is responsible for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions showing the rates and due dates of certain contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme. The Trustee is also responsible for keeping records in respect of contributions received in respect of active members of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the Schedule of Contributions.

It is our responsibility to provide a statement about contributions paid under the Schedule of Contributions to the Scheme and to report our opinion to you.

### The purpose of our work and to whom we owe our responsibilities

This statement is made solely to the Scheme's Trustee in accordance with the Pensions Act 1995 and Regulations made thereunder. Our work has been undertaken so that we might state to the Scheme's Trustee those matters we are required to state to it in an auditor's statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee for our work, for this statement, or for the opinions we have formed.

### KPMG LLP

Chartered Accountants and Statutory Auditor  
15 Canada Square  
Canary Wharf  
London, E14 5GL  
United Kingdom

19 October 2017

# Summary of contributions

## Statement of Trustee's responsibilities in respect of contributions

The Scheme's Trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions showing the rates of contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme and the dates on or before which such contributions are to be paid. The Scheme's Trustee is also responsible for keeping records of contributions received in respect of any active member of the Scheme and for procuring that contributions are made to the Scheme in accordance with the schedule.

The below summary has been prepared on behalf of, and is the responsibility of, the Trustee. It sets out the employers' and employees' contributions payable to the Scheme under the Schedule of Contributions for the year ended 30 June 2017. The Scheme's auditor reports on contributions payable under the Schedule, as shown in the "2017 per Schedule" column below, in their auditor's statement about contributions.

	2017 per Schedule £ million	2017 Additional £ million	2017 Total £ million
Employers' normal contributions	204	40	244
Employees' normal contributions	6	0	6
Employers' deficit funding contributions	250	0	250
Employers' other contributions	25	0	25
Employees' additional voluntary contributions	0	5	5
Employees' added years contributions	0	0	0
<b>Total contributions (see note 3 to the financial statements)</b>	<b>485</b>	<b>45</b>	<b>530</b>

Approved on behalf of the Trustee Board

**Paul Spencer CBE**

Chairman

19 October 2017

# Consolidated fund account

For the year ended 30 June 2017

	Notes	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
<b>Contributions and benefits</b>			
Employers' contributions	3	519	530
Employees' contributions	3	11	16
<b>Total contributions</b>		<b>530</b>	<b>546</b>
Benefits paid or payable	4	(2,274)	(2,282)
Payments to and on account of leavers	5	(75)	(31)
Administration expenses	6	(63)	(46)
<b>Net withdrawals from dealings with members</b>		<b>(1,882)</b>	<b>(1,813)</b>
<b>Returns on investments</b>			
Investment income	8	983	861
Change in market value of investments	9	4,222	3,972
Investment management expenses	10	(94)	(89)
Taxation	11	14	2
<b>Net returns on investments</b>		<b>5,125</b>	<b>4,746</b>
<b>Net increase in the Scheme during the year</b>		<b>3,243</b>	<b>2,933</b>
<b>Net assets of the Scheme</b>			
At 1 July		46,101	43,168
At 30 June		49,344	46,101

The notes on pages 38 to 63 form an integral part of the financial statements.

# Consolidated statement of net assets

(Available for benefits)

At 30 June 2017

	Notes	30 June 2017 £ million	30 June 2016 £ million
<b>Investment assets</b>			
Equities		11,459	11,677
Bonds		21,412	19,422
Property		1,432	1,875
Pooled investment vehicles	12	13,545	11,113
Loans		299	271
Derivatives	13	932	1,870
AVC investments	14	206	172
Deposits and short-term investments		869	2,769
Other investment assets	15	1,045	585
<b>Total investment assets</b>		<b>51,199</b>	<b>49,754</b>
<b>Investment liabilities</b>			
Derivatives	13	(751)	(2,268)
Longevity insurance contract	16	(351)	(223)
Other investment liabilities	17	(635)	(1,125)
<b>Total investment liabilities</b>		<b>(1,737)</b>	<b>(3,616)</b>
<b>Total net investments</b>		<b>49,462</b>	<b>46,138</b>
Current assets	20	64	81
Current liabilities	21	(182)	(118)
<b>Net assets of the Scheme at 30 June</b>		<b>49,344</b>	<b>46,101</b>

The notes on pages 38 to 63 form an integral part of the financial statements.

## Consolidated statement of net assets

### (Available for benefits)

The financial statements summarise the transactions of the Scheme and the net assets at the disposal of the Trustee. It does not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which takes into account such obligations, is dealt with in the Actuary's statement and report on actuarial liabilities and these financial statements should be read in conjunction with this report.

The notes on pages 38 to 63 form part of these financial statements.

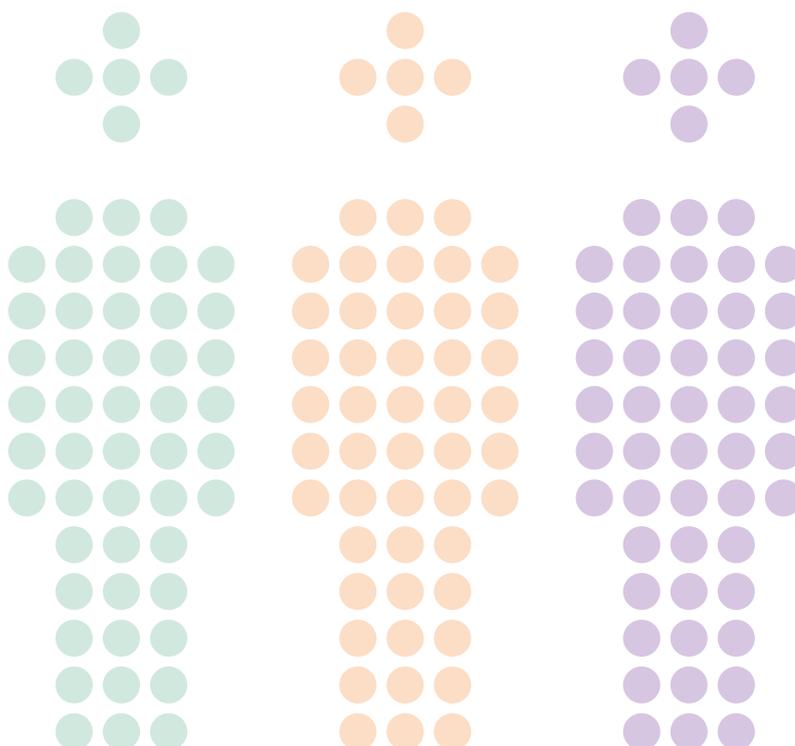
These financial statements were approved by the Trustee Board on 19 October 2017 and signed on their behalf by:

**Paul Spencer CBE**

Chairman

**John Wroe**

Trustee Director



# Notes to the financial statements

## 1. Basis of preparation

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including amendments to these regulations issued on 1 March 2016, Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council (“FRS 102”) and the guidance set out in the revised Statement of Recommended Practice “Financial Reports of Pension Schemes” (Revised November 2014) (“Pensions SORP”).

## 2. Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### Functional and presentational currency

The Scheme’s functional currency and presentational currency is Sterling (“GBP”). Assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the year end. Transactions denominated in foreign currencies are translated into Sterling at the spot exchange rate at the date of the transaction. The financial statements of consolidated overseas subsidiary undertakings are translated into Sterling at the exchange rates ruling at the year end. Foreign exchange gains and losses arising on conversion or translation are dealt with in the Consolidated fund account as part of the change in market value of investments.

### Contributions

Employers’ and employees’ normal contributions and employers’ deficit and other funding contributions are accounted for on an accruals basis in accordance with the Schedule of Contributions certified by the Actuary. Additional voluntary contributions are accounted for on an accruals basis.

### Benefits

Pensions in payment are accounted for in the year to which they relate. Payments represent all valid benefit claims notified to the Trustee during the Scheme year. Pension benefits include any realised gains or losses on the longevity insurance contract incurred during the year.

### Transfers

Individual transfers in and out of the Scheme are accounted for on a cash basis. Group transfers are accounted for on a cash basis, unless the terms of the agreements signed by the Trustee relating to such transfers state otherwise.

### Administration and other expenses

Administrative expenses and other expenses are accounted for on an accrual basis.

### Basis of consolidation

Under FRS 102 and the Pensions SORP it is not a requirement for the Scheme to consolidate subsidiary undertakings and joint ventures, however, it may choose to do so. The Trustee has elected to prepare consolidated financial statements for the Scheme, that consolidates investments in subsidiary undertakings where permitted. Consolidation results in the fair value of underlying assets and liabilities, and income and expenses of each investment in a group entity to be aggregated with those presented by the Scheme. Investments in group entities are reported in the Scheme’s Consolidated statement of net assets at their fair value. The fair value of the net assets of each investment in a group entity is presented in a manner that best represents the nature of the investment, such as consolidation of investments where permitted or presentation as equities or pooled investment vehicles. The Trustee has applied objective judgment based on the facts and circumstances of each subsidiary undertaking and joint venture to ensure the Scheme’s consolidated financial statements present a true and fair view.

## 2. Accounting policies (continued)

### Investments in subsidiary undertakings

A subsidiary undertaking is defined as an entity controlled by another entity. Control is defined as the power to govern the operating and financial policies of an entity to obtain benefits from its activities.

Under FRS 102, a subsidiary undertaking shall be excluded from consolidation and included at fair value where the investment is held exclusively with a view to subsequent resale. FRS 102's definition of "held exclusively with a view to subsequent resale" includes an interest which is held as part of an investment portfolio. An interest held as part of an investment portfolio is one where its value to the investor is through fair value as part of a directly or indirectly held basket of investments rather than as a vehicle through which the investor carries out business.

Where a subsidiary undertaking is not held exclusively with a view to subsequent resale, for example a trading entity, it has to be reported in the Scheme's Consolidated statement of net assets at fair value. A subsidiary undertaking may be consolidated by the Scheme so long as its assets and liabilities are measured at fair value. For a subsidiary undertaking where there is goodwill, the goodwill cannot be revalued and has to be amortised under FRS 102, therefore it does not represent fair value and it cannot be consolidated by the Scheme.

A summary of subsidiary undertakings that are consolidated is included in the note 25 "Subsidiary undertakings". The results of subsidiary undertakings that are consolidated in these financial statements are included from the date of acquisition and up to the date of disposal using the acquisition method of accounting. Consolidation is based on the latest available financial statements for those undertakings with a year end up to three months prior to that of the Scheme. In the case where an undertaking has a year end of more than three months prior to that of the Scheme, unaudited management information is used. Adjustments are made to align the accounting policies of the relevant undertaking with those of the Scheme.

