BT PENSIONS TEACH-IN

22 June 2026

Presentation transcript

00:00:03:18 - 00:00:28:17
Mark Smith
Good afternoon and welcome everyone to this teach-in by the BT pensions team. Thanks very much for coming. We'll try and keep the event to about an hour. Please note that we won't be providing new information about the forthcoming train your funding valuation. Following the presentation, there will be a question and answer session. If you're online, please type into the team's Q&A tab.

00:00:28:19 - 00:00:52:06
Mark Smith
I'd like to make everyone aware that this event is being recorded for replay purposes. Before we start, I'd like to draw your attention to the forward-looking statements. Caution in the presentation, for example, of the factors that could cause actual results to differ from any forward-looking statements that we may make. We'll post the presentation slides on our website.

00:00:52:08 - 00:00:59:24
Mark Smith
And with that, I'll now hand over to Neil.

00:01:00:01 - 00:01:35:03
Neil Harris
Thank you very much and welcome to our pensions teach-in session today. I'm Neil Harris and I look after corporate finance for BT. We're hosting this in advance of the triennial valuation date of the BT pension scheme. And this is an update to a similar event we held three years ago in June 2023. The valuation outcome will depend on conditions at the end of the month, the future negotiation with the BT pension scheme, and therefore we won't be commenting on the outcome of that.

00:01:35:03 - 00:02:08:11
Neil Harris
Two numbers I'm sure you'll be aware of already; the funding deficit was 3.7 billion as at 30 June 2023, and in the BT PS Annual report for June 2025, the roll forward value was 3.2 billion. There are three people presenting today. I'm joined by my colleagues, Paul Rodgers and Shan Abdullah, who lead our pensions team. Any of the regular attendees amongst you with a good memory will recall that this is the same team that hosted our last two sessions in 2023 and 2020.

00:02:08:17 - 00:02:34:23
Neil Harris
And for those of you that joined those sessions, you'll note there's a lot of familiar content in this presentation representing a continuation of a long term plan. So today we will take you through three key areas of our pension scheme , we'll recap on the key features of the BT pension scheme, its strategy and the risks it is taking, as well as the risks that it's not taking.

00:02:35:00 - 00:03:06:08
Neil Harris
We'll explain how the IAS19 accounting position has evolved over the last year, and will outline the process we're taking for the forthcoming 2026 funding valuation .Shan, Paul and I will talk to some slides and then we'll open up to Q&A at the end. We're seeking to leave you with a few key messages today. First, the differences and similarities between our two key measures of our pension obligations.

00:03:06:09 - 00:03:45:22
Neil Harris
The IAS19 and the funding deficits. Second, how the investment strategy has been de-risked, thereby narrowing the range of outcomes and how this de-risking will continue through 2034. And third, how the 2020 and the 2023 valuations have provided the foundations for this 2026 valuation. Specifically, how the BTPS has confidence it will be well funded if the deficit widens, and also our route to a refund of contributions if they are not needed in the future.

00:03:45:24 - 00:03:53:23
Neil Harris
And on that, I'll hand over to Shan.

00:03:54:00 - 00:04:18:17
Shan Abdullah
Thank you. Neil. I'm Shan Abdullah. I've been with BT since 2013 and lead on pensions risk and strategy. I'm an actuary by background and prior to joining BT, I was a pensions consultant advising large pension schemes on investments, funding and strategy. Today I'll be providing an overview of our pension obligations and the journey that we're on.

00:04:18:19 - 00:04:46:08
Shan Abdullah
As a brief reminder, BT sponsors both defined benefit or DB and Defined Contribution or DC plans. Can we move on to the next slide, please? Thank you. Benefits for DB plans are determined by the plan rules, typically dependent on factors such as years of service and pensionable pay, but not on the value of actual contributions made by BT and by members.

