



Report and Accounts

for the year ended 30 June **2016**

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Management and advisers

Scheme registration number

10085003

Trustee

BT Pension Scheme Trustees Limited

Trustee Directors

Paul Spencer CBE (Chairman)
Catherine Claydon (Deputy Chair)
Adrian Askew
The Law Debenture Pension Trust Corporation plc
(represented by David Felder)
Donald MacDonald
Billy McClory
Jim McNally
Beryl Shepherd
John Wroe

Scheme secretary

Susan Welch

Actuary

Michael Pardoe FIA, Willis Towers Watson

Auditor

Deloitte LLP

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

Ashmore Investment Management Limited
BlackRock Investment Management (UK) Limited
Hermes Fund Managers Limited
M&G Investment Management Limited
Magellan Asset Management Limited
Wellington Management International Limited

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
Lloyds Chambers
1 Portsoken Street
London E1 8HZ

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 2016.

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 302,898 members of the Scheme at 30 June 2016.

Investment performance

The twelve months to 30 June 2016 were characterised by volatile markets and a general uneasiness with the reality of disappointing economic growth and of seemingly ever lower interest rates. From a UK perspective, the outcome of the EU referendum further exacerbated these global trends. Against this backdrop, rate sensitive assets and currency gains proved to be the most important contributors to returns for UK based investors.

The Scheme produced an investment return of 11.9% for the twelve months to 30 June 2016; this brings the return over the past three years to a rate of 8.8% per annum (7.0% ahead of the Retail Prices Index and 8.0% ahead of the Consumer Prices Index). A more detailed analysis of the performance of investments is given 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 first such report following completion of the 2014 valuation was carried out as at 30 June 2015 and details of the results were sent out to members in Spring 2016. Since 30 June 2015, while the Scheme's assets have performed well and the Trustee has sought to lessen the impact of falling interest rates, the Scheme's liabilities have increased and it is likely that the funding of the Scheme may have deteriorated further.



The Scheme is undertaking an interim valuation at 30 June 2016, the results of which will be provided in the next Summary Funding Statement which is expected to be published in 2017.

Sponsor update

In May 2015 Ofcom commenced a review of the digital communications sector, which included the ownership and governance of Openreach. Openreach is currently a business division of BT, the sponsoring employer of the Scheme. To safeguard the interests of members, the Trustee has and will continue to engage with Ofcom to ensure that they understand the potential implications for the Scheme of any actions they may wish to pursue.

Paul Spencer CBE

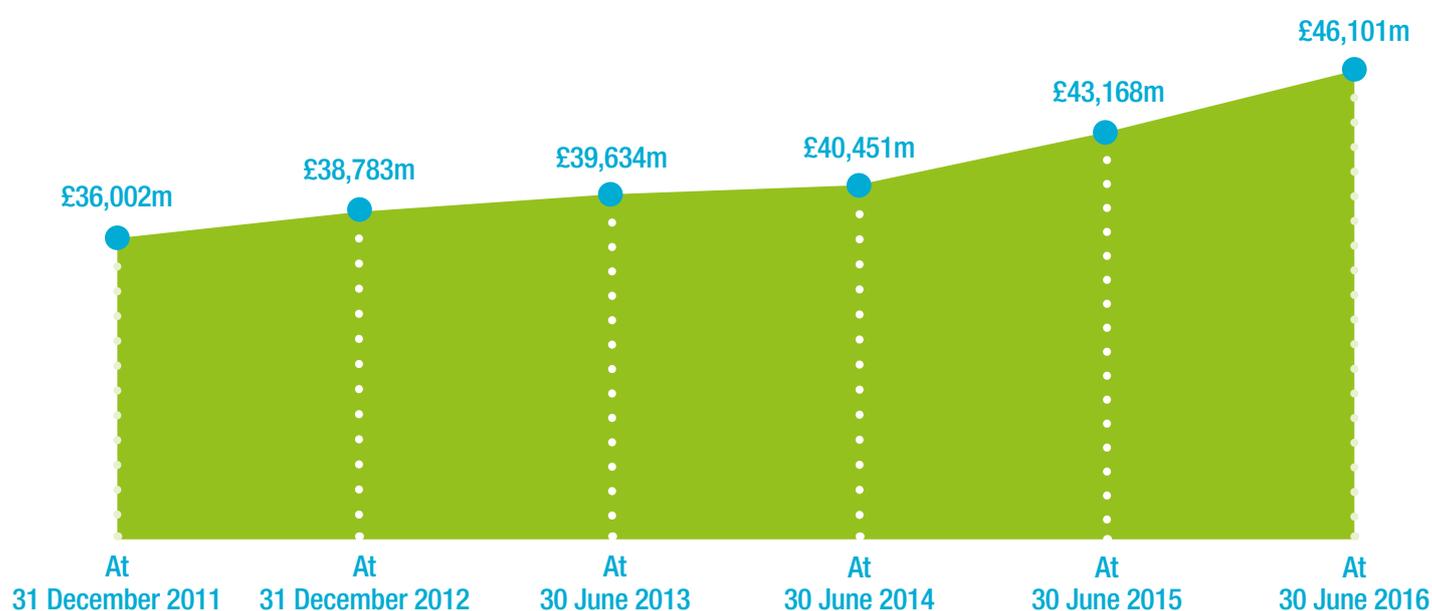
Chairman

14 December 2016

Key facts

“ The overall investment return on the Scheme’s assets was 11.9% for the year to 30 June 2016. This represents a real return of 11.5% above inflation measured by CPI. ”

Net assets of the Scheme



Allocation of investments

	30 June 2016
Equities	32.5%
Government bonds and cash	23.8%
Investment grade credit	15.7%
Other growth assets	15.6%
Property	12.4%
Total	100.0%

Information about the managed asset allocation of the Scheme at 30 June 2016 is given in Understanding the financial statements on page 27.

Key facts

Annualised investment returns

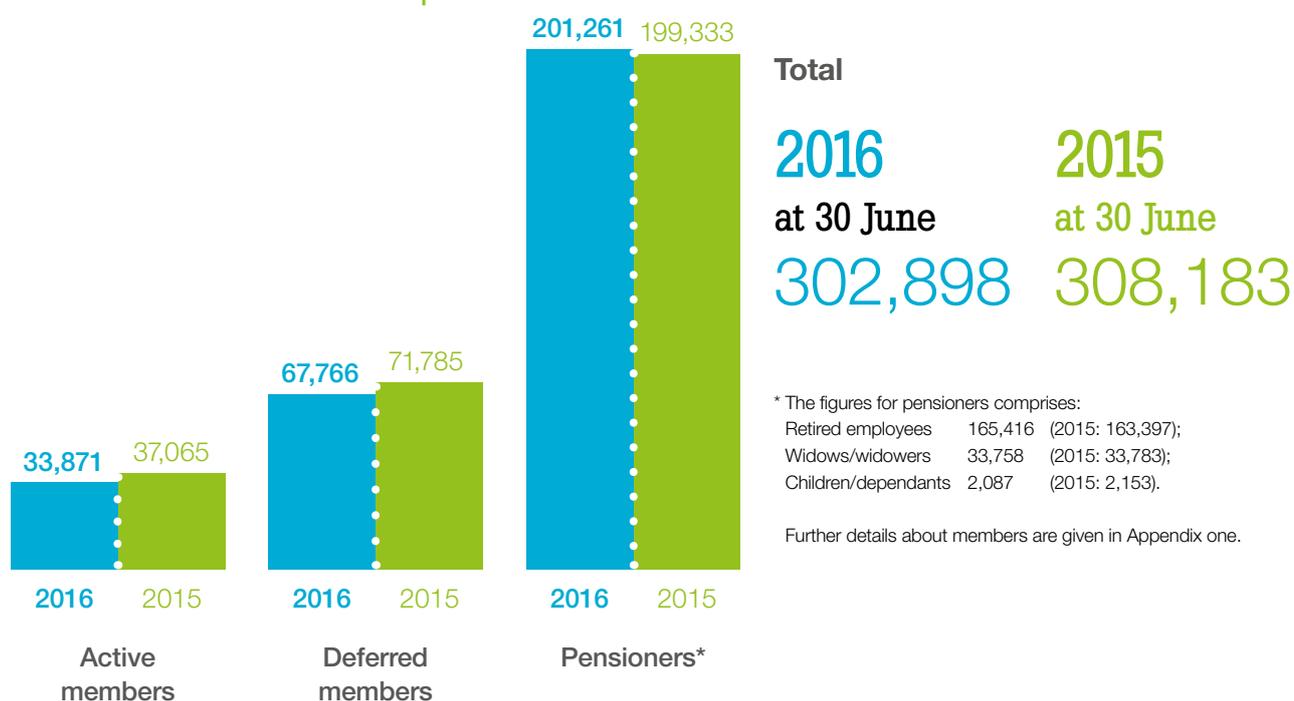
	2016	2015	2014	3 years	5 years	10 years	15 years
Scheme actual	11.9%	8.3%	6.2%	8.8%	7.5%	5.7%	6.3%
Benchmark ¹	10.9%	6.9%	6.2%	8.0%	7.2%	5.1%	5.6%
Scheme real – adjusted ² RPI ³	10.3%	7.3%	3.5%	7.0%	5.3%	2.8%	3.5%
Scheme real – adjusted ² CPI ³	11.5%	8.4%	4.3%	8.0%	6.0%	3.4%	4.2%

¹ The benchmark is a composite of a range of financial market indices that are representative of the Scheme's investment strategy. The Trustee is considering the use of alternative benchmarks based on the development of the Scheme's liabilities to better reflect the Trustee's investment objectives.

² Scheme real adjusted equals Scheme actual less RPI and CPI respectively.

³ 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 and £250 million in March 2016. A further contribution of £250 million will be paid in March 2017. Thereafter, BT will make a series of further contributions averaging over £580 million each year until 31 March 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 2014 valuation, BT's regular contributions were increased from 13.5% to 16.0% of members' pensionable pay (less members' mandatory contributions) from April 2015. Furthermore, they are 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:

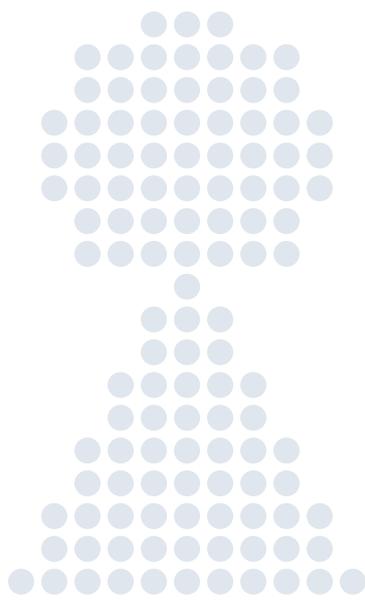
- The 'negative pledge' provided by BT in 2010. This provides comfort to the Scheme that, within certain limits, future creditors will not be granted superior security. The negative pledge has been extended to cover BT, BT Group and their subsidiaries, including any new companies that may be acquired 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 has received an actuarial report from the Actuary on the funding position of the Scheme as at 30 June 2015. This is not a full triennial valuation and is not agreed between the Trustee and BT. It uses an approach that the Actuary regards as consistent with that adopted for the 2014 valuation of the Scheme, allowing for changes in investment market conditions. Between 30 June 2014 and 30 June 2015 the funding shortfall increased from £7,044 million to £9,960 million.

The Scheme is currently undertaking an interim valuation at 30 June 2016, the results of which are expected to be finalised in 2017.



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 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, longevity and asset returns in order to assess the potential impact on funding and the risks associated with different asset allocations.

The Trustee is targeting a ratio of interest rate and inflation hedging of approximately 40% (on a solvency basis) 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 life of the Scheme, and as the Scheme matures, the Trustee expects to reduce the level of growth assets (including equities and property) and increase the level of matching assets (including gilts and corporate bonds). 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/or 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 a copy of the current Statement of Investment Principles is reproduced in Appendix two.