### Investments in joint ventures

Investments in joint ventures are contractual arrangements to undertake economic activity subject to joint control. The Scheme invests in joint ventures as part of its investment portfolio. The Scheme is not required to consolidate investments in joint ventures but it may choose to do so where permitted. The fair value of the net assets in a joint venture are presented in a manner that best represents the nature of the investments. Investments in joint ventures are presented as pooled investment vehicles.

### Investments

Purchases and sales of securities are accounted for on a trade date basis. Property purchases are accounted for on exchange of unconditional contracts, otherwise on completion and sales are accounted for on completion.

### Offsetting financial assets and liabilities

Financial assets and liabilities are not offset unless there is a legally enforceable right to set off the assets and liabilities and the Scheme intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### Valuation of investments

Investment assets and liabilities are included in the financial statements at fair value. Fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction. The methods of determining fair value for classes of investments are detailed below.

Securities listed on order-driven exchanges are valued at closing bid prices at the year end. Other securities listed on recognised stock exchanges are valued at closing bid prices. For bond investments this valuation is reduced by the accrued interest therein. Such accrued interest is included in other investment assets.

Unquoted securities consist of equities, bonds, pooled investment vehicles and loans and are included at fair values estimated by the Trustee using appropriate valuation techniques. Unquoted equities are valued in accordance with International Private Equity and Venture Capital (IPEVC) guidelines based on the latest available information provided by investment managers. Unquoted bonds are valued using the latest market prices or discounted cash flow models that consider credit risk. Unquoted pooled investment vehicles and unit linked insurance policies are fair valued at year end published or available net asset valuations provided by the investment manager. Unquoted corporate loans are carried at fair value using the latest available prices in the market. Loans advanced for other investment activities are carried at cost less any provision for impairment.

## 2. Accounting policies (continued)

UK investment properties are independently valued by CBRE Limited and JLL, chartered surveyors, on the basis of market value in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors. Overseas properties are valued by independent nationally recognised appraisal firms that hold the Member of the Appraisal Institute designation. The valuations take into consideration the current estimate of the rental values and market yields of properties.

Derivatives are fair valued using the following valuation techniques:

For exchange traded derivatives that are assets, fair value is based on closing bid prices. For exchange traded derivatives that are liabilities, fair value is based on closing offer prices.

Futures contracts are exchange traded and fair value is determined using the exchange price for closing out the contract at the year end.

Options can be exchange traded or over the counter contracts. For exchange traded options contracts, fair value is determined using the exchange price for closing out the option at the year end. For over the counter options contracts, fair value is determined using pricing models that consider the time value of money, volatility and the current market and contractual prices of the underlying instruments.

Swaps are over the counter contracts and fair value is the current value of the future expected net cash flows, taking into account the time value of money. Fair value is calculated using discounted cash flows and market data at year end.

Open forward foreign currency contracts are over the counter contracts and are valued using forward currency rates at the year end. The unrealised appreciation or depreciation on open forward foreign currency contracts is calculated based on the discounted net present value of the difference between the contracted rate and the rate to close out the contract.

The longevity insurance contract is valued based on the future expected net cash flows, taking into account the time value of money and using market data at the year end.

### Investment income

Dividend income from equity investments is accounted for on the ex-dividend date. Interest income from bonds, deposits and short-term investments is taken into account on an accruals basis. Rental income from property is accounted for on an accruals basis. Income from pooled investment vehicles is accounted for when declared by the investment manager. Insurance risk and premium fees on the longevity insurance contract are recognised in the year incurred.

### Change in market value of investments

The change in market value of investments during the year comprises all increases and decreases in the fair values of investments held at any time during the year, including profits and losses realised on sales of investments during the year and unrealised changes in market value of investments held during the year.

### Sale and repurchase agreements

Securities sold subject to repurchase agreements are included in the financial statements within their respective investment classes at the year end fair value of the securities to be repurchased. Securities purchased subject to reverse repurchase agreements are included in the financial statements within other investment assets at the year end fair value of the securities to be repurchased.

### Collateral

Cash collateral balances due from and due to brokers are included in the financial statements within other investment assets and liabilities. Non-cash collateral that is pledged by the Scheme continues to be recognised in the Scheme's financial statements. Non-cash collateral posted by the Scheme by way of title transfer is derecognised in the Scheme's financial statements. Non-cash collateral pledged to the Scheme is not recognised in the Scheme's financial statements.

### Commitments

Commitments for property investments are stated at the amount authorised by the Trustee to provide development finance and to purchase properties. Commitments for securities investments are stated at the amount which may be called on partially paid and unpaid shares or which may be due on sub-underwriting contracts or which remain undrawn in commitments to pooled investment vehicles.

### 3. Contributions

On 29 January 2015 the Trustee and sponsor announced the agreement on the 30 June 2014 actuarial valuation and recovery plan. A sixteen year recovery plan has been agreed, and the sponsor is obliged to make a deficit funding contribution of £1,500 million by 30 April 2015, followed by £250 million in each of the years to 31 March 2016 and 31 March 2017. From 2018 to 2024, BT will make payments in line with the 2011 agreement (an average of £690 million per annum). After that, BT will pay £495 million per annum through to 2029, with a final payment of £289 million in 2030.

As a result of the 30 June 2014 actuarial valuation, the sponsor's regular contributions rate was increased from 13.5% to 16.0% effective from 1 April 2015 to 30 June 2017, and then increasing to 16.9% from 1 July 2017.

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Employers' normal contributions <sup>1</sup>	244	258
Employers' deficit funding contributions	250	250
Employers' other contributions <sup>2</sup> (refer to note 6)	25	22
<b>Employers' contributions</b>	<b>519</b>	<b>530</b>
Employees' normal contributions <sup>3</sup>	6	7
Employees' additional voluntary contributions	5	8
Employees' purchase of added years	0	1
<b>Employees' contributions</b>	<b>11</b>	<b>16</b>
<b>Total contributions</b>	<b>530</b>	<b>546</b>

<sup>1</sup>Employers' normal contributions include an allowance for any administrative expenses directly incurred by the Scheme.

<sup>2</sup>Employers' other contributions relate to reimbursement of the Pension Protection Fund levy (PPF levy) in accordance with the Schedule of Contributions certified on 29 January 2015.

<sup>3</sup>In 2004, the sponsor introduced a Salary Sacrifice scheme, 'Smart Pensions', whereby some Scheme members have taken a reduction in their salary in return for ceasing their contributions. The majority of members decided to participate in Smart Pensions resulting in all such employees' contributions being reported as employers' contributions.

### 4. Benefits paid or payable

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Pensions <sup>4</sup>	1,950	1,930
Commutations of pensions and lump sum retirement benefits	315	342
Lump sum death benefits	9	9
Taxation where lifetime or annual allowance exceeded <sup>5</sup>	0	1
	<b>2,274</b>	<b>2,282</b>

<sup>4</sup>In July 2014 a longevity insurance arrangement was entered into to protect the Scheme against costs associated with potential increases in life expectancy. This arrangement covers approximately 25% of the Scheme's longevity risk. Pensions benefits include a realised loss of £6 million on the arrangement during the year (2016: Realised loss of £4 million).

<sup>5</sup>Taxation arising on benefits paid or payable is in respect of members whose benefits exceeded the lifetime allowance or annual allowance and who elected to take lower benefits from the Scheme in exchange for the Scheme settling their tax liability. During the year the Scheme settled members tax liabilities in exchange for reduced future benefits. This included nine cases in respect of lifetime allowances amounting to £0.186 million (2016: Eight cases amounting to £0.739 million), and five cases in respect of annual allowances amounting to £0.130 million (2016: Five cases amounting to £0.094 million).

## 5. Payments to and on account of leavers

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Individual transfers out	75	31
	<b>75</b>	<b>31</b>

## 6. Administration expenses

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
PPF levy and associated costs <sup>6</sup> (refer to note 3)	33	22
Administration expenses <sup>7</sup>	30	24
	<b>63</b>	<b>46</b>

<sup>6</sup>The PPF levy comprised of £25 million for the 2016/2017 levy (2016: £22 million), and £6 million on outstanding PPF levies following the conclusion of the 'last man standing' assessment for the years 2011/2012 to 2014/2015, and associated interest charges estimated at £2 million (2016: £nil).

<sup>7</sup>Administration expenses include pensions administration expenses, actuary fees, custody fees, legal fees, other professional fees and includes £3 million of expenses in respect to related party transactions (2016: £4 million). Refer to note 23 "Related party transactions" for further information.

## 7. Auditors' remuneration

A summary of remuneration received by the auditors to the Scheme and subsidiary undertakings during the year are disclosed in the table below. Auditors' remuneration represents the combined remuneration of KPMG LLP and Deloitte LLP during the periods in the year that they were the auditors of the Scheme.

	KPMG LLP 7 April 2017 to 30 June 2017 £ thousand	Deloitte LLP 1 July 2016 to 6 April 2017 £ thousand	Total Year ended 30 June 2017 £ thousand	Total Year ended 30 June 2016 £ thousand
<b>Auditors' remuneration</b>				
Fees payable to Scheme's auditors for audit of Scheme's financial statements	346	26	372	293
Fees payable to Scheme's auditors for audit of Scheme's subsidiaries pursuant to legislation	571	579	1,150	1,303
<b>Total audit fees</b>	<b>917</b>	<b>605</b>	<b>1,522</b>	<b>1,596</b>
Other services pursuant to legislation	0	145	145	150
Tax services	0	37	37	43
Further assurance	0	1,061	1,061	40
Management consultancy	12	0	12	19
<b>Total non-audit fees</b>	<b>12</b>	<b>1,243</b>	<b>1,255</b>	<b>252</b>
Fees payable to the Scheme's auditors in respect of associated pension scheme	0	17	17	18
<b>Total remuneration to the Scheme's auditors</b>	<b>929</b>	<b>1,865</b>	<b>2,794</b>	<b>1,866</b>

## 7. Auditors' remuneration (continued)

	Year ended 30 June 2017 £ thousand	Year ended 30 June 2016 £ thousand
<b>Remuneration payable to other audit firms</b>		
Audit fees	838	848
Non audit-fees	3,195	2,199
<b>Total remuneration to other audit firms</b>	<b>4,033</b>	<b>3,047</b>

The £4,033k of remuneration paid to other audit firms includes remuneration to KPMG and Deloitte during the periods of the year they were not the auditors of the Scheme and subsidiary undertakings.

## 8. Investment income

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Dividends from equities	246	226
Income from bonds	443	446
Net rental income from properties <sup>8</sup>	108	101
Income from pooled investment vehicles	101	81
Derivatives	78	11
Longevity insurance contract	(30)	(30)
Interest on deposits and short-term investments	37	26
	<b>983</b>	<b>861</b>

<sup>8</sup>Net rental income from properties is stated after deducting £20 million of property related expenses (2016: £22 million).

