Pensions Teach-in

7 July 2020

Forward-looking statement caution

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An introduction to today's speakers

Neil Harris – Director Tax, Treasury, Insurance & Pensions
- Joined BT in 2015
- 30+ years' experience in corporate finance roles, including AstraZeneca, BHP Billiton, Cable & Wireless, Centrica & Serco
- Accountant

Paul Rogers – Pensions Risk Director
- Joined BT in 2011
- 20+ years' experience in pensions
- Actuary

Shan Abdullah – Pensions Senior Manager
- Joined BT in 2014
- 10+ years' experience in pensions
- Actuary

Bob Scott – LCP, Partner (Independent expert)
- 40+ years' experience in pensions including 38 at LCP
- Actuary
- Past chair of the Association of Consulting Actuaries

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Key messages

We use two methods to calculate our pension deficit:

- IAS 19, to determine our balance sheet position, is measured on a "best-estimate" basis, but does not allow for the scheme's investment strategy
- Funding, to determine our cash payments, reflects the scheme's investment strategy, but is measured prudently

Our recent dividend decision and investment plans, including our FTTP programme, are positive for our covenant

The 2017 BTPS funding agreement provides a strong foundation on which to build our 2020 agreement, such as over what period we seek to pay off deficits

Covid-19 may reduce the pace and scale of any changes to the pension regulatory regime

BT focused on sustainable growth in value, which includes supporting its pension plans

Drive sustainable growth in value

Grow EBITDA

Grow free cash flow

Invest in value-enhancing growth	Support pension plans	Progressive dividends	Maintain strong balance sheet
• Target 20m FTTP by mid-to-late 2020s • 5G footprint doubled by March 2021 • Modernisation of BT to deliver £2bn annualised gross cost savings by March 2025	• Fair and affordable recovery plan • £2bn bonds issued to BTPS[1] in 2018/19 • £1.25bn & £900m deficit payments to BTPS[1] in 2019/20 & 2020/21 respectively	• Dividend re-based to 7.7p per share for 2021/22 • Continued progressive policy from re-based level	• Smooth long-dated debt maturity profile • Targeting BBB+ through cycle rating • BBB rating floor

[1] BT Pension Scheme

Overview of BT’s pension plans

What are the different types of pension plans?

Defined Benefit (“DB”)	Defined Contribution (“DC”)
Benefits: • determined by the plan rules • dependent on factors such as age, years of service and pensionable pay • not dependent on actual contributions made by the company or members	Benefits linked to: • contributions paid • the performance of each individual’s chosen investments • the form in which individuals choose to take their benefits
BT exposed to investment and other risks, leading to liabilities recognised on the balance sheet	**BT not exposed** to investment and other risks

The Group’s main plans are in the UK

BT Pension Scheme (BTPS)	• DB • Closed to future benefit accrual on 30 June 2018 for majority of members • 286,000 deferred members and pensioners
BT Retirement Saving Scheme (BTRSS)	• DC • Contract-based arrangement operated by Standard Life • 67,000 active members
EE Pension Scheme (EEPS)	• DB section closed to future benefit accrual in 2014 • DC section open to new joiners with 9,000 active members
BT Hybrid Scheme (BTHS)	• Combines elements of DB and DC • Set up in April 2019 for non-management employees formerly in the BTPS • Closed to new entrants on 30 September 2019 • 4,000 active members

- BT also has retirement arrangements around the world in line with local markets and culture

Source: BT Group plc Annual Report 2020, pg. 164, 172

Closing the BTPS has significantly reduced the build-up of DB benefits & risk

Changes to pension benefits in 2018

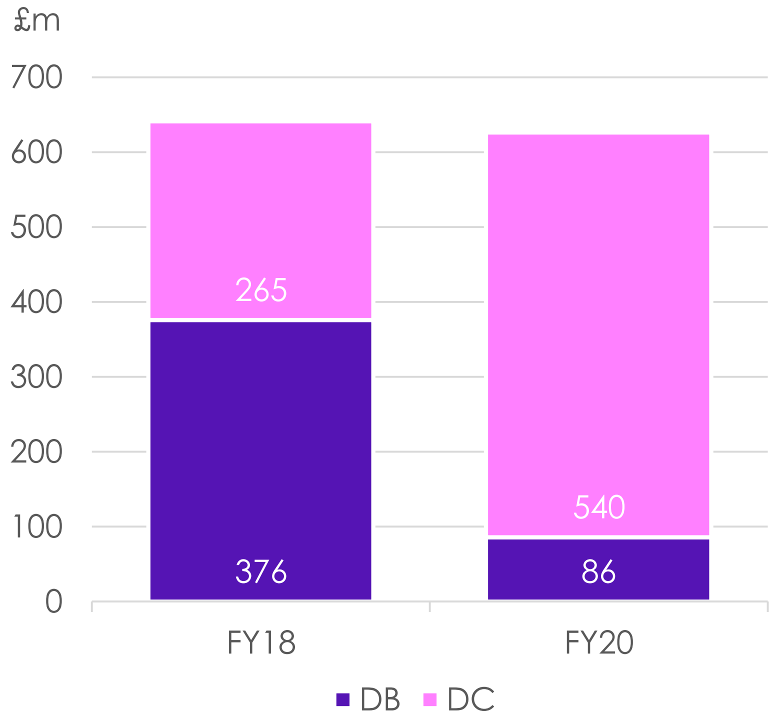
BTPS (DB)	• Closed to future accrual for >99% of active members from 30 June 2018

Affected employees were:

- eligible to join:
  - BTRSS
  - BTHS, if non-management
- provided enhanced contribution rate from BT for a temporary period

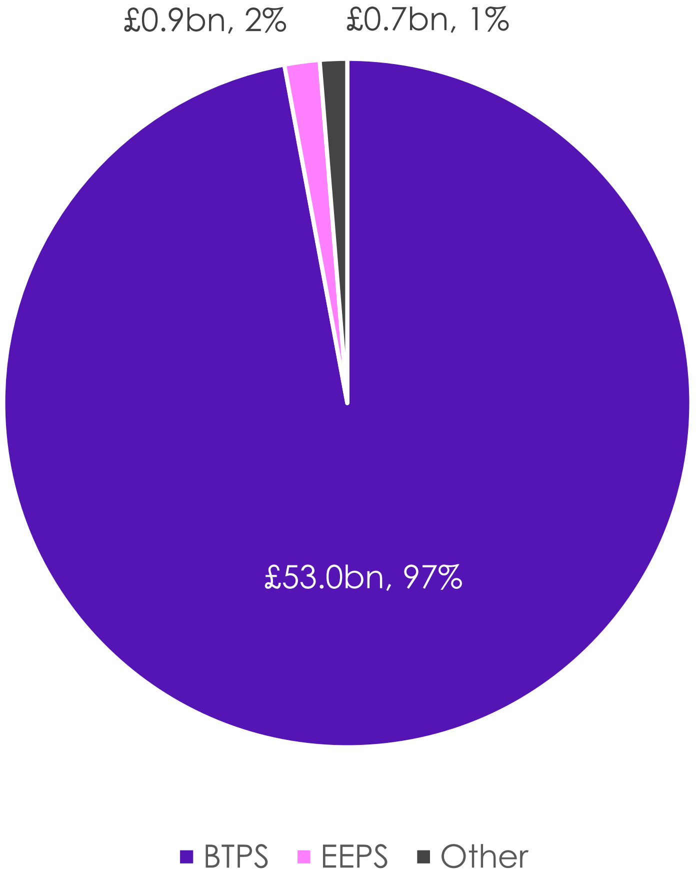
BTRSS (DC)	• BT's standard contribution rate increased from around 8% to 10% from 1 June 2018
BTHS (DB + DC)	• Set up in 2019 for non-management employees impacted by closure of the BTPS

Service cost (including administration expenses and PPF[1] levy)