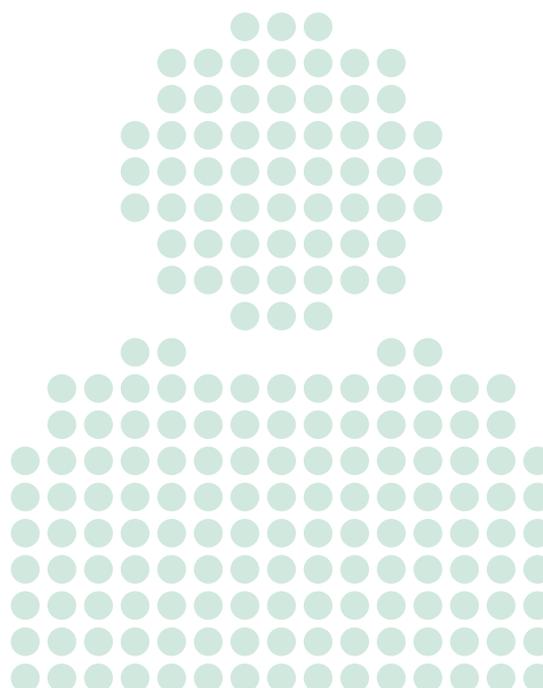
Measuring investment performance

The Trustee monitors investment performance against the Scheme's strategic investment objectives. Reports are provided regularly by BTPSM to the Trustee and include detail on Scheme level risks, cash flows and the performance of underlying mandates against their respective benchmarks. Details of the annualised investment returns are given on page 6.

For the Trustee

Paul Spencer CBE

Chairman
14 December 2016



Trustee Board

The following are the Trustee Directors

1



1. Paul Spencer CBE, Chairman ^a

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 a member of the Audit Committee. He is also non-executive chair of BTPSM, and a member of its remuneration committee.

Biography

Paul was appointed non-executive chairman 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 is also chair of its investment committee. In addition he is 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 chairman of State Street Managed Pension Funds. He is a past President of the Association of Corporate Treasurers and past chairman of NS&I (National Savings and Investments).

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

^a Chairman appointed by BT with the agreement of the recognised trade unions.

^b Member-nominated Trustee Director selected by the recognised trade unions and NFOP.

^c Employer-nominated Trustee Director.

2



2. Catherine Claydon, Deputy Chair ^c

Appointment

Catherine was appointed to the Trustee Board on 1 January 2013 and was appointed Deputy Chair to the Trustee Board in May 2015. She is a member of the Administration and Communications Committee and the Investment Committee. She was appointed as a non-executive director of Hermes Fund Managers Limited on 5 May 2016.

Biography

Catherine has over twenty-five years of experience in the City. She was a managing director at Goldman Sachs and Lehman Brothers in their pensions advisory groups. She is currently a non-executive director of Witan Investment Trust plc and Dunedin Income Growth Investment Trust Limited. She is also an independent member of the board of the Barclays UK Retirement Fund and an independent member of the investment committee of the Unilever UK Pension Fund.

3. Adrian Askew ^b

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 1997-2003 and was chair of the trustees for the Connect Pension and Life Assurance Scheme from 2003-2009. Adrian is a member of the National Federation of Occupational Pensioners (NFOP).

Trustee Board

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4. David Felder ^c

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, the Responsible Investment Oversight Committee and the AVC Committee. 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.

5. Donald MacDonald ^b

Appointment

Donald was appointed to the Trustee Board on 1 May 1998. He is chair of the Responsible Investment Oversight Committee and a member of the Investment Committee. He is also an independent adviser to the BTPSM remuneration committee.

Biography

Donald was a national officer for the Communication Workers Union (CWU) until his retirement in 2004. He was a Post Office and BT telecommunications technician for many years.

Donald is a member of the CWU and NFOP, and is a director of Inflection Point Capital Management. He was previously chair of the Institutional Investors' Group on Climate Change and the United Nations Principles for Responsible Investment. Donald is a BT Pension Scheme pensioner.

5



6



6. Billy McClory ^b

Appointment

Billy was appointed to the Trustee Board on 1 September 1997. He is a member of the Audit Committee. He is also the senior non-executive director of Hermes Fund Managers Limited.

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 pension 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 National Federation of Occupational Pensioners.

Trustee Board

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7. Jim McNally ^c

Appointment

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

Biography

Jim is HR director for reward and pensions for BT Group. He is responsible for the functional leadership of reward, pensions and benefits across BT Group's worldwide operations. He advises the BT remuneration committee and chairs BT's global pension and benefits management group (which covers all group arrangements except the Scheme). He is a member of BT's senior leadership team, a trustee of the BT Healthcare Trust and the BT Rehabilitation Trust.

Jim has over twenty-five years of experience in remuneration and benefits and has held senior remuneration director roles at four FTSE100 companies.

8



8. Beryl Shepherd ^b

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 Beryl has held the position of chair of the Telecoms & Financial Services Executive of the CWU. She is an active member of the BT Pension Scheme and a member of the NFOP.

9. John Wroe ^c

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 a member of the Responsible Investment Oversight Committee.

Biography

John is group director of treasury for BT Group, responsible for BT's worldwide treasury and insurance activities. He is a member of BT's senior leadership team, a trustee of the BT Healthcare Trust and the BT Rehabilitation Trust, and a director of Communicator Insurance Company Limited. He joined BT in 1992, and has held a number of senior finance roles at BT. Prior to joining BT he worked for Coopers & Lybrand (now part of PricewaterhouseCoopers). He is a Chartered Accountant.

John is an active member of the BT Pension Scheme.

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, e.g. 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 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 Trustee 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 a policy is in place in relation to gifts and hospitality. 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.



Governance of the Scheme

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 thirteen 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 business. This included the Trustee's response to Ofcom's review of digital communications, reviewing the level of investment risk in the Scheme and establishing the Trustee's strategic plan for the year ahead.

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.

Trustee Board Committees

The Trustee Board has delegated some powers and responsibility 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.

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 18.

Audit Committee

Members

John Wroe – **Chair**
Billy McClory
Paul Spencer CBE

The Audit Committee is responsible for the Scheme's annual report and accounts and the discharge of its duties, and the maintenance of appropriate accounting records and financial controls.

The Committee supervises the preparation of the Scheme's annual report and accounts and provides oversight of internal audit, and external audit to ensure the policy on auditor independence is maintained. In addition, the Committee oversees Scheme governance and the effectiveness of risk management processes and the internal controls framework.

The Committee met four times during the year and subsequently two meetings were held up to the date of the approval of the report and accounts. In addition, the Committee oversaw the implementation of FRS102 - The Financial Reporting Standard applicable to the UK and Republic of Ireland, and the guidance set out in the Revised Pensions SORP. It reviewed the Scheme's 2016/2017 cost budget, reviewed reports on operational due diligence of third party investment managers and 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.

In addition, during the year an evaluation of the Committee was undertaken covering committee composition, meeting documentation, proceedings and management, and effectiveness of the terms of reference. Recommended actions arising from the evaluation exercise have been implemented.

A verification working group oversees the disclosure and verification of the information in the report and accounts 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.

Governance of the Scheme

Investment Committee

Members

Paul Spencer CBE – **Chair**
Catherine Claydon
David Felder
Donald MacDonald
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 Investment Committee has been enhanced during the year to support the Committee in overseeing the effectiveness of the Scheme's investment strategy. Reporting to the Committee includes quarterly performance reports, an annual review of performance over the year and rolling three years, and an annual review of the Scheme's investment costs. The Committee also reviews '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.

In addition to regular reporting on investment performance and risk, the Committee considered a range of topics including the Scheme's liquidity policy, investment costs and the implementation of credit and equity allocations. The Committee also received presentations from a number of external parties on the economic and market outlook.

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.

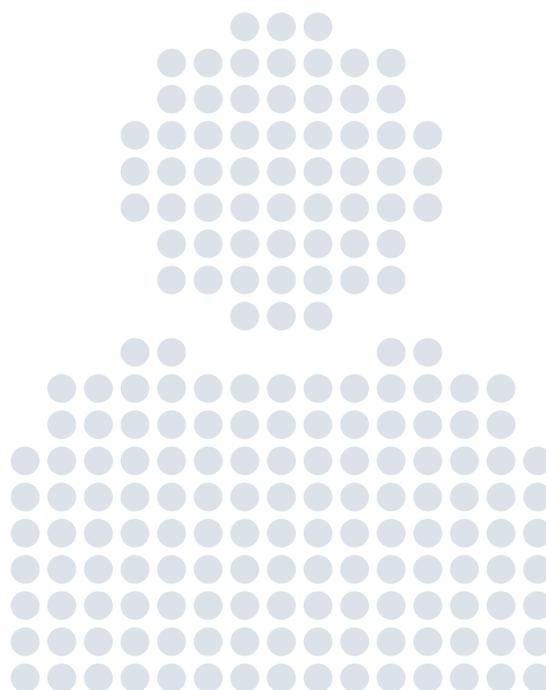
Responsible Investment Oversight Committee

Members

Donald MacDonald – **Chair**
David Felder
Jim McNally
John Wroe

The Responsible Investment Oversight Committee oversees the Scheme's responsible investment strategy with the objective of securing tangible long-term benefits for Scheme members. It also has oversight of the implementation of this strategy and the consideration of financially relevant environmental, social and governance (ESG) factors in the Scheme's investment decision making and stewardship activities.

The Committee met twice during the year and considered the Scheme's responsible investment policy and climate and carbon risk management framework. The Committee also received presentations from Hermes Fund Managers Limited on their approach to responsible investment within global emerging markets. Updates were provided on stewardship activities and engagement.



Governance of the Scheme

Administration and Communications Committee

Members

Adrian Askew – **Chair**
Catherine Claydon
Jim McNally
Beryl Shepherd

The Administration and Communications Committee is responsible for overseeing administration services provided to Scheme 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. The Committee considered, reviewed and finalised the new Trust Deed and Rules and received and reviewed quarterly reports from Accenture on the pensions administration of the Scheme. The Committee also provided oversight on a number of projects relating to pensions administration.

AVC Committee

Members

Beryl Shepherd – **Chair**
David Felder
Jim McNally

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 market review of AVC providers to ensure members receive a value-for-money offering. The implementation of the enhancements recommended by this review is currently being planned.

Other Committees

Discretions Committee

Members

Adrian Askew
Catherine Claydon
Beryl Shepherd

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 a 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

Billy McClory
Donald MacDonald
Jim McNally

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 IDRP.

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 2016.

Trustee Director	Trustee Board	Audit Committee	Investment Committee	Responsible Investment Oversight Committee	Administration and Communications Committee	AVC Committee
Number of meetings	13	4	7	2	5	3
Paul Spencer CBE	13	4	7	-	-	-
Catherine Claydon	12	-	6	-	5	-
Adrian Askew	12	-	-	-	5	-
The Law Debenture Pension Trust Corporation plc (represented by David Felder)	13	-	5	2	-	3
Donald MacDonald	11	-	6	2	-	-
Billy McClory	13	4	-	-	-	-
Jim McNally	13	-	-	2	5	3
Beryl Shepherd	13	-	-	-	4	3
John Wroe	13	4	7	2	-	-



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 chairman 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 implements the Trustee's strategy and objectives.

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.



Governance of the Scheme

Internal control and risk management

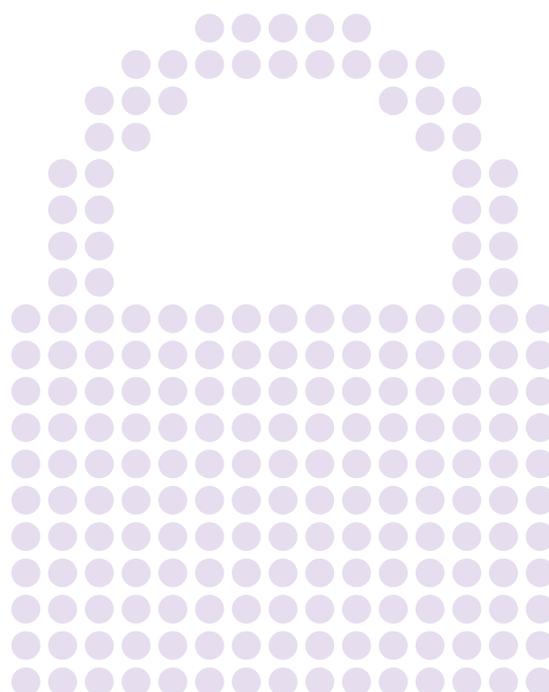
The Trustee Board is responsible for the Scheme's internal controls and risk management. The responsibility for monitoring risks has been delegated to relevant Committees, and BTPSM who, in turn, provides escalation and assurance on the management of risks to the respective Committees and the Board. 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 control 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 control 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 control 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 control 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 the Scheme or are held in safe-keeping with an independent professional custodian, appointed by the Trustee. The Trustee's policy is to separate management and custody, which minimises the risk of misuse of Scheme assets. Custody arrangements are reviewed regularly by the Trustee, with the assistance of BTPSM, to ensure the custodian performs its duties and continues to maintain an appropriate risk management and control environment.