00:04:46:10 - 00:05:18:07
Shan Abdullah
As a result, we're exposed to both upside and downside risks, such as the investments outperforming or underperforming our expectations. We may therefore need to adjust our contributions upwards or downwards to ensure that the plan is fully funded. There are a number of measures we can use to estimate our obligation, which I'll talk about shortly. For DC plans, our obligations are to provide a pre-agreed level of contributions which members can invest towards their retirement.

00:05:18:09 - 00:05:42:15
Shan Abdullah
We have no future exposure to investment, longevity or other risks. Our main plan is the BT pension scheme, which forms 97% of our retirement liabilities and will be the focus of the rest of the presentation. Moving on to the next slide, we look at a brief overview of the governance of the TPS.

00:05:42:17 - 00:06:20:21
Shan Abdullah
Similar to most large pension funds, it's managed by an independent trustee who has a number of duties and powers provided by legislation. There are nine trustee directors who need to act in the best interest of beneficiaries. Legislation provides a trustee with a number of powers and I'll call out two main ones. Firstly, it's setting the investment strategy where the trustee is required to consult with BT, and secondly, setting the actuarial assumptions for assessing funding position and therefore any required contributions which requires BT's agreement.

00:06:20:23 - 00:06:52:14
Shan Abdullah
Day to day functions such as administration managing the investments are carried out by the scheme's primary service provider, Brightwell. And of course, the operation of the pension schemes is overseen by the Pensions Regulator, who ensures employers and pension schemes fulfil their duties to scheme members. Turning to slide ten. We illustrate the current projection of benefits, which will be paid out from the scheme over the next 60 years, shown in purple.

00:06:52:16 - 00:07:21:24
Shan Abdullah
This projection is prepared by an independent actuary and requires a number of assumptions, the key ones being how benefits will increase with inflation and how long pensions will be paid out to members and their dependents. These payments peaked in 2026 and are forecast to reduce over time as membership numbers decline. Our liabilities are the present value of these benefit payments and are shown in pink.

00:07:22:01 - 00:07:51:20
Shan Abdullah
Our liabilities reduce over time, broadly halving over the next 15 to 20 years. The projection shown uses our IAS19 assumptions which are broadly best estimate. Using different assumptions will lead to a different projection of the cash flows, and therefore a different estimate for the liabilities. If inflation is higher than assumed, then the benefits paid out of the scheme in each year will be higher, increasing our liabilities.

00:07:51:22 - 00:08:18:12
Shan Abdullah
But the scheme invests in such a way that the investments held are also expected to increase in value were inflation to be higher than assumed, so that there is limited impact on our contributions, and we'll look at this later. Alternatively, if life expectancy is lower than assumed, the cash flows will be paid out for a shorter period, contracting the chart to the left and reducing our liabilities.

00:08:18:14 - 00:08:52:12
Shan Abdullah
Turning to the next slide. We monitor our liabilities primarily through two lenses funding and IAS19. IAS19 is calculated based on the IFS accounting standard which is formulaic. It determines our balance sheet and is used by rating agencies for their metrics. Under this approach, the discount rate assumes the assets will be invested in a portfolio of AA rated corporate bonds, ignoring the schemes current and future planned investment strategy.

00:08:52:13 - 00:09:31:08
Shan Abdullah
The rest of the assumptions reflect BT's best estimate view. By contrast, the funding approach is used to determine our cash payments at each triennial valuation and is calculated in line with the various Pensions Acts, new funding regulations and a code of practice, which gives guidance on how to comply with these regulations, came into force in 2024. These set clear regulatory expectations, including how much investment risk schemes should take as they mature and the requirement to recover deficits as soon as the employer can reasonably afford.

00:09:31:10 - 00:10:00:12
Shan Abdullah
The funding liabilities reflect the schemes current and future planned investment strategy, and the legislation requires that the assumptions overall are set prudently. The level of prudence is not defined in legislation, and is reviewed by BT and the trustees as part of each triennial evaluation. The surplus or deficit is the difference between the liabilities and the value of the assets.

