Pensions Briefing

29 June 2023
Forward looking statements caution

Certain information included in this announcement is forward looking and involves risks, assumptions and uncertainties that could cause actual results to differ materially from those expressed or implied by forward looking statements. Forward looking statements cover all matters which are not historical facts and include, without limitation, projections relating to results of operations and financial conditions and the Company’s plans and objectives for future operations. Forward looking statements can be identified by the use of forward looking terminology, including terms such as ‘believes’, ‘estimates’, ‘anticipates’, ‘expects’, ‘forecasts’, ‘intends’, ‘plans’, ‘projects’, ‘goal’, ‘target’, ‘aim’, ‘may’, ‘will’, ‘would’, ‘could’ or ‘should’ or, in each case, their negative or other variations or comparable terminology. Forward looking statements in this announcement are not guarantees of future performance. All forward looking statements in this announcement are based upon information known to the Company on the date of this announcement.

Accordingly, no assurance can be given that any particular expectation will be met and readers are cautioned not to place undue reliance on forward looking statements, which speak only at their respective dates. Additionally, forward looking statements regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Other than in accordance with its legal or regulatory obligations (including under the UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority), the Company undertakes no obligation to publicly update or revise any forward looking statement, whether as a result of new information, future events or otherwise. Nothing in this announcement shall exclude any liability under applicable laws that cannot be excluded in accordance with such laws.
Today’s speakers

Neil Harris
Director, Corporate Finance

Shan Abdullah
Pensions Senior Manager

Paul Rogers
Pensions and Insurance Director
## Agenda

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Key messages

We use two methods to calculate our pension deficit:
- IAS 19: formulaic “best-estimate” measure; determines our balance sheet and used for rating agency metrics
- Funding: negotiated “prudent” measure; determines our cash payments

The BTPS is continuing to de-risk its asset strategy and is performing in line with the 2017 plan:
- BTPS accepts growth asset risk to benefit from higher expected returns
- BTPS actively considers alternative strategies with run-on currently viewed as most appropriate

The BTPS has scale and experience
- Scheme navigated the 2022 market conditions effectively
- No concerns raised from recent TPR review

The 2020 BTPS funding agreement provides a strong platform for 2023 valuation
- the ABF switch-off and co-investment vehicle provide protection against future surpluses
- the downside stabiliser proactively deals with any increase in the deficit
Overview of BT’s pension plans
BTPS forms the majority of BT’s obligation

<table>
<thead>
<tr>
<th>Defined Benefit (“DB”)</th>
<th>Defined Contribution (“DC”)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BT Pension Scheme (BTPS)</td>
<td>BT Retirement Saving Scheme (BTRSS)</td>
</tr>
</tbody>
</table>
| ▪ DB section closed to future benefit accrual in 2018  
  - 270,000 deferred members and pensioners | ▪ DC  
  ▪ Contract-based arrangement operated by Standard Life  
  ▪ 65,000 employees |
| EE Pension Scheme (EEPS)  
  - DB section | Other global retirement arrangements |
| ▪ DB section closed to future benefit accrual in 2014 | ▪ DB and DC plans, in line with local markets and culture |

Source: BT Group plc Annual Report 2023
The BTPS is administered and managed by an independent Trustee

**Trustee**

- 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

**Key Trustee powers**

- Set the investment strategy
  - BT consultation required
- Set assumptions for evaluating the funding deficit and set the level / timing of deficit contributions
  - BT agreement required

**Trustee supported by**

- **Brightwell (BTPSM)**
  - Principal service provider (funding & fiduciary management, administration & other operational services)
- **Scheme Actuary**
  - Carries out number of statutory roles, including performing triennial valuation
- **Independent advisers**
  - Across a range of specialisms, including legal, covenant and investment

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The Pensions Regulator (TPR) | Ensures scheme sponsors and pension schemes fulfil their duties to scheme members, e.g. intervenes if BT/Trustee can’t agree funding deficit
Benefits from the BTPS are expected to be paid over more than 60 years

Projecting future expected benefit payments involves significant judgement about uncertain events. e.g.:
- inflation
- life expectancy

Cashflows peak in 2026
Higher inflation would increase the projected cashflows in each year
 Longer life expectancy would result in cashflows being paid for longer
Two key methods to value our obligations

<table>
<thead>
<tr>
<th>IAS 19</th>
<th>Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose</td>
<td>Balance sheet in BT Group accounts</td>
</tr>
<tr>
<td>Regulation</td>
<td>IFRS standards</td>
</tr>
<tr>
<td>Frequency</td>
<td>Semi-annually</td>
</tr>
</tbody>
</table>