Source: BT Group plc Annual Report 2020, pg. 162
[1] Pension Protection Fund

The BTPS represents over 97% of the Group's DB pension liabilities



Source: BT Group plc Annual Report 2020, pg. 162

Background to the BT Pension Scheme

The BTPS is administered and managed by an independent Trustee

Trustee

Chairman of the Trustees

Member nominated Trustees

Employer nominated Trustees

- Trustee duties include:
  - acting in the best interests of beneficiaries
  - administering the Scheme in line with Scheme rules
  - acting prudently, responsibly and honestly
- Nine Trustee directors, appointed by BT
- Usually appointed for a three-year term and eligible for re-appointment

Trustee supported by

BT Pension Scheme Management

- Executive arm of the Trustee and principal investment adviser

Scheme Actuary

- Carries out number of statutory roles, including performing triennial valuation

Independent advisers

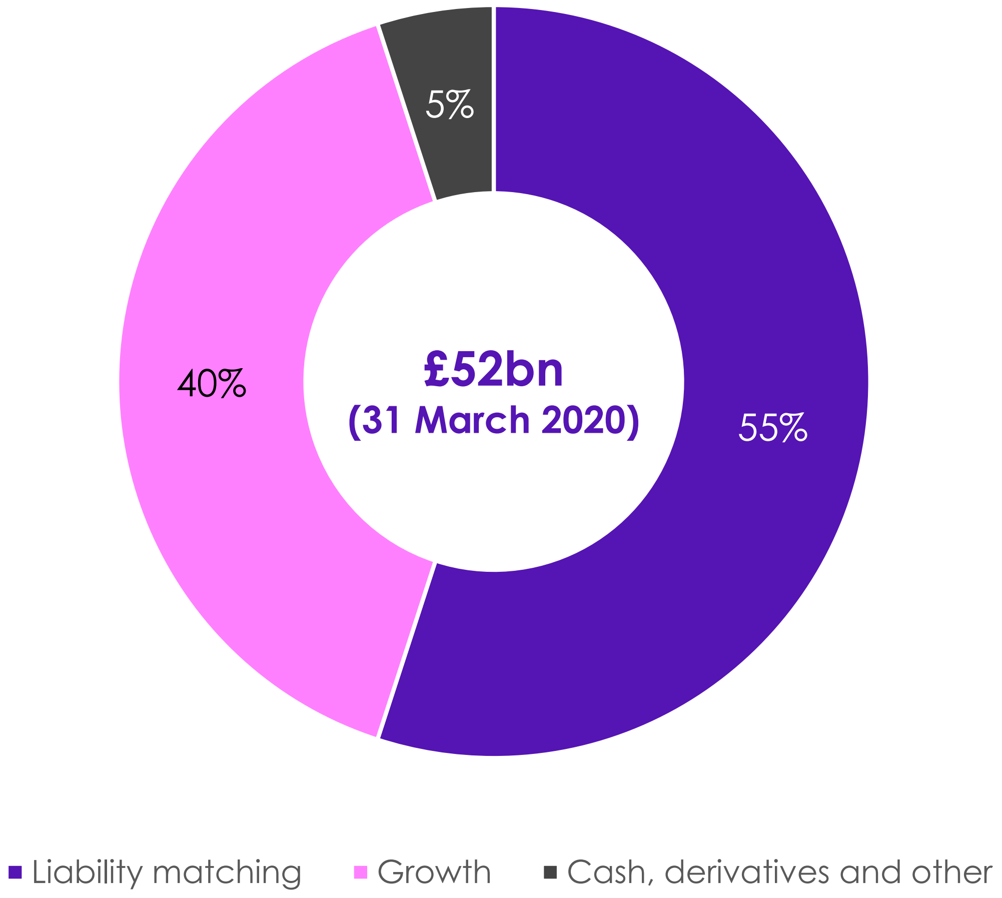
- Across a range of specialisms, including legal, covenant and investment

The Pensions Regulator (TPR)

- Ensures scheme sponsors and pension schemes fulfil their duties to scheme members

Source: BT Group plc Annual Report 2020, pg. 165

BTPS has a well-diversified investment strategy

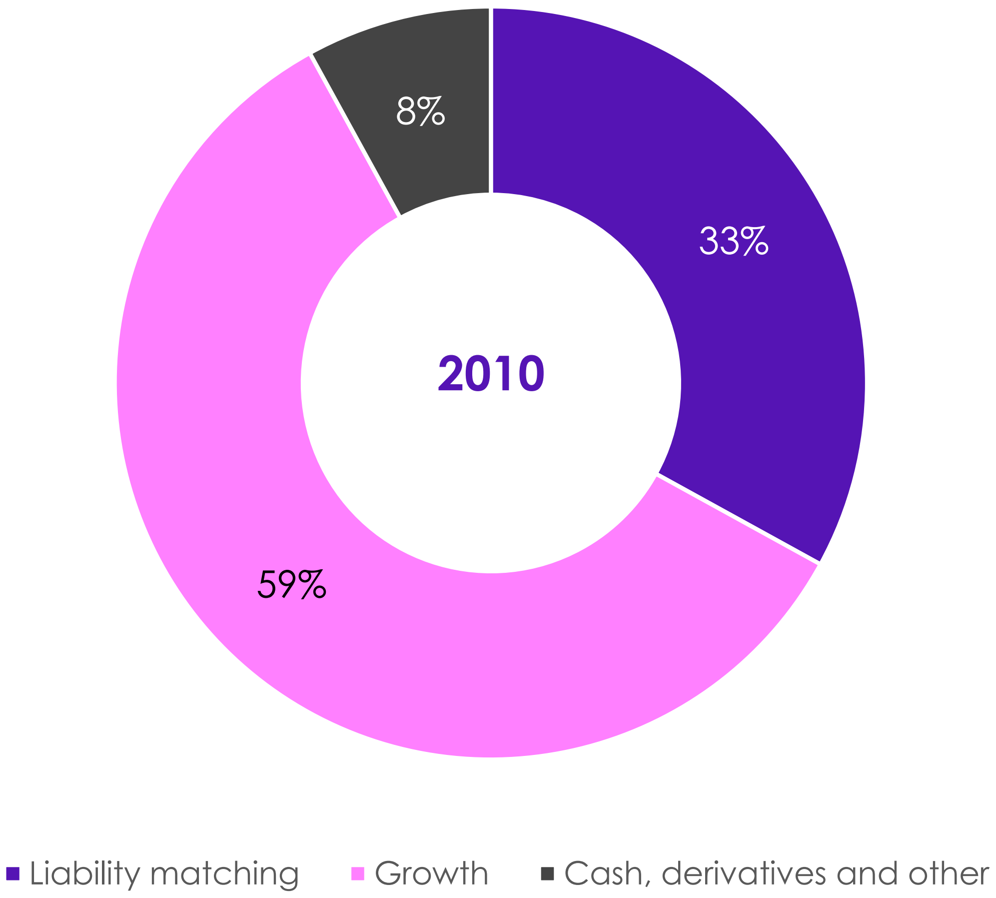


Category	Value at 31 Mar 2020 (£bn)
UK government bonds	13.9
Global investment grade credit	14.4
UK listed equity	0.3
Overseas developed listed equity	6.7
Emerging markets listed equity	1.0
Private equity	1.3
UK property	3.5
Overseas property	1.1
Absolute return	1.2
Non core credit	4.2
Mature infrastructure	1.5
Cash balances	2.3
Longevity insurance contract	(0.8)
Other[1]	1.6