00:10:00:14 - 00:10:29:11
Shan Abdullah
When measuring both the IAS19 and funding deficits, the assets include the value of bonds issued by BT, which the invests in as these are tradeable in the market. At the 2020 valuation, BT agreed to meet 2 billion of the deficit over a 13 year period through an asset backed funding arrangement, or ABF for short, which provides annual cash flows secured on EE limited.

00:10:29:13 - 00:11:03:22
Shan Abdullah
The fair value of the ABF is currently 1.1 billion and broadly represents the value of remaining payments expected to be needed by the BTPS to achieve full funding. The treatment differs depending on whether we are assessing the funding deficit or the IAS19 deficit. For funding it is included upfront in the value of the assets, and so payments from the ABF to the BTPS each year are not counted as deficit contributions when they're paid to prevent double counting.

00:11:03:24 - 00:11:21:16
Shan Abdullah
Under the accounting rules, we ignore the upfront value of the ABF in our group account, and so payments from the ABF to the BTPS are treated as deficit contributions at the point that they are made, and reduce IAS19 deficit.

00:11:21:18 - 00:11:50:16
Shan Abdullah
On the next slide, we'll look at how the BTPS deficit has evolved since 2017. The chart shows funding deficit in red and grey, which are measurements as at 30 June each year and IAS19 deficits in purple, which are measurements as at 31 March each year. Overall, the deficits on both a funding and accounting basis have reduced over the last 8 to 9 years.

00:11:50:18 - 00:12:25:20
Shan Abdullah
In May 2021, we issued a 2 billion ABF to the BTPS, which reduced the funding deficit but left the IAS19 deficit unaffected. A key point to call out is to caution any reader cross between IAS19 and funding. This reflects the structural differences in methodology which I talked about earlier, but also timing. Different valuation dates lead to different market conditions and therefore have an impact on both the liability projections and the fair value of the assets.

00:12:25:22 - 00:12:37:12
Shan Abdullah
And therefore the IAS19 deficit can both move differently to the funding deficit but also be higher or lower than the funding deficit.

00:12:37:14 - 00:13:03:07
Shan Abdullah
Turning to slide 13. We'll take a look at how the BTPS invests. The table on the left shows 31 billion of asset portfolio at 31 March 26 and how it's split by category. The BTPS adopts a diversified investment strategy with over a quarter of the assets invested in growth assets, which aims to provide capital appreciation over the long term.

00:13:03:09 - 00:13:38:07
Shan Abdullah
The allocations reflect the trustees view on a range of areas, including the balance between generating returns and risk exposure, the extent to which the assets should be allocated to offset movements in the liabilities from changes in interest rates and inflation. The extent to which the assets should provide cash flows to meet benefit payments. Liquidity requirements for derivatives held by the scheme, and a general principle of diversification across asset classes, geographies and public and private markets.

00:13:38:09 - 00:14:07:01
Shan Abdullah
At 31 March, 26 derivative and insurance instruments held to hedge the liabilities had negative valuations. As you see on the bottom of the chart. For longevity hedges, the negative balances reflect current forecasts of life expectancy being lower than when the hedges were put in place on average. As we are not fully hedged, the liabilities for the fell by a greater amount over the same period.

00:14:07:03 - 00:14:32:00
Shan Abdullah
For financial hedges, a key component to call out is the increase in long term interest rates following the 2022 mini budget, which led to a fall in the value of interest rate derivatives held, but also our liabilities. Both of these factors are part of the overall strategy to reduce risk and funding deficit volatility. Turning to the right of the slide.

00:14:32:05 - 00:15:02:06
Shan Abdullah
Let's look at a few examples of assets held. The BTPS invests in private equity and private credit funds, which have a large number of underlying investments and are managed by an external fund manager. These investments provide diversification from public markets and access to a greater range of investments, but introduce liquidity risk to the portfolio. Recent press has drawn attention to liquidity challenges in some private credit funds.

00:15:02:08 - 00:15:34:07
Shan Abdullah
These concerns typically have arisen in retail fund structures, where a mismatch can arise if redemptions increase, but the underlying loans are illiquid. The BTPS holds its private credit exposure through segregated funds, which are designed to hold assets through the investment life cycle. And the overall portfolio has sufficient liquidity, which means it's not exposed to these liquidity risks.