## 9. Reconciliation of investments

For the year from 1 July 2016 to 30 June 2017	Market value at 30 June 2016 £ million	Net investment/ (disinvestment) £ million	Change in market value £ million	Market value at 30 June 2017 £ million
<b>Investment assets/(liabilities)</b>				
Equities	11,677	(2,731)	2,513	11,459
Bonds	19,422	953	1,037	21,412
Property	1,875	(393)	(50)	1,432
Pooled investment vehicles	11,113	971	1,461	13,545
Loans	271	28	0	299
Derivatives <sup>9</sup>	(398)	1,238	(659)	181
AVC investments	172	13	21	206
Longevity insurance contract	(223)	0	(128)	(351)
	<b>43,909</b>	<b>79</b>	<b>4,195</b>	<b>48,183</b>
Deposits and short-term investments	2,769		39	869
Other investment assets/(liabilities)	(540)		(12)	410
<b>Total net investments</b>	<b>46,138</b>		<b>4,222</b>	<b>49,462</b>

<sup>9</sup>Derivatives include both the derivative assets and liabilities which are presented separately in the Consolidated statement of net assets.

## 9. Reconciliation of investments (continued)

For the year from 1 July 2016 to 30 June 2017	Purchases at cost and derivative payments £ million	Sales proceeds and derivative receipts £ million	Net investment/ (disinvestment) £ million
<b>Investment assets/(liabilities)</b>			
Equities	5,437	(8,168)	(2,731)
Bonds	13,594	(12,641)	953
Property	27	(420)	(393)
Pooled investment vehicles	3,629	(2,658)	971
Loans	28	0	28
Derivatives	4,727	(3,489)	1,238
AVC investments	14	(1)	13
Longevity insurance contract	0	0	0
	<b>27,456</b>	<b>(27,377)</b>	<b>79</b>

Transaction costs are incremental costs directly attributable to the acquisition or disposal of an investment and are included in the cost of purchases and deducted from sale proceeds. Direct transaction costs incurred during the year to 30 June 2017 amounted to £11 million and include fees, commissions and taxes (2016: £8 million). In addition to these transaction costs, indirect costs are incurred through the bid-offer spread on investments and costs charged within pooled investment vehicles, however they are not separately provided to the Scheme.

For the year from 1 July 2016 to 30 June 2017	Transaction costs				
	Fees £ million	Commissions £ million	Taxes £ million	Other £ million	Total £ million
<b>Investment assets/(liabilities)</b>					
Equities	0	4	0	0	4
Property	1	3	0	0	4
Pooled investment vehicles	1	1	0	0	2
Derivatives	0	1	0	0	1
<b>Total transaction costs</b>	<b>2</b>	<b>9</b>	<b>0</b>	<b>0</b>	<b>11</b>

For the year from 1 July 2015 to 30 June 2016	Transaction costs				
	Fees £ million	Commissions £ million	Taxes £ million	Other £ million	Total £ million
<b>Investment assets/(liabilities)</b>					
Equities	0	3	0	0	3
Property	2	1	1	0	4
Derivatives	0	1	0	0	1
<b>Total transaction costs</b>	<b>2</b>	<b>5</b>	<b>1</b>	<b>0</b>	<b>8</b>

## 10. Investment management expenses

	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Investment management expenses <sup>10</sup>	94	89
	<b>94</b>	<b>89</b>

<sup>10</sup>Investment management expenses include £21 million of expenses to operate BT Pension Scheme Management Limited (2016: £18 million); £30 million of non HFML management expenses (2016: £25 million) and £43 million of direct HFML management expenses (2016: £46 million). Refer to note 23 "Related party transactions" for further information.

## 11. Taxation

The Scheme is a registered pension scheme under provisions of the Finance Act 2004 for taxation purposes and it is therefore exempt from income tax and capital gains tax. The tax charge or credit presented in the Consolidated fund account represents irrecoverable withholding taxes or refunds of withholding taxes arising on investment income, and deferred taxation on all timing differences relating to investment property.

## 12. Pooled investment vehicles

The Scheme's investments in pooled investment vehicles at the year end comprised:

	30 June 2017 £ million	30 June 2016 £ million
Equities	576	1,041
Bonds	180	222
Hedge funds	4,533	4,304
Liquidity funds	2,457	0
Mature infrastructure	510	431
Private equities	1,677	1,345
Property	3,612	3,769
Unit linked insurance policies	0	1
	<b>13,545</b>	<b>11,113</b>

Included within pooled investment vehicles are certain investments where legal or contractual restrictions can limit the timing of redemptions. This is a characteristic of the investments which is considered as part of the initial investment decision making process, and these restrictions are actively monitored on an ongoing basis.

## 12. Pooled investment vehicles (continued)

The Scheme is the sole investor in a number of pooled investment vehicles. The table below provides information on the assets and liabilities of these investments.

	30 June 2017		30 June 2016	
	Assets £ million	Liabilities £ million	Assets £ million	Liabilities £ million
<b>Private equity</b>				
Hermes Private Equity Investments Holding 2004 L.P.	11	0	15	0
Hermes Private Equity Investments Holding 2005 L.P.	35	0	39	0
Hermes Private Equity Investments Holding 2006 L.P.	54	0	59	0
Hermes Private Equity Investments Holding 2007 L.P.	19	0	25	0
Hermes Private Equity Investments Holding 2008 L.P.	31	0	46	0
Hermes GPE PEC 1 L.P.	179	0	216	0
Hermes GPE PEF 1 L.P.	440	0	366	0
Hermes GPE Horizon L.P.	409	0	141	0
Orthogonal Partners I L.P.	94	0	91	0
	<b>1,272</b>	<b>0</b>	<b>998</b>	<b>0</b>
<b>Property</b>				
Argent Group plc	39	(12)	74	(47)
Gotham Segregated Account I L.P.	211	(45)	195	(50)
Hermes Factory Outlets Unit Trust	0	0	217	(2)
Hermes Factory Outlets No. 2 Unit Trust	0	0	133	0
Lionstone-Hermes Real Estate Venture L.P.	204	(36)	190	(46)
MEPC Fund Unit Trust	867	(239)	551	(181)
	<b>1,321</b>	<b>(332)</b>	<b>1,360</b>	<b>(326)</b>
<b>Other funds</b>				
Apollo Tower Credit Fund L.P.	98	0	0	0
ATCF Holdco Sarl	78	0	0	0
Ares European Credit Strategies Fund II (B) L.P.	479	(23)	413	(17)
HCN L.P.	466	(86)	356	(34)
Hermes Alternative Funds plc	12	0	90	(1)
Hermes Direct Lending Fund L.P.	60	(2)	0	0
Hermes Real Estate Senior Debt Fund L.P.	289	(2)	324	(7)
Strategic Investment Portfolio L.P.	1,303	0	1,260	0
	<b>2,785</b>	<b>(113)</b>	<b>2,443</b>	<b>(59)</b>
<b>Total</b>	<b>5,378</b>	<b>(445)</b>	<b>4,801</b>	<b>(385)</b>

## 13. Derivatives

### Objectives

The Trustee has authorised the use of derivatives as part of the overall investment strategy for the Scheme. The main objectives for the use of derivatives are summarised below.

### Futures contracts

Futures contracts are entered into as a method of managing the Scheme's exposure to a particular market or sector. Futures contracts provide an efficient way of modifying portfolio risk to remain within asset allocations governed by the investment strategy of the Scheme.

### Options contracts

Options contracts are acquired or sold as a method of managing the Scheme's exposure to a particular market or sector.

### Swap contracts

Swap contracts are used to modify the Scheme's exposure to various asset classes. Interest rate swaps are held to decrease the Scheme's interest rate risk exposure. Inflation swaps are held to decrease the Scheme's inflation risk exposure.

### Foreign exchange forward contracts

Foreign exchange forward contracts are used to manage the Scheme's currency exposures.

Disclosure of the derivatives held at year end are set out below:

	30 June 2017 £ million	30 June 2016 £ million
<b>Assets</b>		
Futures contracts		
- Equities	13	2
- Fixed interest	5	8
- Currency	0	0
Options contracts	47	91
Swap contracts	627	1,687
Foreign exchange forward contracts	240	82
	<b>932</b>	<b>1,870</b>

	30 June 2017 £ million	30 June 2016 £ million
<b>Liabilities</b>		
Futures contracts		
- Equities	(47)	(29)
- Fixed interest	(2)	(24)
- Currency	0	0
Options contracts	(59)	0
Swap contracts	(601)	(1,579)
Foreign exchange forward contracts	(42)	(636)
	<b>(751)</b>	<b>(2,268)</b>

### 13. Derivatives (continued)

Futures contracts Exchange traded	30 June 2017				30 June 2016			
	Economic exposure				Economic exposure			
	Long £ million	Short £ million	Asset £ million	Liability £ million	Long £ million	Short £ million	Asset £ million	Liability £ million
Equities	9	(2,995)	13	0	777	(447)	2	(29)
Fixed interest	250	(804)	5	(2)	487	(946)	8	(24)
Currency	0	0	0	0	0	(25)	0	0
	<b>259</b>	<b>(3,799)</b>	<b>18</b>	<b>(2)</b>	<b>1,264</b>	<b>(1,418)</b>	<b>10</b>	<b>(53)</b>

Futures contracts Over the counter	30 June 2017				30 June 2016			
	Economic exposure				Economic exposure			
	Long £ million	Short £ million	Asset £ million	Liability £ million	Long £ million	Short £ million	Asset £ million	Liability £ million
Equities	0	(239)	0	(47)	0	0	0	0
	<b>0</b>	<b>(239)</b>	<b>0</b>	<b>(47)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

The economic exposure represents the notional value of securities purchased or sold under the futures contracts.

All of the contracts settle in less than one year (2016: All contracts settle in less than one year). At the end of the year the Scheme held cash collateral of £111 million on futures contracts (2016: Scheme held cash collateral of £53 million on futures contracts).

Option contracts	30 June 2017				30 June 2016			
	Notional amount of outstanding contracts				Notional amount of outstanding contracts			
	Long £ million	Short £ million	Asset £ million	Liability £ million	Long £ million	Short £ million	Asset £ million	Liability £ million

#### Exchange traded

Currency - put	0	0	0	0	21	0	0	0
	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>21</b>	<b>0</b>	<b>0</b>	<b>0</b>

#### Over the counter

Currency	13	0	0	0	0	0	0	0
Interest rate swaptions	8,398	(7,934)	47	(59)	1,484	(1,811)	91	0
	<b>8,411</b>	<b>(7,934)</b>	<b>47</b>	<b>(59)</b>	<b>1,484</b>	<b>(1,811)</b>	<b>91</b>	<b>0</b>

Notional amount of outstanding contracts represents the value of underlying securities protected by the purchased options.

All of the contracts settle in less than one year, except for interest rate swaptions contracts that have maturity dates of up to thirty one years. (2016: All contracts settle in less than one year, except for interest rate swaptions contracts that have maturity dates of up to twenty one years).