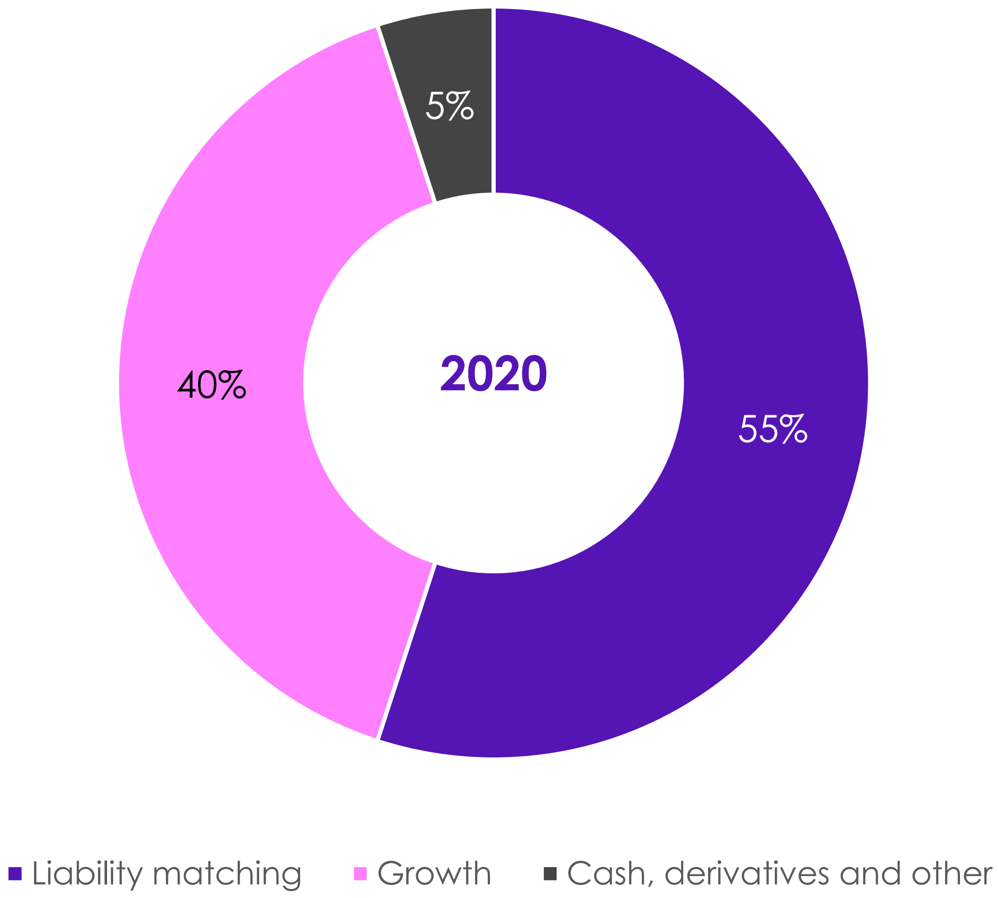
[1] Includes collateral posted in relation to derivatives held by the BTPS, e.g. equity, interest rate, inflation and FX derivatives

Source: BT Group plc Annual Report 2020, pg. 166

BTPS assets today are better matched to movements in the liabilities



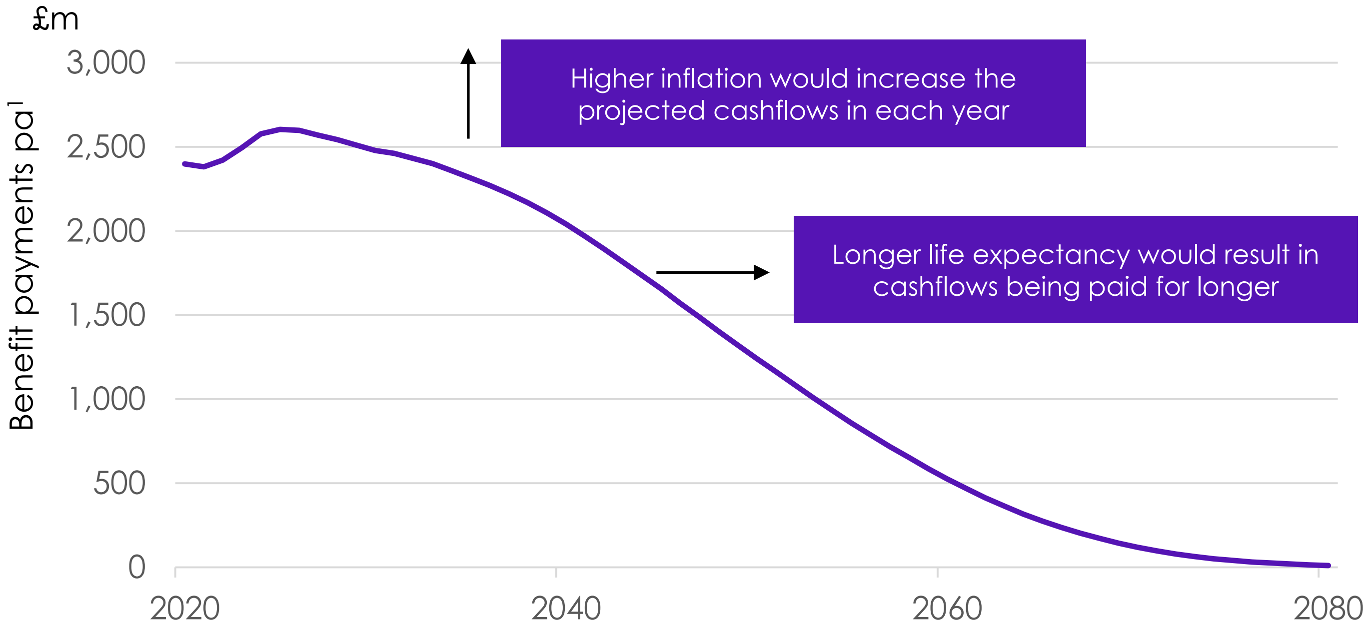
Source: BT Group plc Annual Report 2010, pg. 130



Source: BT Group plc Annual Report 2020, pg. 166

Benefits from the BTPS are expected to be paid over more than 60 years

- Projecting future expected benefit payments requires a number of assumptions:
  - inflation, life expectancy, member behaviour (e.g. options at retirement; retirement patterns; existence of a spouse or dependant on death)



- Liabilities are the present value of the future estimated benefit payments

[1] Forecast benefits payable from the BTPS at 31 March 2020, based on IAS 19 assumptions
Source: BT Group plc Annual Report 2020, pg. 164

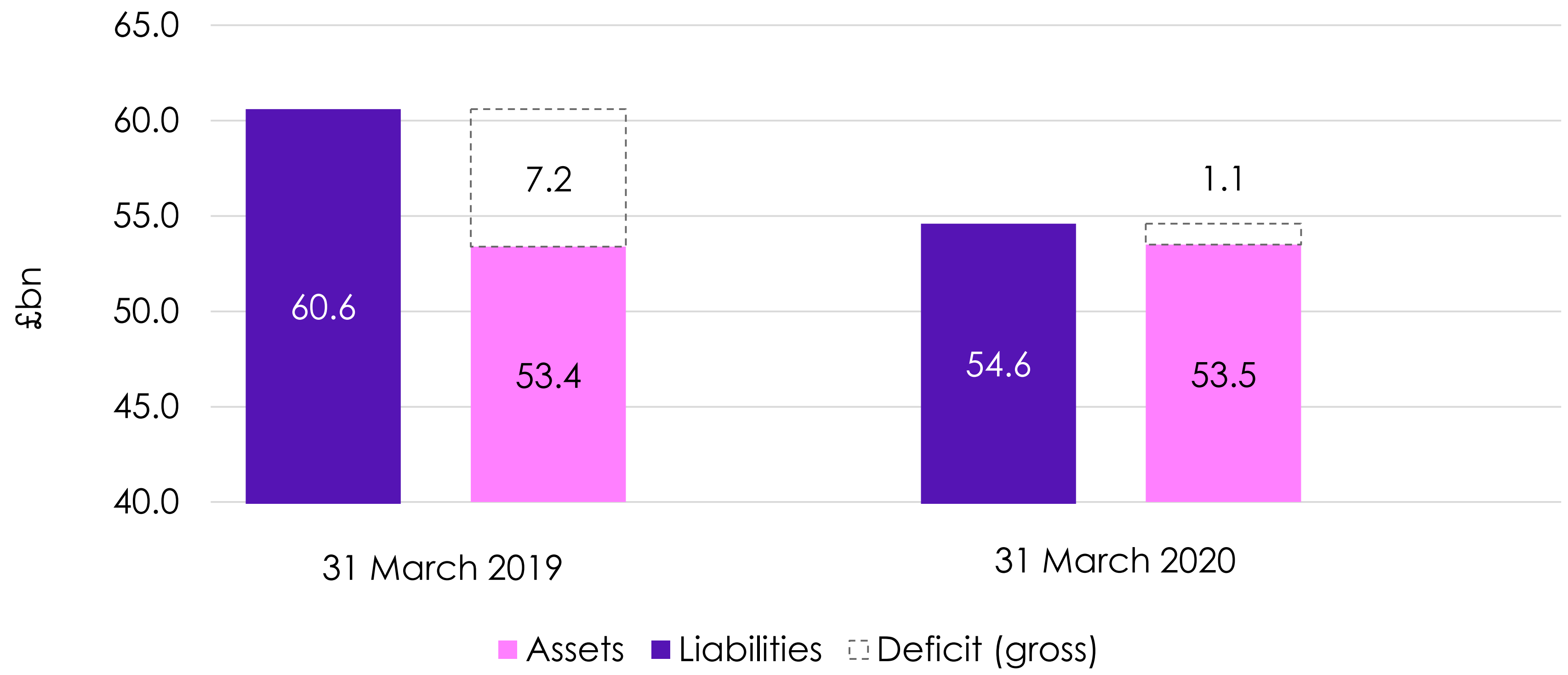
Different approaches are used for IAS 19 and the funding valuation

