Report & Accounts
31 December 2011
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Management and Advisers

**Scheme Secretary**
Agnes Lynch

**Scheme Registration Number**
100850030

**Trustee**
BT Pension Scheme Trustees Limited

**Trustee Directors**
- Paul Spencer CBE (Chairman) [appointed as Chairman 1 March 2011]
- Adrian Askew [appointed 11 January 2011]
- David Barford [died 2 April 2012]
- Law Debenture Pension Trust Corporation plc [represented by David Felder] [appointed 15 September 2011]
- Donald MacDonald
- Billy McClory
- Andrew Parker
- Beryl Shepherd
- John Wroe
- Howard Marchant [retired 10 January 2011]
- Rod Kent [Chairman] [retired 28 February 2011]

**Actuary**

**Auditor**
Deloitte LLP, London

**Legal Adviser**
Hogan Lovells International LLP

**Pensions Administrator**
Accenture HR Services
Venture House
Venture Way
Chesterfield
S41 8NR

**Banker**
The Northern Trust Company

**Executive Arm of the Trustee**
BT Pension Scheme Management Limited:
- Nigel Labram – Chief Executive Officer

**Principal Investment Managers**
Hermes Fund Managers Limited:
- Hermes Investment Management Limited
- Hermes Real Estate Investment Management Limited
- Hermes Focus Asset Management Limited
- Hermes GPE LLP [Joint Venture]
- Hermes BPK Partners LLP
BlackRock Investment Management (UK) Limited
Legal & General Investment Management Limited
M&G Investment Management Limited

**Custodian of Assets**
The Northern Trust Company

**Principal Sponsoring Employer**
British Telecommunications plc
81 Newgate Street
London EC1A 7AJ

If you require further information regarding this report, please contact:
BT Pension Scheme Management Limited
Lloyds Chambers
1 Portsoken Street
London E1 8HZ
Chairman’s Statement.

My first year as Chairman has been a busy one, and one in which the economic outlook has continued to be challenging. As a Trustee Board, we recognise the importance of the BT Pension Scheme (the Scheme) to our pensioners as well as to those yet to retire. We continue to work hard to make sure that the Scheme is as well managed as possible, so that all members can be confident that they will receive the pension to which they are entitled.

Valuation Update
The Trustee agreed to undertake the Valuation at 30 June 2011, instead of 31 December 2011. This was to ensure a substantial deficit payment could be made before the end of BT’s financial year. Dislocation to the Gilts market at 31 December 2011 made it difficult to assess the position at that date. The valuation at 30 June 2011 provisionally valued the funding deficit at £4.1 billion and the Trustee and BT agreed that this will be met by a one-off contribution of £2 billion in March 2012, followed by nine payments of £325 million from March 2013 to March 2021. The Trustee also agreed a number of other protections with BT. These include schedules of future additional payments depending on the results of the 2014 and 2017 valuations; no reliance on investment outperformance under the terms of the Recovery Plan; protective mechanisms relating to future corporate actions on dividends, share buy-backs and disposals; and a shorter recovery period than was agreed at the last valuation.

Since reaching this provisional agreement, the valuation deficit has been finalised at £3,937 million as at 30 June 2011 and the deficit contributions payable for years 2015 to 2021 amended to £295 million per annum. The deficit contributions of £325 million in 2013 and 2014 remain unchanged.

Crown Guarantee Update
When BT was privatised in 1984 the Government gave a guarantee of meeting BT’s pension liabilities which would only come into effect if BT becomes insolvent. This has become known as the “Crown Guarantee”. Over time there have been different interpretations as to the precise scope of this Crown Guarantee. For many years the Trustee has sought to achieve clarity on this issue, considering this to be an important ultimate safeguard for our members. Having exhausted all other avenues for achieving this, the Trustee decided that this was a matter that could only be clarified by the Courts. Accordingly, in order to best protect members’ interests, the Trustee has applied to the High Court (“Court”) for a ruling on the Crown Guarantee. BT has been supportive of this action.

In October 2010, the Court gave a judgment addressing the two central issues in this case but it left further issues to be resolved at another hearing. This further hearing took place in November 2011 and judgment was given in December 2011. Taking the Court’s judgments together and taking account of matters conceded by the Government, the position can be summarised as follows:

1. The Crown Guarantee covers the payments that BT is obliged to make into the Scheme to fund all the benefits for all of its members (whenever they joined the Scheme), subject to two exceptions. The Crown Guarantee does not cover payments either in respect of benefits earned while a member was employed by a BT Group company other than BT, or in respect of benefits which have been augmented by BT.

2. If the benefits that are provided by the Scheme are changed in the future, it remains to be determined whether payments to fund the altered benefits will be covered.

If the Scheme is wound up, BT is obliged to make payments into the Scheme to meet any deficit in the Scheme and this would be measured by reference to the cost of buying annuities from an insurance company to meet benefits in full. The Crown Guarantee covers this payment obligation of BT in respect of relevant benefits.

It is possible that the Court’s decision will be subject to appeal.

Investment Outlook
The global economic outlook continues to cause nervousness in the markets and the Scheme’s investments have not been unaffected by the volatility experienced throughout 2011. It was generally a poor year for equities, but a much better one for the Gilt market, as problems in the Eurozone and austerity in the UK led investors to seek safe haven investments. The Scheme produced an investment return of 1.7% for the year, this brings the return over the last 3 years to a rate of 8.4% per annum, [4.4%/4.8% ahead of the Retail Price Index/Consumer Price Index respectively]. A more detailed analysis of the performance of the investments during 2011 is given later in the report.

AVC Switch
As well as monitoring the Scheme’s investments for the benefit of all the Scheme members, the Trustee’s duties also include reviewing the suitability of the investment options that the Scheme provides for members’ AVCs. Following a recent review of the funds offered the decision was taken to remove one of the fund options, the Santander Deposit Fund, and replace it with the Standard Life Managed Cash Pension Fund. The replacement fund has been carefully selected to give a comparable return while improving the financial protection for investors and providing a more diversified approach. Members whose AVCs are invested in the Santander Deposit Fund were contacted recently and informed that their investments (both existing funds and future contributions) will be automatically switched to the Standard Life Managed Cash Fund from 1 May 2012.

David Barford
Finally, it is with much sadness that I have to inform you that David Barford passed away on 2 April 2012. On a professional level, David has been an outstanding Trustee Director, whilst on a personal level, David was a warm, generous and kind friend to all those who knew him at the BT Pension Scheme. We shall miss his counsel, his friendship and his humour.

Paul Spencer CBE
Chairman of BT Pension Scheme
### Key Facts 2011

The overall investment return on BTPS assets was **1.7%** over the year. This compares with a benchmark return of **3.7%**. See page 14.

#### Value of the Fund

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>£39,674m</td>
<td>£31,344m</td>
<td>£34,112m</td>
<td>£36,698m</td>
<td>£36,002m</td>
<td></td>
</tr>
</tbody>
</table>

#### Annualised investment returns

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BTPS Actual</td>
<td>12.2%</td>
<td>11.8%</td>
<td>1.7%</td>
<td>8.4%</td>
<td>2.3%</td>
<td>6.2%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Benchmark</td>
<td>11.6%</td>
<td>10.7%</td>
<td>3.7%</td>
<td>8.6%</td>
<td>1.7%</td>
<td>5.4%</td>
<td>6.4%</td>
</tr>
<tr>
<td>BTPS Real¹ − Adjusted RPI²</td>
<td>9.8%</td>
<td>7.0%</td>
<td>-3.1%</td>
<td>4.4%</td>
<td>-1.1%</td>
<td>2.9%</td>
<td>3.9%</td>
</tr>
<tr>
<td>BTPS Real¹ − Adjusted CPI²</td>
<td>9.4%</td>
<td>8.1%</td>
<td>-2.5%</td>
<td>4.8%</td>
<td>-0.9%</td>
<td>3.7%</td>
<td>4.8%</td>
</tr>
</tbody>
</table>

¹ BTPS Real Adjusted equals BTPS actual less RPI and CPI respectively.
² Retail Price Index (RPI) and Consumer Price Index (CPI) are measures of UK inflation.

#### Fund membership

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>Change</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributing Members</td>
<td>51,861</td>
<td>-4,157</td>
<td>47,704</td>
</tr>
<tr>
<td>Deferred Members</td>
<td>89,714</td>
<td>-4,420</td>
<td>85,294</td>
</tr>
<tr>
<td>Pensioners*</td>
<td>189,835</td>
<td>+3,742</td>
<td>193,577</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>331,410</strong></td>
<td><strong>-4,835</strong></td>
<td><strong>326,575</strong></td>
</tr>
</tbody>
</table>

* The figure in the table for pensioners comprises 157,254 retired employees; 33,966 widows/widowers; 2,357 children/dependants.

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*Hedge Fund 8.8%  Fixed interest 22.0%
Other Alternatives 13.1%  Inflation-linked 20.6%
UK Equities 6.6%  Property 11.4%
Overseas Equities 17.3%  

* The net assets of the Scheme have been reclassified so that the managed asset allocation as at 31 December 2011 can be observed. Further details are on pages 17 and 18.

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* The figure in the table for pensioners comprises 157,254 retired employees; 33,966 widows/widowers; 2,357 children/dependants.
Report by the Trustee

Scheme Funding Update

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

The 2011 valuation has been carried out at 30 June 2011 rather than 31 December 2011. This has enabled the valuation to be largely completed to allow a lump sum payment to be made prior to the end of BT’s 2012 financial year. Dislocation to the Gilts market at 31 December 2011 and the absence of regulatory guidance and practice about how to deal with those abnormal market conditions made it difficult to assess the position at that date. Future triennial valuations are expected to be based on a June valuation date as this will enable the Trustee and BT to complete the valuation within BT’s financial year.

The Trustee and BT reached provisional agreement on the results of the 2011 funding valuation during March 2012. The funding deficit was provisionally agreed to be around £4.1 billion as at 30 June 2011, which equates to a funding level of 90%. The valuation was undertaken using similar methodology as the previous valuation at 31 December 2008, when the deficit was £9.0 billion (equivalent to a funding level of 77%).

As part of the provisional agreement, the Company agreed to pay additional contributions in order to return the Scheme to a fully funded position by 31 March 2021. In particular, BT paid a deficit contribution of £2 billion in March 2012 and agreed to make further payments of £325 million each year from 2013 until 2021.

Since reaching this provisional agreement, the valuation deficit has been finalised as £3,937 million as at 30 June 2011 and the deficit contributions payable for years 2015 to 2021 amended to £295 million per annum. The deficit contributions of £325 million in 2013 and 2014 remain unchanged.

The recovery plan makes no allowance for investment outperformance compared with the 2008 valuation which included approximately a £1.5 billion allowance.

The deficit contributions are in addition to the Company’s normal contributions. As a result of the 2011 valuation, the Company will amend these regular contributions from 13.6% to 13.5% of members’ pensionable pay (less members’ mandatory contributions) from June 2012.

In order to provide greater certainty over future payments, BT has also agreed with the Trustee a schedule of contingent payments depending on the agreement reached at the next valuations in 2014 and 2017, and the size of any deficit disclosed at these valuations. As at 30 June 2011, the total value of the deficiency payments and the contingent payments amounted to some £7 billion.

Legally binding agreements between the Trustee and BT reached in 2008 to improve the security of the members’ benefits have been retained or improved as part of the 2011 provisional agreement. These include:

- BT provided the Scheme with a ‘negative pledge’ in 2010, which remains in place. In common with other lenders to BT, this provides comfort to the Scheme that, within certain limits, future creditors will not be granted superior security.
- BT has agreed that if over the period 1 March 2012 to 30 June 2015, cumulative shareholder distributions exceed cumulative pension deficit contributions, then BT will make matching additional contributions to the Scheme.
- BT has agreed to consult with the Trustee if it considers making a special dividend or embarking on a share buy-back programme (excluding any possible buy-back of shares associated with existing employee share plans).
- BT has agreed that if it generates net cash proceeds greater than £1 billion from disposals, net of acquisitions, as measured at annual review dates until 30 September 2015 and the deficit at the time is over £2 billion, then BT will make additional contributions to the Scheme equal to one third of the net cash proceeds.
- BT has also agreed to consult with the Trustee if it considers making acquisitions with a total cost of more than £1 billion in any 12 month period.
- The Trustee and BT have also agreed that if active members’ pensionable salary increases between 2011 and 2014 are higher than the rate of inflation over the period, BT will pay the extra cost of the resulting strain on the Scheme within 12 months.

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

The Scheme Actuary provides an interim report on funding to the Trustee each year between full actuarial valuations. The next report following completion of the 2011 valuation is expected to be carried out as at 30 June 2012.

On 30 June 2011, R Hails resigned as the Scheme Actuary and M J Pardoe was appointed to replace him. R Hails confirmed that there were no matters surrounding his resignation that needed to be brought to the attention of the members.
Scheme Management

The Scheme is managed and administered by the Trustee, BT Pension Scheme Trustees Limited, on behalf of the members in accordance with the terms of the Scheme Rules and all relevant legislation. Further information on the Trustee is given in Appendix one.

BT Pension Scheme Management Limited (BTPSM) is the executive arm of the Trustee and provides advice and services in five broad areas: investment asset allocation, fund manager selection and monitoring, risk and liability management, governance and operations. BTPSM is a 100% subsidiary of Hermes Fund Managers Limited (Hermes), which is itself a 100% subsidiary of the Scheme. BTPSM was authorised by the Financial Services Authority on 13 February 2009.

The Trustee has delegated pension administration to BT and BT has sub-delegated the administration to Accenture HR Services (Accenture). Therefore, the keeping of members’ records and the calculation and payment of benefits are undertaken by Accenture. This pension service is governed by a Service Level Agreement, which defines the standards of service to be provided. Further information on Accenture is given in Appendix two.

Scheme Investment

Scheme Investment Policy

The Trustee reviews the Investment Policy of the Scheme, in conjunction with the Scheme Funding Valuation. The Trustee, supported by BTPSM, analyses future projections of a wide spectrum of potential outcomes of inflation, interest rates and asset returns to assess the potential range of funding levels and risks associated with different asset allocations. The monitoring of the future projections of the Scheme’s liabilities is also included in this analysis. This “Asset-Liability” monitoring approach is widely adopted in financial institutions and pension schemes, and assists the Trustee in deciding a suitable medium and long-term investment strategy for the Scheme.

The “Asset-Liability” monitoring process and ongoing advice from BTPSM allows the Trustee to identify the future liability constraints on the Scheme and how the assets will meet these liabilities. The Trustee, with the assistance of BTPSM, will over the Scheme’s life expect to reduce the level of return seeking assets and increase the level of liability matching assets in order to minimise the impact of future adverse events. The assets and liabilities are carefully monitored on an ongoing basis, and the Trustee is well positioned to respond quickly to changes in markets and funding in order to protect the Scheme’s assets.

Statement of Investment Principles

A Statement of Investment Principles has been agreed by the Trustee following written advice from BTPSM and consultation with the sponsor, 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 at least annually. A copy of the Statement of Investment Principles as at 31 December 2011 is reproduced in Appendix six.

Measuring Investment Performance and Scheme Benchmark

The Trustee has set the objective of outperforming the strategic benchmark over three years (from capital appreciation and investment income) on the assets of the Scheme. The strategic benchmark return is calculated by combining the strategic target weights set by the Trustee for each asset class (see page 15) with the total return, including capital appreciation and income, that would have been achieved by passively investing in indices which are chosen to reflect the performance of each asset class.

The Trustee monitors the Scheme’s performance against this benchmark. BTPSM reports monthly to the Trustee on the overall Scheme performance and the performance of underlying mandates against their respective index benchmarks.

For the Trustee
P Spencer CBE
Chairman
9 May 2012
The Governance of the BT Pension Scheme

Trustee Governance – Trustee Knowledge and Understanding (TKU)
All the Trustee Directors currently have the skills and knowledge necessary to carry out their role effectively. However, in areas such as finance and investment, some Trustee Directors have more detailed knowledge than others.

On appointment, a new Trustee Director receives full information regarding the Scheme, the role of a Trustee, the service level agreement with Accenture for administration, investment objectives (including the Statement of Investment Principles), minutes of recent Trustee meetings and information on the BTPSM and Hermes organisations. New Trustee Directors are also asked to complete a questionnaire identifying their training needs. Relevant initial and ongoing training is then provided.

The Trustee Directors are asked at least annually to identify their further training needs. The Chairman of the Trustee Board, supported by the Secretary to the Trustee, is responsible for a formal and rigorous annual appraisal of the Trustee Directors. This includes an assessment of their competence in the various areas of trusteeship, and the need for further training. Suitable further training is then provided and comprehensive records are kept of all training undertaken by each Trustee Director.

The Chairman of the Trustee Board is responsible for ensuring that Trustee Directors taking investment decisions are familiar with the issues involved and are able to evaluate critically any advice received. The Trustee applies the Myners Principles, but has taken a deliberate decision that strategic investment issues should be considered by the Trustee body as a whole, and not by a committee.

The Trustee Directors believe that investment strategy (as opposed to day-to-day decisions) should be considered by the full Trustee body. The Investment Committee considers more detailed and tactical issues. A sub-committee with appropriate expertise may be appointed from time to time for specific projects.

The Trustee’s governance approach takes account of the Codes of Practice issued by the Pensions Regulator. The Trustee has a forward-looking business plan that, amongst other matters, sets out what issues should be considered by the Trustee, and when.

Appointment and Removal of Trustee Directors
The current arrangements for appointing and removing Trustee Directors are summarised below. The Trustee revised the arrangements in 2007 after consultation with relevant parties.

1. Under the terms of the Scheme Rules there are nine Trustee Directors appointed by BT, the recognised Trade Unions and the National Federation of Occupational Pensioners (NFOP).

2. The Chairman of the Trustee Board is appointed by BT with the agreement of the recognised Trade Unions.

3. BT appoints four employer-nominated Trustee Directors. Two of them will normally hold senior positions with BT, and two will normally hold (or have held) senior positions in commerce or industry.

4. The Trustee’s member-nominated Trustee Director procedure provide that four member-nominated Trustee Directors are selected by the recognised Trade Unions and NFOP. The recognised Trade Unions and NFOP have agreed arrangements whereby they will convene a selection panel to fill vacancies. They will consider candidates from each organisation. 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.

5. Trustee Directors will be appointed for a three year term, but are then eligible for reappointment. Unanticipated vacancies (e.g. from death or resignation) will be filled within six months.

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

Trustee Board Committees
The Trustee Board delegates certain areas of oversight to four Board Committees. Each Committee has terms of reference which are reviewed regularly and reports up to the Trustee Board.