### 13. Derivatives (continued)

Swap contracts - Over the counter			30 June 2017			
Type of contract	Expiration	Nature of swap	Notional principal		Asset £ million	Liability £ million
			Long £ million	Short £ million		
Equity total return	< 3 years	Common stock	13,153	0	2	(4)
Interest rate	< 52 years	Fixed for floating and floating for fixed	24,156	(2,654)	505	(152)
Inflation rate	< 52 years	Coupon for floating	4,811	0	0	(435)
Bond total return	< 4 years	UK Government bonds	757	0	115	(10)
Credit default	< 42 years	Itraxx Europe	30	(52)	5	0
			<b>42,907</b>	<b>(2,706)</b>	<b>627</b>	<b>(601)</b>

Swap contracts - Over the counter			30 June 2016			
Type of contract	Expiration	Nature of swap	Notional principal		Asset £ million	Liability £ million
			Long £ million	Short £ million		
Equity total return	< 1 year	Common stock	6,456	0	73	(14)
Interest rate	< 53 years	Fixed for floating and floating for fixed	17,334	(1,869)	1,460	(76)
Inflation rate	< 52 years	Coupon for floating	4,747	0	0	(1,489)
Bond total return	< 5 years	UK Government bonds	637	0	152	0
Credit default	< 30 years	Itraxx Europe	39	(17)	2	0
			<b>29,213</b>	<b>(1,886)</b>	<b>1,687</b>	<b>(1,579)</b>

At the end of the year the Scheme provided cash collateral of £444 million, received pledged bond collateral of £136 million and it pledged bond collateral of £1,299 million on swap contracts and the longevity insurance contract (2016: Provided cash collateral of £610 million; pledged bond collateral of £1,501 million).

### 13. Derivatives (continued)

Foreign exchange forward contracts – Over the counter		30 June 2017			30 June 2016		
Currency bought	Currency sold	Notional principal £ million	Asset £ million	Liability £ million	Notional principal £ million	Asset £ million	Liability £ million
EUR	GBP	92	0	0	86	1	0
AUD	USD	0	0	0	544	10	(1)
CAD	USD	0	0	0	160	0	(5)
USD	GBP	2,624	0	(10)	373	5	0
USD	OTHER	1,641	7	(12)	2,477	11	(22)
GBP	EUR	958	3	(3)	558	0	(24)
GBP	JPY	66	1	0	684	0	(51)
GBP	OTHER	543	1	(1)	68	0	(1)
GBP	USD	14,566	214	(2)	8,894	29	(473)
JPY	GBP	409	0	(12)	6	1	0
NOK	USD	431	2	0	775	0	(17)
SEK	EUR	0	0	0	239	0	(3)
SEK	USD	368	11	0	687	0	(20)
OTHER	OTHER	735	1	(2)	2,165	25	(19)
		<b>22,433</b>	<b>240</b>	<b>(42)</b>	<b>17,716</b>	<b>82</b>	<b>(636)</b>

All of the contracts settle in less than two years (2016: All of the contracts settle in less than one year).

### 14. Additional voluntary contributions (AVCs)

Members AVCs are invested separately from the principal scheme on a money purchase basis with Equitable Life Assurance Society, Standard Life Assurance Company, BlackRock Investment Management (UK) Limited and Legal & General Investment Management Limited. These assets are in the form of cash deposits and insurance policies securing additional benefits on a money purchase basis for those members electing to pay AVCs. Members participating in these arrangements receive an individual annual statement each year, confirming the amounts held in their account and the movements in the year. The aggregate amount of AVC investments is as follows:

	Insurance policies £ million	Cash deposits £ million	30 June 2017 £ million	30 June 2016 £ million
At start of year	25	147	172	149
Net contributions by members	2	11	13	17
Change in market value of investments	3	18	21	6
<b>At end of year</b>	<b>30</b>	<b>176</b>	<b>206</b>	<b>172</b>

## 15. Other investment assets

	30 June 2017 £ million	30 June 2016 £ million
Accrued investment income	165	196
Amounts due from brokers	712	245
Margin deposits – initial	130	14
Margin deposits – variation	0	30
Receivable on sale of investments	0	100
Reverse repurchase agreements	38	0
	<b>1,045</b>	<b>585</b>

## 16. Longevity insurance contract

	30 June 2017 £ million	30 June 2016 £ million
Longevity insurance contract <sup>11</sup>	351	223
	<b>351</b>	<b>223</b>

<sup>11</sup>Represents unrealised loss on longevity insurance contract involving the exchange of future payments based on expected longevity with future payments based on actual longevity.

## 17. Other investment liabilities

	30 June 2017 £ million	30 June 2016 £ million
Amounts due to brokers	588	277
Deferred income	17	19
Margin deposits – initial	14	0
Margin deposits – variation	16	605
Repurchase agreements	0	224
	<b>635</b>	<b>1,125</b>

## 18. Fair valuation hierarchy

The fair values of financial assets and liabilities have been estimated based on the following fair value hierarchy:

**Level 1:** Unadjusted quoted price in an active market for identical assets or liabilities that can be accessed at the measurement date.

**Level 2:** Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

**Level 3:** Inputs that are unobservable (i.e. for which market data is unavailable) for the asset or liability.

A fair value measurement is categorised in its entirety on the basis of the lowest level input that is significant to the fair value measurement in its entirety. Assessing whether inputs are observable and whether the unobservable inputs are significant may require judgment and a careful analysis of the inputs used to measure fair value, including consideration of factors specific to the asset or liability. The Scheme's financial assets and liabilities have been fair valued using the hierarchy categories.

	30 June 2017			
Asset class	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
Equities	10,267	0	1,192	11,459
Bonds	12,107	9,065	240	21,412
Property	0	1,432	0	1,432
Pooled investment vehicles	0	4,985	8,560	13,545
Loans	0	299	0	299
Derivatives	16	165	0	181
AVC investments	176	30	0	206
Deposits and short-term investments	869	0	0	869
Longevity insurance contract	0	0	(351)	(351)
Other investment assets and liabilities	410	0	0	410
<b>Total net investments</b>	<b>23,845</b>	<b>15,976</b>	<b>9,641</b>	<b>49,462</b>

	30 June 2016			
Asset class	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
Equities	10,819	18	840	11,677
Bonds	10,857	8,365	200	19,422
Property	0	1,875	0	1,875
Pooled investment vehicles	0	3,354	7,759	11,113
Loans	0	271	0	271
Derivatives	(43)	(355)	0	(398)
AVC investments	147	25	0	172
Deposits and short-term investments	2,713	56	0	2,769
Longevity insurance contract	0	0	(223)	(223)
Other investment assets and liabilities	(540)	0	0	(540)
<b>Total net investments</b>	<b>23,953</b>	<b>13,609</b>	<b>8,576</b>	<b>46,138</b>

## 18. Fair valuation hierarchy (continued)

Significant assumptions applied in the determination of fair values for financial assets and liabilities subject to valuation techniques are set out below.

30 June 2017			
Level 2	Fair value £ million	Valuation technique	Significant assumptions
Bonds	9,065	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Property	1,432	RICS guidelines	Rental yields, occupancy rates
Pooled investment vehicles	4,985	Published net asset values	Redemption discount
Loans	299	Amortised cost	Discount rate, credit risk
Derivatives	165	Forward rates, yield curves	Cost of carry, yield curves
AVC investments	30	Published net asset values	Redemption discount
<b>Total</b>	<b>15,976</b>		

30 June 2017			
Level 3	Fair value £ million	Valuation technique	Significant assumptions
Equities	1,192	IPEVC guidelines	Discount rate, earnings assumptions
Bonds	240	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Pooled investment vehicles	8,560	Published net asset values	Redemption discount
Longevity insurance contract	(351)	Discounted cash flow	Discount rate, cash flow profile, actuarial assumptions
<b>Total</b>	<b>9,641</b>		



## 18. Fair valuation hierarchy (continued)

30 June 2016			
Level 2	Fair value £ million	Valuation technique	Significant assumptions
Equities	18	Evaluated pricing models, broker quotes	Market risk
Bonds	8,365	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Property	1,875	RICS guidelines	Rental yields, occupancy rates
Pooled investment vehicles	3,354	Published net asset values	Redemption discount
Loans	271	Amortised cost	Discount rate, credit risk
Derivatives	(355)	Forward rates, yield curves	Cost of carry, yield curves
AVC investments	25	Published net asset values	Redemption discount
Deposits and short-term investments	56	Amortised cost	Discount rate, credit risk
<b>Total</b>	<b>13,609</b>		

30 June 2016			
Level 3	Fair value £ million	Valuation technique	Significant assumptions
Equities	840	IPEVC guidelines	Discount rate, earnings assumptions
Bonds	200	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Pooled investment vehicles	7,759	Published net asset values	Redemption discount
Longevity insurance contract	(223)	Discounted cash flow	Discount rate, cash flow profile, actuarial assumptions
<b>Total</b>	<b>8,576</b>		

## 19. Investment risks

### Investment objective

The investment objective of the Scheme is to maintain an investment portfolio with appropriate liquidity which will generate investment returns to meet, together with future contributions, the benefits payable under the Trust Deed and Rules as they fall due. The Trustee sets the investment strategy for the Scheme as detailed in the Statement of Investment Principles (SIP). FRS 102 requires the disclosure of information in relation to market risk and credit risk.

- **Market risk:** This is the risk the fair value or future cash flows of a financial instrument may fluctuate because of changes in market prices. Market risk comprises interest rate risk, currency risk and other price risk.
  - **Interest rate risk:** This is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
  - **Currency risk:** This is the risk the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
  - **Other price risk:** This is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the financial instrument or its issuers, or factors affecting all similar financial instruments traded in the market.
- **Credit risk:** This is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

The Scheme is exposed to inflation risk and longevity risk as detailed below.

- **Inflation risk:** This is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in inflation.

The Scheme is subject to inflation risk because some of the Scheme's investments are held in inflation linked bonds and derivatives (refer to "Interest rate risk" disclosure in this note for investment exposures). The Trustee hedges Scheme liabilities on a sensitivity basis as part of the investment strategy. Under this strategy, if inflation increases the value of inflation linked investments will rise to help match the increase in actuarial liabilities arising from an increase in inflation linked pension payments. Similarly, if inflation falls the inflation linked investments will fall in value as will the actuarial liabilities.

- **Longevity risk:** This is the risk of higher than expected life expectancy trends amongst the Scheme's pensioners.

A longevity insurance arrangement has been entered into to protect the Scheme against costs associated with potential increases in life expectancy of the Scheme's pensioners. This arrangement covers approximately 25% of the Scheme's longevity risk.