	IAS 19	Funding
Purpose	**Balance sheet in BT plc accounts**	**Setting cash payments**
Regulation	IFRS standards	2004 Pensions Act
Frequency	Semi-annually	At least every three years
Key assumptions		
Determined by	BT	BT and Trustee agreement
Discount rate	Yield curve based on AA corporate bonds	Yield curve reflecting prudent[1] return expected from BTPS assets
Inflation	Best estimate	Prudent overall approach[1]
Mortality	Best estimate	Prudent overall approach[1]
Asset value	BT's estimate of market value	Market value

[1] Prudence is not defined in legislation and is reviewed as part of each funding valuation. An increase in prudence would lead to higher liabilities and deficit

IAS 19 position at 31 March 2020 (all plans)

Group IAS 19 deficit fell to £1.1bn at 31 March 2020



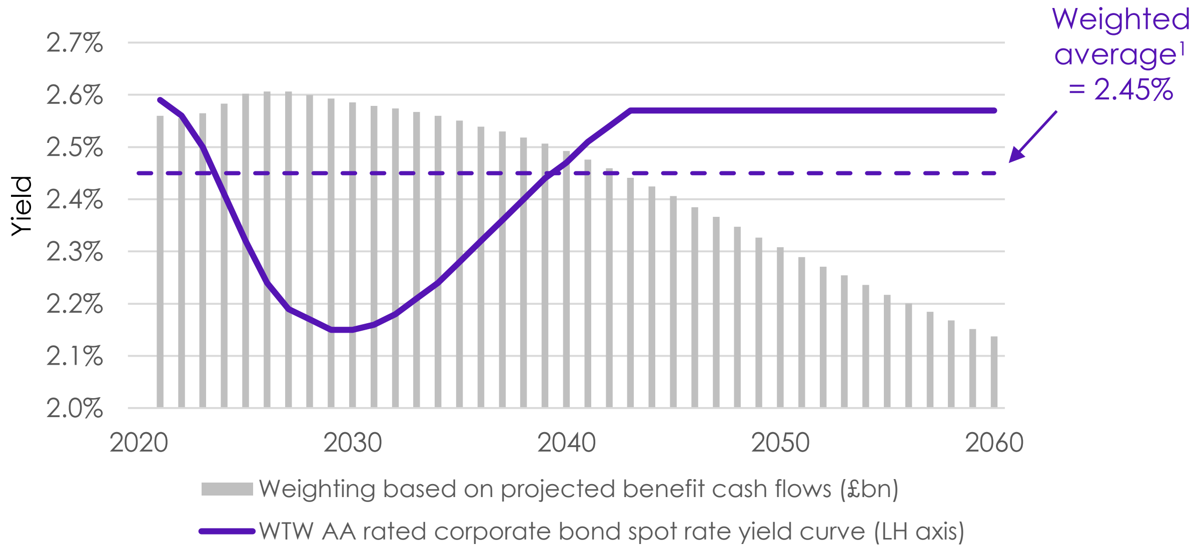
Note: We estimate our IAS 19 deficit materially worsened in April 2020 principally reflecting a reversion in credit spreads

Source: BT Group plc Annual Report 2020, pg. 162

31 March 2020 IAS 19: Discount rate and RPI inflation

Discount rate

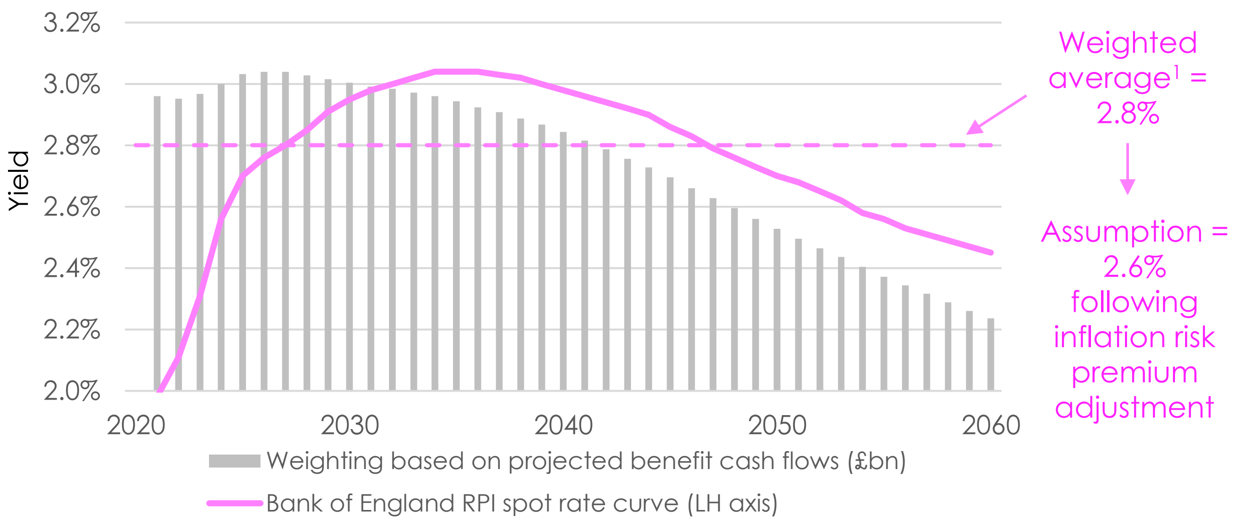
- Uses **AA corporate bond yield curve** and projected benefit cash flows



Source: Standard corporate bond yield curve derived by Willis Towers Watson (WTW)

RPI inflation

- Uses **inflation curve derived from gilts** and projected benefit cash flows
- 0.2ppt adjustment for an inflation risk premium