00:15:34:09 - 00:16:05:07
Shan Abdullah
The property portfolio looks to invest in things like office buildings, industrial parks and retail complexes. An example is the investment in the King's Cross estate, which is the largest urban regeneration program in Europe, regenerating a 67 acre site and includes Google as a tenant. Other examples include regeneration projects such as Paradise in Birmingham, which is a 17 acre city centre development combining civic, retail and leisure space.

00:16:05:09 - 00:16:49:15
Shan Abdullah
NOMA in Manchester, which is a large-scale scheme blending commercial, residential and community uses, and Wellington Place in Leeds, a 20-acre office led development. Each is focused on revitalizing urban areas and creating sustainable, high-quality environments. The mature infrastructure portfolio looks to invest in real assets such as energy generation. An example is the investment in Fallago Rig, one of the largest onshore wind farms in the UK, which generates enough clean energy to power 86,000 homes and avoids more than 100,000 tonnes of CO_2 annually.

00:16:49:17 - 00:16:59:15
Shan Abdullah
Another is Cadent, the UK's largest gas distribution network, providing stable, regulated cash flows.

00:16:59:17 - 00:17:28:17
Shan Abdullah
Moving on to the next slide. Around 25 billion of the total BTPS assets have a quoted price in an active market. The rest don't and therefore judgment is required to value them. We get comfort over the valuations through a multi-layered assurance process. There are industry guidelines of how valuations should be carried out. Taking an unquoted property asset as an example.

00:17:28:19 - 00:17:56:22
Shan Abdullah
The Royal Institution of Chartered Surveyors sets out guidelines on how valuation should be carried out. The majority of our unquoted assets are invested through funds typically managed by large established managers, which have their own valuation controls and governance. Those valuations are subject to an independent review as part of fund managers audit process, and for most retail investors, assurance would usually stop at this point.

00:17:57:01 - 00:18:34:18
Shan Abdullah
But for the BTPS there are additional layers. Brightwell, the fiduciary manager appointed by the trustee, aggregates the valuations and carries out its own checks over whether the fund managers valuations are appropriate. An independent auditor provides assurance that Brightwell checks are adequate. And finally, for the scheme accounts every 30 June. The scheme's auditors, currently KPMG, carry out their own testing over the valuations to ensure they are reasonable; and a similar process is carried out for BT Group's accounts every 31st March.

00:18:34:20 - 00:19:09:23
Shan Abdullah
It's important to note that some of these unquoted assets are bond and bond-like assets that the BTPS intends to hold over the long term because they provide contractual income, and so the mark to market valuations matter less than whether the assets remain. Income generating the absolute amount of unquoted assets is reducing over time. And these sales have broadly been at prevailing holding value at the time of sales, giving us further comfort that the BTPS valuations are reliable.

00:19:10:00 - 00:19:38:08
Shan Abdullah
On the next slide, we'll look at how the investment strategy has evolved and the journey that we're on. Our strategy is to run-on the scheme rather than look to ensure the benefits with a third party. The BTPS started a journey following the 2017 valuation to gradually de-risk to a mainly bond and bond like portfolio. By 2034, when the majority of members will be receiving their pension benefits.

00:19:38:10 - 00:20:16:19
Shan Abdullah
Back in 2017, 46% of the portfolio was held in growth assets and over the last three valuation cycle this has gradually reduced in line with the agreed plan. Beneath this headline shift, the mix of growth assets has varied over time, reflecting changing return expectations. Opportunities to exit positions and liquidity requirements. From 2034, the bond and bond-like portfolio is expected to provide adequate income and capital repayments to meet the benefit payments as they forward due.

00:20:16:21 - 00:20:46:02
Shan Abdullah
Rather than needing to generate cash through asset sales. It will continue to generate returns above risk free rate as shown on the right. This journey allows investment returns to continue to play a role in eliminating the deficit. One narrowing the range of outcomes. And with that, I'll hand over to Paul.