The Northern Trust Company has been master custodian since 18 November 2008.

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 2016, the number of active members fell from 37,065 to 33,871 while the number of pensions being paid rose from 199,333 to 201,261. The number of members with deferred rights fell from 71,785 to 67,766. A detailed analysis is given in Appendix one.

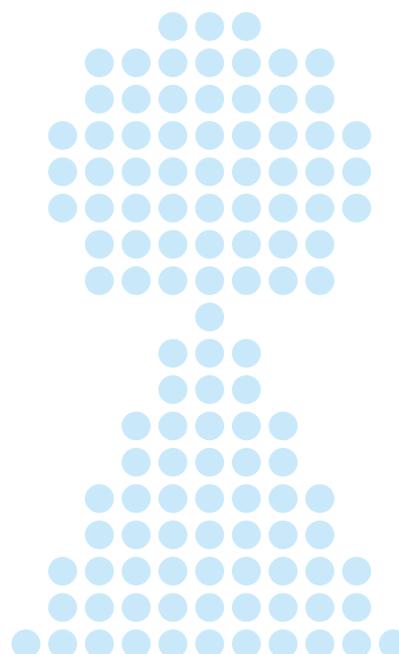
Membership of the Scheme falls into one of three 'sections': Section A, Section B and Section C. Details of these can be found on the website: www.btpensions.net/40/member-booklets.

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 2016, there was no increase for Sections A and B pensions in payment and the increase for Section C pensions was 1.2%. 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 for revaluation from 2011 onwards is calculated by reference to CPI.



Statement of Trustee's responsibilities

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

Trustee responsibilities in respect of the financial statements

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 that year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year;
- state whether applicable United Kingdom Accounting Standards, including FRS 102, have been followed, subject to any material departures disclosed and explained in the financial statements; and
- contain the information specified in Regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.

The Trustee has supervised the preparation of the financial statements and has agreed suitable accounting policies, to be applied consistently, making any estimates and judgements on a prudent and reasonable basis.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an Annual Report.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to it to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities including the maintenance of an appropriate system of internal controls.

Trustee responsibilities in respect of contributions

The 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 Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the Schedule of Contributions. Where breaches of the Schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

Investment report

Review of the year to 30 June 2016

The past year has been particularly eventful and, at times, difficult to interpret and navigate. Looking back over the year it may seem that little has changed as global economic activity remained underpinned by positive, but unimpressive growth. Relative to expectations, however, there have been some significant adjustments creating ripple effects across markets. In particular, the expected divergence in monetary policy between developed countries did not play out as decisively as anticipated by investors at the beginning of the year.

In the US, the Federal Reserve delayed its first interest rate hike since June 2006 from September to December 2015 citing uncertainties over Chinese growth and then stepped back from making any further rate hikes in the period as domestic economic data remained sluggish.

Outside the US, both the European and Japanese Central Banks fulfilled their promises of more monetary stimulus. However, the impact of both has been quite muted as markets became more concerned by the unintended consequences of pushing interest rates further into negative territory.

The most surprising event of the year came closer to home courtesy of the “Brexit” referendum at the end of June 2016. The market reaction from the unexpected outcome led investors to downgrade expectations for UK growth and monetary policy. The Bank of England subsequently lowered interest rates by 0.25% and expanded their quantitative easing programme.

Outside developed markets, fears of a Chinese hard-landing proved to be exaggerated or premature as economic conditions stabilised thanks to more expansive than expected fiscal measures.

The interplay of all the above trends has led to a roller-coaster of a year with global equity markets only modestly down, but having suffered and mostly recovered from two large drawdowns (-13% and -15% in local currency). Currencies, and Sterling in particular, played a pivotal role in asset returns as did the level of interest rates which set new historic lows in a number of countries, the UK included.

Altogether the past year has brought to the fore a general uneasiness over the direction and tools of monetary policy for both investors and policymakers. At the same time, concerns over the sustainability of the current economic cycle increased every time growth expectations undershot expectations. Providing convincing solutions to both concerns will be a challenge that we expect will be the driver of future market trends.

Investment performance

The Scheme's overall investment return for the year to 30 June 2016 was 11.9%. This is ahead of the average over the last five and ten years of 7.5% per annum and 5.7% per annum respectively.

Over the longer term, the Scheme outperformed CPI over all time periods: including 6.0% per annum over five years, 3.4% per annum over ten years and 4.2% per annum over fifteen years. Further performance information is provided on page 6.

During the year to 30 June 2016, the Scheme's overall 11.9% return (10.3% real return with reference to RPI; 11.5% real return with reference to CPI) outperformed the minimum return underpinning the most recent actuarial valuation at 30 June 2014. The return was largely driven by strong contributions from rate sensitive assets and currency gains on foreign denominated assets.

Within growth assets, the best performing asset class was property with a performance of 11.1%. The other growth asset allocation (consisting of allocations to absolute return, emerging market debt, credit opportunities and mature infrastructure) posted a return of 5.1%, whilst the equity allocation saw a small decline of -2.2%. Currency gains helped the overall growth asset allocation to an overall positive gain of 10.8% for the year to 30 June 2016. Matching assets were the main beneficiaries of falling interest rates during the year with the overall allocation gaining 11.9%.

Investment report

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 2016, is shown in the table below. Pooled investment vehicles, loans, derivatives, cash and borrowings have been re-allocated to the appropriate asset class to reflect the underlying exposures. Further explanation of these re-allocations is on pages 27 to 28.

Asset class	30 June 2016
Equities	32.5%
Government bonds and cash	23.8%
Investment grade credit	15.7%
Other growth assets	15.6%
Property	12.4%
Total	100.0%

Growth Asset Portfolio

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 return, 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 2016, approximately 90% of the Scheme's equity allocation was invested in publicly listed securities whilst approximately 10% was invested in private equities. Furthermore, the Scheme hedged part of its total equity exposure through a derivatives strategy.

Public equities

Approximately half 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 half of the listed equities exposure is allocated to active managers whose objectives are to outperform their respective listed equity benchmark.

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, but with higher volatility.

Equity Hedging

The Scheme has implemented an option based equity derivative strategy to hedge the downside risk of part the equity allocation.

Property

The Scheme's property portfolio is managed by Hermes Real Estate Investment Management Limited, and at 30 June 2016 was invested approximately 75% in the UK and 25% 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

As of 30 June 2016, approximately 67% of the Scheme's exposure to investment grade corporate bonds was allocated to a UK corporate bond portfolio and the remaining 33% was invested globally.

Government bonds

100% of the Government bond allocation was invested in index linked gilts at 30 June 2016.

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. As at 30 June 2016, the total amount of self investment was £9 million (2015: £9 million), representing 0.02% (2015: 0.02%) of the net assets of the Scheme. There were no properties occupied by BT owned by the Scheme at 30 June 2016 and at 30 June 2015.

Responsible investment

On behalf of the Trustee, BTPSM's responsible investment activities are focused on three core areas:

Understanding the Scheme's current and potential exposures to both short and long-term environmental, social and governance (ESG) risks and opportunities.

Following work with Mercer on the potential impact of climate change risks on the portfolio, the Scheme enhanced its climate and carbon risk management process. As part of an annual review, this process involves updating the Scheme's central case policy scenario, monitoring exposure to high risk assets and managing carbon exposure using different methods, including engaging with portfolio companies.

Integrating ESG factors into the Scheme's investment processes including designing investment mandates, new manager searches and ongoing manager monitoring.

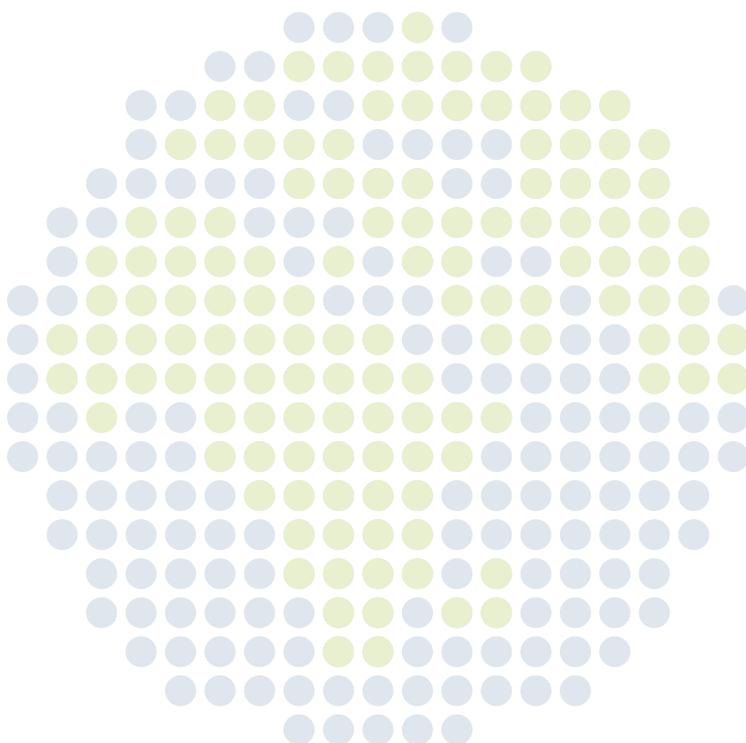
BTPSM evaluates the quality of investment managers' approaches to ESG integration and stewardship. To help improve the quality of ESG integration, BTPSM helped to contribute to the Principles for Responsible Investment guide for equity investors.¹

¹ A copy of the guide is available at: www.unpri.org/news/pri-launches-esg-integration-guide-for-equity-investors

Ensuring the Scheme's stewardship activities deliver long-term value.

Day-to-day stewardship activities, including holding portfolio companies' management to account and proxy voting, are delegated to agents including Hermes Equity Ownership Services (HEOS) and the Scheme's active managers where appropriate. During the year HEOS engaged with 306 companies in the Scheme's portfolios on a range of 858 environmental, social and ethical, governance, strategy and risk issues.

A record of the Scheme's voting and engagement activities for the year can be found at: www.btpensions.net/151/voting-disclosure and www.btpensions.net/152/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 2016. The table below reclassifies assets such as PIVs, derivatives and loans into their appropriate asset classes so the asset allocation as at 30 June 2016 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	11,677	–		(11,677)	7	–	0.0%
Actively managed	–	854	1	5,196	4, 7, 9	6,050	13.1%
Passively managed	–	186	1	7,140	4, 7, 9	7,326	15.9%
Private equity	–	1,473	1	159	5, 9	1,632	3.5%
Equities	11,677	2,513		818		15,008	32.5%
Bonds	19,422	–		(19,422)	8	–	0.0%
Investment grade credit	–	665	1	6,572	3, 8, 9	7,237	15.7%
Government bonds and cash	–	–		10,972	3, 6, 8, 9	10,972	23.8%
Bonds and cash	19,422	665		(1,878)		18,209	39.5%
Property	1,875	3,769	1	73	5, 9	5,717	12.4%
Absolute return	–	1,810	1	109	9	1,919	4.2%
Mature infrastructure	–	431	1	898	9	1,329	2.9%
Non-core credit	–	1,925	1	1,994	9	3,919	8.5%
Other growth assets	–	4,166		3,001		7,167	15.6%
Other Categories							
Pooled investment vehicles	11,113	(11,113)	1	–		–	0.0%
Loans	271	–		(271)	3	–	0.0%
Other net assets	1,743	–		(1,743)	2, 9	–	0.0%
	46,101	0		0		46,101	100.0%

Understanding the financial statements

Footnotes

- ¹ Investments in pooled investment vehicles (PIVs) have been reclassified into the appropriate asset class.
- ² Other net assets include deposit and short-term investments, derivative contracts, AVC investments, other investment assets and liabilities, and net current assets. These have been reclassified to their appropriate asset exposures.
- ³ Loans include investments in debt instruments and have been reclassified to the investment grade credit category within the bonds asset class.
- ⁴ 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.
- ⁵ The Scheme consolidates certain entities it controls and thus the underlying assets and liabilities of those entities are presented in the appropriate line 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.
- ⁶ The cash balance represents the value of cash and cash equivalents, net of the amount required to back open derivative contracts.
- ⁷ Equities have been reclassified between those that are actively and passively managed.
- ⁸ Bonds have been reclassified between investment grade corporate bonds and government bonds.
- ⁹ Investments are classified according to the legal nature of the security or investment instrument within the 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 2016 which comprise the Consolidated Fund Account, the Consolidated Statement of Net Assets, and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS102 "The Financial Reporting Standard applicable in the UK and the Republic of Ireland".