Source: RPI inflation spot rates, Bank of England (BoE) website

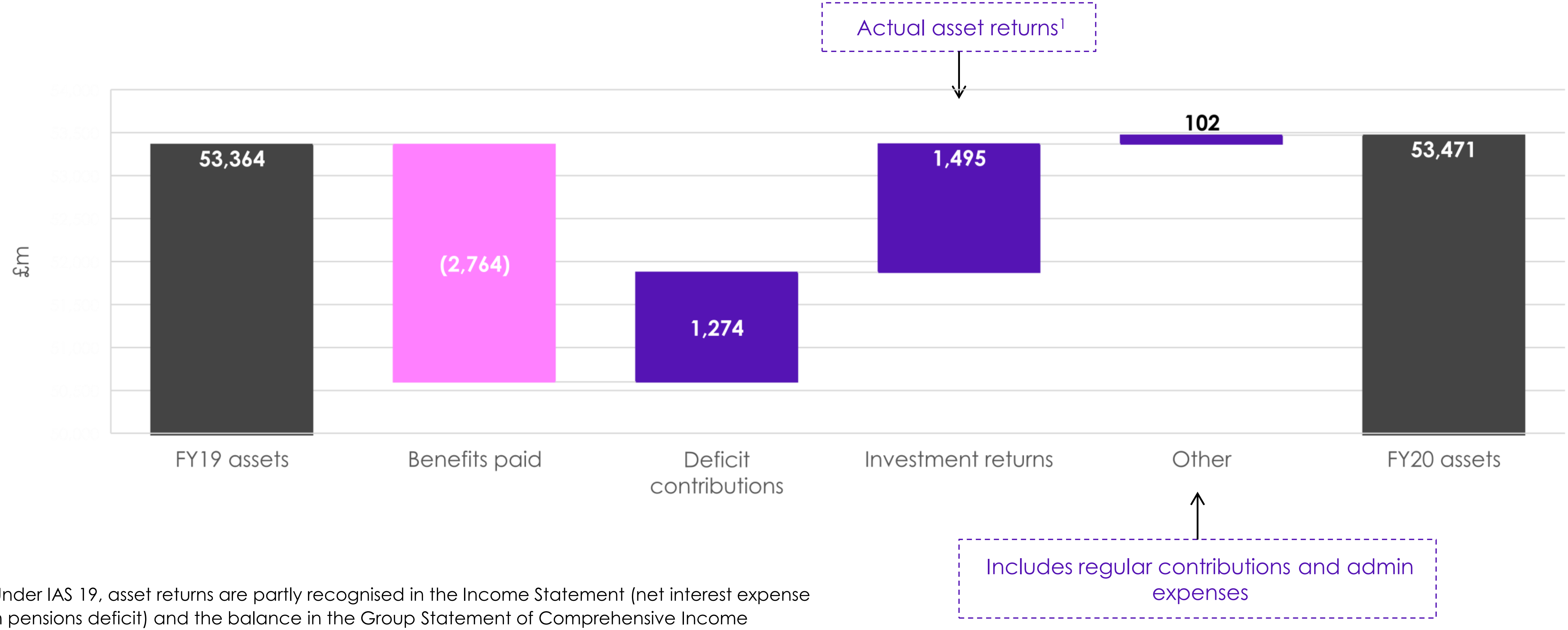
[1] Represents a single-equivalent rate which provides the same present value as applying the full curve to each cashflow

31 March 2020 IAS 19: mortality, CPI inflation and other assumptions

	Approach
Mortality	• Uses: – **current mortality rates**, based on experience of BTPS members – **future improvements** based on a model published by UK actuarial profession's Continuous Mortality Investigation (CMI 2018 Mortality Projections model)
Inflation	• CPI inflation set in relation to RPI inflation assumption • Consultation on the future of RPI creates **uncertainty around future expectations of RPI and CPI**
Other assumptions	• Significant number of other assumptions required to value liabilities based on scheme experience and actuarial input, such as: – member behaviour (e.g. options chosen at retirement; retirement patterns; existence of a spouse or dependant on death)

How the IAS 19 position changed over FY20

The assets were broadly unchanged over FY20



[1] Under IAS 19, asset returns are partly recognised in the Income Statement (net interest expense on pensions deficit) and the balance in the Group Statement of Comprehensive Income

Source: BT Group plc Annual Report 2020, pg. 163

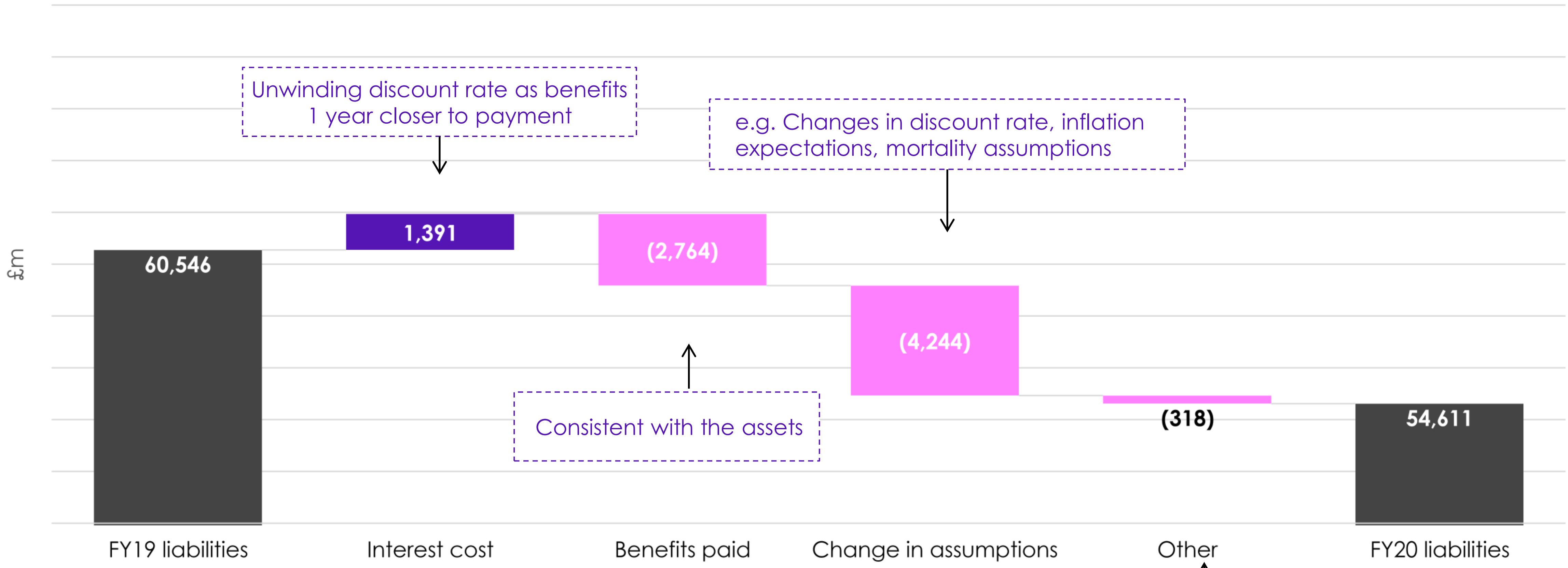
Illustrative roll-forward of assets over FY20

	Change in illustrative market indicator	Sensitivity[1,2]	Example calculation	Implied impact (£bn)
Assets at 31 March 2019				**53.4**
Benefit payments			From FY19	(2.6)
Deficit contributions				1.3
Investment returns				
- bond yields	Bank of England: 0.7% fall	£9.1bn increase for 1.1% fall	= (0.7)% x £9.1bn / (1.1)%	5.8
- inflation	Bank of England: 0.6% fall	£4.2bn increase for 0.7% increase	= (0.6)% x £4.2bn / 0.7%	(3.6)
- equities	MSCI world (GBP): 6% fall	£2.8bn fall for 30% fall in equities	= (6)% x £(2.8)bn / (30)%	(0.6)
- life expectancy	CMI paper: 0.5 years fall	£0.7bn increase for 1.25 years increase	= (0.5) x £0.7bn / 1.25	(0.3)
Est. assets at 31 March 2020				**53.4**
Other (e.g. FX, property returns, credit spreads)				0.1
Assets at 31 March 2020				**53.5**

[1] The sensitivities represent the impact of each event in isolation - in practice a combination of events could arise and the impact may differ, e.g. due to changes in the market value of the assets, the investment strategy, or if the shape of the bond/inflation curves change

[2] Source: BT Group plc Annual Report 2019, pg. 152

The IAS 19 liabilities reduced over FY20



Includes:
- Benefit accrual
- Scheme experience (e.g. actual deaths vs expected; members' options at retirement where different to expected)