00:20:46:04 - 00:21:12:05
Paul Rogers
Thanks. I'm Paul Rodgers, the pensions and insurance director at BT. I've worked here since 2011 and I'm a pensions actuary by background. I'm going to start by looking at how sensitive our funding position is to changes in external factors. Some of these factors have an immediate impact, such as interest rates and inflation. Others, like life expectancy, change more gradually with the assumptions reviewed as part of each valuation.

00:21:12:07 - 00:21:35:14
Paul Rogers
The chart is a simplified illustration showing a range of scenarios taken from our 2026 annual report. The scenarios are expected to occur with a 5% likelihood over the next 12 months, and we show how these scenarios could impact the funding deficit. For example, the first set of bars on the chart look at the impact of a 1.2% fall in long term interest rate expectations.

00:21:35:16 - 00:22:00:15
Paul Rogers
This change lowers bond yields and the discount rate, increasing liabilities by 5.3 billion. Bond assets held by the scheme increase by 3.8 billion. Mitigating part, but not all of the change in liabilities. The scheme then uses derivatives to further hedge the risk. In this scenario, the interest rate derivatives held by the scheme increase in value by around 1.2 billion.

00:22:00:17 - 00:22:33:12
Paul Rogers
This reduces the net exposure of the funding deficit to 0.3 billion. As well as using derivatives to manage interest rate risk. They're also used to reduce inflation, longevity and to some extent, growth asset risk. This has helped reduce volatility over the last decade, limiting changes to the deficit, particularly when navigating different interest rate environments. The BTPS carefully manages the risks introduced by using derivatives such as the need to post collateral and have available liquidity.

00:22:33:14 - 00:23:04:06
Paul Rogers
The chart highlights that our key residual risk exposures today are to growth assets and life expectancy. Turning to slide 18. The chart shows how the funding deficit has reduced progressively since 2017 through the payment of deficit contributions. We've shown the deficits at triennial valuations in dark blue and then at annual funding updates in light blue. We've then shown the impact of potential volatility in a year with the vertical red arrows.

00:23:04:08 - 00:23:34:13
Paul Rogers
These show how outcomes could have evolved under different market and demographic conditions over a year, either favourable or unfavourable. We assume a combination of positive or negative events involving a 1% change in real interest rates, a 15% move in equities, and a half year change in life expectancy. Now, the scenario we've chosen is pretty illustrative, but it helps show how the range of potential outcomes has come down over time.

00:23:34:15 - 00:23:51:07
Paul Rogers
This has been driven by continued de-risking of the investment strategy and overall reduction in the assets and liabilities and increased longevity hedging, all providing more certainty over future funding outcomes.

00:23:51:09 - 00:24:15:14
Paul Rogers
I'll go on. And the chart on the left of this slide shows the IAS19 position at the start and end of the 2026 financial year. On the right, we break down the change in position over the year. The first item in the waterfall is the interest on the deficit. As you'd expect in a scheme where assets are lower than liabilities, deficit contributions of 0.8 billion then reduce the deficit.

00:24:15:15 - 00:24:43:14
Paul Rogers
And these include 180 million of payments made to the through our asset backed funding arrangements. There were 0.6 billion of headwinds from lower than expected asset returns. And there were experienced adjustment headwinds of 0.1 billion, which included an update to our views on life expectancy. This all led to a 0.1 increase in the deficit over the financial year.

00:24:43:16 - 00:25:06:20
Paul Rogers
And if I turn to the next slide, I'll provide some background to mortality trends. The has hedged around half of its mortality risk. And what this slide is doing is trying to illustrate the current uncertainty in predicting mortality following Covid 19. The charts at the bottom of the slide have the same data points, but we've overlaid two possible trend lines.