This report is made solely to the Trustee, as a body, in accordance with 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. Our audit work has been undertaken so that we might state to the Trustee those matters we are required to state to them 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 Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Trustee and the auditor

As explained more fully in the Statement of Trustee's Responsibilities, the Scheme's Trustee is responsible for the preparation of financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Scheme's circumstances and have been consistently applied and adequately disclosed; the reasonableness of

significant accounting estimates made by the Trustee; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 30 June 2016, and of the amount and disposition at that date of its assets and liabilities, other than the liabilities to pay pensions and benefits after the end of the year;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- contain the information specified in Regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

Deloitte LLP

Chartered Accountants and Statutory Auditor
London
United Kingdom

14 December 2016

Independent auditor's statement about contributions

To the Trustee of the BT Pension Scheme

We have examined the summary of contributions to the BT Pension Scheme for the Scheme year ended 30 June 2016 on page 31.

This statement is made solely to the Trustee, as a body, in accordance with Regulation 4 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our work has been undertaken so that we might state to the Trustee those matters we are required to state to them 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 Trustee as a body for our work, for this statement, or for the opinion we have formed.

Respective responsibilities of the Trustee and the auditor

As explained more fully in the Statement of Trustee's Responsibilities, 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 and to report our opinion to you.

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 on page 31 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.

Statement about contributions payable under the Schedule of contributions

In our opinion, contributions for the Scheme year ended 30 June 2016 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.

Deloitte LLP

Chartered Accountants and Statutory Auditor
London
United Kingdom

14 December 2016

Summary of contributions

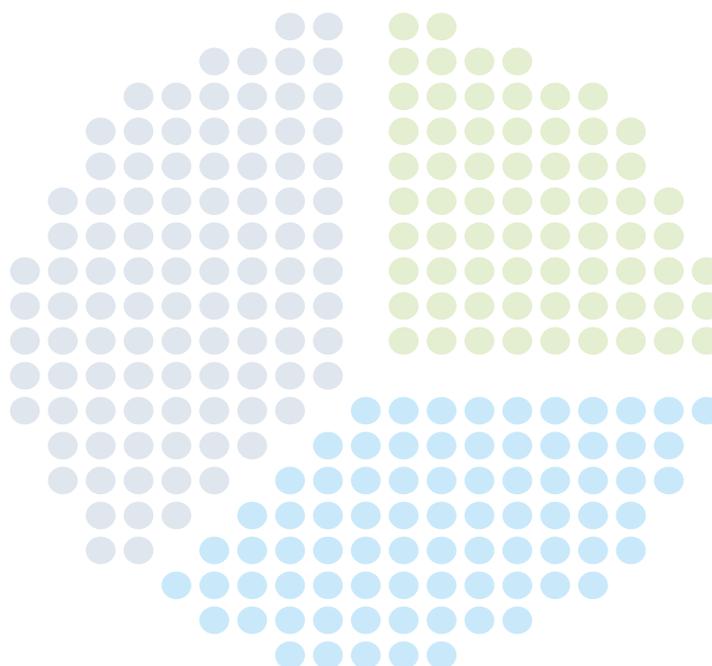
This summary has been prepared on behalf of, and is the responsibility of, the Trustee. It sets out the employer and member contributions payable to the Scheme under the Schedule of contributions for the year ended 30 June 2016. The Scheme's auditor reports on contributions payable under the Schedule, as shown in the "2016 Per Schedule" column below, in their auditor's statement about contributions on page 30.

	2016 Per Schedule £ million	2016 Additional £ million	2016 Total £ million
Employers' normal contributions	215	43	258
Members' normal contributions	7	0	7
Employers' deficit funding contributions	250	0	250
Employers' other contributions	22	0	22
Members' additional voluntary contributions	0	8	8
Members' added years contributions	0	1	1
Total contributions (see note 4 to the financial statements)	494	52	546

Approved on behalf of the Trustee Board

Paul Spencer CBE
Chairman

14 December 2016



Consolidated fund account

For the year ended 30 June 2016

	Notes	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
Contributions and benefits			
Employers' contributions	4	530	1,769
Employees' contributions	4	16	16
Total contributions		546	1,785
Benefits paid or payable	5	(2,282)	(2,230)
Payments to and on account of leavers	6	(31)	(28)
Administration expenses	7	(46)	(51)
Net withdrawals from dealings with members		(1,813)	(524)
Returns on investments			
Investment income	9	861	797
Change in market value of investments	10	3,972	2,527
Investment management expenses	11	(89)	(100)
Taxation	12	2	17
Net returns on investments		4,746	3,241
Net increase in the Scheme during the year		2,933	2,717
Net assets of the Scheme			
At 1 July		43,168	40,451
At 30 June		46,101	43,168

The notes on pages 35 to 66 form an integral part of the financial statements.

Consolidated statement of net assets

(Available for benefits)

At 30 June 2016

	Notes	30 June 2016 £ million	30 June 2015 £ million
Investment assets			
Equities		11,677	9,649
Bonds		19,422	17,177
Property		1,875	1,828
Pooled investment vehicles	13	11,113	10,309
Loans		271	198
Derivatives	14	1,870	542
AVC investments	15	172	149
Deposits and short-term investments		2,769	3,682
Other investment assets	16	585	761
Total investment assets		49,754	44,295
Investment liabilities			
Derivatives	14	(2,268)	(726)
Longevity insurance contract	17	(223)	(36)
Other investment liabilities	18	(1,125)	(298)
Total investment liabilities		(3,616)	(1,060)
Total net investments		46,138	43,235
Current assets	21	81	69
Current liabilities	22	(118)	(136)
Net assets of the Scheme at 30 June		46,101	43,168

The notes on pages 35 to 66 form an integral part of the financial statements.

Consolidated statement of net assets

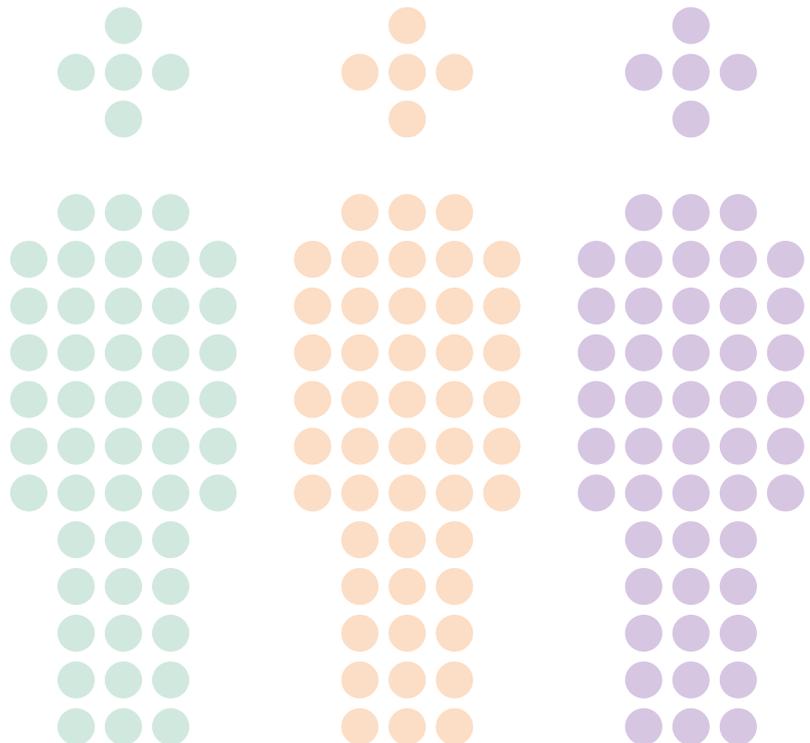
The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which takes into account such obligations, is dealt with in the Actuary's statement and Report on actuarial liabilities on page 67 of the Annual Report and these financial statements should be read in conjunction with this report.

The notes on pages 35 to 66 form part of these financial statements.

These financial statements were approved by the Trustee Board on 14 December 2016 and signed on their behalf by.

Paul Spencer CBE
Chairman

John Wroe
Trustee Director



Notes to the financial statements

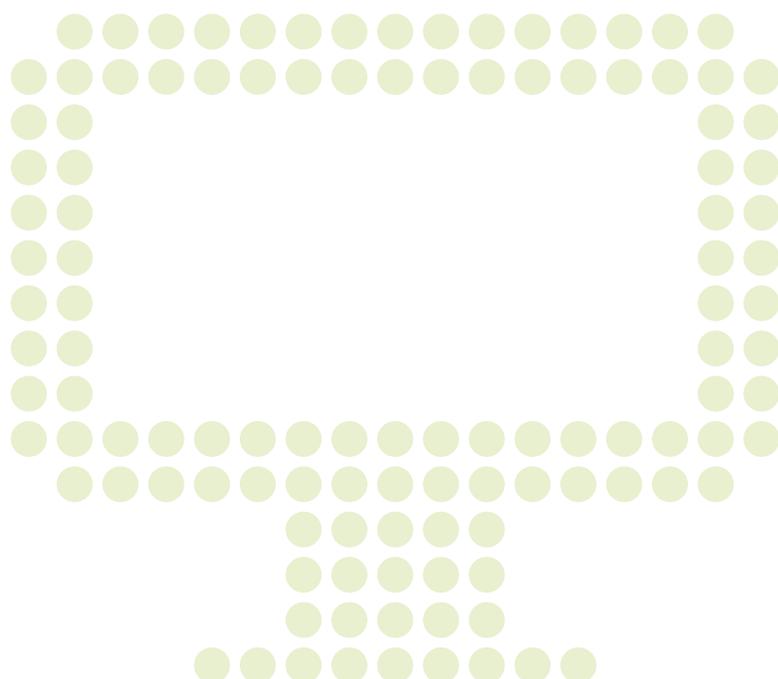
1. Basis of preparation

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”).

The adoption of amendments to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, issued on 1 March 2016 and effective on 1 April 2016, align regulatory requirements governing the audit of occupational pension schemes with FRS 102. It is expected to improve the usefulness of financial statements to stakeholders with investments reported in a manner consistent with the Trustee’s investment strategy.

FRS 102 and the revised Pensions SORP were adopted by the Scheme for the year beginning 1 July 2015.

The Scheme early adopted Amendments to FRS 102 - Fair value hierarchy disclosures, published by the Financial Reporting Council on 8 March 2016. The amendments relate to disclosures of financial instruments based on the fair value hierarchy, and are applicable to financial institutions and retirement benefit plans. It simplifies the preparation of disclosures about financial instruments, whilst increasing the consistency with disclosures that users of financial statements will often be familiar with. The amendments are required to be adopted for accounting periods beginning on or after 1 January 2017, and early application is permitted. These amendments have been reflected in the fair value hierarchy disclosures in the Scheme’s financial statements for the year beginning 1 July 2015.