Source: BT Group plc Annual Report 2020, pg. 163

Illustrative roll-forward of liabilities over FY20

	Change in illustrative market indicator	Sensitivity[1,2]	Example calculation	Implied impact (£bn)
Liabilities at 31 March 2019				**60.5**
Interest on liabilities			60.5 x 2.35%	1.4
Benefit payments			From FY19	(2.6)
Change in assumptions:				
- bond yields	iBoxx £ AA 15+ index: 0.05% fall	£11.4bn increase for 1.1% decrease	(0.05)% x £11.4bn / (1.1)%	0.5
- inflation	Bank of England: 0.6% fall in RPI inflation	£5.4bn increase for 0.7% increase	(0.6)% x £5.4bn / 0.7%	(4.6)
- life expectancy	CMI paper: 0.5 years fall	£2.9bn increase for 1.25 years increase	(0.5) x £2.9bn / 1.25	(1.2)
Est. liabilities at 31 March 2020				**54.0**
Other changes (e.g. RPI reform, experience)				0.6
Liabilities at 31 March 2020				**54.6**

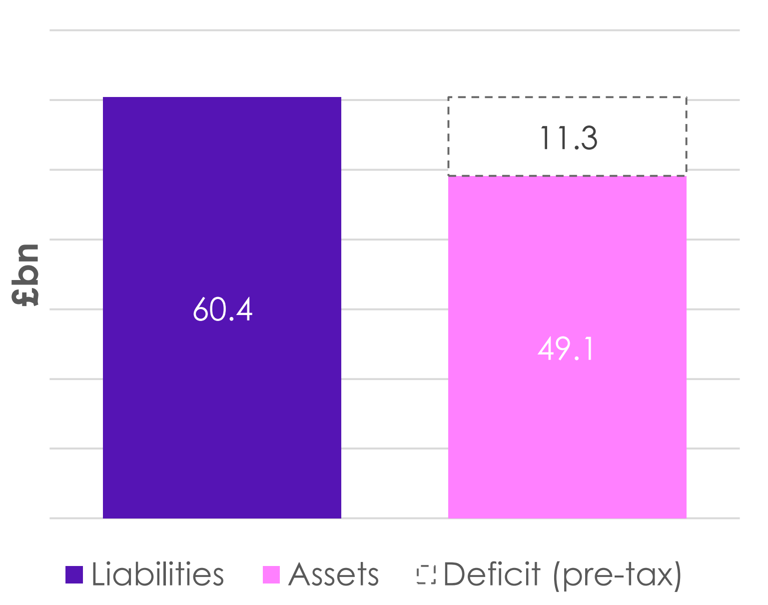
[1] The sensitivities represent the impact of each event in isolation - in practice a combination of events could arise and the impact may differ, e.g. due to changes in the value of the liabilities, or if the shape of the corporate bond/inflation curve changes

[2] Source: BT Group plc Annual Report 2019, pg. 152

BT Pension Scheme: triennial funding valuation

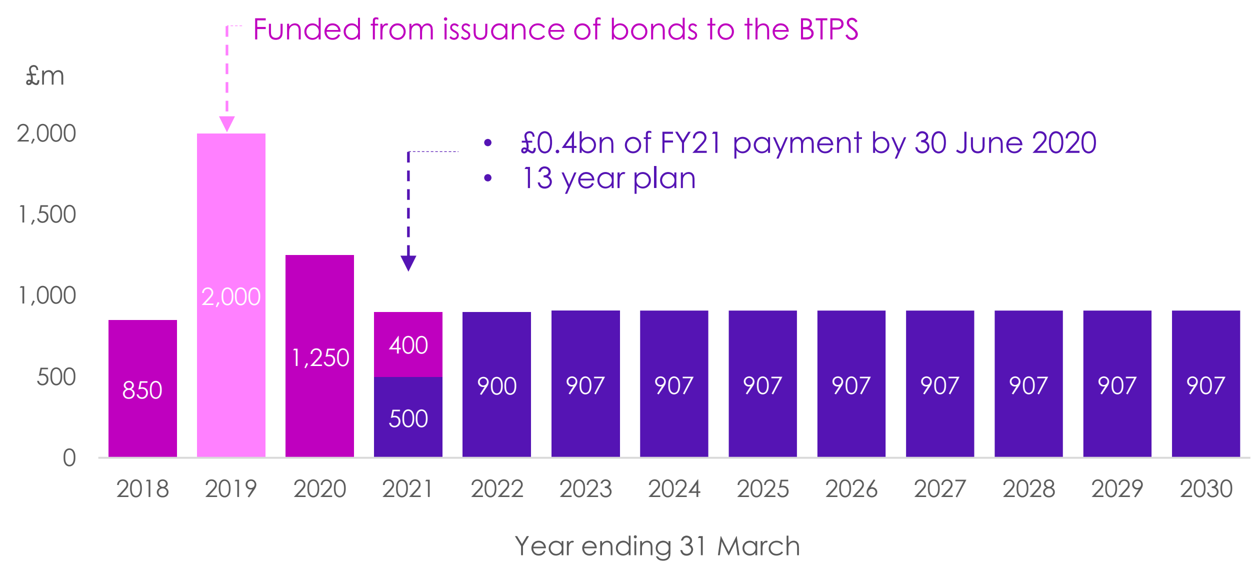
At the 2017 valuation, BT agreed to eliminate the £11.3bn deficit by 2030

Deficit at 30 June 2017



Source: BT Group plc Annual Report 2020, pg. 169

Scheduled contributions to eliminate deficit



Source: BT Group plc Annual Report 2020, pg. 170, BT RNS announcing valuation agreement

A number of protections were agreed as part of the 2017 valuation

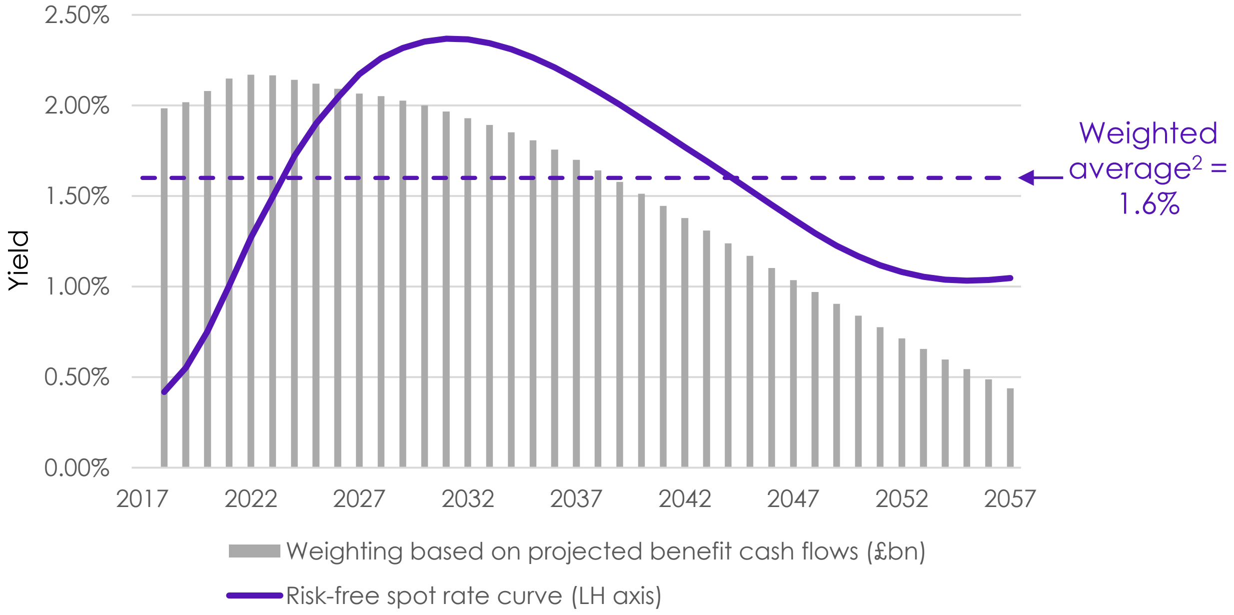
Feature	Detail
Shareholder distributions	Additional contributions where shareholder distributions exceed a threshold which allows for: • 10% pa dividend per share growth; plus • £200m per year of share buybacks on a cumulative basis
Material corporate events	Additional contributions where net cash proceeds >£1.0bn from disposals (net of acquisitions): • additional contributions payable to the BTPS equal to one third of those net cash proceeds
	BT will consult with the Trustee if: • acquisitions / disposals >£1.0bn • it considers making a Class 1 transaction (acquisition or disposal) which will have material impact on BTPS • it is, or is likely to be, subject to a takeover offer
	BT will advise the Trustee if: • other material corporate actions which would materially impact BT's covenant to the BTPS
Negative pledge	Future creditors will not be granted superior security to the BTPS in excess of a £1.5bn threshold