00:25:06:23 - 00:25:37:06
Paul Rogers
And if I explain the charts in some more detail, we're showing average mortality rates over time for males aged 40 to 85 across the England and Wales population. So a representative category for the BT pension scheme population. The rate is standardised. So we can allow a consistent comparison over time. So if you look 2005 up to around about 2011, you see a steady trend of improving life expectancy.

00:25:37:07 - 00:26:06:03
Paul Rogers
And then we see a slowdown in improvements as well as the significant increase in mortality in 2020 and 2021 as a result of the pandemic. Now, this gives us a challenge in how to project life expectancy from here. The chart on the left reflects a view that life expectancy improvements have stopped in recent years, whereas the chart on the right would support a view that life expectancy is continuing to improve, but at a slower rate than in the recent past.

00:26:06:05 - 00:26:41:06
Paul Rogers
The actual future trends will depend on a range of factors, including the persistence of Covid effects., health impacts linked to cost of living challenges, NHS capacity pressures and advances in medical technology, and emerging influences such as weight loss drugs. As part of the valuation a detailed analysis of life expectancy is carried out looking at membership experience and how this compares to industry forecasts, this will help inform the discussion over the appropriate assumption to be used at the valuation.

00:26:41:08 - 00:27:09:20
Paul Rogers
And so to recap so far. The BT Pension Scheme is a defined benefit scheme which forms around 97% of our pension liabilities. It uses a diversified strategy to invest in illiquid and liquid assets and de-risking over the period to 2034. Investment returns continue to play a role in eliminating the deficit. While we progress to a portfolio where income and capital repayments largely meet the member benefit payments as they fall due.

00:27:09:22 - 00:27:37:20
Paul Rogers
We use two measures to evaluate the pensions deficit IAS19 and funding, and it's the funding measure that drives the trustees investment decisions and the cash contributions we make. We'll now look at the valuation as at 30 June 2026, which is just over a week away. And the slide shows some of the technical and practical items in the valuation process that we'll be working through with the trustee.

00:27:37:22 - 00:28:01:10
Paul Rogers
We'll need to consider changes in legislation and regulation and confirm that our current approach remains consistent with the new funding rules that Shan mentioned earlier. The membership data will all need to be collated and checked, and the trustee will be reviewing the strengths of the company covenant in detail. We'll need to negotiate the appropriate assumptions to use for the valuation.

00:28:01:10 - 00:28:27:05
Paul Rogers
And this will include longevity, which I discussed earlier, and will then agree the future contributions that we need to make and the associated legal protections. We've concluded recent valuations between November and May, following the valuation date, so well in advance of the formal 15 month statutory deadline. Slide 24 gives a recap of where we were back at the last valuation.

00:28:27:07 - 00:28:54:09
Paul Rogers
We agreed a funding deficit at 30 June 2023 of 3.7 billion, and this was to be met through 4.2 billion paid into either the BTPS or our co-investment vehicle over a seven year period, and a stabilizer mechanism, first introduced at the 2020 valuation, gives greater certainty to both parties. This reduces the risk of overpaying and proactively deals with new deficit if. this arises between valuations.

00:28:54:09 - 00:29:17:07
Paul Rogers
I'll now give a little more detail on slide 25 of the features we agreed at the 2023 valuation, and we see these as a good base for the 2026 valuation. So if I start with our asset backed funding vehicle or ABF, this provides a stream of payments to the and is treated as an asset by the scheme.

00:29:17:10 - 00:29:48:12
Paul Rogers
This funding will remain in place and if the pension scheme reaches full funding, payments will stop and that will reduce the risk of overpayments. To move on to the co-investment vehicle we put in place previously. Since 30th June 2023, we've made 1.9 billion of scheduled deficit contributions into the vehicle. A further 2.3 billion, and that's the next four years of scheduled contributions can also be paid into the vehicle.

00:29:48:14 - 00:30:23:08
Paul Rogers
And once contributions are paid in, the assets are invested by the BTPS as if part of the overall portfolio. The contributions can then be refunded to us from 2032. If the money isn't needed by the BTPS. On the third area of the slide, we also agreed future funding commitments to help deal with any new deficits proactively, and this involves regular check to test if we're ahead or behind at two consecutive dates, and the current approach leads to extra contributions each year between 150 million and 300 million if we're behind schedule by more than a billion.