2. Transition to FRS 102

This is the first year the Scheme has presented financial statements under FRS 102 and the revised Pensions SORP. The last financial statements prepared under “Old UK GAAP” and the previous Pensions SORP (Revised May 2007) was for the year ended 30 June 2015. “Old UK GAAP” is defined as Financial Reporting Standards and Statements of Standard Accounting Practice superseded by FRS 100 “Application of Financial Reporting Standards”, FRS 101 “Reduced Disclosure Framework” and FRS 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland”. The date of transition to FRS 102 was 1 July 2014 and the nature and effect of the transition is presented below.

	1 July 2014 £ million	30 June 2015 £ million
Net assets of the Scheme as previously stated	40,349.461	43,083.935
Effect of transition:		
Fair valuation adjustments to investments	101.692	84.237
Deferred taxation accrual adjustments	(0.044)	(0.141)
Expense accrual adjustments	(0.119)	(0.014)
Net assets of the Scheme as restated	40,450.990	43,168.017
		Year ended 30 June 2015 £ million
Net increase in Scheme as previously stated		2,734.475
Effect of transition:		
Fair valuation adjustments to investments		(17.455)
Deferred taxation accrual adjustments		(0.097)
Expense accrual adjustments		0.105
Net increase in the Scheme as restated		2,717.028

Fair valuation adjustments to investments

The Scheme held investments in group entities that were previously consolidated. Under FRS 102 and the revised Pensions SORP it is not a requirement for the Scheme to consolidate group entities, however it may choose to do so where permitted. Investments in group entities with net asset values of £51.763 million at 30 June 2015 (2014: £34.308 million) have been fair valued at £136.000 million at 30 June 2015 in accordance with IPEVC guidelines (2014: £136.000 million).

Deferred taxation accrual adjustments

Under Old UK GAAP, FRS 19 “Deferred Taxation” required full provision on deferred taxation assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a taxation computation. However, FRS 19 prohibited the recognition of deferred taxation on timing differences arising when a non-monetary asset, such as investment property, is revalued without there being any binding commitment to sell the asset at the reporting date. FRS 102 requires the recognition of deferred taxation on all timing differences at the reporting date relating to investment property measured at fair value unless it has a limited useful life. Under FRS 102 and the revised Pensions SORP, deferred taxation on timing differences arising on revaluation of investment property subject to taxation of £0.141 million has been accrued for at 30 June 2015 (2014: £0.044 million).

Expense accrual adjustments

Under Old UK GAAP there was no explicit requirement to account for short-term employee benefits such as paid annual leave. Under FRS 102, when an employee has rendered services to an entity during the reporting year, the entity shall measure the amount of short-term employee benefits expected to be paid in exchange for that service.

2. Transition to FRS 102 (continued)

The Scheme consolidates BT Pension Scheme Management Limited (“BTPSM”) as a subsidiary undertaking in the Scheme’s financial statements. BTPSM has recognised the expected cost of accumulating compensated absences when its employees render services that increase their entitlement to future compensated absences, at the undiscounted additional amount that BTPSM expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting year. Under FRS 102 and the revised Pensions SORP, BTPSM accrued £0.014 million of unused entitlement to future compensated absences (2014: £0.119 million).

Accounting treatment of subsidiary undertakings and joint ventures

Under Old UK GAAP, FRS 2 “Accounting for subsidiary undertakings” and FRS 9 “Associates and joint ventures”, the Scheme consolidated both subsidiary undertakings and joint ventures. Under FRS 102 and the revised Pensions SORP it is not a requirement for the Scheme to consolidate subsidiary undertakings and joint ventures, however, it may choose to do so where permitted. The Trustee has elected to prepare consolidated financial statements for the Scheme, that consolidates investments in subsidiary undertakings where permitted, as disclosed in note 26 “Subsidiary undertakings”. The Trustee has applied objective judgment based on the facts and circumstances of each entity to ensure the Scheme’s financial statements give a true and fair view.

Accounting for operating lease incentives

A lessor may sometimes provide an incentive for a lessee to enter into a lease agreement. Under Old UK GAAP the value of a lease incentive, such as a rent free period, was spread over the period to the first rent review, being the point at which the rent is reset to market rates. Under FRS 102 and the revised Pensions SORP, lease incentives are spread over the lease term. There is no impact on the Scheme’s net assets at 30 June 2015 due to change in accounting treatment (2014: Nil).

3. 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 have been 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

Normal contributions and employers’ augmentation, 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 period to which they relate. Payments represent all valid benefit claims notified to the Trustee during the Scheme year. Pension benefits include any realised gain/(loss) 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.

3. Accounting policies (continued)

Basis of consolidation

Under FRS 102 and the revised 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 would result 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 are 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.

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 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 26 "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 accounts 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 investment. 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.

3. Accounting policies (continued)

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 the principal classes of investment 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 value 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.

UK investment properties are independently valued by CBRE Limited, 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 will be based on closing bid prices. For exchange traded derivatives that are liabilities, fair value will be 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 option contracts, fair value is determined using the exchange price for closing out the option at the year end. For over the counter option 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 of open 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 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 value 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.

3. Accounting policies (continued)

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 is recognised in the financial statements within deposits and short-term investments. 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 remains undrawn in commitments to pooled investment vehicles.

4. 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 had been agreed, and the sponsor was obliged to make a deficit 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. For the seven years from 2018 to 2024 the sponsor will make payments in line with the 30 June 2011 agreement between the Trustee and the sponsor. This will be followed by five annual payments of £495 million through to 2029 and a final payment of £289 million in 2030.

As a result of the 30 June 2014 actuarial valuation, the sponsor's regular contribution 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 2016 £ million	Year ended 30 June 2015 £ million
Employers' normal contributions ¹	258	248
Employers' deficit funding contributions	250	1,500
Employers' other contributions ² (refer to note 7)	22	21
Employers' contributions	530	1,769
Employees' normal contributions ³	7	8
Employees' additional voluntary contributions	8	7
Employees' purchase of added years	1	1
Employees' contributions	16	16
Total contributions	546	1,785

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

²Employers' other contributions relate to reimbursement of the Pension Protection Fund levy in accordance with the Schedule of Contributions certified on 29 January 2015.

³In 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 have decided to participate in Smart Pensions which results in all such employees' contributions being reported as employers' contributions.

5. Benefits paid or payable

	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
Pensions ⁴	1,930	1,901
Commutations of pensions and lump sum retirement benefits	351	329
Lump sum death benefits	0	0
Taxation where lifetime or annual allowance exceeded ⁵	1	0
	2,282	2,230

⁴In 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 £4 million on the arrangement during the year (2015: £3 million).

⁵Taxation 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 eight cases in respect of lifetime allowances amounting to £0.739 million (2015: Five cases amounting to £0.148 million), and five cases in respect of annual allowances amounting to £0.094 million (2015: Three cases amounting to £0.034 million).

6. Payments to and on account of leavers

	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
Individual transfers out to other schemes	31	28
	31	28

7. Administration expenses

	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
PPF levy and associated costs (refer to note 4)	22	24
Administration expenses ⁶	24	27
	46	51

⁶Administration expenses include pensions administration expenses, actuary fees, custody fees, legal fees, other professional fees. It includes £4 million of expenses in respect to related party transactions (2015: £4 million). Refer to note 24 "Related party transactions" for further information.

8. Auditor's remuneration

A summary of remuneration received by auditors to the Scheme and subsidiary undertakings is disclosed in the table below.

	Year ended 30 June 2016 £ thousand	Year ended 30 June 2015 £ thousand
Auditor's remuneration		
Fees payable to Scheme's auditor for audit of Scheme's financial statements	293	310
Fees payable to Scheme's auditor for audit of Scheme's subsidiaries pursuant to legislation	1,303	1,219
Total audit fees	1,596	1,529
Other services pursuant to legislation	150	146
Tax services	43	55
Further assurance	40	267
Management consultancy	19	228
Total non-audit fees	252	696
Fees payable to the Scheme's auditor in respect of associated pension scheme	18	17
Total remuneration to the Scheme's auditor	1,866	2,242
Auditor's remuneration payable to other audit firms		
Audit fees	848	701
Non-audit fees	2,199	1,874
Total remuneration to other audit firms	3,047	2,575



9. Investment income

	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
Dividends from equities	226	193
Income from bonds	457	457
Net rental income from properties ⁷	101	76
Income from pooled investment vehicles	81	92
Longevity insurance contract	(30)	(53)
Interest on deposits and short-term investments	26	32
	861	797

⁷Net rental income from properties is stated after deducting £22 million of property related expenses (2015: £25 million).

10. Reconciliation of investments

For the year from 1 July 2015 to 30 June 2016	Market value at 30 June 2015 £ million	Net investment/ (disinvestment) £ million	Change in market value £ million	Market value at 30 June 2016 £ million
Investment assets/(liabilities)				
Equities	9,649	861	1,167	11,677
Bonds	17,177	(230)	2,475	19,422
Property	1,828	1	46	1,875
Pooled investment vehicles	10,309	(709)	1,513	11,113
Loans	198	81	(8)	271
Derivatives ⁸	(184)	975	(1,189)	(398)
AVC investments	149	17	6	172
Longevity insurance contract	(36)	0	(187)	(223)
	39,090	996	3,823	43,909
Deposits and short-term investments	3,682		219	2,769
Other investment assets/(liabilities)	463		(70)	(540)
Total net investments	43,235		3,972	46,138

⁸Derivatives include both the derivative assets and liabilities which are shown separately in the Consolidated statement of net assets.

10. Reconciliation of investments (continued)

For the year from 1 July 2015 to 30 June 2016	Purchases at cost and derivative payments £ million	Sales proceeds and derivative receipts £ million	Net investment/ (disinvestment) £ million
Investment assets/(liabilities)			
Equities	5,118	(4,257)	861
Bonds	8,704	(8,934)	(230)
Property	256	(255)	1
Pooled investment vehicles	3,793	(4,502)	(709)
Loans	305	(224)	81
Derivatives	3,831	(2,856)	975
AVC investments	17	0	17
Longevity insurance contract	0	0	0
	22,024	(21,028)	996

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 2016 amounted to £8 million and include fees, commissions and taxes (2015: £28 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 2015 to 30 June 2016	Transaction costs				
	Fees £ million	Commissions £ million	Taxes £ million	Other £ million	Total £ million
Investment assets/(liabilities)					
Equities	0	3	0	0	3
Property	2	1	1	0	4
Derivatives	0	1	0	0	1
Total transaction costs	2	5	1	0	8

For the year from 1 July 2014 to 30 June 2015	Transaction costs				
	Fees £ million	Commissions £ million	Taxes £ million	Other £ million	Total £ million
Investment assets/(liabilities)					
Equities	0	4	0	3	7
Property	2	6	11	0	19
Derivatives	0	2	0	0	2
Total transaction costs	2	12	11	3	28

11. Investment management expenses

	Year ended 30 June 2016 £ million	Year ended 30 June 2015 £ million
Investment management expenses ⁹	89	95
Investment performance fees ¹⁰	0	5
	89	100

⁹Investment management expenses include £1 million of expenses in property subsidiaries (2015: £4 million); £18 million of expenses to operate BT Pension Scheme Management Limited (2015: £18 million); £24 million of non HFML management expenses (2015: £23 million); £46 million of direct HFML management expenses (2015: £50 million). Refer to note 24 "Related party transactions" for further information.

¹⁰Investment performance fees amount to £nil on direct mandates with HFML (2015: £5 million). Refer to note 24 "Related party transactions" for further information.

12. Taxation

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

13. Pooled investment vehicles

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

	30 June 2016 £ million	30 June 2015 £ million
Equities	1,041	1,166
Bonds	222	323
Hedge funds	4,304	4,155
Mature infrastructure	431	335
Private equities	1,345	1,100
Property	3,769	2,892
Unit linked insurance policies	1	338
	11,113	10,309

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.