- **Audit Committee** – The Chairman is John Wroe and the other members on the Committee are Billy McClory and Paul Spencer. The Committee is responsible for advising the Trustee on the discharge of its duties with regard to the Scheme’s financial statements and the maintenance of proper records and controls.

The Committee supervises the preparation of the Trustee’s annual reports and provides oversight over external audit, internal audit, internal financial control and risk management.
• **Investment Committee** – The Chairman is Paul Spencer and the other members on the Committee are David Barford, David Felder, Donald MacDonald and John Wroe. During the year Rod Kent retired from the position as Chairman on 28 February 2011. David Felder who represents Law Debenture Pension Trust Corporation plc was appointed on 15 September 2011. The Committee is responsible for the oversight of performance, manager selection and the implementation of strategic and tactical asset allocation. It also oversees the investment authority delegated to BTPSM.

• **Administration and Communications Committee** – The Chairman is Andrew Parker and the other members on the Committee are Adrian Askew, Agnes Lynch and Beryl Shepherd. During the year Howard Marchant retired from the position as Chairman on 10 January 2011. Adrian Askew joined the Committee as a new member, when he became a Trustee Director on 11 January 2011. Agnes Lynch was replaced by Catherine Redmond, Executive Director of BTPSM on 16 February 2012. The Committee is responsible for agreeing guidelines for the exercise of discretions and the associated appeals procedure. It is also responsible for pensions administration matters and communications with members, including oversight of the Scheme website.

• **Policy Committee** – This Committee held its inaugural meeting on 16 November 2011. The Chairman is Donald MacDonald and the other members on the Committee are Adrian Askew and Andrew Parker. The Committee is responsible for keeping abreast of current and future public policy challenges, their potential impacts on the Scheme and proposed mitigation. The Committee monitors the long term sustainability (including stewardship) of BTPS’ assets and considers opportunities and risks. The Committee will recommend and propose to the Trustee Board and Investment Committee any appropriate actions in this regard.

In addition, there is the Discretions Sub-Committee. The Discretions Sub-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. The members on this Sub-Committee are Adrian Askew, Agnes Lynch and Beryl Shepherd. The Internal Disputes Resolution Procedure (IDRP) Stage 2 Appeals Panel 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. The members on the Panel are Billy McClory, Donald MacDonald and Andrew Parker.
Attendance at Trustee’s Meetings
The table below shows the attendance at all meetings during 2011:

<table>
<thead>
<tr>
<th>Trustee Director</th>
<th>Main Board</th>
<th>Administration &amp; Communications Committee</th>
<th>Audit Committee</th>
<th>Investment Committee</th>
<th>Policy Committee</th>
<th>BTPSM Board</th>
<th>Hermes Board and Committees</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of meetings</td>
<td>10</td>
<td>4</td>
<td>4</td>
<td>10</td>
<td>1</td>
<td>7</td>
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<tr>
<td>A Askew 1</td>
<td>9</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>1</td>
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<td>-</td>
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<tr>
<td>D Barford 2</td>
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<td>-</td>
<td>-</td>
<td>8</td>
<td>-</td>
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<td>21</td>
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<tr>
<td>D Felder 3</td>
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<td>-</td>
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<td>-</td>
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<td>-</td>
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<tr>
<td>R Kent 4</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>D MacDonald 5</td>
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<td>-</td>
<td>-</td>
<td>10</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>H Marchant 6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>B Shepherd 9</td>
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<td>8</td>
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<tr>
<td>J Wroe 11</td>
<td>10</td>
<td>-</td>
<td>3</td>
<td>10</td>
<td>-</td>
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</tr>
</tbody>
</table>

1 A Askew: Appointed 11 January 2011. Member of Administration and Communications Committee, member of the Policy Committee. Non-executive Director of BTPSM: Appointed 26 March 2012.
2 D Barford: Died 2 April 2012. Member of the Investment Committee. Non-executive Director of Hermes.
3 Law Debenture Pension Trust Corporation plc [represented by David Felder]: Appointed 15 September 2011. Member of the Investment Committee and Non-executive Director of BTPSM: Appointed 22 March 2012.
4 R Kent: Retired as Chairman of BTPS 28 February 2011.
5 D MacDonald: Appointed whole year. Member of the Investment Committee and Chairman of the Policy Committee.
6 H Marchant: Retired 10 January 2011. Member of the Administration and Communications Committee.
7 W McClory: Appointed whole year. Member of Audit Committee and Non-executive Director of Hermes. Appointed whole year.
8 A Parker: Appointed whole year. Chairman of the Administration and Communications Committee and member of the Policy Committee.
9 B Shepherd: Appointed whole year. Member of the Administration and Communications Committee.
10 P Spencer: Appointed whole year. Appointed as Chairman of Trustee Board and Investment Committee 1 March 2011 and member of the Audit Committee. Appointed as Chairman of Hermes 7 June 2011.
11 J Wroe: Appointed whole year. Chairman of the Audit Committee and member of the Investment Committee.

In addition, all of the Trustees Directors attended one Strategic Away Day on 11 January 2011 and one investment manager offsite event on 18 May 2011.

Advisers to the Trustee
BTPSM is the principal investment adviser for the Scheme. Where appropriate, independent professional advice is obtained on investment or other matters. Such independent advice would include modelling the assets and liabilities of the Scheme according to various investment return, demographic and inflationary outcomes, so as to assist the Trustee in deciding a suitable medium and long-term investment strategy for the Scheme. The Secretary to the Trustee (the Secretary) works in BTPSM and is responsible for agreeing the agenda for Trustee meetings and the provision of timely, accurate and considered information. In particular, the Secretary is responsible for ensuring the Trustee is kept fully informed on pension consultation documents, legislation and general good practice, as well as on issues concerning the administration of the Scheme.

The Trustee has appointed a number of professional advisers and managers, as listed on page 3.

Actuarial advice to the Trustee is provided by the Scheme Actuary – M J Pardoe, a senior employee of Towers Watson Limited. The Trustee has appointed Hogan Lovells International LLP for legal advice.
Security of Assets
Custodians hold or control the evidence of ownership of the assets of the Scheme, which they will deliver or amend (generally against payment) only on properly executed instructions. The Trustee is responsible for appointing and replacing custodians and all appointments require undertakings to be given by the custodians in a written contract. The Northern Trust Company was appointed as custodian on 18 November 2008.

The Trustee’s policy is to have separate management and custody, which minimises the risk of a misuse of Scheme assets. Custody arrangements are reviewed regularly by the Trustee to ensure that the custodians continue to have appropriate control and checking procedures in place. The Trustee is assisted in these reviews by BTPSM and by external expert advisers.

Policy on Auditor Independence
When commissioning non-audit work from the external Auditor, Deloitte LLP, the below policy is applied to ensure auditor independence:

1. The external Auditor will not be given work where there is a potential for conflict of interest during the supply of non-audit services. Such services may include actuarial, valuation, remuneration and accounting services together with investment advice or investment banking,

2. No assignment may be placed with the external Auditor without the concurrence of the BTPSM Chief Operating Officer,

3. Approval of the Audit Committee Chairman or Audit Committee is required in advance for all non-audit services provided by the external Auditor. However, certain assignments have been pre-approved by the Audit Committee under a continuing authority,

4. Fees for all assignments of the external Auditor are reported to the Audit Committee on a quarterly basis.

The policy is applicable to the Scheme, including subsidiary entities, and the services provided by the external Auditor and its affiliates

Appropriate disclosure of fees payable to Deloitte LLP is made in note 7 to the accounts on page 26.

Recovery in the Event of a Disaster
The Scheme administrator, Accenture, BTPSM and Hermes, have a documented strategy for recovering from a disaster. This includes the use of alternative disaster recovery sites to which key staff can be relocated. The disaster recovery plans are regularly reviewed and tested to ensure that time-critical functions are able to resume as quickly as possible and that everyone is kept informed on a need-to-know basis of progress. All the main suppliers of services to the Scheme, including the external investment managers, bankers and custodians of assets, also have disaster recovery plans that are regularly reviewed and tested.

Internal Control and Risk Management
The Risk Assurance Team within Hermes, which consists of Operational Risk and Compliance, monitors internal controls and risk management in relation to both investment management and administration services provided by Hermes and BTPSM to the Scheme. In addition, the Hermes Internal Audit team reviews audited internal control reports, such as the AAF 01/06 or SAS 70 reports, from the other investment managers on page 3 that manage assets of the Scheme. A review of internal controls and risk management at the Scheme administrator, Accenture HR Services, is carried out by the BT Internal Audit Department. Risk reports from all these areas are considered by the Scheme Audit Committee. The Hermes Audit Committee provides reports to the Scheme Audit Committee on its work and would report any major failures of internal controls.

The Scheme Audit Committee is responsible for internal control and risk management of the Scheme, and for reviewing the effectiveness of the risk assessment process. The process is designed to manage, rather than eliminate, the risk of error, loss or the failure to comply with regulatory requirements or to achieve business objectives. The risk assessment is updated on a regular basis enabling a rolling register of significant current risks to be maintained. Additionally, regular internal audit reviews of each of the main Hermes and BTPSM activities are conducted to identify and record risks. The results of these reviews are reported to the boards and senior management of the company concerned, as well as to the Hermes Audit Committee. The frequency of reviews is based on a risk assessment of each area of the business.

The Hermes Risk Assurance Team includes the operational risk, and the compliance functions. The operational risk function perform risk assessments of the business, investigate and analyse errors, losses and breaches, are responsible for business continuity planning, corporate insurance arrangements and key risk indicator reporting, and counterparty credit risk management. The internal audit function conducts a rolling programme of independent control reviews and investigations where necessary. The compliance function is responsible for advising Hermes management on FSA and other regulatory matters and changes to regulations, and also carries out a risk based monitoring programme in relation to the major areas of regulatory risk. BTPSM secretariat is responsible for advising the Trustee on matters relating to Pensions Regulations. In addition, BTPSM, Hogan Lovells International LLP and Towers Watson Limited advise the Trustee on matters in relation to pensions legislation and regulation.
Governance of Hermes
The Scheme has wholly owned Hermes since 1995. The governance arrangements, are as follows:

The Board of Hermes
The role of Hermes Chairman is held by Paul Spencer (being appointed on 1 June 2011). Glyn Jones retired as Chairman of Hermes on 31 May 2011. During the year the Hermes Board comprised the non-executive Chairman, two non-executives (who are also Trustee Directors, in addition to the Chairman who is also a Trustee), three independent non-executives and three Hermes executive Directors. The appointment of key roles onto the Hermes Board will require formal consultation with the Trustee and, where appropriate, with BT. The Board of Hermes meets every alternate calendar month, with additional ad hoc meetings held when necessary. Minutes of the Hermes Board meetings are seen by the main Trustee Board. The Hermes detailed business plan require the ultimate approval of the Trustee.

Board Appraisal
The Hermes Chairman, supported by the Hermes Company Secretary, is responsible for a formal and rigorous annual appraisal of the effectiveness of the Hermes Board and the Hermes Board Sub-Committees. A separate management appraisal operates for the executive Directors. The Non-executive Directors are responsible for evaluating the performance of the Hermes Chairman.

Board Committees
There is a separate Hermes Audit Committee in addition to the Scheme Audit Committee. There is also a Hermes Nomination Committee and Hermes Remuneration Committee. In October 2011, Hermes established a separate Risk and Compliance Committee. All the committees have clearly defined terms of reference setting out their role, principal responsibilities, powers, membership, quorum requirements and frequency of meetings. Minutes are kept by the Hermes Company Secretary of each committee to record all decisions. The Hermes Board also receives regular reports from each of the Committees.

Principal Hermes Committees
- **Nomination Committee** - responsible for identifying and nominating candidates to fill Hermes Board vacancies and for approving the appointment of a director to the Board of a subsidiary operating company of Hermes. The Committee comprises, the Hermes Chairman and two Non-executive Directors from the Hermes Board. The Hermes Chairman chairs the Nomination Committee.

- **Audit Committee** - responsible for reviewing, and challenging where appropriate, the risk management framework, systems, processes, procedures and controls in relation to all investment management activity and administration services that Hermes has contracted to provide to its clients. The Committee is also responsible for reviewing and challenging, where appropriate, the actions and judgements of management in relation to the Hermes financial statements, business review and any related formal statements before submission to, and approval by, the Board. The Committee provides reports to the Scheme Audit Committee on its work and would report any major failures of internal controls. The Committee comprises three non-executive directors on the Hermes Board. The Committee is chaired by a non-executive director on the Hermes Board. A representative of the internal and external auditors attends meetings, when requested, to report on any internal control findings.

- **Risk and Compliance Committee** - the Committee has oversight of the risk management framework of Hermes and specifically the effectiveness of risk management, governance and compliance activity within Hermes. The Committee will support the Hermes Board in its consideration of its business activities that expose the business to material risk with explicit and dedicated focus on current and forward-looking aspects of risk exposure. It advises the Hermes Board on considerations and process for setting the risk appetite and related tolerances, taking into account the Hermes Board’s overall degree of risk aversion and Hermes’ current financial situation. The Hermes Board retains responsibility for approval of the risk appetite. The Committee is chaired by a Non-executive Director on the Hermes Board.

- **Remuneration Committee** - responsible for remuneration matters relating to Hermes including determining targets for performance related pay schemes, contractual terms on termination and the approval of major changes in employee benefit structures throughout Hermes, excluding BTPSM. The Committee comprises the Hermes Chairman and two Non-executive Directors on the Hermes Board. The Committee is chaired by a Non-executive Director on the Hermes Board.

Hermes Subsidiary Boards
Appointments to subsidiary company Boards require the formal approval of the Hermes Nomination Committee.
Pension Administration Matters

Membership
On 31 March 2001, the Scheme was closed to new entrants. The significance of this for the Scheme is that over time the investment strategy of the Scheme will need to change to reflect the gradual reduction in the number of contributing members and the increasing average age of the membership.

The Scheme is a registered occupational pension scheme and ceased to be contracted out of the State Second Pension (S2P) from 6 April 2009. In 2011 the number of contributing members fell from 51,861 to 47,704, while the number of pensions being paid rose from 189,835 to 193,577. The number of members with deferred rights fell from 89,714 to 85,294. A detailed analysis is given in Appendix two on page 44.

Transfer Values
All transfer values paid during 2011 were calculated as cash equivalents (within the meaning of Chapter IV Part IV of the Pension Schemes Act 1993) and verified in the manner prescribed under Section 97 of the Act. No allowance for discretionary benefits was made in the calculation of cash equivalents.

Pensions Increases
The Scheme Rules require the rates of pension increase for Section A/B to reflect the increase provided by the Government public sector pensions. The basis of the increase for Section A/B pensions corresponds to that for the Principal Civil Service Pension Scheme, from which the Scheme was originally derived.

The Government has announced that future public sector increases (and accordingly Section A/B increases) will increase by reference to the Consumer Price Index (CPI).

In respect of Section C, the Scheme Rules currently require the rates of pension increase to reflect the annual rise in the Retail Price Index (RPI) up to 5%.

For deferreds for all sections, each member’s pension is revalued for the period between the date of leaving reckonable service and the date the pension commences. Revaluation for each year the benefit was deferred before 2011 will be calculated by reference to RPI, and only for revaluation for 2011 and onwards benefits will be calculated by reference to CPI.

In April 2012, the increase for Section A/B pensions in payment was 5.2% and the increase for Section C pensions was 4.8%. The Trustee does not have the power to pay pension increases above the level required by the Scheme Rules without the agreement of BT.

Statement of Trustee’s Responsibilities
The audited financial statements, which are prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP), are the responsibility of the Trustee. Pension scheme regulations require the Trustee to make available to scheme members, beneficiaries and certain other parties, audited financial statements for each scheme year which:

- show a true and fair view of the financial transactions of the scheme during the scheme year and of the amount and disposition at the end of that year of the assets and liabilities, other than liabilities to pay pensions and benefits after the end of the scheme year; and

- contain the information specified in the Schedule to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including a statement as to whether the financial statements have been prepared in accordance with the Statement of Recommended Practice, “Financial Reports of Pension Schemes (revised May 2007)”.

The Trustee is responsible for making available certain other information about the Scheme in the form of an annual report.

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.

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 appropriate internal controls.
Investment Report

Review of the year

2011 was a weak year for equity returns, and a strong one for the Gilt market. This hardly does justice to the volatility of sentiment and market prices through the year, as investors shifted from fears of inflation and central bank tightening, to worries of a new Lehman-like event and pleas for policy easing.

The conventional wisdom in the first half of the year was that the economic recovery had taken root. Unemployment rates fell in the US and UK during this time, while rising commodity prices pushed inflation further above central banks’ comfort zone. Initially, though, monetary policy continued to stimulate. The US Federal Reserve’s November 2010 decision to begin a new round of quantitative easing (QE) meant that they continued to inject money into the system until June.

The combination of easy money and recovering economic activity proved supportive for economically-sensitive assets such as equities, property and corporate bonds, while safe havens such as Gilts and the US dollar came under pressure from greater investor appetite for risk and greater concerns over inflation. The second quarter, though, represented a high water mark for economic sentiment in the year.

During this time, a series of concerns began to weigh on investors. The Japanese tsunami of March 2011 disrupted the recovery in global manufacturing by disturbing supply chains for a range of goods during quarter two. As we moved into the summer, the US and UK economies showed signs of slowing which, given the fragile nature of the recovery, created genuine fears of a renewed slide into recession. Even emerging economies caused concern as their central banks engineered economic slowdown to control inflation, especially in China.

As a result, markets had already entered a consolidation phase by the end of quarter two. The third quarter, though, was dominated by the problems within the euro area. As it became clear that Greece’s 2010 bailout package was insufficient, bondholders worried about potential losses both there and elsewhere, including Spain, Italy and even France. When concerns about hidden exposures in Europe’s banks were added to the mix, investors feared a 2008 style seizing of financial markets. Global equities fell by 20% in just three months to end-September, while the rally in Gilts drove their yields down by nearly a full percentage point. The euro crisis risked turning the UK slowdown into a slump, prompting the Bank of England to agree a new £75 billion QE programme in October, even though CPI inflation over the previous year had been over 5%.

By December, indications that European leaders had finally agreed on conditions for a Greece bailout, together with aggressive European Central Bank (ECB) action to provide longer-term loans to the region’s banks, eased investor concerns. Almost unnoticed, US economic data had also improved during the second half of 2011, and these factors allowed a modest relief rally into the end of the year. Global equities ended the year down 6%, while Gilts rallied over 15%.

Most investors, though, remained extremely cautious about the outlook, with much of Europe apparently in renewed recession.