**Key assumptions**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Discount rate</td>
<td>Yield curve based on AA corporate bonds</td>
<td>Yield curve reflecting prudent return expected from BTPS assets</td>
</tr>
<tr>
<td>Inflation</td>
<td>Best estimate</td>
<td>Prudent overall approach (^1)</td>
</tr>
<tr>
<td>Mortality</td>
<td>Best estimate</td>
<td>Prudent overall approach (^1)</td>
</tr>
<tr>
<td>Asset value</td>
<td>Fair value</td>
<td>Fair value</td>
</tr>
<tr>
<td>BT Bonds</td>
<td>Included</td>
<td>Included</td>
</tr>
<tr>
<td>ABF (^2)</td>
<td>Excluded</td>
<td>Included</td>
</tr>
</tbody>
</table>

\(^1\) 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

\(^2\) Asset backed funding vehicle
BTPS has a diversified investment strategy with 33% invested in growth assets

<table>
<thead>
<tr>
<th>31 Mar 2023 (£bn)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth (33%)</strong></td>
<td></td>
</tr>
<tr>
<td>UK Listed equity</td>
<td>0.1</td>
</tr>
<tr>
<td>Overseas developed equity</td>
<td>1.7</td>
</tr>
<tr>
<td>Private equity</td>
<td>1.1</td>
</tr>
<tr>
<td>Property</td>
<td>3.4</td>
</tr>
<tr>
<td>Absolute return</td>
<td>0.9</td>
</tr>
<tr>
<td>Non core credit</td>
<td>4.2</td>
</tr>
<tr>
<td>Mature infrastructure</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>38.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Liability matching, cash and other (67%)</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK government bonds</td>
<td>13.2</td>
</tr>
<tr>
<td>Global investment grade credit</td>
<td>10.4</td>
</tr>
<tr>
<td>Secure income assets</td>
<td>3.7</td>
</tr>
<tr>
<td>Cash balances</td>
<td>3.0</td>
</tr>
<tr>
<td>Insurance/derivative contracts</td>
<td>(5.0)</td>
</tr>
<tr>
<td>Other</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>38.7</td>
</tr>
</tbody>
</table>

**Private equity:**
- Investments through Hermes GPE funds in companies that are not publicly traded

**Property:**
- Investments in office buildings, industrial parks, apartments, or retail complexes.
- Example: King’s Cross estate

**Absolute return:**
- Investments in hedge funds providing diversification and performing well during periods of market stress

**Non core credit:**
- Investments in bonds and emerging market debt
- Delivering equity like returns with less risk over the last decade, as designed

**Mature infrastructure:**
- Investments in “real assets”, which contain physical assets such as bridges, roads, highways, energy
- Example: Fallago Rig wind farm

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1 Source: BT Group plc Annual Report 2023, pg. 194
c85% of assets valued as at 31 March and all assets valued each 30 June

100%
of assets valued at each 30 June annual update (for BTPS accounts)

85%
of assets valued as at 31 March (for BT Group accounts)
  - All other assets valued within 3 months of 31 March

40%
of assets are unquoted investments, e.g. property
  - Valuation inputs not directly observable and require judgement

Assurance over the valuations

- Valued in line with the latest market guidelines (e.g. RICS)
- Funds operate controls and audit processes. Directly held illiquid assets externally valued
- Brightwell’s controls, to ensure appropriate valuations, audited by BDO
- For both BTPS and BT Group accounts

Asset valuations
Fiduciary manager review
Audited by KPMG
By 2034, the BTPS will be primarily invested in bond-like assets

The asset strategy assumes the BTPS is “run-on”, i.e. all future member benefits are paid from the Scheme, using existing assets, future investment returns and BT contributions.
Interest rates and inflation are well hedged on a funding basis

Scenarios expected to occur with 1-in-20 likelihood, based on the 30 June 2022 funding position

- 1.2 percentage point fall in bond yields
- 0.9 percentage point increase in credit spreads
- 1.1 percentage point increase in inflation rate
- 20% fall in growth assets
- 1.30 year increase in life expectancy

Sensitivities illustrate the mechanical impact of a change in long-term average expectations at the calculation date.

Note: The impact shown under each scenario looks at each event in isolation— in practice a combination of events could arise and the sensitivities shown are not additive or linear, e.g. the impact will be lower if the assets/liabilities are smaller.

Source: BT Group plc Annual Report 2023, pg. 198
BT’s pension plans - recap

- The BT Pension Scheme forms around 97% of our liabilities
- The BTPS has a diversified investment strategy which de-risks over the period to 2034, and allows investment returns to continue playing a role in eliminating the deficit
- We use two measures to evaluate the pensions deficit – IAS 19 and funding
The last year
Significant movements in long-term interest rates were well managed by the BTPS.

BTPS annual report, 6 October 2022: “Our hedges have continued to perform as expected, and up to the date of signing there has been no worsening in our estimated funding position.”