13. 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 2016		30 June 2015	
	Assets £ million	Liabilities £ million	Assets £ million	Liabilities £ million
Hedge funds				
Ares European Credit Strategies Fund II (B) L.P.	413	(17)	251	(1)
HCN L.P.	356	(34)	321	(50)
Hermes Alternative Funds plc	90	(1)	508	(95)
Hermes Real Estate Senior Debt Fund L.P.	324	(7)	99	(1)
Strategic Investment Portfolio L.P.	1,260	0	1,112	0
	2,443	(59)	2,291	(147)
Private equity				
Hermes Private Equity Investments Holding 2004 L.P.	15	0	15	0
Hermes Private Equity Investments Holding 2005 L.P.	39	0	37	0
Hermes Private Equity Investments Holding 2006 L.P.	59	0	60	0
Hermes Private Equity Investments Holding 2007 L.P.	25	0	25	0
Hermes Private Equity Investments Holding 2008 L.P.	46	0	57	0
Hermes Private Equity Investments Holding 2009 L.P.	0	0	1	0
Hermes GPE PEC 1 L.P.	216	0	358	0
Hermes GPE PEF 1 L.P.	366	0	230	0
Hermes GPE Horizon L.P.	141	0	0	0
Orthogonal Partners I L.P.	91	0	81	(1)
	998	0	864	(1)
Property				
Argent Group plc	74	(47)	134	(3)
Gotham Segregated Account I L.P.	195	(50)	148	(38)
Hermes Factory Outlets Unit Trust	217	(2)	103	0
Hermes Factory Outlets No. 2 Unit Trust	133	0	114	0
Lionstone-Hermes Real Estate Venture L.P.	190	(46)	56	(22)
MEPC Fund Unit Trust	551	(181)	486	(169)
	1,360	(326)	1,041	(232)
Total	4,801	(385)	4,196	(380)

14. 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.

Option contracts

Option 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 rate risk exposure.

Foreign exchange forward contracts

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

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

	30 June 2016 £ million	30 June 2015 £ million
Assets		
Futures contracts		
- Equities	2	8
- Fixed interest	8	2
- Currency	0	0
Option contracts	91	0
Swap contracts	1,687	463
Foreign exchange forward contracts	82	69
	1,870	542

	30 June 2016 £ million	30 June 2015 £ million
Liabilities		
Futures contracts		
- Equities	(29)	(26)
- Fixed interest	(24)	(2)
- Currency	0	0
Option contracts	0	0
Swap contracts	(1,579)	(633)
Foreign exchange forward contracts	(636)	(65)
	(2,268)	(726)

14. Derivatives (continued)

Futures contracts Exchange traded	30 June 2016				30 June 2015			
	Economic exposure				Economic exposure			
	Long £ million	Short £ million	Asset £ million	Liability £ million	Long £ million	Short £ million	Asset £ million	Liability £ million
Equities	777	(447)	2	(29)	1,710	(350)	8	(26)
Fixed interest	487	(946)	8	(24)	396	(447)	2	(2)
Currency	0	(25)	0	0	0	(5)	0	0
	1,264	(1,418)	10	(53)	2,106	(802)	10	(28)

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 (2015: All contracts settle in less than one year). At the end of the year the Scheme held cash collateral of £53 million on futures contracts (2015: Scheme provided cash collateral of £253 million on futures contracts).

Option contracts	30 June 2016				30 June 2015			
	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								
Fixed interest – call	0	0	0	0	339	0	0	0
Currency - call	0	0	0	0	6	(37)	0	0
Currency - put	21	0	0	0	0	0	0	0
	21	0	0	0	345	(37)	0	0
Over the counter								
Interest rate swaptions	1,484	(1,811)	91	0	389	(387)	0	0
	1,484	(1,811)	91	0	389	(387)	0	0
	1,505	(1,811)	91	0	734	(424)	0	0

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

The currency put option contracts settle in less than one year. The interest rate swaptions contracts have maturity dates of between six and twenty one years (2015: All contracts settle in less than one year, except for currency call options with a notional amount of £0.3 million and market value of £0.3 million that settle in less than two years, and interest rate swaptions with a gross notional amount of £776.0 million and market value of £0.2 million that settle in less than twenty three years).

14. Derivatives (continued)

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
			29,213	(1,886)	1,687	(1,579)

Swap contracts - Over the counter			30 June 2015			
Type of contract	Expiration	Nature of swap	Notional principal		Asset £ million	Liability £ million
			Long £ million	Short £ million		
Equity total return	< 1 year	Common stock	568	0	0	(19)
Interest rate	< 54 years	Fixed for floating and floating for fixed	9,510	(1,878)	460	(205)
Inflation rate	< 54 years	Coupon for floating	4,740	0	2	(393)
Bond total return	< 4 years	UK Government bonds	121	0	0	(12)
Credit default	< 30 years	Itraxx Europe	54	(91)	1	(4)
			14,993	(1,969)	463	(633)

At the end of the year the Scheme provided cash collateral of £610 million and pledged bond collateral of £1,501 million on swap contracts and the longevity insurance contract (2015: Cash collateral of £53 million; pledged bond collateral of £812 million).



14. Derivatives (continued)

Foreign exchange forward contracts – Over the counter		30 June 2016			30 June 2015		
Currency bought	Currency sold	Notional principal £ million	Asset £ million	Liability £ million	Notional principal £ million	Asset £ million	Liability £ million
EUR	GBP	86	1	0	3	0	0
AUD	USD	544	10	(1)	744	0	(5)
CAD	USD	160	0	(5)	151	0	(5)
USD	GBP	373	5	0	432	0	0
USD	OTHER	2,477	11	(22)	1,169	8	(2)
GBP	EUR	558	0	(24)	358	9	0
GBP	JPY	684	0	(51)	276	2	0
GBP	OTHER	68	0	(1)	42	0	0
GBP	USD	8,894	29	(473)	5,778	36	(13)
JPY	GBP	6	1	0	0	0	0
NOK	USD	775	0	(17)	701	0	(10)
SEK	EUR	239	0	(3)	206	0	(1)
SEK	USD	687	0	(20)	667	4	(8)
OTHER	OTHER	2,165	25	(19)	2,222	10	(21)
		17,716	82	(636)	12,749	69	(65)

All of the contracts settle in less than one year (2015: All of the contracts settle in less than one year, except for contracts to buy GBP and sell DKK with a notional principal of £2.0 million and market value of £0.2 million that settle in less than four years, contracts to buy GBP and sell EUR with a notional principal of £45.0 million and market value of £4.0 million that settle in less than five years, and contracts to buy GBP and sell SEK with a notional principal of £15.0 million and market value of £2.0 million that settle in less than four years).

15. 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 and BlackRock Investment Management (UK) 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 2016 £ million	30 June 2015 £ million
At start of year	23	126	149	125
Net contributions by members	1	16	17	20
Change in market value of investments	1	5	6	4
At end of year	25	147	172	149

16. Other investment assets

	30 June 2016 £ million	30 June 2015 £ million
Accrued investment income	196	166
Amounts due from brokers	245	330
Margin deposits – initial	14	110
Margin deposits – variation	30	155
Receivable on sale of investments	100	0
	585	761

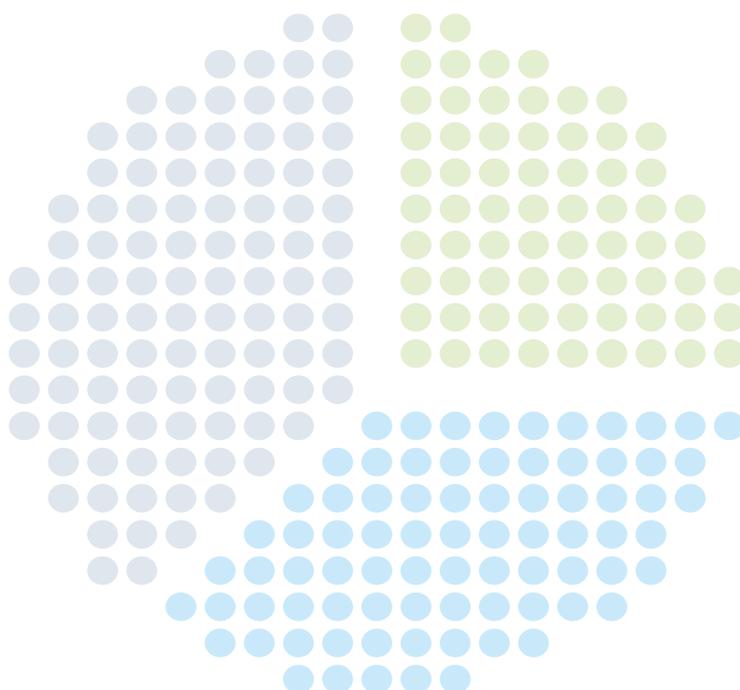
17. Longevity insurance contract

	30 June 2016 £ million	30 June 2015 £ million
Longevity insurance contract ¹¹	223	36
	223	36

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

18. Other investment liabilities

	30 June 2016 £ million	30 June 2015 £ million
Amounts due to brokers	277	189
Deferred income	19	11
Margin deposits – initial	0	9
Margin deposits – variation	605	89
Repurchase agreements	224	0
	1,125	298



19. 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 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 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)
Total net investments	23,953	13,609	8,576	46,138

	30 June 2015			
Asset class	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
Equities	8,927	16	706	9,649
Bonds	9,411	7,564	202	17,177
Property	0	1,828	0	1,828
Pooled investment vehicles	0	4,243	6,066	10,309
Loans	0	198	0	198
Derivatives	(18)	(166)	0	(184)
AVC investments	126	23	0	149
Deposits and short-term investments	3,414	268	0	3,682
Longevity insurance contract	0	0	(36)	(36)
Other investment assets and liabilities	463	0	0	463
Total net investments	22,323	13,974	6,938	43,235

19. 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 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
Total	13,609		

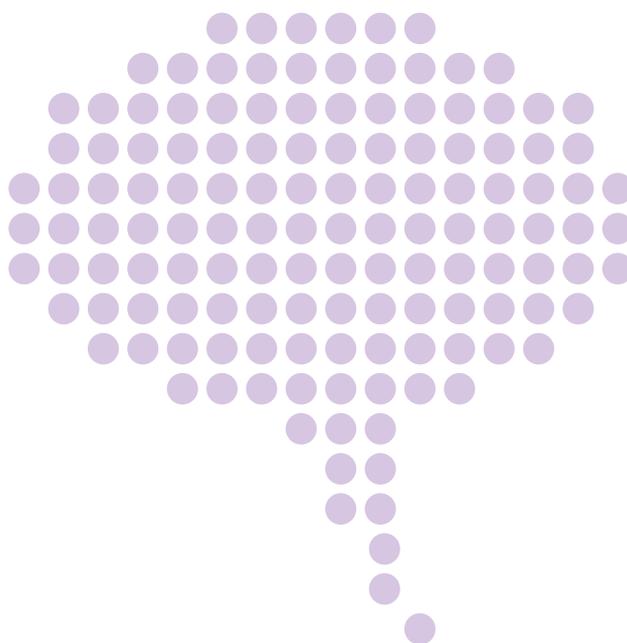
30 June 2016			
Level 3	Fair value £ million	Valuation technique	Significant assumptions
Equities	840	IPEVC guidelines	Discount rate, earnings assumptions
Bonds	200	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Pooled investment vehicles	7,759	Published net asset values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



19. Fair valuation hierarchy (continued)

30 June 2015			
Level 2	Fair value £ million	Valuation technique	Significant assumptions
Equities	16	Evaluated pricing models, broker quotes	Market risk
Bonds	7,564	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Property	1,828	RICS guidelines	Rental yields, occupancy rates
Pooled investment vehicles	4,243	Published net asset values	Redemption discount
Loans	198	Amortised cost	Discount rate, credit risk
Derivatives	(166)	Forward rates, yield curves	Cost of carry, yield curves
AVC investments	23	Published net asset values	Redemption discount
Deposits and short-term investments	268	Amortised cost	Discount rate, credit risk
Total	13,974		

30 June 2015			
Level 3	Fair value £ million	Valuation technique	Significant assumptions
Equities	706	IPEVC guidelines	Discount rate, earnings assumptions
Bonds	202	Evaluated pricing models, broker quotes	Credit risk, market risk, yield curves
Pooled investment vehicles	6,066	Published net asset values	Redemption discount
Longevity insurance contract	(36)	Discounted cash flow	Discount rate, cash flow profile, actuarial assumptions
Total	6,938		



20. 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 risks.
 - **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 for the other party by failing to discharge an obligation.