Investment Performance

The investment return for 2011 was 1.7%, with the Scheme underperforming its benchmark by 2.0%. This compares with investment returns of 11.8% in 2010 and 12.2% in 2009. The Scheme achieved an annualised return of 2.3% over the past five years, 6.2% over ten years and 6.9% over the past 15 years. A comparison of Scheme’s returns against benchmark is provided on page 5.

2011 saw large varying returns across the different asset classes of the Scheme. Equities performed poorly and detracted 2.5% from the performance of the Scheme. This was offset by the strong returns in fixed income and inflation linked which added 5.9%. Property added a further 0.8% to the total return whilst alternatives were slightly down, taking away a further 0.3%. Within the asset classes, individual managers on average performed well. The Scheme’s equity managers added £109 million by outperforming their benchmarks, managers within alternatives added £73 million and fixed income mandates added £19 million.

During late 2010 the Trustee decided to introduce a tactical investment strategy with the intention of reducing the impact on the Scheme’s bond portfolio of increases in long term interest rates. The rationale was that with the global economy seemingly in recovery and interest rates at a 250 year low, there was a significant risk that rates would rise causing bond prices to fall. To mitigate this risk, holdings of Gilts were reduced and the interest rate exposure in the UK Corporate Bond allocation was hedged. This would have protected the Scheme’s bond holdings from declining in value should rates begin to rise. In the event, the developments during 2011 saw investors flee towards the apparent safety of Gilts during the second half causing interest rates to fall and bond prices to rise. In response to this, this strategy reduced Scheme returns by 2.1% (£758 million), which was the main reason for underperformance relative to benchmark. The remainder of the strategy was closed during 2012.

Over the second half of the year the Scheme was tactically underweight in equities compared to the long term target adding 0.2% (£80 million) to the Scheme. The Global Large Cap (GLC) portfolio (see page 16) contributed 0.6% (£206 million) to the Scheme compared to the alternative of simply investing passively in global equity indices. The GLC portfolio delivered a positive return in a year when wider equities fell, illustrating the merits of the approach. GLC invests in a small number of larger international companies deliberately chosen for their low-debt, sustainable business models. Such companies are, in the Trustee’s view, ideally suited to producing returns but with much less volatility than passive equities in the difficult current economic environment. Currency gains on the Scheme’s overseas assets were limited due to relatively small movements in exchange rates during the year.
Outlook
Many investors ended 2011 feeling overwhelmed by threats from every direction. The US economic recovery remains fragile, Emerging Market economies have seen central banks grappling with inflation and the euro area has at times appeared to be a Lehman-style crisis in the making. Even Bank of England officials have admitted that the outlook for the UK is a hostage to events overseas.

Fortunately, there are some reasons to believe that investors’ worst fears may not be realised. The US economy ended 2011 with signs of falling unemployment and sustainable growth. China began to ease its monetary policy, lowering the risks of a hard landing, while the European Central Bank began emergency measures to provide longer-term funding to the region’s banks. As such, the Trustee’s central case is that 2012 is a year of weak but positive growth across many regions including the UK. The Trustee remain on watch for two key risks: first, that the euro crisis returns as a result of severe recessions in Southern Europe threatening debt repayment; and second, that investors’ sense of relief becomes so exuberant as to drive excessive gains in equities and renewed increases in commodity prices pushing prices to unsustainable levels. Inflation is expected to ease this year but the Trustee are cautious against being complacent that it is under control longer term.

Distribution of Investments
The strategic allocation of assets between different classes of investment is reviewed regularly and is a key factor in the Trustee’s investment policy. The targets set reflect the Trustee’s views on the appropriate balance to be struck between seeking high returns and incurring risk, and on the extent to which the Scheme’s assets should be distributed to match its liabilities.

In 2011, the Trustee maintained the same long-term targets for the main asset classes as those in 2010. The table below shows how the long term targets have changed between the end of 2008 and the end of 2011.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>End 2008</th>
<th>End 2011</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>33%</td>
<td>31%</td>
<td>-2%</td>
</tr>
<tr>
<td>Fixed Interest</td>
<td>20%</td>
<td>22%</td>
<td>+2%</td>
</tr>
<tr>
<td>Inflation-Linked</td>
<td>15%</td>
<td>15%</td>
<td>-</td>
</tr>
<tr>
<td>Alternatives</td>
<td>20%</td>
<td>21%</td>
<td>+1%</td>
</tr>
<tr>
<td>Property</td>
<td>12%</td>
<td>11%</td>
<td>-1%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>-</td>
</tr>
</tbody>
</table>

The actual distribution of investments at 31 December 2011, compared with 2010, is shown in the pie charts 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 page 18.

As at 31 December 2011, Hermes managed approximately 45% of the Scheme’s assets. Hermes manages all of the Scheme’s property investments and the majority of its inflation-linked mandates.

The Scheme holds the majority of its UK equities in a passive portfolio managed by Legal & General Investment Management (LGIM) which tracks the FTSE 100 Index. This means that performance is closely in line with that of the market. BlackRock Investment Management manages an active portfolio that aims to outperform the Index and Hermes manages a number of active equity portfolios which invest in small and mid-cap companies.
The Scheme has approximately 6% of assets allocated to the Global Large Cap portfolio, which aims to provide defensive exposure to global equities through a concentrated portfolio of large cap, financially conservative companies. The portfolio holds 40 companies drawn from the UK, Europe, North America and Japan, selected on the basis of a predetermined set of screening criteria. The strategic allocation to overseas equity markets, including the Global Large Cap portfolio is 22%; this is split across North America, Europe, Asia Pacific and Emerging Markets. The precise arrangements for the investment of overseas portfolios varies by market, but where practicable a combination of passive and active approaches is generally adopted.

M&G Investment Management manages the majority of the Scheme’s corporate bond investments, amounting to approximately 10% of Scheme assets as at 31 December 2011. Hermes manages the majority of the Scheme’s investments in UK and overseas government bonds and its cash balances.

At 31 December 2011, the Scheme’s investment in hedge funds totalled 8.8%. The Scheme’s investments in commodities and private equity/infrastructure were 3% and 5% respectively. The credit opportunities portfolio established in 2009 to exploit specific dislocations that had arisen in the credit markets had investments totalling 2.9%. The Scheme’s investments in emerging market debit, first invested in December 2010, totalled 3.7% as of 31 December 2011.

**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, some of the investment managers and certain subsidiary undertakings.

BTPSM uses derivatives to manage the Scheme’s risk profile which includes their use to rebalance the Scheme’s asset allocation regularly to keep within guidelines agreed by the Trustee and for making tactical adjustments. For example, the Scheme has large overseas investments, which means that the value of the Scheme’s assets can be affected by movements in foreign currencies. A portion of this exposure embedded in overseas assets is therefore hedged back into Sterling using derivatives as a way of managing currency risk.

The Scheme’s investment managers where applicable use derivatives for the efficient management of the portfolio they manage on behalf of the Scheme. Finally, the Scheme subsidiary undertakings use derivatives and other financial instruments to finance their operations and to manage interest rate and 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 total assets. As at 31 December 2011, the total amount of self investment represented 0.02% of the total assets of the Scheme. There were no properties occupied by BT Group plc owned by the Scheme at 31 December 2011 due to BT related leases expiring during the year.
Sustainable Investment
The Trustee believes that, as a long-term asset owner, it has fiduciary responsibilities to consider long-term factors, including environmental, social and governance (ESG), to help maximise the long-term risk adjusted returns required to meet the Scheme’s liabilities.

The importance of sustainable investment is illustrated by the Scheme being a founder signatory to the United Nations-backed Principles for Responsible Investment initiative (PRI) and one of the Trustee Directors, Donald MacDonald, having been that organisation’s chair for four years, retiring in 2010.

PRI provides a framework for investors to take ESG factors fully into account in their investment and ownership decisions and actions. The Trustee remains committed to its membership and active support of the organisation. The Trustee encourage our investment managers and pension fund peers to sign and implement the PRI.

The Trustee is also guided by and adheres to the requirements of the Financial Reporting Council’s (FRC) Stewardship Code.

The Trustee believes that as a long-term investor with exposure to investment markets for decades into the future, it should seek to take into account a range of sustainability factors:

1. It seeks to play a role in fostering the long-term availability and attractiveness of investment markets overall, and to take account of risks to markets as a whole or to any individual market in which it invests.

2. It seeks to consider long-term risks which may impact investments over the relevant time-horizon, and particularly those risks which are currently poorly understood or managed within the financial markets or corporates.

3. It seeks to act as an interested and active asset holder of its investments so as to call relevant management to account and to seek to encourage the most effective management of risks and opportunities.

More information about the Trustee’s approach to sustainable investment and the particular activities undertaken during 2011 is given on pages 52 to 54.

Further Information
Further information is available on the internet in respect of BTPS (at www.btpensions.net) and in respect of Hermes (at www.hermes.co.uk). BT employees can access information about BTPS on the BT intranet (at http://humanresources.intra.bt.com).

Understanding the financial statements
The disclosures in the financial statements are set by the pensions legislation, UK GAAP and the guidelines in the Statement of Recommended Practice (SORP). These set out how the assets of the Scheme are to be presented in the Consolidated Net Assets Statement and the relevant notes on pages 20 and 24 to 39 respectively. The Scheme can gain exposure to different asset classes by investing in pooled funds such as the Legal and General Investment Management (LGIM) equity tracker funds or by using derivatives.

Investments in funds will be classified as pooled investment vehicles and derivatives are shown separately at the fair value in the Consolidated Net Assets Statement. The presentation of these investments, as guided by the SORP, differs to the asset allocation of the Scheme as managed by the Trustee as at 31 December 2011. The table on page 18 reclassifies assets such as pooled investment vehicles, derivatives and loans into their appropriate asset classes so the managed asset allocation as at 31 December 2011 can be observed.

Investment income
The investment income disclosed in the Consolidated Fund Account on page 19 is £958 million. This represents the value of income earned in 2011 from directly held investments or consolidated via subsidiaries that the Scheme controls. The Scheme invests in certain pooled investment vehicles which do not distribute income back to the Scheme. The income earned on the underlying assets is retained within the funds and is not distributed to the Scheme. The income received will increase the price of the Scheme’s units in the funds and will be reflected in the Change in Market Value of investments. The amount of undistributed income received within LGIM pooled funds that is included in the change in market value balance is £108 million.
### Understanding the financial statements (continued)

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Value Per Consolidated Net Assets Statement £ million</th>
<th>Reclassification</th>
<th>Managed Value £ million</th>
<th>Managed Allocation %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PIV’s £ million</td>
<td>Other £ million</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Footnote</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK</td>
<td>1,671</td>
<td>1,211</td>
<td>(437)</td>
<td>2,445</td>
</tr>
<tr>
<td>Overseas</td>
<td>5,045</td>
<td>2,230</td>
<td>(1,073)</td>
<td>6,202</td>
</tr>
<tr>
<td>Equities</td>
<td>6,716</td>
<td>3,441</td>
<td>(1,510)</td>
<td>8,647</td>
</tr>
<tr>
<td>UK Governanet</td>
<td>340</td>
<td>-</td>
<td>(70)</td>
<td>270</td>
</tr>
<tr>
<td>Overseas Government</td>
<td>1,225</td>
<td>-</td>
<td>(1,121)</td>
<td>104</td>
</tr>
<tr>
<td>UK Corporate</td>
<td>3,302</td>
<td>-</td>
<td>(8)</td>
<td>3,294</td>
</tr>
<tr>
<td>Global (ex UK) Corporate</td>
<td>1,532</td>
<td>403</td>
<td>(598)</td>
<td>1,337</td>
</tr>
<tr>
<td>Short Dated Credit</td>
<td>-</td>
<td>-</td>
<td>1,410</td>
<td>1,410</td>
</tr>
<tr>
<td>Emerging Market Debt</td>
<td>-</td>
<td>13</td>
<td>517</td>
<td>530</td>
</tr>
<tr>
<td>Cash</td>
<td>-</td>
<td>-</td>
<td>945</td>
<td>945</td>
</tr>
<tr>
<td>Fixed interest and Cash</td>
<td>6,399</td>
<td>416</td>
<td>1,075</td>
<td>7,890</td>
</tr>
<tr>
<td>UK Government</td>
<td>6,669</td>
<td>-</td>
<td>(29)</td>
<td>6,640</td>
</tr>
<tr>
<td>Overseas Government</td>
<td>489</td>
<td>-</td>
<td>(51)</td>
<td>438</td>
</tr>
<tr>
<td>UK Corporate</td>
<td>322</td>
<td>-</td>
<td>51</td>
<td>373</td>
</tr>
<tr>
<td>Inflation Linked</td>
<td>7,480</td>
<td>-</td>
<td>(29)</td>
<td>7,451</td>
</tr>
<tr>
<td>UK</td>
<td>3,482</td>
<td>89</td>
<td>72</td>
<td>3,643</td>
</tr>
<tr>
<td>Overseas</td>
<td>110</td>
<td>423</td>
<td>(47)</td>
<td>486</td>
</tr>
<tr>
<td>Property</td>
<td>3,592</td>
<td>512</td>
<td>25</td>
<td>4,129</td>
</tr>
<tr>
<td>Absolute Return</td>
<td>-</td>
<td>3,227</td>
<td>(63)</td>
<td>3,164</td>
</tr>
<tr>
<td>Commodities</td>
<td>-</td>
<td>33</td>
<td>1,063</td>
<td>1,096</td>
</tr>
<tr>
<td>Private Equity</td>
<td>-</td>
<td>1,437</td>
<td>-</td>
<td>1,437</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>357</td>
<td>-</td>
<td>-</td>
<td>357</td>
</tr>
<tr>
<td>Credit Opportunities</td>
<td>-</td>
<td>-</td>
<td>1,055</td>
<td>1,055</td>
</tr>
<tr>
<td>Emerging Market Credit</td>
<td>-</td>
<td>-</td>
<td>776</td>
<td>776</td>
</tr>
<tr>
<td>Alternatives</td>
<td>-</td>
<td>5,054</td>
<td>2,831</td>
<td>7,885</td>
</tr>
<tr>
<td>Other Categories</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Pooled investments</td>
<td>9,423</td>
<td>9,423</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Loans</td>
<td>989</td>
<td>-</td>
<td>(989)</td>
<td>-</td>
</tr>
<tr>
<td>Other assets/liabilities</td>
<td>1,403</td>
<td>-</td>
<td>(1,403)</td>
<td>-</td>
</tr>
<tr>
<td>Net Assets</td>
<td>36,002</td>
<td>-</td>
<td>-</td>
<td>36,002</td>
</tr>
</tbody>
</table>

1. Pooled investment vehicles (PIVs) have been reclassified into the appropriate asset class. For example, the investment in LGIM pooled funds provide exposure to UK and Overseas equities and fixed income. Other pooled investment vehicles invested in either directly or through subsidiaries provide the Scheme with exposure to Property and Alternatives asset classes.

2. Other assets and liabilities include cash, derivatives, borrowings, broker balances, accrued income, deferred income and current assets/liabilities. These have been reclassified to their appropriate asset exposures.

3. Loans include investments in debt instruments and have been reclassified to the Credit Opportunities category within the Alternatives asset class and Global (ex UK) Corporate category within the fixed interest asset class.

4. Exposures to UK equities, Overseas equities and Commodities 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. The majority of the Scheme’s exposure to commodities is via its investment in Hermes Alternative Investment Funds plc, which it controls.

5. The SORP has broader categories for grouping investments. For example, “Fixed interest – public sector” includes Government and other public sector investments. The Scheme consolidates entities it is deemed to control and thus the underlying assets and liabilities of those entities are presented in the appropriate asset line in the net assets statement as guided by the SORP. For example, unlisted equity investments relating to an exposure to Private Equity or Absolute Return (within alternatives asset class) would be included within UK and Overseas equities. 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 remaining, net of what is required to back open derivatives.
## Consolidated Fund Account

### For year ended 31 December 2011

<table>
<thead>
<tr>
<th>Contributions and benefits</th>
<th>Notes</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions</td>
<td>1</td>
<td>721</td>
<td>818</td>
</tr>
<tr>
<td>Benefits</td>
<td>2</td>
<td>(2,080)</td>
<td>(1,991)</td>
</tr>
<tr>
<td>Payments to and on account of leavers</td>
<td>3</td>
<td>(17)</td>
<td>(26)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2,097)</td>
<td>(2,017)</td>
</tr>
<tr>
<td>Net withdrawals from dealing with members</td>
<td></td>
<td>(1,376)</td>
<td>(1,199)</td>
</tr>
<tr>
<td>Returns on investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>4</td>
<td>958</td>
<td>918</td>
</tr>
<tr>
<td>Change in market value of investments</td>
<td>5</td>
<td>(1)</td>
<td>3,208</td>
</tr>
<tr>
<td>Interest payable</td>
<td></td>
<td>(47)</td>
<td>(56)</td>
</tr>
<tr>
<td>Investment management expenses</td>
<td>6</td>
<td>(211)</td>
<td>(215)</td>
</tr>
<tr>
<td>Administration expenses</td>
<td>7</td>
<td>(33)</td>
<td>(28)</td>
</tr>
<tr>
<td>Minority interests</td>
<td>14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>680</td>
<td>3,785</td>
</tr>
<tr>
<td>(Decrease) / Increase in the Scheme during the year</td>
<td></td>
<td>(696)</td>
<td>2,586</td>
</tr>
<tr>
<td>Net assets of the Scheme</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At start of year</td>
<td></td>
<td>36,698</td>
<td>34,112</td>
</tr>
<tr>
<td>At end of year</td>
<td></td>
<td>36,002</td>
<td>36,698</td>
</tr>
</tbody>
</table>
Consolidated Net Assets Statement

As at 31 December 2011

<table>
<thead>
<tr>
<th>Investment Assets</th>
<th>Notes</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>8</td>
<td>1,671</td>
<td>1,862</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>9</td>
<td>5,045</td>
<td>5,367</td>
</tr>
<tr>
<td>Fixed interest investments</td>
<td>10</td>
<td>6,399</td>
<td>4,025</td>
</tr>
<tr>
<td>Index linked investments</td>
<td>11</td>
<td>7,480</td>
<td>5,976</td>
</tr>
<tr>
<td>Property</td>
<td>12</td>
<td>3,592</td>
<td>3,714</td>
</tr>
<tr>
<td>Pooled investment vehicles</td>
<td>13</td>
<td>9,423</td>
<td>11,309</td>
</tr>
<tr>
<td>Loans</td>
<td>14</td>
<td>989</td>
<td>980</td>
</tr>
<tr>
<td>Derivative contracts – assets</td>
<td>15</td>
<td>170</td>
<td>116</td>
</tr>
<tr>
<td>Deposits and short-term investments</td>
<td>16</td>
<td>2,090</td>
<td>4,457</td>
</tr>
<tr>
<td></td>
<td></td>
<td>36,859</td>
<td>37,806</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investments in joint ventures</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of gross assets</td>
<td></td>
<td>388</td>
<td>320</td>
</tr>
<tr>
<td>Share of gross liabilities</td>
<td></td>
<td>(103)</td>
<td>(81)</td>
</tr>
<tr>
<td></td>
<td>17</td>
<td>285</td>
<td>239</td>
</tr>
<tr>
<td>AVC investments</td>
<td>18</td>
<td>91</td>
<td>93</td>
</tr>
<tr>
<td>Other investment assets</td>
<td>19</td>
<td>865</td>
<td>750</td>
</tr>
<tr>
<td></td>
<td></td>
<td>38,100</td>
<td>38,888</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investment liabilities</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative contracts – liabilities</td>
<td>15</td>
<td>(434)</td>
<td>(209)</td>
</tr>
<tr>
<td>Investment borrowings</td>
<td>21</td>
<td>(1,310)</td>
<td>(1,469)</td>
</tr>
<tr>
<td>Other investment liabilities</td>
<td>20</td>
<td>(116)</td>
<td>(130)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net investment assets</td>
<td></td>
<td>36,240</td>
<td>37,080</td>
</tr>
</tbody>
</table>

| Pension liabilities of subsidiaries | 23 | (12)          | (29)          |
| Minority interests                  | 22 | (208)         | (243)         |
|                                   |    | (220)         | (272)         |
| Current assets                      | 24 | 198           | 90            |
| Current liabilities                 | 25 | (216)         | (200)         |
|                                   | 22  | (188)         | (110)         |

| Net current liabilities            |       |                |                |
|                                   |       |                |                |
| Net assets of the Scheme at end of year |       | 36,002         | 36,698         |

The financial statements summarise the transactions of the Scheme and deal with the net assets at disposal of the Trustee. They do not take into account obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which does take into account such obligations, is dealt with in the Report by the Trustee and actuarial certificates included in the Annual Report and these financial statements should be read in conjunction with them. These financial statements were approved by the Trustee on 9 May 2012.