Source: BT Group plc Annual Report 2020, pg. 171

The valuation used an average discount rate of 2.6%

Risk-free curve

- Yield curve based on **gilt and swap rates**[1]
- Equivalent to: 1.6% pa[2] at 30 June 2017



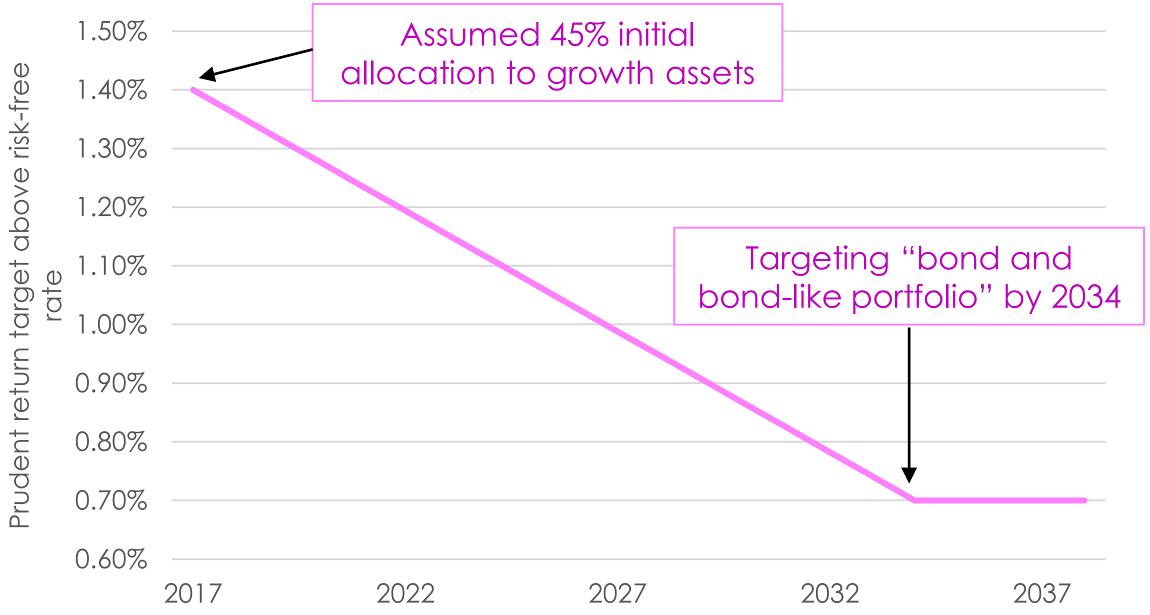
[1] Chart illustrates average of spot rates on nominal UK government bonds (source: Bank of England) and zero coupon swap rates (source: Bloomberg)

[2] Assumption represents a single-equivalent rate which provides the same present value as applying the full curve to each cashflow

Source: BT Group plc Annual Report 2020, pg. 170

Prudent investment return (above risk-free)

- Takes account of: **future asset strategy; expected returns; prudent margin (allowing for covenant)**
- Reviewed at each valuation
- Equivalent to: 1.0% pa[2] at 30 June 2017

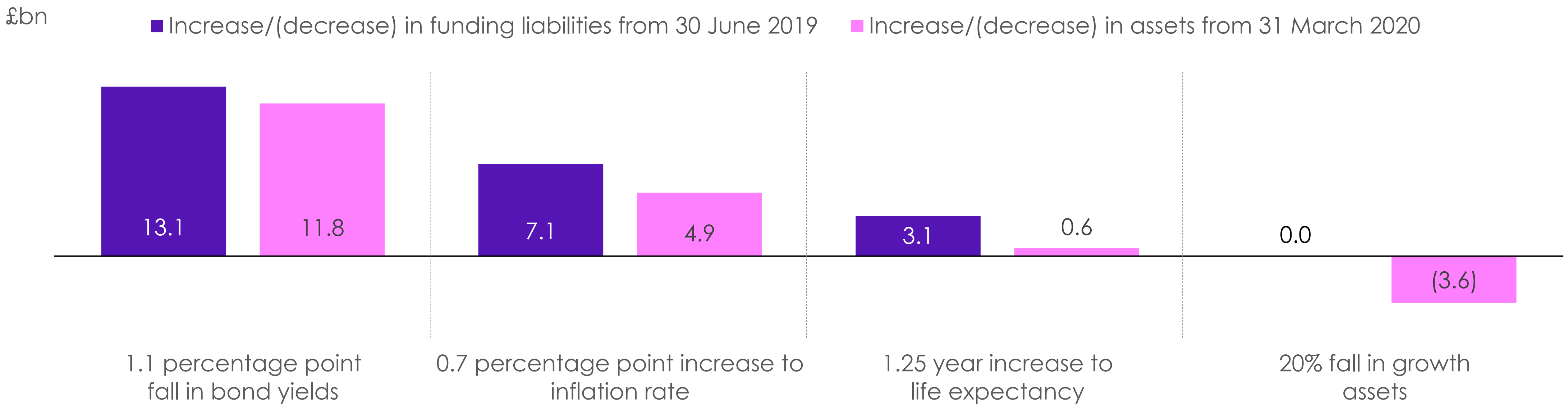


2017 funding valuation: other assumptions

	Approach
Mortality	• Uses: – **current mortality rates**, based on experience of BTPS members – **future improvements** based on a model published by UK actuarial profession's Continuous Mortality Investigation (CMI 2016 Mortality Projections model)
Inflation	• RPI set using inflation curve derived from gilts and swaps, weighted by projected BTPS benefit cash flow • CPI inflation set in relation to RPI inflation assumption • Consultation on the future of RPI creates **uncertainty around future expectations of RPI and CPI**
Other assumptions	• Significant number of other assumptions required to value liabilities based on scheme experience and actuarial input, such as: – member behaviour (e.g. options chosen at retirement; retirement patterns; existence of a spouse or dependant on death)

The BTPS's investments provide a hedge to movements in the funding liabilities

- Changes in external factors, such as interest rates, can impact the assumptions and the measurement of BTPS liabilities
- These factors can also impact the scheme assets and derivatives

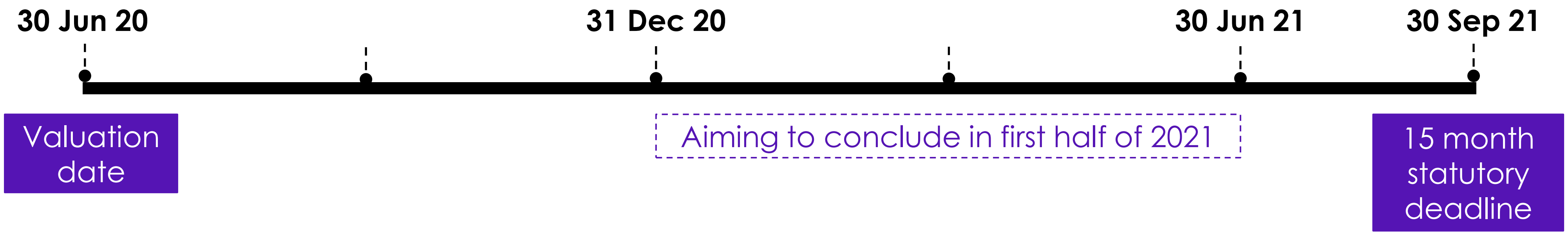


Illustrative scenario which might occur no more than once in every 20 years[1]

[1]The impact shown will vary as the size of the assets/liabilities changes. The impact shown under each scenario looks at each event in isolation – in practice a combination of events could arise.