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

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

The Scheme is subject to inflation rate risk because some of the Scheme's investments are held in inflation linked bonds and derivatives (refer to "Interest rate risk" disclosures 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 rates increase, 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 rates fall the inflation linked bonds 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 was 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.

20. Investment risks (continued)

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. The Scheme's investment portfolio that is subject to interest rate risk at year end is detailed in the table below.

	30 June 2016 £ million	30 June 2015 £ million
Direct exposure		
Bonds	19,422	17,177
Loans	271	198
Derivatives	122	(148)
AVC investments	147	126
Deposits and short-term investments	2,769	3,682
	22,731	21,035
Indirect exposure		
Bonds	222	323
Mature infrastructure	431	335
	653	658
Total	23,384	21,693

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. The Scheme's exposure to currency risk is detailed in the table below.

Currency	Gross exposure 30 June 2016 £ million	Foreign exchange forward contracts (notional principal) £ million	Net exposure 30 June 2016 £ million
Direct exposure			
US Dollar	14,153	(8,894)	5,259
Euro	1,823	(558)	1,265
Japanese Yen	951	(684)	267
Other	3,317	(7,115)	(3,798)
Sterling	25,857	17,251	43,108
	46,101	0	46,101

20. Investment risks (continued)

	Net exposure 30 June 2016 £ million
Indirect exposure	
US Dollar	2,004
Euro	615
Japanese Yen	0
Other	80
Sterling	686
	3,385

Currency	Gross exposure 30 June 2015 £ million	Foreign exchange forward contracts (notional principal) £ million	Net exposure 30 June 2015 £ million
Direct exposure			
US Dollar	13,304	(5,778)	7,526
Euro	1,541	(358)	1,183
Japanese Yen	517	(276)	241
Other	2,628	(5,902)	(3,274)
Sterling	25,178	12,314	37,492
	43,168	0	43,168

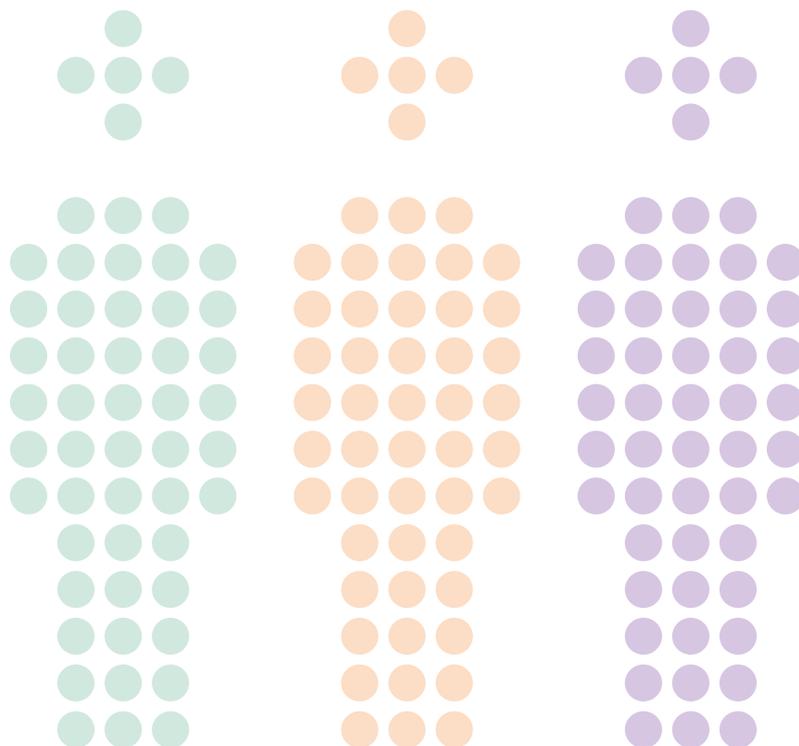
	Net exposure 30 June 2015 £ million
Indirect exposure	
US Dollar	2,205
Euro	460
Japanese Yen	0
Other	54
Sterling	880
	3,599

20. Investment risks (continued)

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 Scheme's investment portfolio that is subject to other price risk at year end is included in the table below.

	30 June 2016 £ million	30 June 2015 £ million
Direct		
Equities	11,677	9,649
Property	1,875	1,828
Derivatives	32	(37)
	13,584	11,440
Indirect		
Pooled investment vehicles	10,460	9,651
	10,460	9,651
Total	24,044	21,091



20. Investment risks (continued)

Credit risk

The Scheme is subject to direct credit risk as it invests in bonds, pooled investment vehicles, 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 revised 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 detailed below.

30 June 2016	Investment grade £ million	Non investment grade £ million	Unrated £ million	Total £ million
Direct exposure				
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
Gross exposure	19,308	1,061	12,852	33,221
Credit derivatives (notional amount on contracts)	(10)	0	0	(10)
Net exposure	19,298	1,061	12,852	33,211
Indirect exposure				
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
Gross exposure	390	121	1,880	2,391
Credit derivatives (notional amount on contracts)	(39)	0	0	(39)
Net exposure	351	121	1,880	2,352

20. Investment risks (continued)

30 June 2015	Investment grade £ million	Non investment grade £ million	Unrated £ million	Total £ million
Direct exposure				
Bonds	15,006	753	1,418	17,177
Pooled investment vehicles	0	0	10,309	10,309
Loans	0	0	198	198
Over the counter derivatives	(166)	0	0	(166)
Deposits and Short-term investments	3,682	0	0	3,682
Gross exposure	18,522	753	11,925	31,200
Credit derivatives (notional amount on contracts)	(37)	0	0	(37)
Net exposure	18,485	753	11,925	31,163
Indirect exposure				
Bonds	14	29	117	160
Pooled investment vehicles	0	0	1,023	1,023
Loans	215	39	452	706
Over the counter derivatives	(1)	0	3	2
Deposits and Short-term investments	0	0	0	0
Gross exposure	228	68	1,595	1,891
Credit derivatives (notional amount on contracts)	(12)	0	0	(12)
Net exposure	216	68	1,595	1,879

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.

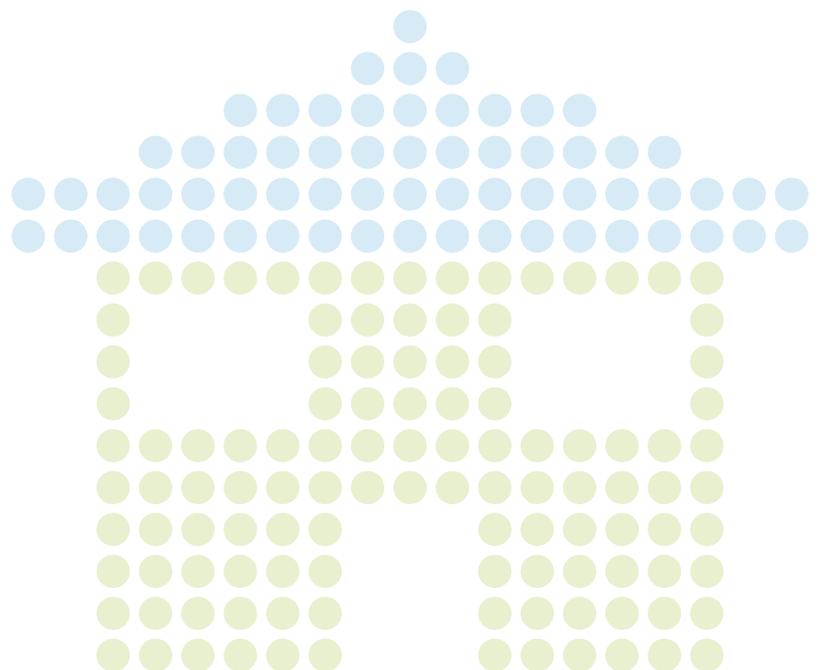
21. Current assets

	30 June 2016 £ million	30 June 2015 £ million
Employers' contributions due	18	21
Employees' contributions due	1	1
Other debtors	58	43
Bank balances	4	4
	81	69

All contributions due to the Scheme relate to the month of June 2016 and were paid in full to the Scheme within the timescale required by the Schedule of Contributions in force at the year end.

22. Current liabilities

	30 June 2016 £ million	30 June 2015 £ million
Accrued benefits	48	45
Other creditors	70	91
	118	136



23. Securities lending

No securities were on loan as at 30 June 2016 or 30 June 2015.

24. 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:

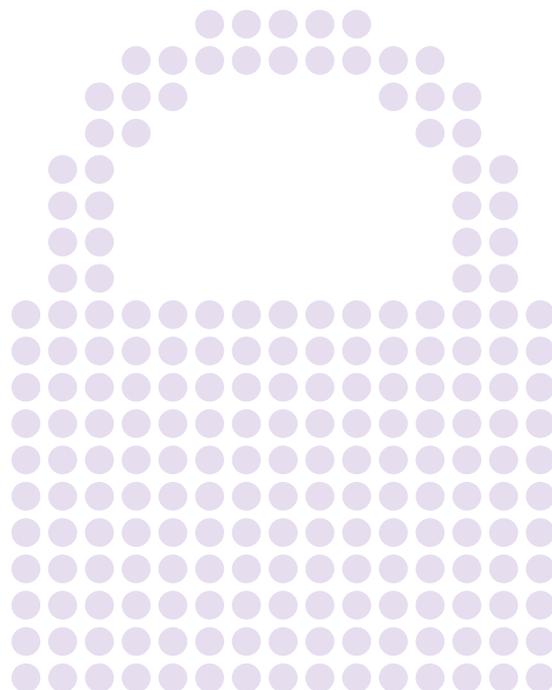
- has control or joint control over the reporting entity;
- has significant influence over the reporting entity; or
- is a member of key management personnel of the reporting entity or of a parent of the reporting entity; and

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 and fellow subsidiary 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.



24. 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 2016 £ thousand	Year ended 30 June 2015 £ thousand
Paul Spencer CBE	200	188
Catherine Claydon	71	70
Adrian Askew	29	28
The Law Debenture Pension Trust Corporation plc (represented by David Felder)	56	55
Donald MacDonald	39	38
Billy McClory	29	28
Beryl Shepherd	29	28
	453	435

Paul Spencer CBE served as non-executive director and chairman of Hermes Fund Managers Limited until March 2016 and received £65,625 (2015: £87,500). Paul Spencer CBE served as non-executive director and chairman of BTPSM Limited during the year and received £65,625 (2015: £87,500). From 1 April 2016, Paul Spencer CBE was not separately remunerated for the role of chairman of the Scheme and BTPSM Limited, therefore the schedule of Trustee director fees reflects this combined role from 1 April 2016. Adrian Askew served as a non-executive director and chairman of the remuneration committee of BTPSM Limited and received £12,500 (2015: £12,500) and £5,000 (2015: £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 £28,038 (2015: £28,798). Billy McClory served as the senior non-executive director of Hermes Fund Managers Limited during the year and received £27,500 (2015: £25,000). John Wroe and Jim McNally as employer-nominated Trustee Directors received no specific fees.

Three Trustee Directors were members of the Scheme at 30 June 2016 (2015: Three). One of these Trustee Directors received a pension from the Scheme during the year in accordance with the Scheme Rules (2015: One).

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-investment

At 30 June 2016, the Scheme did not directly hold any ordinary shares in BT (2015: £nil), however, it held £9 million in BT index-linked investments (2015: £9 million). The total amount of self-investment represents 0.02% of the net assets of the Scheme (2015: 0.02%). At 30 June 2016 there were no properties occupied by BT owned by the Scheme (2015: None).

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.