Signed on behalf of the Trustee:

P Spencer CBE – Chairman

J Wroe – Trustee Director
## Analysis of Change in Market Value of Investments

### Investment Assets

<table>
<thead>
<tr>
<th></th>
<th>Market value at 31 December 2010 £ million</th>
<th>Net investment/ (disinvestment) £ million</th>
<th>Change in market value £ million</th>
<th>Market value at 31 December 2011 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>1,862</td>
<td>[39]</td>
<td>[152]</td>
<td>1,671</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>5,367</td>
<td>103</td>
<td>(425)</td>
<td>5,045</td>
</tr>
<tr>
<td>Fixed interest investments</td>
<td>4,025</td>
<td>2,207</td>
<td>167</td>
<td>6,399</td>
</tr>
<tr>
<td>Index linked investments</td>
<td>5,976</td>
<td>425</td>
<td>1,079</td>
<td>7,480</td>
</tr>
<tr>
<td>Property</td>
<td>3,714</td>
<td>(176)</td>
<td>54</td>
<td>3,592</td>
</tr>
<tr>
<td>Pooled investment vehicles</td>
<td>11,309</td>
<td>(1,742)</td>
<td>(144)</td>
<td>9,423</td>
</tr>
<tr>
<td>Loans</td>
<td>980</td>
<td>26</td>
<td>(594)</td>
<td>989</td>
</tr>
<tr>
<td>Derivative contracts*</td>
<td>[93]</td>
<td>423</td>
<td>(594)</td>
<td>(264)</td>
</tr>
<tr>
<td>Investments in joint ventures</td>
<td>239</td>
<td>41</td>
<td>5</td>
<td>285</td>
</tr>
<tr>
<td>Deposits and short-term investments</td>
<td>4,457</td>
<td>(2,389)</td>
<td>22</td>
<td>2,090</td>
</tr>
<tr>
<td>AVC investments</td>
<td>93</td>
<td>(5)</td>
<td>3</td>
<td>91</td>
</tr>
<tr>
<td>Other investment related assets and liabilities</td>
<td>(849)</td>
<td>288</td>
<td>-</td>
<td>(561)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37,080</strong></td>
<td><strong>(838)</strong></td>
<td><strong>(2)</strong></td>
<td><strong>36,240</strong></td>
</tr>
<tr>
<td>Other assets and liabilities</td>
<td>(382)</td>
<td>143</td>
<td>1</td>
<td>(238)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36,698</strong></td>
<td><strong>(695)</strong></td>
<td><strong>(1)</strong></td>
<td><strong>36,002</strong></td>
</tr>
</tbody>
</table>

* Derivative contracts include both the derivative assets and liabilities which are shown separately on the face of the Consolidated Net Assets Statement.

### Purchases at cost and derivative payments £ million

<table>
<thead>
<tr>
<th></th>
<th>Purchases at cost and derivative payments £ million</th>
<th>Sales proceeds and derivative receipts £ million</th>
<th>Net investment/ (disinvestment) £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>1,042</td>
<td>[1,081]</td>
<td>[39]</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>4,254</td>
<td>[4,151]</td>
<td>103</td>
</tr>
<tr>
<td>Fixed interest investments</td>
<td>7,619</td>
<td>[5,412]</td>
<td>2,207</td>
</tr>
<tr>
<td>Index linked investments</td>
<td>4,688</td>
<td>[4,263]</td>
<td>425</td>
</tr>
<tr>
<td>Property</td>
<td>337</td>
<td>[513]</td>
<td>[176]</td>
</tr>
<tr>
<td>Pooled investment vehicles</td>
<td>2,072</td>
<td>[3,814]</td>
<td>[1,742]</td>
</tr>
<tr>
<td>Loans</td>
<td>321</td>
<td>[295]</td>
<td>26</td>
</tr>
<tr>
<td>Derivative contracts*</td>
<td>1,244</td>
<td>[821]</td>
<td>423</td>
</tr>
<tr>
<td>Investments in joint ventures</td>
<td>41</td>
<td>-</td>
<td>41</td>
</tr>
<tr>
<td>Deposits and short-term investments</td>
<td>-</td>
<td>[2,389]</td>
<td>[2,389]</td>
</tr>
<tr>
<td>AVC investments</td>
<td>-</td>
<td>[5]</td>
<td>[5]</td>
</tr>
<tr>
<td>Other investment related assets and liabilities</td>
<td>288</td>
<td>-</td>
<td>288</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21,906</strong></td>
<td><strong>(22,744)</strong></td>
<td><strong>(838)</strong></td>
</tr>
</tbody>
</table>

Transaction costs are incremental costs that are directly attributable to the acquisition or disposal of an investment and are included in the cost of purchases and in sale proceeds. Transaction costs incurred during the year amounted to £26 million (2010: £24 million). In addition to these transaction costs, indirect costs are incurred through the bid - offer spread on investments in pooled investment vehicles. The amount of indirect costs is not separately provided to the Scheme.
Accounting Policies

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 made under sections 41(1) and (6) of the Pension Act 1995 and the guidelines set out in the Statement of Recommended Practice (Revised May 2007), Financial Reports of Pension Schemes ("Revised SORP").

Basis of Consolidation
The results of subsidiary undertakings are included from the date of acquisition and up to the date of disposal using the acquisition method of accounting. Where the Scheme has significant influence, a direct or indirect interest in an undertaking, and takes an active involvement in the management of the business then that interest is accounted for using the gross equity method in the case of joint ventures.

The Scheme holds a number of property investments through interests in partnerships. Such investments are consolidated by including the Scheme’s share of assets, liabilities, revenues and expenses. Consolidation and equity accounting are based on the latest available annual accounts for those undertakings with a year end up to three months prior to that of the Scheme. In the case where a subsidiary has a year end 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.

Contributions
Normal contributions and employers’ augmentation, other and deficit 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
Benefits payable represent all valid benefit claims notified to the Trustee during the Scheme 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.

Investment Income
Income from property, fixed interest and index linked securities and other income receivable is taken into account on an accruals basis. Income from all other marketable securities is taken into account on the date when stocks are quoted ex-dividend.

Change in Market Value of Investments
This includes profits and losses on investments sold during the year and the change in market value of investments held during the year.

Foreign Currencies
The accounts of consolidated overseas entities have been translated into Sterling at the exchange rate ruling at the year end. Exchange differences arising thereof have been dealt with in the Consolidated Fund Account within Change in Market Value of Investments. Assets and liabilities in foreign currencies are translated into Sterling at the rate ruling at the year end. Exchange differences arising from translation are dealt with in the Consolidated Fund Account within Change in Market Value of Investments.
Accounting Policies (continued)

Valuation of Investments
Securities listed on order-driven exchanges are valued at closing prices at the year end. Other securities listed on recognised stock exchanges are valued at closing bid prices. For fixed interest and index linked securities this valuation is reduced by the accrued interest therein. Such interest is included in other investment assets. Open derivative contracts are included in the Consolidated Net Assets Statement at fair value.

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

Options can be exchange traded or over the counter contracts. For exchange traded options, fair value is determined using the exchange price for closing out the option at the year end. For over the counter options, the 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 normally calculated using discounted cash flows and using market data at the year end.

Open forward foreign currency contracts at the Net Assets Statement date are over the counter contracts and are valued using forward currency rates at that date. The unrealised appreciation and 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.

Unlisted securities consists of equities, fixed interest and index linked instruments and pooled investment vehicles. Unlisted equities are valued in accordance with International Private Equity and Venture Capital (IPEVC) guidelines based on the latest available information from investment managers. Unlisted fixed interest and index linked instruments are valued using the latest market prices or using discounted cash flow models that consider credit risk.

Holdings in pooled investment vehicles are valued at the year end published or available net asset valuation. Fair value provisions may be applied following a review by the Scheme’s investment manager.

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 Properties are valued on the basis of market value. The UK investment properties were independently valued as at 31 December 2011 by CBRE Limited or Knight Frank LLP, 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 were valued by local professional valuers or by the Scheme’s local property agents.

Sale and Repurchase agreements
Securities sold subject to repurchase agreements are included in the accounts within their respective investment classes at the year end market value of the securities to be repurchased. Collateral received for repurchase agreements is excluded from the accounts. Securities purchased subject to reverse repurchase agreements are included in the accounts within receivable assets at the year end market value of the securities to be repurchased.

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. Sales are accounted for on completion.

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 investment funds.

Pension Benefits
A number of the subsidiaries of the Group operated defined benefit pension schemes.

The pension Scheme’s assets and liabilities are measured using fair values, and the pension Scheme’s deficit is recognised in full and presented on the face of the Consolidated Net Assets Statement. The movement in the Scheme deficit is included within the Change in Market Value of Investments.
Notes to the Accounts

1. Contributions

An actuarial valuation was undertaken as at 31 December 2008 and in accordance with the revised Recovery Plan agreed with the employer on 25 March 2011, the employer made a deficit payment of £505 million in March 2011, and is obliged to make a deficit payment of £583 million in December 2012 increasing thereafter by 3% each year until 2025 resulting in a final payment of £856 million.

On 23 March 2012, the Trustee and the employer announced the provisional agreement of the results of an actuarial valuation as at 30 June 2011 and provisionally agreed a new Recovery Plan. Under this provisional agreement, the employer was obliged to make a deficit contribution of £2,000 million in 2012 and the payment was made by the employer in March 2012. The final actuarial valuation as at 30 June 2011 was completed on 9 May 2012 and under the terms of the agreed Recovery Plan the employer is obliged to pay deficit contributions of £325 million in 2013 and 2014, thereafter £295 million from 2015 to 2021.

It had been agreed as part of the 2008 actuarial valuation to reduce the employers’ regular contributions from 19.5% to 13.6% with effect from 1 April 2009, however this reduction was not implemented until after the 2008 valuation was completed in February 2010. The amounts overpaid are being offset against the regular contributions due from October 2011.

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employers’ normal contributions</td>
<td>189</td>
<td>266</td>
</tr>
<tr>
<td>Employers’ deficit funding contributions</td>
<td>505</td>
<td>525</td>
</tr>
<tr>
<td>Employers’ other contributions¹</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>704</td>
<td>800</td>
</tr>
<tr>
<td>Members’ normal contributions²</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>Total contributions payable under the Schedules of Contributions</td>
<td>717</td>
<td>814</td>
</tr>
<tr>
<td>Members’ additional voluntary contributions</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Members’ purchase of added years</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>721</td>
<td>818</td>
</tr>
</tbody>
</table>

¹ This relates to the reimbursement of the Pension Protection Fund Levy in accordance with the Schedule of Contributions signed on 25 March 2011.

² In 2004, BT introduced a Salary Sacrifice Scheme, Smart Pensions, whereby some BTPS 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 of the contributions being reported as employers’ rather than members’ contributions.
2. Benefits

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement pensions</td>
<td>1,653</td>
<td>1,579</td>
</tr>
<tr>
<td>Lump sum retirement benefits</td>
<td>413</td>
<td>401</td>
</tr>
<tr>
<td>Death benefits</td>
<td>14</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,080</strong></td>
<td><strong>1,991</strong></td>
</tr>
</tbody>
</table>

3. Payments to and on account of leavers

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual transfers out</td>
<td>17</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17</strong></td>
<td><strong>26</strong></td>
</tr>
</tbody>
</table>

4. Investment income

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>58</td>
<td>52</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>132</td>
<td>120</td>
</tr>
<tr>
<td>Fixed interest investments</td>
<td>383</td>
<td>294</td>
</tr>
<tr>
<td>Index linked investments</td>
<td>87</td>
<td>103</td>
</tr>
<tr>
<td>Property, net of expenses</td>
<td>236</td>
<td>252</td>
</tr>
<tr>
<td>Pooled investment vehicles</td>
<td>23</td>
<td>49</td>
</tr>
<tr>
<td>Deposits and short term investments</td>
<td>35</td>
<td>48</td>
</tr>
<tr>
<td>Share of operating income in joint ventures</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>958</strong></td>
<td><strong>918</strong></td>
</tr>
</tbody>
</table>

Income from property is net of property related expenses of £48 million (2010: £46 million).

Note 13 discloses further analysis of the pooled investment vehicles. Only a small proportion of these investments distribute income back to the Scheme. At 31 December 2011, the Scheme held £3,188 million (2010: £4,987 million) of pooled funds within LGIM and the underlying exposure is predominantly to UK and Overseas equities. The income received from the underlying equities is retained within the pooled funds. The Scheme’s equivalent share of this income was £108 million and the benefit of this is reflected through the increase in price of the Scheme’s units in the pooled funds and is represented through the change in market value of investments as disclosed on page 21.

5. Change in market value of investments

This includes profits and losses on investments sold during the year and the change in value of investments held during the year. An analysis of the change in market value of investments is included on page 21.
6. Investment management expenses

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment management expenses*</td>
<td>157</td>
<td>160</td>
</tr>
<tr>
<td>Investment management performance fees**</td>
<td>52</td>
<td>53</td>
</tr>
<tr>
<td>Other expenses</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>211</td>
<td>215</td>
</tr>
</tbody>
</table>

* These fees include £57 million of consolidated expenses in property subsidiaries (2010: £29 million) and £99 million of consolidated costs to operate Hermes Fund Managers Limited (2010: £76 million).

** These fees include £29 million of performance related investment management expenses within Hermes Fund Managers Limited (2010: £25 million).

7. Administration expenses

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>PPF Levy</td>
<td>12</td>
<td>9</td>
</tr>
<tr>
<td>Administration expenses</td>
<td>21</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>33</td>
<td>28</td>
</tr>
</tbody>
</table>

Administration expenses are after charging the Auditor’s remuneration for the audit of the Scheme’s accounts as disclosed in the table below. The other fees paid to audit firms are also disclosed below and are included in “Investment management expenses” in Note 6. These fees will be incurred in subsidiaries that the Scheme controls.

**Auditor’s remuneration**

<table>
<thead>
<tr>
<th></th>
<th>2011 £ thousand</th>
<th>2010 £ thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees payable to the Scheme’s auditor (Deloitte LLP) for the audit of the Scheme’s accounts</td>
<td>339</td>
<td>238</td>
</tr>
<tr>
<td>Fees payable to the Scheme’s auditor for the audit of the Scheme’s subsidiaries pursuant to legislation</td>
<td>1,408</td>
<td>1,294</td>
</tr>
<tr>
<td><strong>Total audit fees</strong></td>
<td>1,747</td>
<td>1,532</td>
</tr>
<tr>
<td>Other services pursuant to legislation</td>
<td>164</td>
<td>147</td>
</tr>
<tr>
<td>Tax services</td>
<td>67</td>
<td>87</td>
</tr>
<tr>
<td>Corporate finance – aborted acquisitions</td>
<td>-</td>
<td>153</td>
</tr>
<tr>
<td>Further assurance work</td>
<td>220</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total non-audit fees</strong></td>
<td>451</td>
<td>387</td>
</tr>
<tr>
<td>Fees payable to the Scheme’s auditor and their associates in respect of associated pension schemes</td>
<td>14</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total remuneration to the Scheme’s auditor</strong></td>
<td>2,212</td>
<td>1,935</td>
</tr>
<tr>
<td>Auditor’s remuneration payable to other audit firms</td>
<td>528</td>
<td>480</td>
</tr>
<tr>
<td>Audit fees</td>
<td>528</td>
<td>480</td>
</tr>
<tr>
<td>Non-audit fees</td>
<td>662</td>
<td>792</td>
</tr>
<tr>
<td><strong>Total remuneration to other audit firms</strong></td>
<td>1,190</td>
<td>1,272</td>
</tr>
</tbody>
</table>
7. Administration expenses (continued)

<table>
<thead>
<tr>
<th>Trustee fees</th>
<th>2011 £ thousand</th>
<th>2010 £ thousand</th>
</tr>
</thead>
<tbody>
<tr>
<td>P Spencer</td>
<td>154</td>
<td>50</td>
</tr>
<tr>
<td>A Askew</td>
<td>22</td>
<td>-</td>
</tr>
<tr>
<td>D Barford</td>
<td>55</td>
<td>55</td>
</tr>
<tr>
<td>D Felder</td>
<td>16</td>
<td>-</td>
</tr>
<tr>
<td>R Kent</td>
<td>33</td>
<td>200</td>
</tr>
<tr>
<td>D MacDonald</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>H Marchant</td>
<td>1</td>
<td>25</td>
</tr>
<tr>
<td>W McClory</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>B Shepherd</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td><strong>354</strong></td>
<td><strong>401</strong></td>
</tr>
</tbody>
</table>

H Marchant and R Kent resigned on 10 January 2011 and 28 February 2011 respectively. A Askew and D Felder were appointed as Trustee Directors on 11 January 2011 and 15 September 2011 respectively. P Spencer was appointed Chairman of the Trustee on 1 March 2011.