The Trustee manages investment risks within agreed risk limits which are set taking into account the Scheme's strategic investment objectives. These objectives and risk limits are implemented by BTPSM and through investment management agreements in place with investment managers and monitored by the Trustee. Further information on the Trustee's approach to risk management is detailed in this note.

The Scheme is exposed to liquidity risk, which is the risk that the Scheme will encounter difficulty in realising its assets or raising funds to meet its obligations, primarily in respect to funding members pension benefits and collateral requirements. The Trustee manages the Scheme's liquidity risk by monitoring potential and actual future liquidity requirements on an ongoing basis, ensuring that sufficient cash resources can be made available for projected cash requirements of the Scheme.

### Interest rate risk

The Scheme is subject to interest rate risk on bonds, pooled investment vehicles, loans, derivatives, deposits and short-term investments. The Trustee hedges Scheme liabilities on a sensitivity basis as part of the investment strategy. Under this strategy, if interest rates fall, the value of these investments will rise to help match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise, investment values will fall in value as will the actuarial liabilities because of an increase in the discount rate.

## 19. Investment risks (continued)

### Currency risk

The Scheme is subject to currency risk as some investments are held in overseas markets, either as segregated investments or pooled investment vehicles. The Trustee manages currency exposures with strategic currency hedging benchmark limits achieved through a currency hedging policy. It is also exposed to indirect currency risk on underlying investments held in pooled investment vehicles.

### Other price risk

Other price risk arises in the Scheme's investments portfolio that includes equities, property, pooled investment vehicles and derivatives. The Trustee has set a target investment return expected to be sufficient to support payment of the Scheme's liabilities. A diverse portfolio of investments is used to manage exposure to price movements.

The following table summarises the extent to which various classes of investments are affected by market risks:

	Market risk			Total 30 June 2017 £ million	Total 30 June 2016 £ million
	Interest rate	Currency	Other price		
Equities	○	◐	●	11,459	11,677
Bonds	●	◐	○	21,412	19,422
Property	○	◐	●	1,432	1,875
Pooled investment vehicles	◐	◐	●	13,545	11,113
Loans	●	◐	○	299	271
Derivatives	◐	◐	◐	181	(398)
Longevity insurance contract	◐	○	●	(351)	(223)
AVC investments	◐	◐	●	206	172
Deposits and short-term investments	●	◐	○	869	2,769
Other investment assets/(liabilities)	◐	◐	◐	410	(540)
<b>Total net investments</b>				<b>49,462</b>	<b>46,138</b>

In the above table, the relevant risks affect the asset classes with ● significant exposure, ◐ some exposure or ○ no exposure with the following definitions.

An investment risk determined to have significant exposure is a risk that in the judgment of management, represents a material component of gross overall investment risk exposure to the Scheme, before derivative overlay contracts are taken into consideration to manage investment risk.

An investment risk determined to have some exposure is a risk that in the judgment of management, has a limited contribution to gross overall investment risk exposure to the Scheme.

An investment risk determined to have no exposure is a risk that in the judgment of management, has either a residual or no contribution to gross overall investment risk to the Scheme.

In addition, the Trustee uses derivatives to manage investment risk exposures of the Scheme as detailed in note 13.

### Credit risk

The Scheme is subject to direct credit risk as it invests in bonds, pooled investment vehicles, loans, over the counter derivatives, and holds deposits and short-term investments. It is also exposed to indirect credit risk on underlying investments held in pooled investment vehicles. The Pensions SORP recommends credit risk exposure on investments in pooled investment vehicles is disclosed on a look through basis. Credit quality of direct and indirect investments subject to credit risk is provided in this note.

## 19. Investment risks (continued)

Credit risk 30 June 2017	Investment grade £ million	Non investment grade £ million	Unrated £ million	Total £ million
<b>Direct exposure</b>				
Bonds	18,512	744	2,156	21,412
Pooled investment vehicles	0	0	13,545	13,545
Loans	0	0	299	299
Over the counter derivatives	165	0	0	165
Deposits and short-term investments	869	0	0	869
<b>Gross exposure</b>	<b>19,546</b>	<b>744</b>	<b>16,000</b>	<b>36,290</b>
Credit derivatives (notional amount on contracts)	(22)	0	0	(22)
<b>Net exposure</b>	<b>19,524</b>	<b>744</b>	<b>16,000</b>	<b>36,268</b>
<b>Indirect exposure</b>				
Bonds	(9)	85	102	178
Pooled investment vehicles	0	0	1,354	1,354
Loans	0	75	1,045	1,120
Over the counter derivatives	(16)	0	0	(16)
Deposits and short-term investments	0	0	0	0
<b>Gross exposure</b>	<b>(25)</b>	<b>160</b>	<b>2,501</b>	<b>2,636</b>
Credit derivatives (notional amount on contracts)	(26)	0	0	(26)
<b>Net exposure</b>	<b>(51)</b>	<b>160</b>	<b>2,501</b>	<b>2,610</b>

## 19. Investment risks (continued)

Credit risk 30 June 2016	Investment grade £ million	Non investment grade £ million	Unrated £ million	Total £ million
<b>Direct exposure</b>				
Bonds	16,893	1,061	1,468	19,422
Pooled investment vehicles	0	0	11,113	11,113
Loans	0	0	271	271
Over the counter derivatives	(354)	0	0	(354)
Deposits and short-term investments	2,769	0	0	2,769
<b>Gross exposure</b>	<b>19,308</b>	<b>1,061</b>	<b>12,852</b>	<b>33,221</b>
Credit derivatives (notional amount on contracts)	(10)	0	0	(10)
<b>Net exposure</b>	<b>19,298</b>	<b>1,061</b>	<b>12,852</b>	<b>33,211</b>
<b>Indirect exposure</b>				
Bonds	22	51	117	190
Pooled investment vehicles	0	0	1,109	1,109
Loans	373	70	654	1,097
Over the counter derivatives	(6)	0	0	(6)
Deposits and short-term investments	1	0	0	1
<b>Gross exposure</b>	<b>390</b>	<b>121</b>	<b>1,880</b>	<b>2,391</b>
Credit derivatives (notional amount on contracts)	(39)	0	0	(39)
<b>Net exposure</b>	<b>351</b>	<b>121</b>	<b>1,880</b>	<b>2,352</b>

An investment grade rating indicates the counterparty to the security has a relatively low risk of default. Credit risk is managed under a credit risk management and counterparty approval policy. Approved counterparties are subject to credit risk assessments, regular monitoring of exposures against approved limits, credit quality and changes in credit conditions. Credit risk on derivatives depends on whether the derivatives are exchange traded or over the counter. Exchange traded derivatives are transacted with clearing brokers and credit risk is restricted to margin amounts posted to the clearing broker. Over the counter derivatives are not guaranteed by any regulated exchange and therefore the Scheme is subject to risk of failure by the counterparty. ISDA agreements with executed credit support annexes are in place with counterparties. The credit risk for over the counter derivatives is managed by collateral arrangements with counterparties.

The Scheme's investments in pooled investment vehicles are unrated. Credit risk on pooled investment vehicles is mitigated by the underlying investments of the pooled investment vehicles being ring fenced from the investment manager, the regulatory environments in which the investment managers operate and diversification of investments amongst a number of pooled arrangements. Due diligence reviews of investment managers are conducted on an ongoing basis, including the monitoring of any changes to regulatory and operating environments of investment managers.

## 20. Current assets

	30 June 2017 £ million	30 June 2016 £ million
Employers' contributions due	3	18
Employees' contributions due	0	1
Other debtors	58	58
Bank balances	3	4
	<b>64</b>	<b>81</b>

All contributions due to the Scheme relate to the month of June 2017 and were paid in full to the Scheme within the timescale required by the Schedule of Contributions in force at the year end.

## 21. Current liabilities

	30 June 2017 £ million	30 June 2016 £ million
Accrued benefits	50	48
Other creditors	132	70
	<b>182</b>	<b>118</b>

## 22. Securities lending

No securities were on loan at 30 June 2017 or 30 June 2016.

## 23. Related party transactions

In considering the Scheme's related party relationships it is necessary to assess the substance of relationships and not merely their legal form. FRS 102 states a person or a close member of that person's family is related to a reporting entity if that person:

- has control or joint control over the reporting entity;
- has significant influence over the reporting entity; or
- is a member of key management personnel of the reporting entity or of a parent of the reporting entity; and

An entity is related to a reporting entity if any of the following conditions apply:

- the entity and the reporting entity are members of the same group (which means that each parent, subsidiary undertaking and fellow subsidiary undertaking is related to the others);
- one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);
- both entities are joint ventures of the same third party;
- one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsor is also related to the reporting entity;
- the entity is controlled or jointly controlled by a person identified above;
- a person identified above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

FRS 102 defines key management personnel as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

This note provides information on transactions between the Scheme and related parties, all of which were conducted on terms equivalent to those that prevail in arm's length transactions.

## 23. Related party transactions (continued)

### Trustee related party transactions

Members of the Trustee Board represent key management personnel of the Scheme. The compensation of key management personnel is detailed in the table below.

Trustee director fees	Year ended 30 June 2017 £ thousand	Year ended 30 June 2016 £ thousand
Paul Spencer CBE	230	200
Catherine Claydon (resigned 31 December 2016)	36	71
Adrian Askew	30	29
The Law Debenture Pension Trust Corporation plc (represented by David Felder)	57	56
Donald MacDonald (resigned 10 January 2017)	21	39
Ben Marshall (appointed 11 January 2017)	13	0
Keith Nichols (appointed 15 May 2017)	7	0
Billy McClory	30	29
Beryl Shepherd	30	29
John Wroe	7	0
	<b>461</b>	<b>453</b>

Further to the amounts disclosed above, the following Trustee directors received additional compensation from other group entities: Paul Spencer CBE served as non-executive director and chair of Hermes Fund Managers Limited until March 2016 and received £65,625 for the year ended 30 June 2016. Paul served as non-executive director and chair of BTPSM Limited during the year. From 1 April 2016, Paul was not separately remunerated for the role of Chairman of the Trustee Board and chair of BTPSM Limited, therefore the schedule of Trustee director fees reflects this combined role. Adrian Askew served as a non-executive director and chair of the remuneration committee of BTPSM Limited and received £12,500 (2016: £12,500) and £5,000 (2016: £5,000) respectively. The Law Debenture Pension Trust Corporation plc (represented by David Felder) served as a non-executive director of BTPSM Limited and received £15,447 (2016: £28,038). Billy McClory served as the senior non-executive director of Hermes Fund Managers Limited during the year and received £35,000 (2016: £27,500). Jim McInally received no fees. John Wroe received no fees until June 2017.

Two Trustee directors were members of the Scheme at 30 June 2017 (2016: Three).