24. Related party transactions (continued)

Other related party transactions

The table below sets out related party transactions and balances between the Scheme and subsidiary undertakings (refer to note 26 “Subsidiary undertakings” for information on the Scheme’s subsidiaries):

Related party	Transaction	30 June 2016		30 June 2015	
		Expense 30 June 2016 £ million	Payable 30 June 2016 £ million	Expense 30 June 2015 £ million	Payable 30 June 2015 £ million
Hermes Fund Managers Limited	Investment management and performance fees (direct and indirect)	(57)	(6)	(66)	(21)
Hermes Fund Managers Limited	Other expenses	(4)	(1)	(4)	(1)
Hermes Fund Managers Limited	Loan provided by Scheme	0	6	0	6
		(61)	(1)	(70)	(16)

25. Commitments and contingent liabilities

	30 June 2016 £ million	30 June 2015 £ million
Property	208	258
Calls on partly paid shares and underwriting commitments	1,349	1,545
	1,557	1,803



26. Subsidiary undertakings

Subsidiary undertaking	Principal activity	Holding	30 June 2016 Ownership %	30 June 2015 Ownership %
Subsidiary undertakings presented on a consolidated basis				
BT Pension Scheme Management Limited ¹⁵	Executive arm of Trustee	Ordinary shares	100	100
BTPS Insurance ICC Limited ¹³	Longevity insurance	Ordinary shares	100	100
BTPSI (No.1) IC Limited ¹³	Longevity insurance	Ordinary shares	100	100
Apus No.8 Junior Unit Trust ¹²	Property investment and development	Units	100	0
Carraway Belfast Investments Unit Trust ¹²	Property investment and development	Units	100	100
Carraway Tunbridge Wells Investments Unit Trust ¹²	Property investment and development	Units	100	100
One America Square LP ¹⁸	Property investment and development	Partnership capital	100	0
Poole Unit Trust ¹²	Property investment and development	Units	100	0
Retail Value L.P. ¹⁵	Property investment and development	Partnership capital	100	100
Subsidiary undertakings not presented on a consolidated basis				
Ares European Credit Strategies Fund II (B) L.P. ¹⁷	Investment management	Partnership capital	100	100
Argent Group plc ¹⁵	Property investment and development	Ordinary shares	100	100
Hermes Alternative Funds plc ¹⁶	Investment management	Ordinary shares	99	98
Gotham Segregated Account I L.P. ¹⁸	Property investment and development	Partnership capital	99	99
HCN L.P. ¹⁷	Investment management	Partnership capital	100	100
Hermes Factory Outlets Unit Trust ¹⁵	Property investment and development	Units	100	50
Hermes Factory Outlets No. 2 Unit Trust ¹⁵	Property investment and development	Units	100	90
Hermes Fund Managers Limited ¹⁵	Investment management	Ordinary shares	100	100
Hermes Real Estate Senior Debt Fund L.P. ¹⁵	Investment management	Partnership capital	100	100
Hermes Private Equity Investments Holding 2004 L.P. ¹³	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2005 L.P. ¹³	Investment in private equity funds	Partnership capital	100	100

26. Subsidiary undertakings (continued)

Subsidiary undertaking	Principal activity	Holding	30 June 2016 Ownership %	30 June 2015 Ownership %
Subsidiary undertakings not presented on a consolidated basis (continued)				
Hermes Private Equity Investments Holding 2006 L.P. ¹³	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2007 L.P. ¹⁴	Investment in private equity funds	Partnership capital	100	100
Hermes Private Equity Investments Holding 2008 L.P. ¹⁴	Investment in private equity funds	Partnership capital	100	100
Hermes GPE PEC 1 L.P. ¹⁴	Investment in private equity	Partnership capital	100	100
Hermes GPE PEF 1 L.P. ¹⁴	Investment in private equity funds	Partnership capital	100	100
Hermes GPE FRWL Holdco Limited ¹⁵	Investment in private equity	Ordinary shares	93	93
Hermes GPE Horizon L.P. ¹⁴	Investment in private equity	Partnership capital	100	0
Lionstone-Hermes Real Estate Venture L.P. ¹⁸	Property investment and development	Partnership capital	99	99
MEPC Fund Unit Trust ¹⁵	Property investment and development	Units	100	100
Hexagon Real Estate Investments Sarl ¹⁹	Property investment and development	Ordinary shares	75	75
Orthogonal Partners I L.P. ¹⁴	Investment in private equity funds	Partnership capital	100	100
Strategic Investment Portfolio L.P. ¹²	Investment management	Partnership capital	100	100

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

The fair value of net assets of subsidiary undertakings that are not consolidated by the Scheme in aggregate amounted to £4,911 million (2015: £4,194 million). This comprised of £5,296 million of assets and £385 million of liabilities (2015: £4,862 million of assets and £668 million of liabilities). £2,042 million of the fair value of net assets related to investments managed by HFML (2015: £1,796 million), that comprised of £2,098 million of assets and £56 million of liabilities (2015: £1,961 million of assets and £165 million of liabilities).

27. 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 as 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.

Significant inputs and assumptions used in the actuarial valuations at 30 June 2011 and 30 June 2014 are set out below.

	30 June 2011	30 June 2014
Assets (£bn)	36.98	40.35
Liabilities (£bn)	(40.91)	(47.39)
Deficit (£bn)	(3.93)	(7.04)
Funding level	90.4%	85.1%
Equivalent real discount rate	2.0%	1.0%
Average RPI inflation	3.2%	3.5%
CPI inflation (long-term)	2.2%	2.5%

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 the next contribution of £250 million is due by 31 March 2017. Details of the other deficit contributions due after 31 March 2017 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 2015, providing a formal update of the funding position, which revealed that the past service deficiency had increased to £9,960 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. Prior to that valuation, the Trustee will receive an additional Actuarial Report that provides my update of the funding position as at 30 June 2016.

M J Pardoe FIA

Towers Watson Limited (a Willis Towers Watson company)

14 December 2016

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 2016	30 June 2015	30 June 2014
Membership			
Active members	33,871	37,065	40,229
Deferred members	67,766	71,785	75,935
Current pensioners of whom:	201,261	199,333	197,736
Retired employees	165,416	163,397	161,601
Widows/widowers	33,758	33,783	33,908
Children/dependants	2,087	2,153	2,227

	Year ended 30 June 2016	Year ended 30 June 2015	Year ended 30 June 2014
Changes to membership			
Normal age retirements from active status	20	65	49
Ill health early retirements	87	80	95
Early retirement	3,998	3,558	3,157
Deferred benefits set up	1,057	1,096	755
Normal age retirements from deferred status	2,462	3,260	2,953
Benefits transferred out and trivially commuted	245	290	167
Optants out	19	0	14
Death in service	44	48	48
Death in retirement	6,511	7,303	6,341
Death in deferment	90	97	80
Late retirement	0	0	1
New records set up			
Section B rejoiners	19	27	36
Widows, spouse, widowers and dependants	1,821	1,923	1,666
Children	70	71	78
Benefits transferred in	0	0	0

Appendix two

Statement of Investment Principles

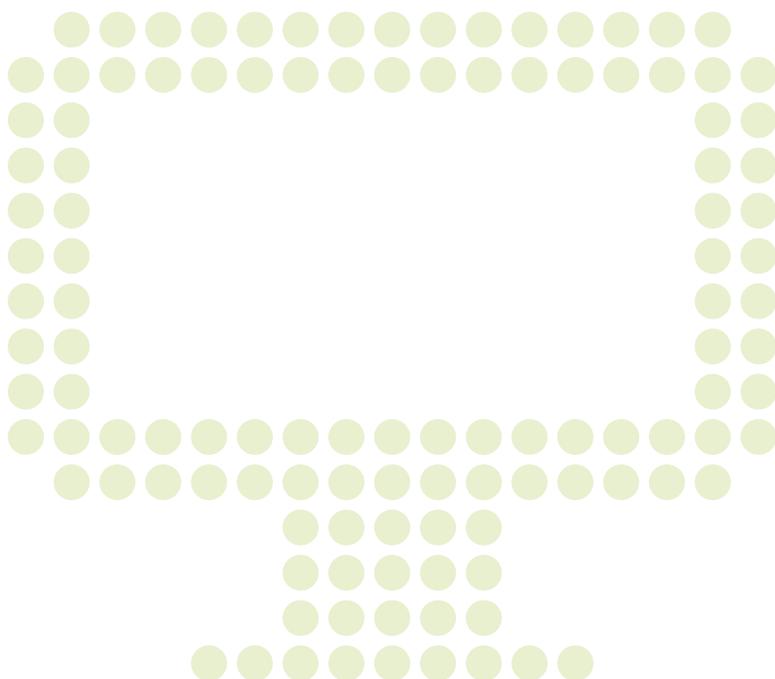
Introduction

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

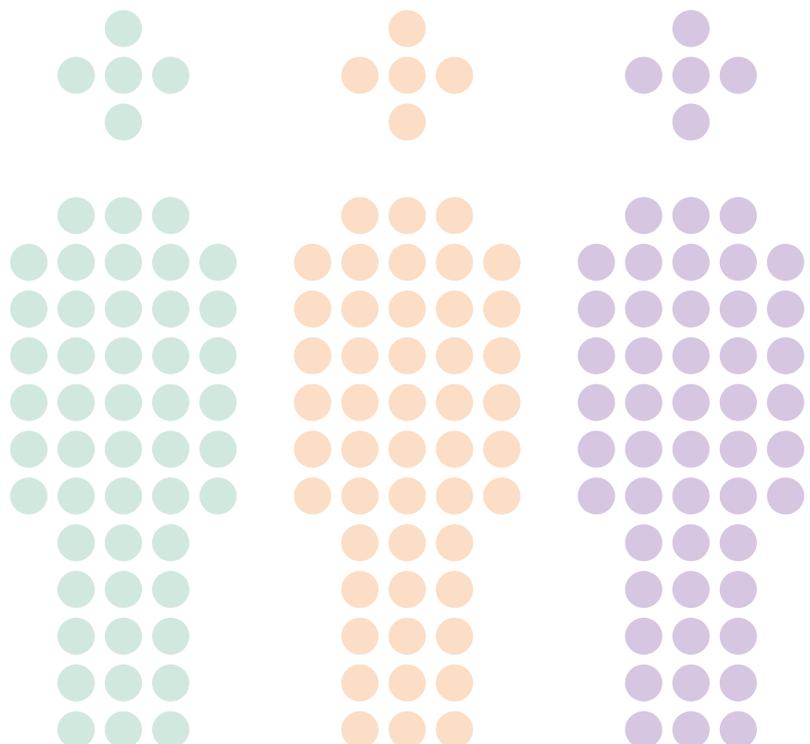
The Trustee has a fiduciary responsibility to meet the Scheme's liabilities and as a long-term asset owner considers sustainable factors to improve long-term risk adjusted returns, including social, environmental and ethical issues and the exercise of ownership rights.

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 endeavors 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.



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

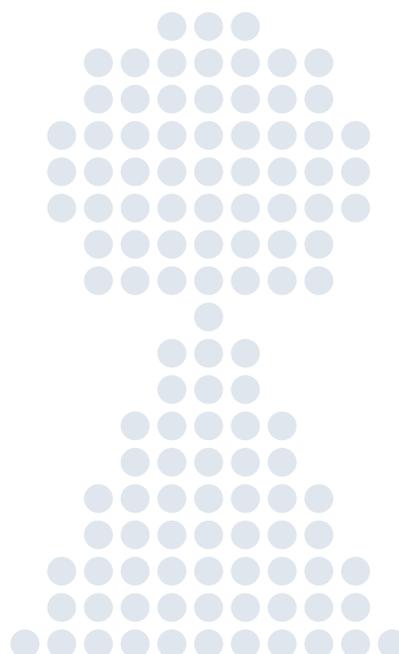
I certify that, in my opinion, the calculation of the Scheme's technical provisions as at 30 June 2014 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the Trustee of the Scheme and set out in the Statement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

M J Pardoe

Fellow of the Institute and Faculty of Actuaries
Towers Watson Limited

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 movements 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. Both futures and options are used by the Scheme as a means to buy or sell with a single transaction the equivalent of a wide range of securities.

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 with a third party 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.

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.

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 10 working days after it has been prepared or revised.

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.

The Scheme

The BT Pension Scheme.

SORP

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

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 dealt 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,
Lloyds Chambers,
1 Portsoken Street,
London E1 8HZ

Website: **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**.

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**.

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