In addition to the above Trustee fees:

D Barford and W McClory served as Directors of Hermes Fund Managers Limited during the year, and received £25,000 (2010: £25,000) and £12,500 (2010: £12,500) respectively. P Spencer was appointed Director and Chairman of Hermes Fund Managers Limited on 7 June 2011 and received £7,292 (2010: £0) and £43,750 (2010: £0) respectively.

P Spencer was a Director of BT Pension Scheme Management Limited and received £13,542 (2010: £18,750). P Spencer was also elected as Chairman of BT Pension Scheme Management Limited with effect from 2 June 2011 and received £43,750 (2010: £0).

A Parker and J Wroe as employer-nominated Trustee Directors receive no specific fees.

8. UK equities

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed UK equities</td>
<td>1,614</td>
<td>1,860</td>
</tr>
<tr>
<td>Unlisted UK equities</td>
<td>57</td>
<td>2</td>
</tr>
<tr>
<td><strong>1,671</strong></td>
<td><strong>1,862</strong></td>
<td></td>
</tr>
</tbody>
</table>

9. Overseas equities

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed overseas equities</td>
<td>4,769</td>
<td>5,267</td>
</tr>
<tr>
<td>Unlisted overseas equities</td>
<td>276</td>
<td>100</td>
</tr>
<tr>
<td><strong>5,045</strong></td>
<td><strong>5,367</strong></td>
<td></td>
</tr>
</tbody>
</table>

10. Fixed interest investments

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK public sector</td>
<td>340</td>
<td>315</td>
</tr>
<tr>
<td>Other UK listed</td>
<td>3,203</td>
<td>2,886</td>
</tr>
<tr>
<td>Other UK unlisted</td>
<td>99</td>
<td>30</td>
</tr>
<tr>
<td>Overseas public sector</td>
<td>1,225</td>
<td>230</td>
</tr>
<tr>
<td>Other overseas listed</td>
<td>1,532</td>
<td>564</td>
</tr>
<tr>
<td><strong>6,399</strong></td>
<td><strong>4,025</strong></td>
<td></td>
</tr>
</tbody>
</table>
11. Index linked investments

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK public sector</td>
<td>6,669</td>
<td>5,257</td>
</tr>
<tr>
<td>Other UK listed</td>
<td>309</td>
<td>260</td>
</tr>
<tr>
<td>Other UK unlisted</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Overseas public sector</td>
<td>489</td>
<td>451</td>
</tr>
<tr>
<td>Other overseas listed</td>
<td>8</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td><strong>7,480</strong></td>
<td><strong>5,976</strong></td>
</tr>
</tbody>
</table>

12. Property

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Offices</td>
<td>1,495</td>
<td>1,557</td>
</tr>
<tr>
<td>Retail</td>
<td>1,632</td>
<td>1,722</td>
</tr>
<tr>
<td>Industrial</td>
<td>355</td>
<td>378</td>
</tr>
<tr>
<td></td>
<td><strong>3,482</strong></td>
<td><strong>3,657</strong></td>
</tr>
<tr>
<td>Overseas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>49</td>
<td>-</td>
</tr>
<tr>
<td>Offices</td>
<td>61</td>
<td>57</td>
</tr>
<tr>
<td></td>
<td><strong>3,592</strong></td>
<td><strong>3,714</strong></td>
</tr>
</tbody>
</table>

13. Pooled investment vehicles

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managed funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property – UK</td>
<td>52</td>
<td>60</td>
</tr>
<tr>
<td>Property – Overseas</td>
<td>413</td>
<td>305</td>
</tr>
<tr>
<td>Hedge Funds – UK</td>
<td>638</td>
<td>617</td>
</tr>
<tr>
<td>Other – UK</td>
<td>790</td>
<td>957</td>
</tr>
<tr>
<td>Hedge Funds – Overseas</td>
<td>1,456</td>
<td>2,181</td>
</tr>
<tr>
<td>Other – Overseas</td>
<td>2,777</td>
<td>2,070</td>
</tr>
<tr>
<td>Unlisted insurance policies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LGIM Pooled Funds</td>
<td>3,188</td>
<td>4,987</td>
</tr>
<tr>
<td>Unit Trusts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property – UK</td>
<td>37</td>
<td>35</td>
</tr>
<tr>
<td>Property – Overseas</td>
<td>72</td>
<td>97</td>
</tr>
<tr>
<td></td>
<td><strong>9,423</strong></td>
<td><strong>11,309</strong></td>
</tr>
</tbody>
</table>

At 31 December 2011, LGIM pooled funds represented 8.8% of the net assets of the Scheme (2010: 13.6%). The LGIM pooled funds have underlying exposures to global equities and bonds. At 31 December 2011, the Scheme exposures via the investment in LGIM were: UK equities 3.3% (2010: 5.9%), Overseas equities 4.7% (2010: 7%) and Global bonds 0.8% (2010: 0.7%). At 31 December 2011, the largest holding was the investment in the LGIM UK Equity Index tracker fund which amounted to £1,088 million (2010: £2,197 million) representing 3% (2010: 5.9%) of the Scheme assets.

Geographical analysis of the registration of the companies operating the pooled investment vehicles is disclosed in Appendix four on page 46.

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 on going basis.
14. Loans

Loans consist of £452 million (2010: £487 million) in corporate loan investments in Strategic Investment Portfolio L.P. which is a 100% subsidiary of BTPS and £491 million (2010: £467 million) of funds loaned to support external investment activities of which £2 million (2010: £2 million) relates to property. There was £46 million (2010: £26 million) of loans as a result of the consolidation of entities that the Scheme controls.

15. Derivative contracts

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Futures contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK equities</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Fixed interest overseas</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Commodities</td>
<td>10</td>
<td>7</td>
</tr>
<tr>
<td>Options</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Swaps</td>
<td>29</td>
<td>13</td>
</tr>
<tr>
<td>FX forward contacts</td>
<td>115</td>
<td>81</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>170</td>
<td>116</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Liabilities</strong></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Futures contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK equities</td>
<td>[3]</td>
<td>-</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>[13]</td>
<td>[7]</td>
</tr>
<tr>
<td>Fixed interest UK</td>
<td>[3]</td>
<td>-</td>
</tr>
<tr>
<td>Commodities</td>
<td>[2]</td>
<td>-</td>
</tr>
<tr>
<td>Swaps</td>
<td>[331]</td>
<td>[56]</td>
</tr>
<tr>
<td>FX forward contracts</td>
<td>[82]</td>
<td>[146]</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(434)</td>
<td>(209)</td>
</tr>
</tbody>
</table>
### Derivative contracts (continued)

#### Objectives and Policies
The Trustee has authorised the use of derivatives by the investment managers as part of the overall investment strategy for the Scheme. The main objectives for the use of derivatives are summarised as follows:

#### Futures
Futures contracts are entered into as a method of balancing the Scheme’s exposure to a particular market or sector. Futures often provide a cheap and efficient way of modifying portfolio risk to remain within asset allocations governed by the investment strategy of the Scheme.

#### Options
Equity option contracts are acquired or sold in order to take a tactical or strategic position on an underlying equity index or to protect the Scheme from a fall in value in the main markets in which the Scheme invests. Currency option contracts are entered into to hedge the Scheme against adverse foreign exchange rate movements on investments denominated in non-sterling currencies.

### Futures – exchange traded

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK equities</td>
<td>(188)</td>
<td>1</td>
<td>(3)</td>
<td>(212)</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Overseas equities</td>
<td>(1,104)</td>
<td>7</td>
<td>(13)</td>
<td>(466)</td>
<td>8</td>
<td>(7)</td>
</tr>
<tr>
<td>UK fixed interest</td>
<td>(112)</td>
<td>-</td>
<td>(3)</td>
<td>4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Overseas fixed interest</td>
<td>(8)</td>
<td>-</td>
<td>-</td>
<td>(35)</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Commodities</td>
<td>325</td>
<td>10</td>
<td>(2)</td>
<td>264</td>
<td>7</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>18</strong></td>
<td><strong>(21)</strong></td>
<td></td>
<td><strong>18</strong></td>
<td><strong>(7)</strong></td>
<td></td>
</tr>
</tbody>
</table>

All of the above contracts settle in less than one year.

### Options

<table>
<thead>
<tr>
<th>Type of option</th>
<th>2011 Notional amount of outstanding contracts £ million</th>
<th>2011 Asset £ million</th>
<th>2011 Liability £ million</th>
<th>2010 Notional amount of outstanding contracts £ million</th>
<th>2010 Asset £ million</th>
<th>2010 Liability £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overseas – exchange traded</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indices</td>
<td>30</td>
<td>8</td>
<td>-</td>
<td>7</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Overseas – OTC</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commodity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8</strong></td>
<td></td>
<td></td>
<td><strong>8</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

All of the above contracts settle in less than one year.

#### Swaps
Swaps are used to modify the Scheme’s exposure to various asset classes. Commodity and property swaps were held at year end to manage the Scheme’s exposure to these asset classes. Variance swaps were held at year end to hedge the Scheme’s exposure to volatility in equity markets. Interest rate swaps were held to decrease the Scheme’s risk to the impact of interest rate fluctuations on floating rate loans. Credit default swaps were held to manage the credit risk of the Scheme’s bond portfolio.

#### Foreign Exchange Forward Contracts
Foreign exchange forward contracts are used to hedge against adverse foreign exchange rate movements on investments denominated in non-sterling currencies. Disclosures of the derivatives held at year end are set out below:
### 15. Derivative contracts (continued)

#### Swaps - over the counter

<table>
<thead>
<tr>
<th>Type of contract</th>
<th>No. of contracts</th>
<th>Expiration</th>
<th>Nature of swap</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit default</td>
<td>311</td>
<td>&lt; 37 years</td>
<td>Itraxx Europe</td>
<td>334</td>
<td>14</td>
</tr>
<tr>
<td>Interest rate – fixed for floating</td>
<td>120</td>
<td>&lt; 29 years</td>
<td>Fixed for floating</td>
<td>2,697</td>
<td>9</td>
</tr>
<tr>
<td>Property</td>
<td>1</td>
<td>&lt; 7 years</td>
<td>Floating for IPD</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Commodity</td>
<td>166</td>
<td>&lt; 2 years</td>
<td>GSLE for floating</td>
<td>27</td>
<td>6</td>
</tr>
<tr>
<td>Equity total return</td>
<td>1</td>
<td>&lt; 1 years</td>
<td>Common Stock</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>29</td>
<td>(331)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Type of contract</th>
<th>No. of contracts</th>
<th>Expiration</th>
<th>Nature of swap</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit default</td>
<td>142</td>
<td>&lt; 7 years</td>
<td>Itraxx Europe</td>
<td>(373)</td>
<td>2</td>
</tr>
<tr>
<td>Inflation</td>
<td>1</td>
<td>&lt; 50 years</td>
<td>Coupon for floating</td>
<td>50</td>
<td>-</td>
</tr>
<tr>
<td>Interest rate – floating for fixed</td>
<td>8</td>
<td>&lt; 20 years</td>
<td>Floating for fixed</td>
<td>1,090</td>
<td>-</td>
</tr>
<tr>
<td>Interest rate – fixed for floating</td>
<td>15</td>
<td>&lt; 4 years</td>
<td>Fixed for floating</td>
<td>203</td>
<td>-</td>
</tr>
<tr>
<td>Property</td>
<td>7</td>
<td>&lt; 20 years</td>
<td>Floating for IPD</td>
<td>100</td>
<td>5</td>
</tr>
<tr>
<td>Property</td>
<td>6</td>
<td>&lt; 20 years</td>
<td>IPD for floating</td>
<td>100</td>
<td>3</td>
</tr>
<tr>
<td>Variance</td>
<td>6</td>
<td>&lt; 7 years</td>
<td>Indices</td>
<td>(169)</td>
<td>3</td>
</tr>
<tr>
<td>Commodity</td>
<td>76</td>
<td>&lt; 1 years</td>
<td>GSLE for floating</td>
<td>1,285</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>13</td>
<td>(56)</td>
</tr>
</tbody>
</table>
15. Derivative contracts (continued)

FX Forward Contracts - over the counter

<table>
<thead>
<tr>
<th>Currency Bought</th>
<th>Currency Sold</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Notional Principal</td>
<td>Asset</td>
</tr>
<tr>
<td>EUR</td>
<td>GBP</td>
<td>£ million</td>
<td>£ million</td>
</tr>
<tr>
<td>AUD</td>
<td>USD</td>
<td>200</td>
<td>7</td>
</tr>
<tr>
<td>CAD</td>
<td>USD</td>
<td>729</td>
<td>7</td>
</tr>
<tr>
<td>USD</td>
<td>GBP</td>
<td>2,227</td>
<td>7</td>
</tr>
<tr>
<td>USD</td>
<td>OTHER</td>
<td>334</td>
<td>19</td>
</tr>
<tr>
<td>GBP</td>
<td>EUR</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>GBP</td>
<td>JPY</td>
<td>12</td>
<td>-</td>
</tr>
<tr>
<td>GBP</td>
<td>OTHER</td>
<td>469</td>
<td>1</td>
</tr>
<tr>
<td>GBP</td>
<td>USD</td>
<td>303</td>
<td>1</td>
</tr>
<tr>
<td>JPY</td>
<td>GBP</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>NOK</td>
<td>GBP</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>NOK</td>
<td>USD</td>
<td>847</td>
<td>-</td>
</tr>
<tr>
<td>SEK</td>
<td>EUR</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>SEK</td>
<td>USD</td>
<td>81</td>
<td>3</td>
</tr>
<tr>
<td>OTHER</td>
<td>OTHER</td>
<td>1,680</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td></td>
<td>115</td>
<td>(82)</td>
</tr>
</tbody>
</table>

16. Deposits & short-term investments

<table>
<thead>
<tr>
<th>Interest earning deposits</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sterling</td>
<td>1,118</td>
<td>2,809</td>
</tr>
<tr>
<td>Foreign currency</td>
<td>384</td>
<td>252</td>
</tr>
<tr>
<td>Certificate of deposits</td>
<td>538</td>
<td>551</td>
</tr>
<tr>
<td>Commercial paper</td>
<td>18</td>
<td>815</td>
</tr>
<tr>
<td>Floating rate notes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sterling</td>
<td>31</td>
<td>30</td>
</tr>
<tr>
<td>Foreign currency</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>2,090</td>
<td>4,457</td>
</tr>
</tbody>
</table>

As the Scheme is the main investor and controls Hermes Alternative Investment Funds plc ("HAIF"), it has been consolidated as a subsidiary of the Scheme. Its purpose is to gain exposure to commodity assets by entering into commodity swaps where the return is linked to the S&P GSCI Light Energy Total Return Index ("GSLE"). At 31 December 2011, £278 million (2010: £363 million) of the sterling deposits, £538 million (2010: £451 million) of the certificates of deposit and £0 million of the Commercial Paper (2010: £365 million) have been consolidated into deposits and short-term investments representing collateral used by HAIF to enter into and maintain the commodity swap positions. Hermes Commodities Umbrella Fund Limited changed its name to Hermes Alternative Investment Funds plc on 1 March 2011.
17. Investment in joint ventures

The Scheme’s most significant joint ventures are set out below:

BTPS invests in 95% of the equity in Argent Projects No 3 Partnership (AP 3), whose principal place of business is within the United Kingdom. AP 3 is involved in property development projects. BTPS invests in 46% of the equity in Kings Cross Central Limited Partnership, whose principal place of business is in the United Kingdom. BTPS invests in 77.5% of the equity in Hermes GPE LLP, whose principal place of business is within the United Kingdom.

18. AVC Plan

Members’ Additional Voluntary Contributions are invested separately from the principal plan on a money purchase basis with Abbey National plc, Equitable Life Assurance Society, BlackRock, Prudential plc, Scottish Widows, Standard Life Assurance Company, Schroder Investment Management Limited and LGIM.

These assets are in the form of individual building society accounts and insurance policies securing additional benefits on a money purchase basis for those members electing to pay additional voluntary contributions. Members participating in this arrangement each receive an annual statement confirming the amount held in their account and the movements in the year. The aggregate amount of AVC investments is as follows:

<table>
<thead>
<tr>
<th>Insurance policies £ million</th>
<th>Cash deposits £ million</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>At start of year</td>
<td></td>
<td>15</td>
<td>78</td>
</tr>
<tr>
<td>Net withdrawals by members</td>
<td></td>
<td>(1)</td>
<td>(4)</td>
</tr>
<tr>
<td>Change in market value of investments</td>
<td></td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>At end of year</td>
<td></td>
<td>16</td>
<td>75</td>
</tr>
</tbody>
</table>

19. Other investment assets

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued investment incomes</td>
<td>234</td>
<td>219</td>
</tr>
<tr>
<td>Margin deposits*</td>
<td>165</td>
<td>85</td>
</tr>
<tr>
<td>Reverse repurchase agreements - Gilt</td>
<td>357</td>
<td>-</td>
</tr>
<tr>
<td>Amounts due from brokers</td>
<td>109</td>
<td>446</td>
</tr>
<tr>
<td></td>
<td>865</td>
<td>750</td>
</tr>
</tbody>
</table>

* Included within Margin deposit balances are initial margin deposit balances of £155 million (2010: £85 million) and variation margin deposit balances of £10 million (2010: £0 million).

20. Other investment liabilities

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred income</td>
<td>42</td>
<td>55</td>
</tr>
<tr>
<td>Accrued interest payable</td>
<td>-</td>
<td>3</td>
</tr>
<tr>
<td>Amounts due to brokers</td>
<td>74</td>
<td>72</td>
</tr>
</tbody>
</table>
21. Investment borrowings

All Group Investment borrowings are in sterling.

<table>
<thead>
<tr>
<th>Repayment analysis</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 1 year on demand</td>
<td>885</td>
<td>877</td>
</tr>
<tr>
<td>In more than 2 years but less than 5 years</td>
<td>332</td>
<td>592</td>
</tr>
<tr>
<td>In more than 5 years</td>
<td>93</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>1,310</td>
<td>1,469</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Analysis of borrowings between fixed and floating rates</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed rates</td>
<td>983</td>
<td>964</td>
</tr>
<tr>
<td>Floating rates</td>
<td>327</td>
<td>505</td>
</tr>
<tr>
<td></td>
<td>1,310</td>
<td>1,469</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Security analysis</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secured</td>
<td>1,310</td>
<td>1,374</td>
</tr>
<tr>
<td>Unsecured</td>
<td>-</td>
<td>95</td>
</tr>
<tr>
<td></td>
<td>1,310</td>
<td>1,469</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interest rate profile</th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 6%</td>
<td>983</td>
<td>964</td>
</tr>
<tr>
<td>At variable rates of interest</td>
<td>327</td>
<td>505</td>
</tr>
<tr>
<td></td>
<td>1,310</td>
<td>1,469</td>
</tr>
</tbody>
</table>

* Investment borrowings consist of the liability for cash received from sale and repurchase agreements (Gilt repos) and borrowings existing in subsidiary entities, the majority of which relates to loans secured against properties.