00:30:23:09 - 00:30:48:00
Paul Rogers
And that helps provide certainty for both parties and takes early action rather than needing to wait for a new full valuation. This mechanism has been in place for six years, and to date, this yearly test hasn't triggered extra payments. Finally, pension legislation and regulations in the UK provide significant protection to pension schemes and their members.

00:30:48:00 - 00:31:15:06
Paul Rogers
And in recognition of this, we've agreed protections for the trustee in relation to certain corporate activity and this helps give clarity on the potential impact of transactions, although any significant activity would also be reviewed at the time. So I hope that gives a good indication of the process will be following at the valuation and how we see the previous valuation outcomes as a solid platform for the 2026 valuation.

00:31:15:06 - 00:31:24:06
Paul Rogers
And I'll now hand back to Neil to wrap up. Open us up to questions.

00:31:24:08 - 00:32:00:22
Neil Harris
Thank you. Thank you Paul. Before we open up for Q&A, a quick run through again of the key points we've discussed, I think we've explained the formulaic nature of the IAS19 valuation and how it is the three yearly funding valuation that drives our cash contributions. We've also explained how the BTPS has been making progress with its planned de-risking, while allowing for investment returns to help address the deficit, and we now head into the valuation with solid foundations from previous agreements.

00:32:00:24 - 00:32:30:16
Neil Harris
So with that, we can now open up the floor to Q&A. We will start first with those in the room and then move online. We would appreciate it if you could state your name and your institution. And I will ask Shan and Paul to come up on stage to answer any questions.

00:32:30:18 - 00:33:05:14
Polo Tang
Polo Tang at UBS. Firstly, thank you for the presentation. Just to have three separate questions. The first one is just around the hedges because this has reduced the range of outcomes in terms of the valuation compared to prior reviews. But can you just remind us how long the hedging is in place for? That's the first question. Second question, is can you remind us what's happened with the assets since the last triennial review, because you've been paying in 70, 80 million per annum, but you just made the point that the deficit went from the funding deficit went from 3.8 to 3.2.

00:33:05:15 - 00:33:29:05
Polo Tang
So it's been a modest improvement in from recollection. It was the assets that didn't perform rather than any big movement in terms of the liabilities. And can you remind us within the assets, the Thames Water stake, has that been written down to zero? And the final question is in terms of the Crown guarantee. How much of a benefit is that when calculating the deficit funding deficit?

00:33:29:08 - 00:34:05:09
Neil Harris
Thanks. Well I counted 4 questions. If I pick your last question first. The Crown guarantee, we are not allowed to take any benefit of that as part of the funding valuation. So, there's no value attributed to that. So in other words, the funding deficit isn't reduced because of the Crown guarantee. And maybe just in terms of the overall movement of the assets, I think you can see from the IAS19 valuation in our FY 26 accounts we've just published that the return on the assets in the year to March 26th was lower than we had been expected.

00:34:05:09 - 00:34:35:18
Neil Harris
And I think, as Shan explained, that reflects the market conditions as at 31 March. So again, on the asset side, we won't know the number until 30 June. And that may be a gain or a loss since 31 March.

00:34:35:18 - 00:34:58:02
Paul Rogers
I'll do the hedging one. Thames Water to pick up still. So yeah on the hedging one I think you'll see the levels for things like interest rates and inflation. The scheme is largely hedged on those two factors. And your question, that's sort of today. But the scheme will look at those regularly. Adjust those and make sure that we remain over time.

00:34:58:02 - 00:35:26:21
Paul Rogers
The intention is we stay broadly fully hedged on rates and inflation over the lifetime of the of the scheme.

Polo Tang
But then does that have a cost in terms of if you if it's if you're continually doing it. Is that like a significant cost per annum.