Source: Bank of England, 31 May 2023
The IAS 19 deficit increased to £3.1bn, as interest rates increased.

Source: BT Group plc Annual Report 2023, pg. 191
Our published sensitivities can help provide an indication of the deficit

- £3.1bn IAS 19 deficit reported at 31 Mar 23
- Sensitivities overstate deficit by £0.5bn (i.e. <1% of March 22 assets)

1 Institute and Faculty of Actuaries – Continuous Mortality Investigation

**Expected Items**

1. IAS 19 Deficit at 31 March 22
2. Interest on Liabilities
3. Deficit Contributions
4. Bond Yields
5. Credit Spreads
6. Inflation Expectations
7. Bond Returns
8. Growth Assets
9. Life Expectancy
10. IAS 19 Deficit at 31 Mar 23

**Changes in markets and experience**

- Bank of England: 2.0% increase
  Sensitivity: £1.2bn for a 0.8% reduction
- Market indices: 0% increase
  Sensitivity: £3.9bn for a 0.7% increase
- Bank of England: 0.5% fall
  Sensitivity: £0.3bn for a 0.6% increase
- Bank of England: 1.2% (1 year fwd rate)
  Sensitivity: £31.6bn matching assets
- MSCI World (GBP) 1% fall
  Sensitivity: (£3.4bn) for a 20% fall
- CMI*: 0.5 years fall
  Sensitivity: £2.1bn for a 1 year increase

**Other Items**

- Expected Items
  Changes in markets and experience

\[=£56.1bn \times 2.75\%\]

1. £3.1bn IAS 19 deficit reported at 31 Mar 23
2. Sensitivities overstate deficit by £0.5bn (i.e. <1% of March 22 assets)

\[1.1\]

\[1.5\]

\[2.0\]

\[3.0\]

\[3.6\]

\[1.2\]

\[0.3\]

\[0.4\]

\[0.2\]

\[1.1\]
The last year - recap

- Significant interest rate movements led to higher IAS 19 deficit
- Difficult market conditions were well managed by the BTPS
Looking ahead to the 2023 valuation
Contributions have significantly reduced the funding deficit since 2017

<table>
<thead>
<tr>
<th></th>
<th>£bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deficit at 30 June 17</td>
<td>11.3</td>
</tr>
<tr>
<td>Deficit Contributions</td>
<td>(4.5)</td>
</tr>
<tr>
<td>Other</td>
<td>1.2</td>
</tr>
<tr>
<td>Deficit at 30 June 20</td>
<td>8.0</td>
</tr>
<tr>
<td>Deficit contributions</td>
<td>(3.5)</td>
</tr>
<tr>
<td>Other</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Deficit at 30 June 22</td>
<td>4.4</td>
</tr>
</tbody>
</table>
Funding valuation: a budgeting exercise carried out every three years

Steps include:

- collate and check membership data
- 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

Valuation date:
- 30 Jun 23
- 31 Dec 23
- 30 Jun 24
- 30 Sep 24

Window in which last 3 valuations were concluded:
- 30 Jun 23
- 31 Dec 23
- 30 Jun 24
- 30 Sep 24

15-month statutory deadline:
- 31 Dec 23
The 2020 valuation agreement introduced an ABF and stabiliser mechanism.

Deficit at 30 June 2020

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Assets</th>
<th>Deficit (pre-tax)</th>
</tr>
</thead>
<tbody>
<tr>
<td>65.3</td>
<td>57.3</td>
<td>8.0</td>
</tr>
</tbody>
</table>

Financial Year

- Payments to BTPS
- Payments to BTPS or co-investment vehicle
- ABF payments (if BTPS in deficit)

Supported by stabiliser mechanism

Source: BT Group plc Annual Report 2023, pg. 197

Source: BT
The previous valuation agreement forms a platform for the 2023 discussions

**Asset-backed funding**
- Payments of £180m pa secured on EE Limited
- Payments stop if BTPS fully funded at any 30 June

**Co-investment vehicle**
- Up to £4.2bn contribution
- Allows return of money to BT, if not needed by BTPS after 2034
- Invested as if part of overall BTPS portfolio
- Expect to use from FY24

**Future funding commitments**
- Additional payments of up to £200m pa if funding deficit >£1bn behind plan
- Payments stop once funding deficit is back on plan

**Other protections**
- Pensions legislation ensures corporate activity does not disadvantage DB pension schemes
- BTPS protection cover
  - Shareholder distributions
  - Corporate events
  - Negative pledge
2023 valuation recap

- 2020 valuation outcome is a solid platform for the 2023 valuation

- Aim to conclude on a similar timescale to recent valuations
Key messages
Key messages

We use two methods to calculate our pension deficit:
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Q&A