At 31 December 2011, the weighted average time for which fixed rate borrowings were fixed was one year (2010: one year).

Interest rate contracts
At 31 December 2011, the Scheme had fixed interest payable swaps on a notional amount of £0 million (2010: £1,090 million) at a weighted average interest rate of 0% (2010: 4.90%) and for a weighted average period of 0 years (2010: 5.2 years).

Cost of borrowings
The weighted average rate of interest on Scheme borrowings was as follows:

<table>
<thead>
<tr>
<th></th>
<th>2011 %</th>
<th>2010 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>On fixed rate borrowings</td>
<td>1.6</td>
<td>1.5</td>
</tr>
<tr>
<td>On all borrowings</td>
<td>1.6</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Variable rate borrowings bear interest rates fixed in advance for periods ranging from one day to six months by reference to LIBOR.

Available facilities
At 31 December 2011, subsidiaries of the Scheme had undrawn committed facilities of £43 million (2010: £0 million) which expire within one year.
22. Minority interests

<table>
<thead>
<tr>
<th></th>
<th>2011 £ million</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minority interests</td>
<td>208</td>
<td>208</td>
</tr>
</tbody>
</table>

All of the current and prior year minority interests relate to equity interests in companies or partnerships.

23. Pension liabilities of subsidiaries

The Scheme consolidates certain subsidiaries that have defined benefit pension schemes. In accordance with accounting standard FRS17, actuarial valuations are carried out to determine the deficit or surplus that the Scheme recognises in the Consolidated Net Assets Statement.

The Hermes Group operates a defined benefit scheme, the Hermes Group Pension Scheme, funded by the payment of contributions to a separately administered trust fund. The defined benefit scheme was closed to new members on 1 June 2008 and a defined contribution scheme was opened for new members. The Hermes Group closed its final salary pension scheme to future accrual with effect from 31 October 2011. The contributions to this scheme are determined with the advice of independent qualified actuaries on the basis of triennial valuations using the Projected Unit method. The latest valuation was undertaken on 31 December 2011 by a qualified actuary using assumptions that are consistent with FRS17.

The MEPC (Defined Contribution) Scheme was wound up on 31 March 2011. Total pension costs for the defined contribution scheme was £0.1 million (2010: £0.1 million).

In November a subsidiary, MEPC (1946) Limited, made cash payments of £39.6 million to facilitate an insurance company buyout of the MEPC Limited Pension and Assurance Scheme (which is of the defined benefit type). At the first stage in this process, the Trustees of the Scheme signed an insurance contract on 11 November 2011. The buyout is expected to be completed in around one to two years, with the insurer then assuming responsibility for the Scheme’s liabilities, following which the Scheme will be fully wound up. At year end an annuity policy is held as an asset of the Scheme in the Trustees’ name and the subsidiary remains demonstrably committed to the buyout. The latest valuation of the MEPC defined benefit scheme was undertaken on 31 December 2010 by a qualified actuary using assumptions that are consistent with FRS17.

Assumptions and net liability

The major assumptions used for the actuarial valuation:

<table>
<thead>
<tr>
<th></th>
<th>2011 %</th>
<th>2010 %</th>
<th>2009 %</th>
<th>2008 %</th>
<th>2007 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of increase in salaries</td>
<td>2.2</td>
<td>4.4 - 4.7</td>
<td>4.4 - 4.7</td>
<td>3.1 - 4.4</td>
<td>3.4 - 4.9</td>
</tr>
<tr>
<td>Rate of increase in pensions in payment</td>
<td>3.1</td>
<td>3.3 - 3.4</td>
<td>2.8 - 3.7</td>
<td>2.8 - 3.1</td>
<td>3.3 - 3.4</td>
</tr>
<tr>
<td>Discount rate</td>
<td>5.0</td>
<td>5.4</td>
<td>6.4</td>
<td>6.0 - 6.4</td>
<td>5.7 - 5.8</td>
</tr>
<tr>
<td>Inflation assumption</td>
<td>3.2</td>
<td>3.4 - 3.7</td>
<td>2.9 - 3.1</td>
<td>3.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Rate of return on equities</td>
<td>7.2</td>
<td>6.2 - 8.1</td>
<td>6.6 - 8.1</td>
<td>6.7 - 7.6</td>
<td>6.5 - 7.9</td>
</tr>
<tr>
<td>Rate of return on UK Government bonds</td>
<td>3.0</td>
<td>4.2</td>
<td>4.4 - 4.8</td>
<td>3.8 - 4.7</td>
<td>4.5 - 4.8</td>
</tr>
<tr>
<td>Rate of return on bonds and other investments</td>
<td>4.7 - 6.4</td>
<td>5.4 - 7.1</td>
<td>4.8 - 6.2</td>
<td>4.4 - 6.0</td>
<td>4.7 - 6.4</td>
</tr>
</tbody>
</table>

Market value of assets at 31 December

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total fair value of equities</td>
<td>42</td>
<td>96</td>
<td>100</td>
<td>88</td>
<td>104</td>
</tr>
<tr>
<td>Total fair value of bonds</td>
<td>14</td>
<td>59</td>
<td>48</td>
<td>51</td>
<td>59</td>
</tr>
<tr>
<td>Total fair value of other investments</td>
<td>40</td>
<td>30</td>
<td>14</td>
<td>5</td>
<td>11</td>
</tr>
<tr>
<td>Total fair value of assets</td>
<td>96</td>
<td>185</td>
<td>162</td>
<td>164</td>
<td>174</td>
</tr>
<tr>
<td>Present value of scheme liabilities</td>
<td>(108)</td>
<td>(214)</td>
<td>(207)</td>
<td>(159)</td>
<td>(180)</td>
</tr>
<tr>
<td>Deficit in Scheme</td>
<td>(12)</td>
<td>(29)</td>
<td>(45)</td>
<td>(15)</td>
<td>(6)</td>
</tr>
</tbody>
</table>
23. Pension liabilities of subsidiaries (continued)

Changes in assets and liabilities in the year

<table>
<thead>
<tr>
<th>Change in benefit obligation</th>
<th>Total £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit obligation at the beginning of the year</td>
<td>(214)</td>
</tr>
<tr>
<td>Current service cost</td>
<td>(3)</td>
</tr>
<tr>
<td>Interest cost</td>
<td>(8)</td>
</tr>
<tr>
<td>Actuarial gains</td>
<td>9</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>2</td>
</tr>
<tr>
<td>Experience adjustment</td>
<td>(7)</td>
</tr>
<tr>
<td>Buyout of MEPC Limited pension scheme</td>
<td>113</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change in plan assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets at the beginning of the year</td>
<td>185</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>17</td>
</tr>
<tr>
<td>Actuarial (losses)</td>
<td>(2)</td>
</tr>
<tr>
<td>Employer contributions</td>
<td>46</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(1)</td>
</tr>
<tr>
<td>Buyout of MEPC Limited pension scheme</td>
<td>(149)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Deficit at end of year</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(108)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Experience gains/(losses) arising on Scheme liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (£ million)</td>
<td></td>
</tr>
<tr>
<td>(7)</td>
<td>-</td>
</tr>
<tr>
<td>Percentage [%]</td>
<td></td>
</tr>
<tr>
<td>6.5</td>
<td>-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Actuarial gains/(losses) as an amount and a percentage of the discounted value of the Scheme liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (£ million)</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Percentage [%]</td>
<td></td>
</tr>
<tr>
<td>6.5</td>
<td>4.7</td>
</tr>
</tbody>
</table>

24. Current assets

<table>
<thead>
<tr>
<th>Member contributions debtor</th>
<th>2011 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Employers’ contributions debtor</th>
<th>2010 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>-</td>
<td>20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other debtors</th>
<th>2009 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>91</td>
<td>49</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bank balances</th>
<th>2008 £ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>106</td>
<td>20</td>
</tr>
</tbody>
</table>

All contributions due to the Scheme relate to the month of December 2011 and were paid in full to the Scheme within the timescale required by the schedule of contributions currently in force at year end.
25. Current liabilities

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued benefits</td>
<td>38</td>
<td>30</td>
</tr>
<tr>
<td>Other creditors</td>
<td>178</td>
<td>170</td>
</tr>
</tbody>
</table>

26. Stock on Loan

Securities lending has been suspended since 2008 and therefore there were no securities on loan as at 31 December 2011 or as at 31 December 2010.

27. Sale and repurchase agreements

Fixed interest investments have been sold subject to contractual agreements for the repurchase of equivalent securities. Security for the agreements is provided by the cash received on sale and by holding collateral in the form of securities. The liability for cash received on sale and repurchase agreements is included in Note 21 under investment borrowings maturing within one year. The reverse repurchase receivable is shown within Note 19 under other investment assets.

<table>
<thead>
<tr>
<th>Repurchase agreements</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of fixed interest investments sold subject to repurchase agreements at 31 December</td>
<td>842</td>
<td>790</td>
</tr>
<tr>
<td>Value of cash received on sales at 31 December</td>
<td>811</td>
<td>782</td>
</tr>
<tr>
<td>Value of collateral held at 31 December</td>
<td>32</td>
<td>15</td>
</tr>
<tr>
<td>Total value of cash and collateral</td>
<td>843</td>
<td>797</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Reverse repurchase agreements</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of cash paid on purchases at 31 December</td>
<td>357</td>
<td>-</td>
</tr>
<tr>
<td>Value of collateral held at 31 December, not in cash</td>
<td>354</td>
<td>-</td>
</tr>
<tr>
<td>Total value of collateral</td>
<td>354</td>
<td>-</td>
</tr>
</tbody>
</table>

28. Related party transactions

Four Trustee Directors were members of the Scheme at 31 December 2011 (2010: five). One of these Trustee Directors received a pension from the Scheme during 2011 in accordance with Scheme Rules (2010: two).

29. Commitments and Contingent liabilities

<table>
<thead>
<tr>
<th>Commitments for investments</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property</td>
<td>219</td>
<td>356</td>
</tr>
<tr>
<td>Calls on partly paid shares and underwriting commitments</td>
<td>1,605</td>
<td>1,644</td>
</tr>
<tr>
<td></td>
<td>1,824</td>
<td>2,000</td>
</tr>
</tbody>
</table>
### 30. Principal Subsidiary Undertakings

<table>
<thead>
<tr>
<th>Subsidiary</th>
<th>Principal activity</th>
<th>Holding</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argent Group plc</td>
<td>Property investment and development</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Hermes MEPC Business Space Unit Trust</td>
<td>Property investment and development</td>
<td>Ordinary shares</td>
<td>96.4</td>
</tr>
<tr>
<td>Hermes Factory Outlets No. 2 L.P.</td>
<td>Property investment and development</td>
<td>Principal capital</td>
<td>89.6</td>
</tr>
<tr>
<td>Cayuga Global Macro Fund Limited</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Fortress Commodities MA 1 L.P.</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Graham K4D-15V Fund Ltd.</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Fund Managers Limited</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Specialist UK Focus Fund</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>71.2</td>
</tr>
<tr>
<td>Hermes European Focus Fund</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>64.1</td>
</tr>
<tr>
<td>Hermes Alternative Investment Funds plc(^1)</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>97.2</td>
</tr>
<tr>
<td>Strategic Investment Portfolio L.P.(^2)</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes BPK Funds plc</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>98.4</td>
</tr>
<tr>
<td>Hermes Investment Funds plc</td>
<td>Investment management</td>
<td>Ordinary shares</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2004 L.P.(^3)</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2005 L.P.(^3)</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2006 L.P.(^3)</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2007 L.P.</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2008 L.P.</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Private Equity Investments Holding 2009 L.P.</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes GPE PEC 2011-2013 L.P.</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes GPE PEF 2011-2013 L.P.</td>
<td>Investment in private equity funds</td>
<td>Partnership capital</td>
<td>100</td>
</tr>
<tr>
<td>Hermes Infrastructure I L.P.</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>100</td>
</tr>
<tr>
<td>Dream 01 L.P.(^2)</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>100</td>
</tr>
<tr>
<td>Dream 02 L.P.(^2)</td>
<td>Investment management</td>
<td>Principal capital</td>
<td>100</td>
</tr>
</tbody>
</table>

\(^1\) Hermes Commodities Umbrella Fund Limited changed its name to Hermes Alternative Investment Funds plc on 1 March 2011.

\(^2\) Registered in Jersey.

\(^3\) Registered in Guernsey.
31. Self Investment

At 31 December 2011, the Scheme did not directly hold any ordinary shares of BT Group plc (2010: £0 million), however it held £8 million of index linked investments (2010: £7 million) and £0 million of fixed interest bonds (2010: £16 million). The total amount of self investment represents 0.02% of the total assets of the Scheme (2010: 0.1%).

At 31 December 2011, there were no properties occupied by BT Group plc owned by the Scheme due to all leases expiring during the year (2010: two). Rent paid to the Scheme by BT Group plc during the year amounted to £0.03 million (2010: £0.2 million)

32. Taxation

The Scheme is a registered pension scheme under the provisions of the Finance Act 2004 for taxation purposes.
Independent Auditor’s Report

To the Trustee of the BT Pension Scheme

We have audited the financial statements of BT Pension Scheme for the year ended 31 December 2011 which comprise the Consolidated Fund Account, the Consolidated Net Assets Statement, the Analysis of Change in Market Value of Investments and the related notes 1 to 32. 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).

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 Trustee and 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 Trustees; 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. 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 31 December 2011, 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 Regulation 3 of, and the Schedule to, 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
9 May 2012
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 31 December 2011 in Note 1 to the Accounts.

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 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 schedules 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 in Note 1 to the Accounts have in all material respects been paid at least in accordance with the schedules 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 schedules of contributions.

Statement about Contributions payable under the schedules of contributions
In our opinion, contributions for the Scheme year ended 31 December 2011 as reported in the summary of contributions and payable under the schedules of contributions have in all material respects been paid for the period 1 January 2011 to 24 March 2011 at least in accordance with the schedule of contributions certified by the Scheme actuary on 8 May 2009 and for the period 25 March 2011 to 31 December 2011, at least in accordance with the schedule of contribution certified by the Scheme actuary on 25 March 2011.

Deloitte LLP
Chartered Accountants and Statutory Auditor
London United Kingdom
9 May 2012
The Actuary’s Statement

The most recent actuarial valuation of the Scheme was made as at 30 June 2011. 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 service prior to the valuation date; and
- assessing the future level of contributions required, having regard both to the cost of the benefits which will accrue to members after the valuation date and to any past service surplus or shortfall revealed by the valuation.

The valuation of the BT Pension Scheme (BTPS) as a continuing Scheme revealed a past service deficiency of £3,937 million. In light of this deficit, BT agreed to make a lump sum payment of £2.0 billion in March 2012, payments of £325 million in 2013 and 2014, followed by £295 million each year from 2015 to 2021.

The Scheme’s financial position and the level of BT’s contributions will be reviewed in full at the next actuarial valuation of the Scheme, which is due no later than 30 June 2014. BT has however agreed with the Trustee that it will pay additional contributions if the agreed position at either the 2014 or 2017 valuations reveals a deficit in excess of certain thresholds. BT has also agreed that it will pay additional contributions to the Scheme in other circumstances. Full details of these arrangements are set out in a funding agreement between the Trustee and BT.

In addition to these contributions, BT has agreed to pay contributions in respect of service from 1 June 2012 at a rate of 13.5% of salaries less mandatory contributions paid by those members who have opted out of the Smart Pensions arrangements (with an adjustment to reflect a prepayment of contributions by BT in March 2012).

The Employer has also agreed to make further special contributions to meet the strains which arise on account of redundancies while there is a shortfall.

A copy of the certificate to the most recent agreed schedule of contributions is included on this page.

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 either by winding up the Scheme or by continuing it as a closed fund.

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.

M J Pardoe FIA
Towers Watson Limited
9 May 2012

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 2011 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 9 May 2012.

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: 9 May 2012
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

Trustee Directors

Paul Spencer CBE, Chairman
Appointed: 1 September 2009.
Paul is a Non-executive Chairman of State Street Managed Pension Funds. He is also a Non-Executive Director of WPP Group plc, NipponKoa Europe Insurance Limited and TR Property Investment Trust plc. He acts as Chairman of two British Airways Pension Schemes. He is also a Rolls-Royce plc Pension Fund Independent Trustee, Chair of Trustees and of the Investment Committee. He is also a Governor of Motability. Appointed CBE in 2010 New Year’s Honours for ‘services to financial services’.

Adrian Askew
Appointed: 11 January 2011.
Adrian became a National Official of the Society of Telecom Executives (now the Connect Sector of Prospect) in 1987 and retired as General Secretary of Connect at the end of 2009. Adrian was lead officer on pensions matters for the BT Unions from 1997-2003 and was Chair of Trustees for the Connect Pension and Life Assurance Scheme from 2003-2009. Adrian is a member of the NFOP.

David Felder
Appointed: 15 September 2011.
David represents, and is a director of Law Debenture which is a professional independent trustee of pension schemes. David has over 30 years’ experience of working with pension funds in both the public and private sectors, first at Morgan Grenfell (now part of Deutsche Bank) as a fixed income fund manager and then at Kleinwort Benson (now owned by Commerzbank) where he was Head of Fixed Income between 1992 and 1998. David is a fellow of the Securities and Investment Institute.

Andrew Askew
Appointed: 11 January 2011.
Adrian became a National Official of the Society of Telecom Executives (now the Connect Sector of Prospect) in 1987 and retired as General Secretary of Connect at the end of 2009. Adrian was lead officer on pensions matters for the BT Unions from 1997-2003 and was Chair of Trustees for the Connect Pension and Life Assurance Scheme from 2003-2009. Adrian is a member of the NFOP.

Donald MacDonald
Appointed: 1 May 1998.
Donald retired from the CWU in 2004 where he had been a national officer. A Post Office and BT telecommunications technician for many years, he has served as a Director of BT Quest Ltd (BT Qualifying Employee Shares Trust). Donald is a member of the CWU and of NFOP, and a past Chairman of United Nations Principles for Responsible Investment. He is presently Chair of the Institutional Investors’ Group on Climate Change. Donald is a BTPS pensioner.