Source: BT Group plc Annual Report 2020, pg. 169 (assets, 31 March 2020), 170 (funding liabilities, 30 June 2019)

Looking ahead to the 2020 valuation



The funding valuation has a number of steps that take time to complete:

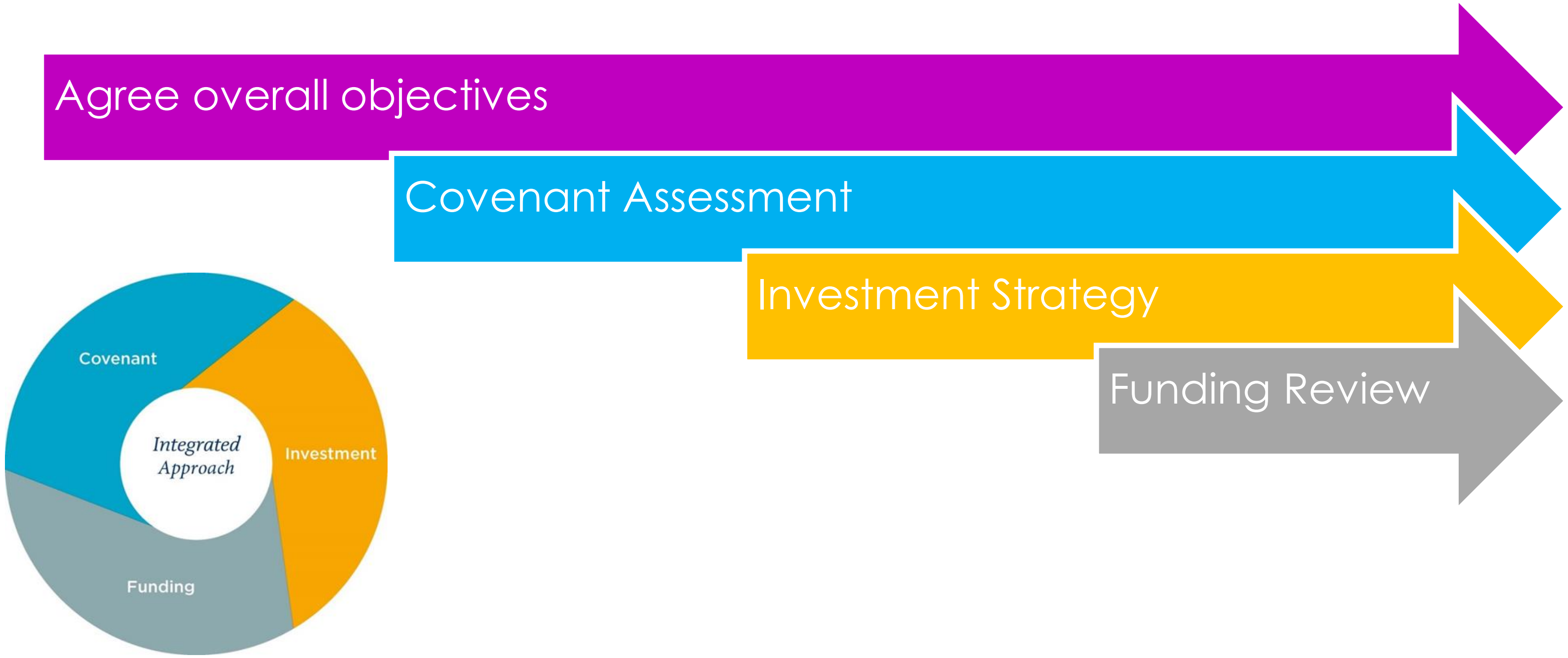
- collate and check membership data at 30 June 2020
- review company covenant
- determine any changes to assumptions / prudence level / approach
- member-by-member actuarial calculations using updated assumptions
- agree contribution schedule and any other legal protections
- valuation documents submitted to Pensions Regulator

Pensions landscape

Funding valuation: a budgeting exercise carried out every three years

How much does the company need to pay in future:

- to recover a prudent estimate of the deficit
- to provide for ongoing benefits (if applicable)
- after taking appropriate account of future investment returns?



Key facets of a covenant assessment

Covenant assessors take account of a range of factors to inform their conclusions

Factor	Positive indicator	Adverse indicator
Legal structure	Parent company support / Employers are key group entities	Small insignificant employer within a wider group
Historic trading & cash flow trends	Stable / Growing	Volatile / Declining
Trading & cash flow forecasts	Growth / Supportable assumptions	Decline / Unreasonable assumptions
Sector prospects	Growing sector	Declining sector
Scheme creditor position	Scheme ranks ahead of or at least equal to other creditors	Scheme ranks behind prior ranking creditors
Balance sheet assets	High proportion having value independent of the Employer (eg property)	High proportion tied to the continued success of the employer (eg goodwill)
Relative size of Employer to Scheme	Profits, cash flows and net assets **high** vs Scheme deficits and investment volatility	Profits, cash flows and net assets **low** vs Scheme deficits and investment volatility
Covenant leakage	No / low dividends and other leakage vs contributions to the Scheme	High dividends and other leakage vs contributions to the Scheme
Recovery plan length	Short	Long

Current considerations in funding valuations

What pension scheme trustees are thinking about in current unpredictable market conditions

External environment

- **A Regulator that wants to be "Clearer, Quicker, Tougher"**
- Consultation on a new statutory funding regime – originally planned for 2021
- But…Government focused on economic recovery and helping UK plc

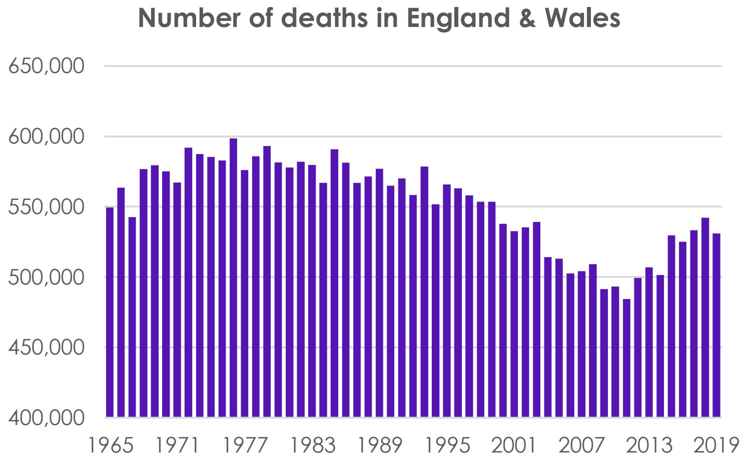
Contributions

- Emphasis on pension schemes being treated equitably
- Particularly in the context of dividends paid to shareholders
- TPR[1] sanctioning contribution holidays, where appropriate

[1] TPR – The Pensions Regulator

Current considerations in funding valuations

What pension scheme trustees are thinking about in current unpredictable market conditions



Assumptions

- Continuing low gilt yields – possibility of negative inflation
- RPI reform changing future increases and asset values
- Slowing life expectancy improvements (even before Covid-19)

Long-term

- Schemes very focused on endgame planning
- Increased use of insurance to remove pensions risk
- Further solutions and products emerging

Key messages and Q&A

Key messages

We use two methods to calculate our pension deficit:

- IAS 19, to determine our balance sheet position, is measured on a "best-estimate" basis, but does not allow for the scheme's investment strategy
- Funding, to determine our cash payments, reflects the scheme's investment strategy, but is measured prudently

Our recent dividend decision and investment plans, including our FTTP programme, are positive for our covenant

The 2017 BTPS funding agreement provides a strong foundation on which to build our 2020 agreement, such as over what period we seek to pay off deficits

Covid-19 may reduce the pace and scale of any changes to the pension regulatory regime

Q&A