### Employer related party transactions

Hermes GPE FRWL Holdco Limited ("Holdco") is a subsidiary of the Scheme and it invests in Fallago Rig Windfarm Limited ("FRWL"). FRWL owns a wind farm that is generating electricity from renewable sources in Great Britain. Effective 1 April 2014 to 31 March 2034 FRWL and BT entered into a power purchase agreement. BT agreed to purchase 50% of the metered output generated by the wind farm and certain associated benefits, including Renewable Obligation Certificates ("ROCs") and Levy Exemption Certificates ("LECs"). In addition, effective 1 April 2014 to 31 March 2034 the Holdco and BT agreed to make certain payments based upon the difference between the price payable under the power purchase agreement for electrical output and a price specified in the agreement.

### Self-investments

At 30 June 2017: the Scheme did not directly hold any ordinary shares in BT (2016: £nil), however, it held £10 million in BT index-linked investments (2016: £9 million), and £4 million in EE Finance plc corporate bond investments (2016: £nil). The total amount of self-investments represents 0.03% of the net assets of the Scheme (2016: 0.02%). At 30 June 2017 there were no properties occupied by BT owned by the Scheme (2016: None).

## 23. Related party transactions (continued)

### Deed of support

The Trustee of the Scheme has agreed to provide additional capital to Hermes Fund Managers Limited (HFML) if the directors of HFML consider its capital is insufficient to meet regulatory capital requirements, and this insufficiency arises as a direct result of obligations HFML has at the time in respect to Hermes Group Pension Scheme in its capacity as a principal employer of the Scheme.

### Other related party transactions

The table below sets out related party transactions and balances between the Scheme and subsidiary undertakings (refer to note 25 “Subsidiary undertakings” for information on the Scheme’s subsidiaries):

Related party	Transaction	30 June 2017		30 June 2016	
		Expense 30 June 2017 £ million	Payable 30 June 2017 £ million	Expense 30 June 2016 £ million	Payable 30 June 2016 £ million
Hermes Fund Managers Limited	Investment management and performance fees	(52)	(6)	(57)	(6)
Hermes Fund Managers Limited	Other expenses	(3)	(1)	(4)	(1)
Hermes Fund Managers Limited	Loan provided by Scheme	0	6	0	6
		<b>(55)</b>	<b>(1)</b>	<b>(61)</b>	<b>(1)</b>

## 24. Commitments and contingent liabilities

	30 June 2017 £ million	30 June 2016 £ million
Property	196	208
Calls on partly paid shares and underwriting commitments	2,394	1,349
	<b>2,590</b>	<b>1,557</b>

## 25. Subsidiary undertakings

Subsidiary undertaking	Principal activity	Holding	30 June 2017 Ownership %	30 June 2016 Ownership %
<b>Subsidiary undertakings presented on a consolidated basis</b>				
BT Pension Scheme Management Limited <sup>12</sup>	Executive arm of Trustee	Ordinary shares	100	100
BTPS Insurance ICC Limited <sup>13</sup>	Longevity insurance	Ordinary shares	100	100
BTPSI (No.1) IC Limited <sup>13</sup>	Longevity insurance	Ordinary shares	100	100
Apus No.8 Junior Unit Trust <sup>15</sup>	Property investment and development	Units	100	100
Carraway Belfast Investments Unit Trust <sup>15</sup>	Property investment and development	Units	100	100
Carraway Tunbridge Wells Investments Unit Trust <sup>15</sup>	Property investment and development	Units	100	100
One America Square L.P. <sup>18</sup>	Property investment and development	Partnership capital	100	100
Poole Unit Trust <sup>15</sup>	Property investment and development	Units	100	100
Retail Value L.P. <sup>12</sup>	Property investment and development	Partnership capital	100	100
<b>Subsidiary undertakings not presented on a consolidated basis</b>				
Ares European Credit Strategies Fund II (B) L.P. <sup>17</sup>	Investment management	Partnership capital	100	100
Argent Group plc <sup>12</sup>	Property investment and development	Ordinary shares	100	100
Hermes Alternative Funds plc <sup>16</sup>	Investment management	Ordinary shares	99	99
Gotham Segregated Account I L.P. <sup>18</sup>	Property investment and development	Partnership capital	99	99
HCN L.P. <sup>17</sup>	Investment management	Partnership capital	100	100
Hermes Factory Outlets Unit Trust <sup>12</sup>	Property investment and development	Units	0	100
Hermes Factory Outlets No. 2 Unit Trust <sup>12</sup>	Property investment and development	Units	0	100
Hermes Fund Managers Limited <sup>12</sup>	Investment management	Ordinary shares	100	100
Hermes Direct Lending Fund L.P. <sup>12</sup>	Investment management	Ordinary shares	100	0
Hermes Real Estate Senior Debt Fund L.P. <sup>12</sup>	Investment management	Partnership capital	100	100
Hermes Private Equity Investments Holding 2004 L.P. <sup>13</sup>	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2005 L.P. <sup>13</sup>	Investment in private equity funds	Partnership capital	100	100

## 25. Subsidiary undertakings (continued)

Subsidiary undertaking	Principal activity	Holding	30 June 2017 Ownership %	30 June 2016 Ownership %
<b>Subsidiary undertakings not presented on a consolidated basis (continued)</b>				
Hermes Private Equity Investments Holding 2006 L.P. <sup>13</sup>	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2007 L.P. <sup>14</sup>	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2008 L.P. <sup>14</sup>	Investment in private equity funds	Partnership capital	100	100
Hermes GPE PEC 1 L.P. <sup>14</sup>	Investment in private equity	Partnership capital	100	100
Hermes GPE PEF 1 L.P. <sup>14</sup>	Investment in private equity funds	Partnership capital	100	100
Hermes GPE FRWL Holdco Limited <sup>12</sup>	Investment in private equity	Ordinary shares	93	93
Hermes GPE Horizon L.P. <sup>14</sup>	Investment in private equity	Partnership capital	100	100
Lionstone-Hermes Real Estate Venture L.P. <sup>18</sup>	Property investment and development	Partnership capital	99	99
MEPC Fund Unit Trust <sup>12</sup>	Property investment and development	Units	100	100
Hexagon Real Estate Investments Sarl <sup>19</sup>	Property investment and development	Ordinary shares	75	75
Orthogonal Partners I L.P. <sup>14</sup>	Investment in private equity funds	Partnership capital	100	100
Strategic Investment Portfolio L.P. <sup>15</sup>	Investment management	Partnership capital	100	100

<sup>12</sup>Registered in England; <sup>13</sup>Registered in Guernsey; <sup>14</sup>Registered in Scotland; <sup>15</sup>Registered in Jersey; <sup>16</sup>Registered in Ireland; <sup>17</sup>Registered in Cayman Islands; <sup>18</sup>Registered in USA; <sup>19</sup>Registered in France.

The fair value of net assets of subsidiary undertakings that are not consolidated by the Scheme in aggregate amounted to £5,421 million (2016: £4,911 million). This comprised of £5,942 million of assets and £521 million of liabilities (2016: £5,296 million of assets and £385 million of liabilities). £2,930 million of the fair value of net assets related to investments managed by HFML (2016: £2,042 million), that comprised £3,342 million of assets and £412 million of liabilities (2016: £2,098 million of assets and £56 million of liabilities).

## 26. Subsequent events

There were no subsequent events requiring disclosure in the Scheme's financial statements.

# Actuary's statement and report on actuarial liabilities

The most recent actuarial valuation of the Scheme was made at 30 June 2014.

The main purposes of an actuarial valuation include:

- determining whether or not the assets already held by the Trustee are sufficient to finance the prospective benefit entitlements of current and former members, to the extent that they relate to pensionable service completed prior to the valuation date; and
- assessing the future level of contributions required, having regard to both the cost of the benefits which will accrue to members after the valuation date and to any past service surplus or shortfall revealed by the valuation.

The valuation of the Scheme as a continuing scheme revealed a past service deficiency of £7,044 million. In light of this deficit, BT agreed to make lump sum payments over the period to 31 March 2030. Payments amounting to £1,500 million were paid in March and April 2015, £250 million was paid in March 2016 and £250 million in March 2017. Details of the other deficit contributions due are documented in the Schedule of Contributions.

In addition to these deficit contributions, BT agreed to pay contributions in respect of service from 29 January 2015, at the following rates of pay deemed to be pensionable, less mandatory contributions paid by those members who have opted out of the Smart Pensions arrangements:

- from 29 January 2015 to 31 March 2015: 13.5%;
- from 1 April 2015 to 30 June 2017: 16.0%;
- from 1 July 2017: 16.9%.

BT has also agreed to make further special contributions to meet any strains which may arise on account of redundancies while there is a funding shortfall.

BT has also agreed that it will pay additional contributions to the Scheme in certain other circumstances. Full details of these arrangements are set out in a funding agreement between the Trustee and BT.

A copy of the certificate to the most recent agreed Schedule of Contributions is included following this statement.

All of the results summarised above are given on the assumption that the Scheme will continue, with members in service accruing further benefits each year. In the unlikely event that the employer ceased paying contributions to the Scheme ("discontinuance"), the Trustee could seek to meet benefit payments by continuing it as a closed fund.

## Actuary's statement and report on actuarial liabilities

Given the large size of the Scheme and the present capacity of the insurance market it is unlikely to be practicable for the Trustee to secure members accrued rights by the purchase of appropriate annuities in the event of the Scheme being discontinued.

The terms currently available from life assurance companies are in any event such that the premiums charged to secure accrued rights in full would significantly exceed the realisable value of the Scheme's present assets.

An Actuarial Report was prepared as at 30 June 2016, providing a formal update of the funding position, which revealed that the past service deficiency had increased to £13,901 million. The Scheme's financial position and the level of BT's contributions will formally be reviewed in full as part of an actuarial valuation no later than 30 June 2017, which is due to be completed no later than 30 September 2018.

**M J Pardoe FIA**

Towers Watson Limited  
(a Willis Towers Watson Company)

19 October 2017

### Form of Actuary's certification of schedule of contributions

**Name of scheme:** BT Pension Scheme

#### **Adequacy of rates of contributions**

1. I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective could have been expected on 30 June 2014 to be met by the end of the period specified in the Recovery Plan.