Bill McClory
Appointed: 1 September 1997.
Billy was employed by Post Office Telecommunications 1968-78, became a National Officer of CPSA, then NCU in 1984 and CWU in 1995. Responsible in the NCU for pension matters in the Post Office and BT, Billy was the lead officer on pension matters for the BT Unions 1990-97. Billy is a member of NFOP. He is also a Trustee of the National Communications Union Staff Superannuation Scheme and was Chair of the Scheme Trustee Board until May 2011.

Andrew Parker
Appointed: 9 April 2008. Andrew became Company Secretary of BT Group plc with effect from 1 April 2008. He has previously held roles as General Counsel of two of BT’s operational divisions, most recently of BT Retail. He has a degree in Law and is a qualified Solicitor. Andrew is a member of BTPS.

Beryl Shepherd
Appointed 1 June 2009.
Beryl has been employed by BT since 1978 and is currently a member of the National Executive Committee of the Communication Workers Union, a position that she has held since 2002. Beryl is Chair of the Trustees of the National Communications Union Staff Superannuation Scheme (NCUSSS). Beryl is an active member of BTPS and a member of NFOP.

Donald MacDonald
Appointed: 1 May 1998.
Donald retired from the CWU in 2004 where he had been a national officer. A Post Office and BT telecommunications technician for many years, he has served as a Director of BT Quest Ltd (BT Qualifying Employee Shares Trust). Donald is a member of the CWU and of NFOP, and a past Chairman of United Nations Principles for Responsible Investment. He is presently Chair of the Institutional Investors’ Group on Climate Change. Donald is a BTPS pensioner.

John Wroe
Appointed: 1 July 2007.
John is Director-Group Treasury, Tax and Risk Management of BT Group, responsible for BT’s tax, treasury, and risk management activities. John has a degree in economics and is a Chartered Accountant. He joined BT in 1992, prior to which he worked for Coopers & Lybrand. John is an active member of BTPS.

Beryl Shepherd
Appointed 1 June 2009.
Beryl has been employed by BT since 1978 and is currently a member of the National Executive Committee of the Communication Workers Union, a position that she has held since 2002. Beryl is Chair of the Trustees of the National Communications Union Staff Superannuation Scheme (NCUSSS). Beryl is an active member of BTPS and a member of NFOP.

John Wroe
Appointed: 1 July 2007.
John is Director-Group Treasury, Tax and Risk Management of BT Group, responsible for BT’s tax, treasury, and risk management activities. John has a degree in economics and is a Chartered Accountant. He joined BT in 1992, prior to which he worked for Coopers & Lybrand. John is an active member of BTPS.
## Appendix Two

### Benefits Administration

<table>
<thead>
<tr>
<th>Membership Statistics</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Membership</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributing Members</td>
<td>47,704</td>
<td>51,861</td>
<td>56,549</td>
</tr>
<tr>
<td>Deferred Beneficiaries</td>
<td>85,294</td>
<td>89,714</td>
<td>93,936</td>
</tr>
<tr>
<td>Current Pensioners of whom:</td>
<td>193,577</td>
<td>189,835</td>
<td>185,512</td>
</tr>
<tr>
<td>Retired Employees</td>
<td>157,254</td>
<td>153,396</td>
<td>149,425</td>
</tr>
<tr>
<td>Widows/Widowers</td>
<td>33,966</td>
<td>34,026</td>
<td>33,683</td>
</tr>
<tr>
<td>Children/Dependants</td>
<td>2,357</td>
<td>2,413</td>
<td>2,404</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Changes to Membership</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal Age Retirements</td>
<td>19</td>
<td>50</td>
<td>226</td>
</tr>
<tr>
<td>Ill Health Early Retirements</td>
<td>51</td>
<td>41</td>
<td>41</td>
</tr>
<tr>
<td>Early Retirement</td>
<td>2,972</td>
<td>2,565</td>
<td>2,480</td>
</tr>
<tr>
<td>Deferred Benefits set up</td>
<td>968</td>
<td>1,676</td>
<td>3,934</td>
</tr>
<tr>
<td>Benefits Transferred Out*</td>
<td>203</td>
<td>434</td>
<td>295</td>
</tr>
<tr>
<td>Optants Out**</td>
<td>13</td>
<td>10</td>
<td>45</td>
</tr>
<tr>
<td>Death in Service</td>
<td>67</td>
<td>74</td>
<td>73</td>
</tr>
<tr>
<td>Death in Retirement</td>
<td>4,052</td>
<td>4,295</td>
<td>5,855</td>
</tr>
<tr>
<td>Death in Deferment</td>
<td>134</td>
<td>158</td>
<td>151</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>New Records Set Up</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New Scheme Members (Employees)</td>
<td>14</td>
<td>19</td>
<td>81</td>
</tr>
<tr>
<td>Widows’ and Widowers’ Pensions</td>
<td>1,723</td>
<td>1,975</td>
<td>1,800</td>
</tr>
<tr>
<td>Children’s and Dependants*</td>
<td>144</td>
<td>174</td>
<td>161</td>
</tr>
<tr>
<td>Benefits Transferred In</td>
<td>1</td>
<td>6</td>
<td>30</td>
</tr>
</tbody>
</table>

* This is the number of transfer values paid during the year.
** Optants out are former members who have chosen to make Personal Pension arrangements or join the State Second Pension Scheme.

Accenture manages the administration of the Scheme, maintaining records and calculating and paying benefits. The Trustee is responsible for ensuring that the Scheme is properly administered and that accurate records are kept. Their requirements are set out in a Service Level Agreement (SLA) between BT and Accenture, which defines the service to be provided and standards to be achieved. Accenture provide BT with a monthly SLA performance report and commentary and the Trustee with a more detailed quarterly report containing performance against SLA, membership analysis and financial information relating to contributions collected and payments made.

The Peopleline Pensions team can be contacted between 8:30am and 5pm Monday to Friday, on 0800 731 4747 if you are a BT employee, or on 0800 731 1919 if you are no longer employed by BT. If resident overseas, the contact number is +44 (0) 1908 358661. Alternatively, please e-mail Peopleline.pensions@accenture.com.

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

30 Largest Investments as at 31 December 2011

The table below shows the 30 largest investment exposures held by the Scheme expressed as a percentage of the total investment assets of the Scheme. The exposure is determined by assets held directly by the Scheme or through pooled investment vehicles and subsidiary entities.

<table>
<thead>
<tr>
<th>Investment</th>
<th>Asset Class</th>
<th>Market Value £m</th>
<th>Investment assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Treasury 0.625% Index Linked 2040</td>
<td>Index Linked</td>
<td>795</td>
<td>2.2%</td>
</tr>
<tr>
<td>UK Treasury 2.5% Index Linked 2024</td>
<td>Index Linked</td>
<td>689</td>
<td>1.9%</td>
</tr>
<tr>
<td>UK Treasury 1.875% Index Linked 2022</td>
<td>Index Linked</td>
<td>625</td>
<td>1.7%</td>
</tr>
<tr>
<td>UK Treasury 2% Index Linked 2035</td>
<td>Index Linked</td>
<td>560</td>
<td>1.5%</td>
</tr>
<tr>
<td>UK Treasury 1.25% Index Linked 2027</td>
<td>Index Linked</td>
<td>521</td>
<td>1.4%</td>
</tr>
<tr>
<td>UK Treasury 4.125% Index Linked 2030</td>
<td>Index Linked</td>
<td>490</td>
<td>1.3%</td>
</tr>
<tr>
<td>UK Treasury 1.125% Index Linked 2037</td>
<td>Index Linked</td>
<td>483</td>
<td>1.3%</td>
</tr>
<tr>
<td>UK Treasury 0.75% Index Linked 2034</td>
<td>Index Linked</td>
<td>429</td>
<td>1.2%</td>
</tr>
<tr>
<td>UK Treasury 2.5% Index Linked 2020</td>
<td>Index Linked</td>
<td>419</td>
<td>1.1%</td>
</tr>
<tr>
<td>UK Treasury 0.125% Index Linked 2029</td>
<td>Index Linked</td>
<td>372</td>
<td>1.0%</td>
</tr>
<tr>
<td>The Centre: MK</td>
<td>Property</td>
<td>319</td>
<td>0.9%</td>
</tr>
<tr>
<td>UK Treasury 0.625% Index Linked 2042</td>
<td>Index Linked</td>
<td>304</td>
<td>0.8%</td>
</tr>
<tr>
<td>Milton Park</td>
<td>Property</td>
<td>272</td>
<td>0.7%</td>
</tr>
<tr>
<td>UK Treasury 1.25% Index Linked 2032</td>
<td>Index Linked</td>
<td>271</td>
<td>0.7%</td>
</tr>
<tr>
<td>Network Rail 1.75% Index Linked 2027</td>
<td>Index Linked</td>
<td>249</td>
<td>0.7%</td>
</tr>
<tr>
<td>UK Treasury 2.5% Index Linked 2016</td>
<td>Index Linked</td>
<td>200</td>
<td>0.5%</td>
</tr>
<tr>
<td>UK Treasury 1.25% Index Linked 2055</td>
<td>Index Linked</td>
<td>177</td>
<td>0.5%</td>
</tr>
<tr>
<td>Units in Goldman Sachs Partnership I</td>
<td>Credit</td>
<td>175</td>
<td>0.5%</td>
</tr>
<tr>
<td>Units in Goldman Sachs Partnership II</td>
<td>Credit</td>
<td>175</td>
<td>0.5%</td>
</tr>
<tr>
<td>Vodafone Group</td>
<td>UK Equities</td>
<td>169</td>
<td>0.5%</td>
</tr>
<tr>
<td>Granta Park</td>
<td>Property</td>
<td>138</td>
<td>0.4%</td>
</tr>
<tr>
<td>Bluewater</td>
<td>Property</td>
<td>126</td>
<td>0.3%</td>
</tr>
<tr>
<td>BHP Billiton</td>
<td>UK Equities</td>
<td>118</td>
<td>0.3%</td>
</tr>
<tr>
<td>Rio Tinto</td>
<td>UK Equities</td>
<td>114</td>
<td>0.3%</td>
</tr>
<tr>
<td>Chineham Park</td>
<td>Property</td>
<td>112</td>
<td>0.3%</td>
</tr>
<tr>
<td>UK Treasury 1.25% Index Linked 2017</td>
<td>Index Linked</td>
<td>108</td>
<td>0.3%</td>
</tr>
<tr>
<td>Birchwood</td>
<td>Property</td>
<td>108</td>
<td>0.3%</td>
</tr>
<tr>
<td>Anglian Water</td>
<td>UK Equities</td>
<td>108</td>
<td>0.3%</td>
</tr>
<tr>
<td>Clarks Village</td>
<td>Property</td>
<td>107</td>
<td>0.3%</td>
</tr>
<tr>
<td>British American Tobacco</td>
<td>UK Equities</td>
<td>98</td>
<td>0.3%</td>
</tr>
</tbody>
</table>

8,831 24.0%
Appendix Four

Geographical Analysis of Securities as at 31 December 2011

<table>
<thead>
<tr>
<th></th>
<th>Equities</th>
<th>Fixed interest</th>
<th>Index linked</th>
<th>Pooled investment vehicles</th>
<th>Total market value</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
<td>£ million</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1,671</td>
<td>3,642</td>
<td>6,983</td>
<td>4,903</td>
<td>17,199</td>
<td>57%</td>
</tr>
<tr>
<td>Overseas</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>1,365</td>
<td>1,137</td>
<td>85</td>
<td>402</td>
<td>2,989</td>
<td>10%</td>
</tr>
<tr>
<td>North America</td>
<td>2,287</td>
<td>733</td>
<td>306</td>
<td>3,705</td>
<td>7,031</td>
<td>24%</td>
</tr>
<tr>
<td>Japan</td>
<td>410</td>
<td>58</td>
<td>43</td>
<td>146</td>
<td>657</td>
<td>2%</td>
</tr>
<tr>
<td>Pacific Basin [ex Japan]</td>
<td>414</td>
<td>218</td>
<td>29</td>
<td>198</td>
<td>859</td>
<td>3%</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>569</td>
<td>611</td>
<td>34</td>
<td>69</td>
<td>1,283</td>
<td>4%</td>
</tr>
<tr>
<td>Total</td>
<td>6,716</td>
<td>6,399</td>
<td>7,480</td>
<td>9,423</td>
<td>30,018</td>
<td>100%</td>
</tr>
</tbody>
</table>

In the table above, pooled investment vehicles are analysed by the domicile of the investment manager and not by the domicile of the underlying investments.
Appendix Five

Property Investment as at 31 December 2011

<table>
<thead>
<tr>
<th>Geographical Analysis</th>
<th>Offices</th>
<th>Retail</th>
<th>Industrial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>London and South East</td>
<td>620</td>
<td>983</td>
<td>243</td>
<td>1,846</td>
</tr>
<tr>
<td>Other</td>
<td>875</td>
<td>649</td>
<td>112</td>
<td>1,636</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,495</td>
<td>1,632</td>
<td>355</td>
<td>3,482</td>
</tr>
</tbody>
</table>

| Overseas              |         |        |            |       |
| North America         | 61      | 49     | -          | 110   |
| **Total**             | 1,556   | 1,681  | 355        | 3,592 |

The above table includes the Scheme’s direct ownership or shared ownership in properties. The Scheme also has additional exposure to overseas property via managed funds and unit trusts. This is disclosed in note 13 on page 28.

The combined value of the 30 highest value properties was £2,634 million (2010 £2,693 million) which amounted to 73% (2010: 74%) of the total value of the property portfolio.

No properties owned by the Scheme as at 31 December 2011 were rented to BT Group plc (2010: two).

The rent payable by BT Group plc on properties held by the Scheme during the year totalled £0.03 million (2010 £0.2 million) which is less than 0.1% (2010: 0.1%) of the total rent payable on all properties held by the Scheme.
Appendix Six

Statement of Investment Principles

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

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

The investment of the assets of the Scheme should be consistent with funding a defined level of benefits within an acceptable level of risk, while trying to minimise the cash cost to BT over the long-term, having regard to the funding requirements of the Pensions Act 2004 and an acceptable level of risk of significant cash injections being required from BT. The Trustee acknowledges that, in particular, the level of investment in risky assets might, over the short to medium-term, influence the volatility of the funding level of the Scheme, and hence may influence the size of the contributions from the employer. The Trustee takes independent advice on the quality of the covenant of BT and thus its ability to meet its obligations. The estimated relative values of the Scheme’s assets and liabilities are regularly monitored.

As part of achieving the Scheme’s objective, the Trustee periodically sets a target for the total real investment return (from both capital appreciation and investment income) on the assets of the Scheme. Currently, this target is a real return of 2.6% per annum.

Risk
Given the ongoing commitment of BT to the Scheme, a degree of investment risk can be taken in the expectation of generating higher returns. This risk is constrained by diversifying across different classes of investment and a range of investment managers. In setting the appropriate level of investment risk the Trustee considers a range of factors, including the impact and probability of a significant fall in the value of the assets of the Scheme, the financial strength or covenant of BT and the financial strength of the plan. Investment risk is monitored by BTPSM on an ongoing basis and reviewed by the Trustee each month.

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.

The Trustee authorises the use of derivatives by BTPSM, some of the Scheme’s investment managers and certain subsidiary undertakings. BTPSM uses derivatives to manage the Scheme’s risk profile which includes their use to rebalance the Scheme’s asset allocation regularly to keep within guidelines agreed by the Trustee and for making tactical adjustments.

Taking Decisions
The Trustee is responsible for the stewardship of the assets of the Scheme. All the Trustee Directors are therefore involved in decisions on the strategic target for the distribution of assets between different classes. In making these decisions the Trustee is assisted by 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 Trustee has an Investment Committee, which has delegated authority for tactical asset allocation. It also oversees the appointment and removal of investment managers and the performance of BTPSM.

Distribution of Investments
Targets set for the strategic allocation of assets between different classes of investment reflect the Trustee’s views on the appropriate balance to be struck between returns and risk, and on the extent to which the Scheme’s assets should be distributed so as to meet its liabilities. Investments are made on the expectation that greater long-term returns will be achieved through a prudent exposure to real assets, including equities and property. The Scheme’s investments are highly diversified by asset class, geographical area, sector and industry.

At 31 December 2011 the target strategic allocation and projected long-term real investment return (ten year medium return expressed in excess of retail price inflation) for each asset class is shown in the table below:

<table>
<thead>
<tr>
<th>Target Allocation %</th>
<th>Expected Real Return %</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>4.3</td>
</tr>
<tr>
<td>22</td>
<td>0.0</td>
</tr>
<tr>
<td>15</td>
<td>(1.5)</td>
</tr>
<tr>
<td>11</td>
<td>3.4</td>
</tr>
<tr>
<td>21</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Alternatives include Commodities, Infrastructure, Hedge Funds, Private Equity, Credit Opportunities and Emerging Credit investments. A portion of the exposure to foreign currencies embedded in the overseas assets is hedged back into Sterling to remove some of the currency risk.
Appendix Six (Continued)

The Trustee’s Investment Committee, advised by BTPSM, continually assesses current market conditions and trends and has defined latitude to implement tactical adjustments around the strategic asset allocation targets for both assets and currencies under authority delegated from the Trustee Board.

Mandates for Advisers and Managers

Hermes is the Scheme’s principal investment manager. However, the Trustee has appointed other investment managers to manage a significant portion of the Scheme’s assets. All investment advisers and managers have agreed in writing with BTPSM, on behalf of the Trustee, the services to be provided and, where appropriate, the performance target and how it will be measured.

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

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

At 31 December 2011, the assets of the Scheme managed by the Principal Investment Managers are set out below:

<table>
<thead>
<tr>
<th>Manager (mandate)</th>
<th>£ million</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hermes [global securities and property]</td>
<td>16,132</td>
<td>44.8</td>
</tr>
<tr>
<td>M&amp;G Investment Management Ltd. (corporate bonds)</td>
<td>3,937</td>
<td>10.9</td>
</tr>
<tr>
<td>Legal &amp; General Investment Management Ltd (global equities)</td>
<td>3,188</td>
<td>8.8</td>
</tr>
<tr>
<td>BlackRock Investment Management (UK) Limited</td>
<td>3,153</td>
<td>8.8</td>
</tr>
<tr>
<td>Other managers</td>
<td>9,592</td>
<td>26.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>36,002</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Performance Measurement

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

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

Sustainable Investment

As a founder member of the United Nations Principles for Responsible Investment (UN PRI), the Scheme uses this framework to ensure that environmental, social and governance issues are taken fully into account in its investments.

When reviewing existing or appointing new investment managers on behalf of the Scheme, managers are encouraged to consider long-term sustainable ownership where possible. The Trustee endeavour to use all available methods to exercise its ownership rights by voting and engaging where possible either directly or via an appointed overlay service.

The Trustee believe that good corporate governance is of paramount importance and the Trustee expect best practice as a minimum in this area from all its managers.

The Trustee also utilise sustainability as an investment theme for the Scheme as opportunities arise.
Scheme Summary

This section summarises the main terms applying to Scheme members in Section B and Section C as at 31 December 2011. They are not intended to be comprehensive and any explanation in it is subject to the Scheme Rules. Section A terms are broadly comparable with Section B, the main difference is that Section A benefits are based on 94% of pensionable pay, whilst for Section B they are based on 100% of pensionable pay. In addition, Section A members who were previously members of the Principal Civil Service Pension Scheme (PCSPS) have a special provision that their benefits will always be greater than or equal to the equivalent PCSPS benefits.

Section B

Normal Pension Age
60 for males and females (65 for pensionable service on and from 1 April 2009).

Eligibility
All permanent full or part-time employees between the ages of 18 and 55, who commenced employment and joined the Scheme prior to 1 April 1986. Section B closed to new members on 1 April 1986.

Members’ Contributions
From 1 April 2009 ordinary contributions vary from 6% to 8.5% depending on pensionable salary and accrual rate, unless the member participates in the salary sacrifice scheme, Smart Pensions, in which case no contributions are payable.

Pensionable Service
Completed service in the Scheme plus any additional service transferred in or added years bought.

Pensionable Salary
Basic pay plus London weighting and certain other allowances are included in pensionable salary but overtime payments are generally excluded.

Final Pensionable Salary
The greater of:

a. the best year’s pensionable salary in the last three years; or
b. the average of the best three consecutive tax years of pensionable salary in the last 10 years of service.

Additional Voluntary Contributions
Choice of added years or in-house money purchase arrangements. From 1 April 2009 members may only purchase added years if they had already entered into a contract to do so prior to 1 April 2009.

Benefits at Normal Retirement
A pension of 1/80th of final pensionable pay + tax-free cash sum of 3/80ths of final pensionable salary for each year of pensionable service. The cash can be used to provide additional pension, or some pension can be converted into additional cash.

From 1 April 2009 benefits (both pension and cash sum benefits) will accrue on a career average revalued earnings basis rather than final salary basis (although pre 1 April 2009 benefits will continue to be linked to final pensionable salary).

Accrual rates for most Section B members will remain unchanged (although members may elect accrual of a pension and lump sum at 90ths rather than 80ths depending on the contributions they pay).

Death in Service
A lump sum of 3 times final pensionable salary is payable. A spouse’s pension (provided two years service has been completed) of one-half of the member’s pension to be calculated and paid as if the member had retired on ill health grounds. Children’s pensions are also payable in respect of children up to age 17 or extended to age 23 if the child is in full-time education or training.

Death after Pension Starts
A spouse’s pension of one-half of the member’s pension plus children’s pensions if applicable, is payable at the date of death. If death occurs within five years of retirement, a lump sum equal to the balance of five years’ pension, at the date of death, is also payable.

Early Retirement
On redundancy, or in special circumstances with employer’s agreement, benefits normally payable from age 50. Actuarially reduced benefits also available on member’s request from age 50. On ill health, benefits payable at any age. Benefits are enhanced where appropriate conditions are met.

Pension Increases
Pensions are increased annually in line with the increases applied by the Government to public sector pensions (currently CPI).

Transferring Benefits
A deferred pension can usually be transferred into, or out of, the BTPS providing the transfer of assets is from one pension scheme to another or used to purchase an annuity. In the case of a transfer payment from the BTPS, the amount will represent the full value of the benefits being transferred including an allowance for future guaranteed increases. No allowance is made for additional discretionary increases. Transfer values are calculated and verified in the manner prescribed by legislation.

Contracting-out
The Scheme ceased to be contracted-out of the State Second Pension from 6 April 2009.
Section C

Normal Pension Age
60 for males and females (65 for Pensionable Service on and from 1 April 2009).

Eligibility
All permanent full or part-time employees between the ages of 18 and 55, who commenced employment on or after 1 April 1986. Section C closed to new members on 31 March 2001.

Members’ Contributions
From 1 April 2009 contributions vary from 6% to 7% depending on Pensionable Salary and accrual rate, unless the member participates in the salary sacrifice scheme, Smart Pensions, in which case no contributions are payable.

Pensionable Service
Completed service in the Scheme plus any additional service transferred in.

Pensionable Salary
Basic pay plus London weighting and certain other allowances are included in Pensionable Salary but overtime payments are generally excluded.

Final Pensionable Salary
Pensionable Salary in whichever continuous period of 12 calendar months of the last three years of Pensionable Service gives the highest figure.

Additional Voluntary Contributions
Choice of in-house money purchase arrangements.

Benefits at Normal Pension Age
A pension of 1/60th x Final Pensionable Salary x Pensionable Service. Part of the pension may be exchanged for a tax-free lump sum subject to legislative limits.

From 1 April 2009 benefits will accrue on a career average revalued earnings basis rather than final salary basis (although pre 1 April 2009 benefits will continue to be linked to Final Pensionable Salary). Most Section C members will accrue a pension of 1/80th x Pensionable Salary for that year together with a tax-free lump sum of 3/80ths x Pensionable Salary for that year (although some members may elect accrual of a pension and lump sum at 90ths rather than 80ths depending on the contributions they pay).

Death in Service
A lump sum of 3 years’ Final Pensionable Salary is payable. A spouse’s pension based on actual and potential Pensionable Service. Children’s pensions are also payable in respect of children up to age 17 or extended to age 23 if the child is in full-time education or training.

Death after Retirement
If death occurs within five years of retirement, a surviving spouse will receive the whole of the member’s pension for the remainder of the five year period. After five years a spouse’s pension of one-half of the member’s pension plus children’s pensions if applicable.

Early Retirement
On redundancy, or in special circumstances with employer’s agreement, benefits normally payable from age 50. Actuarially reduced benefits also available on member’s request from age 50.

On ill health, benefits are payable at any age. Benefits are enhanced where appropriate conditions are met.

Pension Increases
Pensions in payment will increase in line with the Retail Price Index up to 5% per annum. Increases above this are at BT’s discretion.

Transferring Benefits
A deferred pension can usually be transferred into, or out of, the BTPS providing the transfer of assets is from one pension scheme to another or used to purchase an annuity. In the case of a transfer payment from the BTPS, the amount will represent the full value of the benefits being transferred including an allowance for future guaranteed increases. No allowance is made for additional discretionary increases. Transfer values are calculated and verified in the manner prescribed by legislation.

Contracting-out
The Scheme ceased to be contracted-out of the State Second Pension from 6 April 2009.
Sustainable Investment

Integration of sustainability

The Scheme works to integrate sustainable thinking across all areas of activity and across all asset classes. In particular, integration covers:

- asset allocation;
- manager appointment and assessment; and
- approaches to individual asset classes.

One way the Trustee measures the Scheme’s performance and progress in delivering sustainable outcomes through its investments is by participating in the PRI annual survey and assessment. The 2011 PRI survey finds the Scheme in the top quartile of its large asset owner peers across each of the six PRI principles. The Scheme also successfully maintained its top platinum ranking in the third UKSIF survey on UK corporate pension funds’ approach to responsible investment. Achieving these standards fulfils the Trustee’s objective of having a leading position in this area.

Asset allocation

The Trustee is considering key long-term risk factors which may affect the attractiveness of particular assets, geographies or whole asset classes for the Scheme.

With the global economy undergoing dramatic structural change, sustainable development is likely to become a long-term primary driver of industrial and economic risk and opportunity. The Trustee believes long-term megatrends such as demographic shifts, resource scarcity, pollution and climate change could create investment challenges as well as opportunities.

The Scheme is working to seek particular themed investments which have attractive risk-adjusted investment characteristics and which also deliver positive sustainable objectives. As part of this mandate, the Scheme helped to develop and invest £100m in a carbon-tilted passive equity index with the intention of delivering returns similar to those of the broader index with a markedly lower carbon risk exposure.

The Scheme is also exploring increasing its allocation to direct investments in mature UK infrastructure including renewable energy where projects meet our risk-adjusted and inflation-linked return requirements. The Trustee continues to actively engage with the UK market framework to explore ways in which such infrastructure investments can be structured and aligned to meet our long-term needs.

Manager appointment and assessment

The Trustee works with the Scheme’s fund managers to encourage and assist them to integrate long-term factors into their investment decision-making, and to instil an approach to fund management which matches the Scheme’s need for long-term performance. The Trustee seeks where possible to include some requirement to take account of sustainability factors in its contracts with fund managers, and then seeks to hold the managers accountable for delivery against this standard.

The Trustee actively encourages its fund managers to become signatories to the PRI and FRC’s UK Stewardship Code (where UK equity managers) as a way of building their commitment and skills in this area. There were some notable successes in this respect in 2011 with one of the largest investment managers, PIMCO, signing up to the PRI.

The Trustee supports the International Corporate Governance Network of best practice contract terms due to be launched in Spring 2012 and will facilitate its incorporation within its fund managers terms. The Trustee will support efforts for the adoption of these best practice terms across the investment industry to help ensure that long-term thinking is built into fund manager contracts and investment approaches.

Approaches to individual asset classes

The Scheme tailors its approach as relevant to the asset classes in which it invests and the way in which those investments are made.

Real estate

The Scheme’s principal real estate manager, Hermes Real Estate is embedding responsible asset management in its investment practices, partly in response to regulatory pressures but also due to market pressure from investors and demand from occupiers for more sustainable real estate.

Responsible real estate management is now an accepted practice that is expected to continue to grow, along with the uptake of mandatory and voluntary energy and environmental certificates. Indeed, there is growing evidence that more sustainable buildings will remain vacant for shorter periods between leases and face lower risks of obsolescence.

An example of responsible real estate management in practice can be seen in the Scheme's investment in the development of King Cross, the largest new urban development area in the UK. Here there is a commitment to reduce site energy consumption by 50% compared to 2005 standards through on-site combined heat and power generation and new buildings rated BREEAM “Excellent” as a minimum. Working together with occupiers and communities on sustainability issues will result in more attractive spaces for them and more valuable properties for the Scheme.
Following the leadership shown by the Scheme sponsor BT plc, in establishing its environmental management system in the early 1990’s and leading to ISO 14001 certification in six countries, the Trustee, the Scheme and Hermes’ head office successfully maintained the ISO 14001 audit achieved in August 2010. Environmental management more broadly is overseen by the Hermes Environmental Management System working group.

Fixed income
With fixed income becoming an increasingly significant allocation for the Scheme, over the last year the Trustee allocated some specific resource to ensuring that its bonds are voted. The Trustee have also requested that its outsourced engagement service provider also represents its bond holdings and initiates engagements with the issuers of its largest holdings.

The Trustee have also focused on best practice research including how to integrate sustainable factors into the fixed income investment process and are looking into potential conflicts between bond and equity holdings. The Scheme are active members of the PRI working group on bonds which was formed during the year.

Collaboration activities
The Scheme regards collaboration with other asset owners as a vital part of being effective on behalf of beneficiaries, both in general investment areas and in the specific area of sustainable investment and ownership. The Scheme acknowledge a particular responsibility which arises from being the UK’s largest corporate pension scheme. We therefore lead and participate in a range of relevant industry working groups and collaborative activities.

During 2011, the Scheme fostered and participated in meetings of a UK pension scheme roundtable which includes participants from the UK’s largest pension schemes. The aim of this group is to discuss informal ways of working together on common sustainability issues. The Scheme also actively collaborates with UK pension fund peers through our active membership of the National Association of Pension Funds (NAPF) and with European and global asset owners through initiatives including the Institutional Investors Group on Climate Change which is chaired by one of the Trustee Directors, Donald MacDonald.

Active ownership
The Trustee has long believed that being an active owner will, over time, add value to the assets it owns. This applies just as much in real estate investment and private equity as it does in public equities, the asset class where this effort is most well-understood. On public equities, the Trustee is confident that its approach respects the requirements of the FRC’s Stewardship Code for institutional investors. The Scheme, its voting and engagement service provider Hermes Equity Ownership Services (EOS) and wholly-owned manager Hermes Fund Managers have all committed to support the Code and make relevant disclosures on their respective websites.

At the request of its clients, including the Scheme, EOS has developed a way of monitoring its performance through the application of milestone standards against which progress in its engagements is measured. These numbers are outlined on page 54.

Corporate engagement 2011
Over the year, EOS engaged with companies where the Scheme’s aggregate shareholding amounts to almost 40% of its total equities exposure. The 348 companies covered included a significant proportion of the Global Large Cap portfolio, the Scheme’s largest single exposures to listed companies. Please find below examples of two ongoing engagements where EOS have made positive progress during 2011. Further information on EOS’s activities can be found at www.hermes.co.uk/eos.

Moody’s (US)
Issues
• Pressed the company to improve its governance structures by separating the role of chair and CEO.

What was achieved
• Shareholder proposal to separate the roles of CEO and chair secured majority support at the 2011 AGM, resulting in the most high profile win for a proposal of this type in the US during 2011. This was one of only three successful shareholder proposals in the US.

RWE (Germany)
Issues
• The company has an energy production portfolio centred around coal and nuclear. It does not as yet have a credible strategy for reducing carbon emissions and has suffered heavy financial impact from the nuclear phase-out in Germany.

• We are concerned about the composition of the supervisory board on which municipality candidates are over-represented.

What was achieved
• Counterproposal at the AGM 2011 opposing the election of a municipality candidate for the supervisory board gathered a significant 30% of the shareholder vote.

• In the aftermath of the AGM, the chairman of the board was able to push through the election of an independent candidate for CEO over the favourite candidate of the municipalities.
Public policy

As the UK’s largest corporate pension scheme the Trustee believes it is necessary to take an active part directly in certain public policy debates to protect and enhance value for the scheme. The areas the Trustee covers are around pensions policy, investment opportunities and the overall investment framework, and enhancing the protections for long-term investors.

During 2011 the Scheme has been most active around five specific areas of public policy:

1. UK infrastructure – The Trustee are working closely with Infrastructure UK and the NAPF to explore ways the UK Government can help to remove structural barriers to pension funds investing in mature UK infrastructure.

2. Global policies to address climate change – Further to last year’s Scheme-sponsored Mercer report which found climate policy uncertainty could be particularly damaging to the Scheme’s assets and liabilities, the Scheme have been actively engaging policymakers on the issue. For example, we were among the 285 signatories of a joint investor statement on climate change developed (with its support) by the various representative organisations for investors active on this issue – the Institutional Investors Group on Climate Change (IIGCC), UNEPFI and PRI. For further details please see the IIGCC website.

3. Proposed revision of the Institutions of Occupational Retirement Provision (IORP) directive – The Scheme has been working closely with the Government and other stakeholders to engage key European decision makers to mitigate the risk of Solvency II type capital requirements being applied to European pension schemes as early as 2015. If implemented in its current form this policy would force changes to the asset allocation and the reporting methodology of the Scheme’s pension liabilities.

4. Financial Transaction Tax – If implemented on a non-global basis, the proposed Tax would place significant additional direct costs on the Scheme’s investments. It is also likely that agents will look to pass on their increased trading costs onto the Scheme.

5. Rules for FTSE index composition and UK listing rules – Following a series of meetings and a joint asset owner letter to the FTSE consultation, the Scheme successfully encouraged the level of free float required by the FTSE to be raised to 25% with consideration given to further reform in future. This is a welcome victory, improving shareholder protection and corporate governance within the UK market.

Milestone status of engagement

Of the 348 companies engaged, EOS identified 664 separate engagement objectives. The table below shows the 2011 milestone status of EOS’ engagement objectives by theme across the engagement undertaken.

<table>
<thead>
<tr>
<th>Theme</th>
<th>Total (Engagement Objective)</th>
<th>Engagement Objective Status</th>
<th>Completed Engagement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Milestone 0 Milestone 1 Milestone 2 Milestone 3</td>
<td>Milestone 4 Not successful</td>
<td></td>
</tr>
<tr>
<td>Environmental</td>
<td>138</td>
<td>3 32 74 21</td>
<td>8</td>
</tr>
<tr>
<td>Governance</td>
<td>305</td>
<td>19 65 137 63</td>
<td>21</td>
</tr>
<tr>
<td>Social and ethical</td>
<td>128</td>
<td>8 24 49 42</td>
<td>5</td>
</tr>
<tr>
<td>Strategy and risk</td>
<td>93</td>
<td>5 20 39 27</td>
<td>2</td>
</tr>
<tr>
<td>Total Objectives</td>
<td>664</td>
<td>35 141 299 153</td>
<td>36</td>
</tr>
</tbody>
</table>

1Milestone 0 = New objective, Milestone 1 = Raised concerns, Milestone 2 = Acknowledgement of issue, Milestone 3 = Develop credible strategy/set stretching targets, Milestone 4 = Strategy implementations
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 2011 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 9 May 2012.

M J Pardoe
Fellow of the Institute and Faculty of Actuaries
Towers Watson Limited

9 May 2012

Watson House
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Reigate
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Glossary of Terms

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

Corporate Governance
The system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies, whilst the shareholders’ role in governance is to appoint the directors and auditor and to satisfy themselves that a proper governance structure is in place.

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 contributing members of BTPS [mainly former employees].

Equities
Shares directly held in British and overseas 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 means to buy or sell with a single transaction the equivalent of a wide range of securities.

Gilt
Sterling bond issued by the British Government.

Gilt Repurchase Agreement
A form of short-term borrowing by agreement to sale and repurchase of government securities.

Gross Equity Method
A method under which the Scheme accounts for its share of income and gains from joint ventures, and discloses its share of joint venture gross assets and gross liabilities.

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

Index-matched Portfolio
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. Also referred to as passive investment.

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.

Market Value
The best estimate of the price for which assets could be sold at a given date. For further information see “Analysis of Change in Market Value of Investments” on page 21.

Minority Interests
The value of the net assets and the amount of net income and gains attributable to outside shareholders of subsidiaries of the Scheme.

Overlay
Tactical and strategic adjustments which modify the Scheme’s asset and currency allocations.

Pooled investment vehicles
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.

Property Swaps
A property swap is a contract to pay or receive a return based on a property index.

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 Price Index and the Consumer Price Index.

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

Sale and Repurchase Agreements (Repos and Reverse Repos)
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, or at call, 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, or at put, at a specified price.

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

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.

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

Unlisted Investments
Stocks and shares not dealt in on a recognised stock exchange.

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

Variance Swap
A variance swap is a contract to pay or receive a return based on the volatility of a stock index.
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