#### **Adherence to Statement of Funding Principles**

2. I hereby certify that, in my opinion, this schedule of contributions is consistent with the Statement of Funding Principles dated 29 January 2015.
3. I also certify that any rates of contributions forming part of this schedule which the Scheme requires me to determine are not lower than I would have provided for had I had responsibility for preparing or revising the schedule, the Statement of Funding Principles and any recovery plan.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

**Date:** 29 January 2015  
**Name:** M J Pardoe  
**Qualification:** Fellow of the Institute and Faculty of Actuaries  
**Address:** Watson House, London Road, Reigate, Surrey RH2 9PQ

**Name of employer:** Towers Watson Limited

# Appendix one

## Membership statistics

	30 June 2017	30 June 2016	30 June 2015
<b>Membership</b>			
Active members	31,432	33,871	37,065
Deferred members	63,583	67,766	71,785
Current pensioners of whom:	202,439	201,261	199,333
Retired employees	166,668	165,416	163,397
Widows/widowers	33,734	33,758	33,783
Children/dependants	2,037	2,087	2,153

	Year ended 30 June 2017	Year ended 30 June 2016	Year ended 30 June 2015
<b>Changes to membership</b>			
Normal age retirements from active status	19	20	65
Ill health early retirements	78	87	80
Early retirement	3,547	3,998	3,558
Deferred benefits set up	748	1,057	1,096
Normal age retirements from deferred status	2,256	2,462	3,260
Benefits transferred out and trivially commuted	360	245	290
Optants out	7	19	0
Death in service	29	44	48
Death in retirement	6,732	6,511	7,303
Death in deferment	83	90	97
Late retirement	0	0	0
<b>New records set up</b>			
Section B rejoiners	6	19	27
Widows, spouse, widowers and dependants	1,846	1,821	1,923
Children	56	70	71
Benefits transferred in	0	0	0

# Appendix two

## Statement of Investment Principles (revised April 2015)

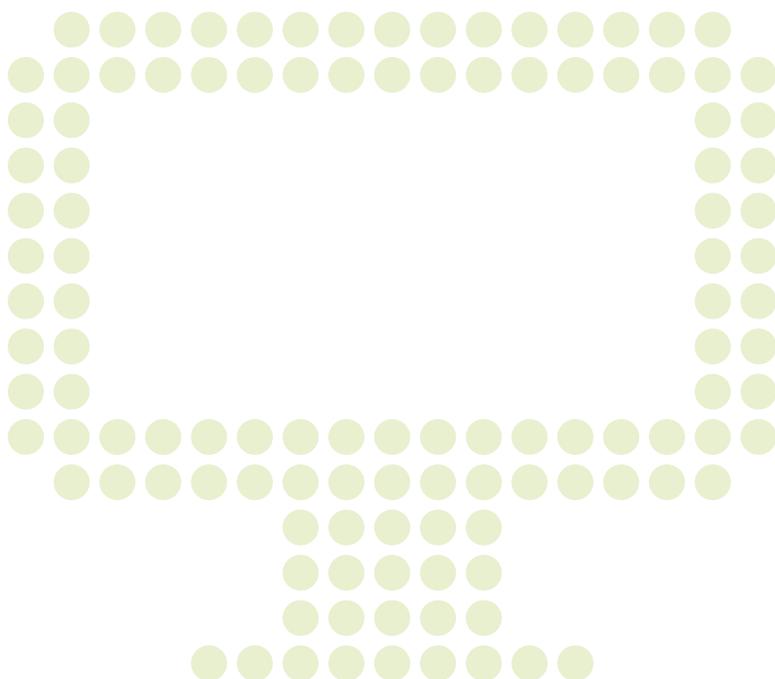
### Introduction

This Statement of Investment Principles (SIP) has been agreed by the Trustee of the Scheme to comply with the requirements of the Pensions Act 1995, as amended, and the Occupational Pension Schemes (Investment) Regulations 2005. It has been prepared following written advice from BTPSM and consultation with the principal sponsoring employer of the Scheme, BT. The SIP is reviewed each year or following any significant change in investment policy of the Scheme. No amendment to this Statement will be made without written advice from a suitably qualified person and after consultation with BT.

### Objectives

The main objectives of the Trustee are to ensure that there are sufficient assets to meet the Scheme's liabilities as they fall due and that all beneficiaries receive the benefits to which they are entitled under the Rules of the Scheme.

The Trustee takes an integrated approach to the management of risk in the Scheme. The Trustee therefore invests the assets of the Scheme consistent with funding a defined level of benefits within an acceptable level of risk, having regard to the affordability of both the immediate and longer term cash cost to BT, and the funding requirements in the Trust Deed and the relevant legislation. 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 size of the contributions from BT. The Trustee considers that a strong employer is the best support for the Scheme and 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.



## Appendix two

### Investment risk and return

Given the ongoing commitment of BT to the Scheme, the Trustee considers that a degree of investment risk can be taken in the expectation of generating higher returns, particularly in the short to medium-term when it has clearer visibility over the covenant provided to the Scheme by BT. In setting the appropriate level of investment risk and return the Trustee considers a range of factors, including the impact and probability of a worsening of the funding position, the financial strength or covenant of BT and the financial strength of the Scheme.

Overall risk in the Scheme is diversified across a range of different types of risk, asset classes, geographical areas, sectors and industries. Assets held by the Scheme from time to time reflect the Trustee's views on the appropriate balance between risk and return and the outcomes it expects should be available from the assets. Investments are made on the expectation that greater long-term returns will be made through a prudent exposure to real assets, including equities and property. In addition, investments are allocated across a range of investment managers to further spread risk. The Trustee also takes into account the liquidity profile of the Scheme's investments. The Trustee's liquidity policy is that there will be sufficient investments in liquid or readily realisable assets to meet cashflow requirements in foreseeable circumstances so that, where possible, the realisation of assets will not disrupt achievement of the Scheme's investment objectives, and that the Scheme will hold sufficient cash to meet anticipated benefit and other payment obligations.

Over the period to 30 June 2019 the Trustee considers it appropriate broadly to maintain the current level of asset risk in the Scheme, having regard to the nature of the liabilities, the overall funding position of the Scheme and the Trustee's assessment of the covenant provided by BT (at the time of writing the Scheme had a 60% allocation to a diversified portfolio of return seeking assets and a 40% allocation to assets which provide a closer match to the Scheme's liabilities). The Trustee will consult with BT on strategic changes in its approach to asset risk.

In light of the expected development of the Scheme's liabilities as the number of retired members increases, the Trustee has set an objective to reduce the level of investment risk gradually over time, and to increase the level of matching between the assets and liabilities.

The Trustee's current intention is to move to a substantially lower risk investment strategy over the next 20 years, when it is expected that the vast majority of liabilities will relate to pensions in payment. The long-term investment strategy will have regard to the nature of the liabilities, the overall funding position of the Scheme and the Trustee's assessment of the covenant provided by BT.

The Trustee is targeting a ratio of interest rate and inflation hedging of around 40% (on a gilts basis; on a funding basis at the time of writing this is equivalent to a hedge ratio of c60%) to reduce the Scheme's exposure to these risks and consequently the volatility of the Scheme's funding position. The pace at which the Scheme increases the level of hedging will have regard to market conditions.

Over the longer term, the Trustee expects the aggregate investment returns delivered by the Scheme's assets to exceed the discount rate assumptions set out in the Scheme's Statement of Funding Principles.

In seeking to meet the investment objectives, the Trustee will invest in a range of asset classes and instruments as permitted in the Scheme Rules. The Trustee will consider a range of asset classes, including:

- Equity instruments
- Bonds and other debt instruments
- Private equity and infrastructure
- Property and land
- Commodities
- Hedge funds
- Currencies
- Cash
- Derivatives
- Insurance contracts

The Trustee recognises that different asset classes are likely to produce different risk and return profiles, and the balance between the various types of investment will be kept under periodic review with the aim of investing in a diversified way to achieve the Scheme's short-term and longer-term risk and return objectives.

The Trustee's policy is to have separate management and custody of assets, which minimises the risk of a misuse of Scheme assets. Custody arrangements are reviewed regularly to ensure that the custodians continue to have appropriate control and checking procedures in place.

## Appendix two

### Taking decisions

The Trustee is responsible for the stewardship of the assets of the Scheme. All of the Trustee Directors are therefore involved in decisions on the overall level and shape of the Scheme's risk profile and the preferred outcomes from the Scheme's assets. In making these decisions the Trustee is assisted by BTPSM 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 Scheme's Investment Committee makes recommendations to the Trustee Board on strategic areas, including the outcomes targeted from the assets (including level of risk, returns, diversification, liquidity, hedging, and maturity profile), and the management of the Scheme's funding risk through the use of derivatives. The Committee has responsibility for the oversight of BTPSM's implementation of the Scheme's investment strategy delegating matters as appropriate to the Implementation Oversight Committee.

### Choosing investments

The Pensions Act distinguishes between investments where the management is delegated to a fund manager with a written contract and those where a product is purchased directly, eg. the purchase of an insurance policy. The Trustee's approach is to review its direct investments and to obtain advice about them at regular intervals. When deciding whether or not to make any new direct investments the Trustee will obtain advice. The advice will consider whether the investment is satisfactory having regard to the requirements of the regulations, the Trust Deed and Rules and the suitability of the investment, and to the principles contained in this statement.

### Use of derivatives and insurance contracts to manage risk

The Trustee may use derivatives and insurance contracts for efficient portfolio management and to manage the Scheme's risk profile, including the Scheme's longevity, inflation and interest rate exposure. The Trustee consults with BT when assessing the strategic use of derivatives and insurance contracts to manage the Scheme's risk profile.

The Trustee authorises the use of derivatives within certain parameters by BTPSM, some of the Scheme's investment managers, and certain subsidiary undertakings. BTPSM is also authorised to use derivatives to rebalance the Scheme's asset allocation on such basis as may be required from time to time to keep within any guidelines set by the Trustee.

### Mandates for investment managers

The Trustee has appointed a number of investment managers to manage the Scheme's assets. All investment managers have agreed in writing with BTPSM, on behalf of the Trustee, the services to be provided and, where appropriate, the performance objective and how they will be measured.

The fees paid to investment managers for these active mandates may comprise a base fee plus, where appropriate, 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 can help align the investment managers' interests with the interests of the Scheme.

Any managers demonstrating consistent or significant under performance or where there are other significant concerns will be subject to a detailed review, undertaken by BTPSM on behalf of the Trustee.

### Performance measurement

The Trustee receives regular reports, at least quarterly and usually more frequently, on investment performance from BTPSM, who monitor the position on an ongoing basis. These reports include an update on progress towards meeting the Scheme's strategic investment objectives and may include detail on Scheme level risks, assets by asset type, Scheme level cash flows, the performance of individual managers and such other matters as may be required by the Trustee from time to time.

## Appendix two

### Sustainable investment

The Trustee has a fiduciary responsibility to meet the Scheme's liabilities and as a long-term asset owner considers sustainable factors to improve long-term risk adjusted returns, including social, environmental and ethical issues and the exercise of ownership rights.

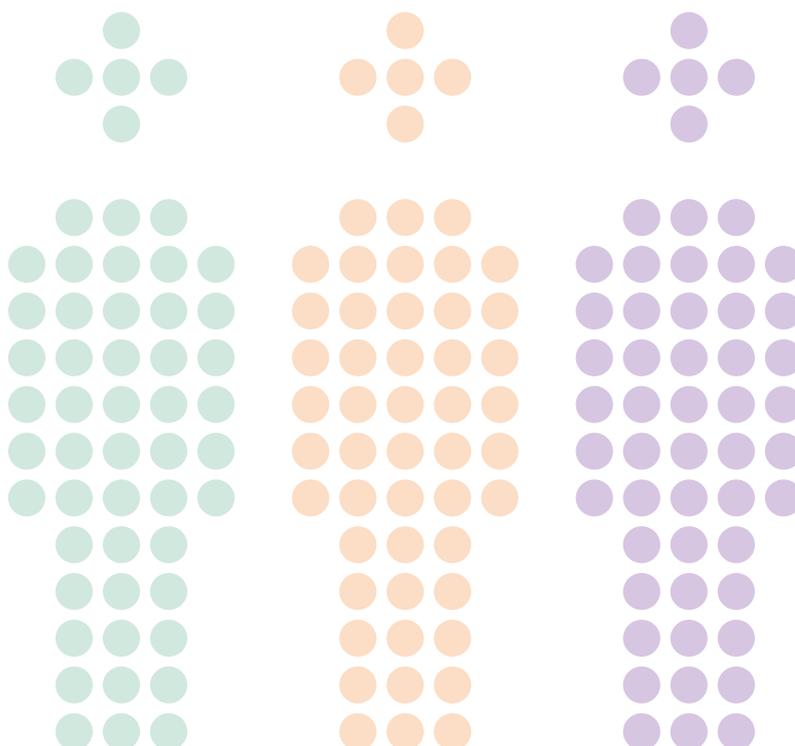
As a founder member of the United Nations-backed Principles for Responsible Investment (PRI), the Scheme's investment managers are expected to demonstrate good governance and are encouraged to consider long-term factors in their investment decision making where possible. These practices are taken into account when the Scheme reviews existing, or appoints new, investment managers.

Guided by the Financial Reporting Council's Stewardship Code, the Trustee endeavours to use all available methods to exercise its stewardship responsibilities by voting and engaging where possible either directly or via an appointed overlay service.

### Additional Voluntary Contributions

The Scheme's Additional Voluntary Contributions (AVC) arrangement provides for benefits to be accrued on a money purchase basis, with the value of members' funds being determined by the value of accumulated contributions adjusted for investment returns net of charges. In selecting and monitoring appropriate investments, the Trustee is aware of the need to provide a range of investment options, which broadly satisfy the varying risk profiles of members, given that members' benefits will be directly determined by the value of the underlying investments.

**(Revised April 2015)**



# Technical provisions statement

Actuarial certification for the purposes of Regulation 7(4)a of The Occupational Pension Schemes (Scheme Funding) Regulations 2005.

**Name of scheme: BT Pension Scheme**

## Calculation of technical provisions

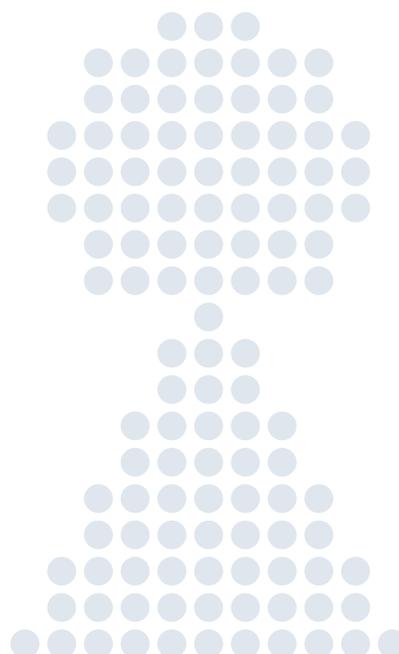
I certify that, in my opinion, the calculation of the Scheme's technical provisions as at 30 June 2014 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the Trustee of the Scheme and set out in the Statement of Funding Principles dated 29 January 2015.

**M J Pardoe**

Fellow of the Institute and Faculty of Actuaries  
Towers Watson Limited  
(a Willis Towers Watson Company)

29 January 2015

Watson House  
London Road  
Reigate  
Surrey  
RH2 9PQ



# Glossary of terms

## Absolute return

This allocation seeks to generate returns irrespective of the direction of markets. Managers within this allocation will typically manage their portfolios without close regard to a specific market benchmark.

## Actively managed

Investments that are selected by investment managers with the aim of outperforming a particular benchmark index.

## Additional Voluntary Contribution (AVC)

A contribution paid by a member of an occupational pension scheme to secure additional benefits.

## Asset mix

The proportions in which the Scheme's assets are distributed between different classes of investment.

## Brexit

Brexit refers to the decision by the UK to leave the European Union following the referendum held on 23 June 2016.

## Corporate governance

The system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies.

## Credit default swap

A credit default swap is a contract which transfers the credit risk of an issuer from one party to another party.

## Deferred beneficiaries

All those who have a right to be paid benefits by the Scheme at a future date, but are not currently active members of the Scheme (mainly former employees).

## Derivative

A financial contract whose price is derived from the movement in an underlying asset, e.g. a single security or basket of securities, interest rates, inflation levels, exchange rates or index movements. Examples of derivative instruments are futures, forwards, options and swaps.

## Equities

Shares directly held in companies.

## Fixed interest securities

Investments on which a fixed rate of interest is received.

## Futures and options contracts

A futures contract is a firm agreement to buy or sell a security or a quantity of securities at a future date; an option confers the right, but no obligation, to complete a similar transaction at a predetermined price.

## Gilt

Sterling bond issued by the UK Government.

## Index-linked securities

Securities on which the rate of interest and the capital value are linked to the rate of inflation.

## Long-term assets

Investments other than those in which funds are held on a temporary basis, e.g. interest-earning deposits and short-dated government securities.

## Longevity transaction

A contract which exchanges payments based on expected longevity with payments based on actual longevity of members.

## Market value

The best estimate of the price for which assets could be sold at a given date.

## Passively managed

Where investments are held in the same proportions as a selected index (e.g. the FTSE All-Share Index) rather than managers being allowed to choose their own investments.

## Glossary of terms

### Pension Protection Fund (PPF)

A fund established by the UK Government to pay compensation to members of eligible defined benefit pension schemes, where there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the scheme to cover PPF levels of compensation.

### Pensions Regulator

The Pensions Regulator was established under the Pensions Act 2004 with effect from 6 April 2005. Its main statutory objectives are to:

- protect the benefits of members of work based pension arrangements;
- keep calls on the Pension Protection Fund to a minimum; and,
- facilitate good pension administration.

### Pensions SORP

The Pensions Statement of Recommended Practice applies to the accounts of occupational pension schemes. It is issued by the Pensions Research Accountants Group (PRAG).

### Pooled Investment Vehicles (PIVs)

Investment vehicles such as managed funds, limited partnerships and unit trusts that combine capital of many investors to allocate according to a particular investment strategy.

### Real rate of return

The difference between the level of return actually earned by investments, including increases in value, and the return necessary in order to keep pace with inflation as measured by the change in the Retail Prices Index (RPI) and the Consumer Prices Index (CPI).

### Realised gains

The net profit on investments sold during the year, calculated by comparing the selling price with the price at which they were purchased, or with the value at which they were transferred to the Scheme at its inception.

### Sale and repurchase agreements

A transaction, carried out under an agreement, in which one party sells securities to another and, at the same time and as part of the same transaction, commits to repurchase equivalent securities on a specified future date at a specified price.

A reverse repo is a transaction, carried out under an agreement, in which one party purchases securities from another and, at the same time and as part of the same transaction, commits to resell equivalent securities on a specified future date at a specified price.

### Schedule of Contributions

The Schedule of Contributions should set out the rates and due dates of contributions to a pension scheme from the participating employer and the members (including contributions due under a recovery plan and contributions to cover expenses). Normally, Trustees will need to agree the Schedule of Contributions with the Scheme's principal employer.

The Schedule of Contributions must be certified by the Scheme Actuary and revised periodically by the Trustees. The Schedule of Contributions must be submitted to The Pensions Regulator for approval within ten working days after it has been prepared or revised.

### The Scheme

The BT Pension Scheme.

## Glossary of terms

### **Transfer value**

The capital sum available to purchase benefits from the new employer's scheme or from an insurance company when an employee changes employment and decides to transfer the pension benefits which he has earned with his previous employer.

### **Trustee Directors**

Directors of BT Pension Scheme Trustees Limited, the corporate Trustee of the BT Pension Scheme (the Trustee). A director of the Trustee is also a member of the Trustee.

### **UK GAAP**

This refers to Generally Accepted Accounting Practice applied in the United Kingdom.

### **Unlisted investments**

Stocks and shares not traded on a recognised stock exchange.

### **Unrealised gains**

The net increase during the year in the market value of investments held at year-end.



# Contact details

## The Trustee of the BT Pension Scheme

The Scheme Secretary,  
BT Pension Scheme,  
One America Square  
17 Crosswall  
London EC3N 2LB

Website: **[www.btpensions.net](http://www.btpensions.net)**.

## Peopleline

Peopleline is the enquiries service provided by Accenture, the Scheme's administrator.

The Peopleline pensions team can be contacted between 8:30am and 5pm Monday to Friday, on **0800 731 1919**.

If resident overseas, the contact number is **+44 (0) 203 023 3420**.

Alternatively, please e-mail **[Peopleline.pensions@accenture.com](mailto:Peopleline.pensions@accenture.com)**.

The address for correspondence is:  
Pension Services, Accenture, Venture House,  
Venture Way,  
Chesterfield S41 8NR

## The Pensions Advisory Service (TPAS)

TPAS is an independent voluntary organisation with local advisers who are experts in pension matters. TPAS can be contacted either through any local Citizens Advice Bureau or at the following address:

The Pensions Advisory Service,  
11 Belgrave Road,  
London SW1V 1RB

## Pensions Ombudsman

If TPAS cannot resolve a complaint or dispute then the Pension Ombudsman should be contacted at the same address as TPAS, shown above.

## The Pensions Regulator

Pension schemes are regulated by The Pensions Regulator, which has power to impose civil penalties and to bring criminal prosecutions for serious breaches of the requirements of the legislation. The Pensions Regulator can be contacted at the following address:

The Pensions Regulator,  
Napier House,  
Trafalgar Place,  
Brighton,  
East Sussex BN1 4DW

## Pension Tracing Service

Information about the Scheme (including a contact address) has been provided to the Pension Tracing Service as required by law. Because the Pension Tracing Service holds the same information for other pension schemes, it offers a service which enables members to trace benefits from previous employers' schemes. The Pension Tracing Service can be contacted at the following address:

Pension Tracing Service  
Mail Handling Site A  
Wolverhampton  
WV98 1LU

This Report and Accounts is available on the Scheme's website, **[www.btpensions.net](http://www.btpensions.net)**.

We also send a short document in hard copy summarising the key developments and performance of the Scheme during the year to each member.