Paul Rogers
No. And the scheme will try and hedge. So for example a payment in 30 years time the scheme will try to look to hedge that with a 30 year hedging instrument.

00:35:26:21 - 00:35:49:12
Paul rogers
So the intention is that it is set up sort of hedged across the portfolio duration today and will remain so.

Polo Tang
And then the Thames Water; and appreciate the comment on the assets. You don't know. Obviously that's up for negotiation now. But I'm just trying to get a longer term historical perspective in terms of the assets I think performed over a two, three year period. So just trying to get a refresher in terms of why that was the case.

00:35:49:12 - 00:36:24:11
Shan Abdullah
You're right that the holding in Thames Water, the equity stake has been written down, which I believe was about 300 million. The scheme also had debt exposure to Thames Water, which was sold off prior to it needing to be written down.

00:36:24:13 - 00:36:49:18
James Barford
James Barford from Enders Analysis. So just dig a little deeper. It might relate to the answer to the last question. So in the last year, there was a 600 million lower return than you were expecting, and that presumably that couldn't have been anything to do with interest rates or that kind of thing, because that should have had a matching effect on the liabilities.

00:36:49:20 - 00:37:10:11
James Barford
So this is presumably must relate in some way to the growth assets. And there aren't that many growth assets. I'm just it just feels quite significant. I'm just trying to dig a little deeper into it. Obviously the 600 million equity in Thames water might account for a large portion of it. And then maybe is that it?

00:37:10:11 - 00:37:44:23
James Barford
Because I'm just trying to if you lose 600 million, you know, if there's a -600 million every year that, that, that that's, that's quite a lot of money. If it's a kind of one off that slightly different. So I was just wondering if you give more colour on why the why the return was 600 million lower.

Neil Harris
I mean, I think generally, you know, we invest in growth assets because we believe it's better for BT to meet the deficit through growth returns on growth assets rather than more deficit contributions from BT.

00:37:45:02 - 00:38:08:23
Neil Harris
And I think when you invest in growth assets growth doesn't come linearly. So you might have a year when things didn't don't perform as you would expect over averages. In terms of are there specific events in FY 26. I'm looking to Shan if there are or not, but I think again it's taking the valuation date of 31 March, which you know, wasn't a particularly bullish date.

00:38:08:23 - 00:38:42:16
Neil Harris
You could easily just have a mark to market on the growth asset portfolio without there being a specific issue.

Shan Abdullah
two things I'd add to Neil's comments. Firstly, 31st March was a time of turbulence market conditions, given the geopolitical sort of nature of what's going on out there. The other one, the way the attribution is shown in our accounts, it follows what's required under IFRS, and we show the movements on the assets separately to the movements on the liabilities.

00:38:42:17 - 00:39:10:02
Shan Abdullah
So even if you are perfectly hedged, the assets you're effectively an interest rates increase, then the value of our assets will have fallen and that will show us assets underperforming expectations. But you will probably see an equivalent movement on the liabilities. Now the thing to call out is the way the funding liabilities move is different to the way the IAS19 liabilities move because of the methodological differences.

00:39:10:02 - 00:39:35:15
Shan Abdullah
And the trustees focus is to hedge the funding liabilities, not the IAS19 liabilities. So that structural difference means that it's more difficult. Or there should be quite a lot of caution when trying to do a read across between the performance on accounting to the performance that you might get on funding.

00:39:35:17 - 00:40:01:01
James Ratzer
Yes. Thank you. It's James from New Street Research, so apologies if I'm going to ask questions I should know the answer to. But I just want to check. So I think was it kind of three years ago you switched to some form of co-investment scheme on the pension scheme, which I understand means that if you were to ever go into surplus, it gives you the ability to then get kind of repaid back.

00:40:01:02 - 00:40:22:14
James Ratzer
But in return for that, I think you've now given up all tax deductibility on making payments into the pension scheme. So I was one. If you can kind of run us through why that was a good deal to do, because it strikes me that the kind of tax deductibility on quite a large deficit is actually a material give up.

00:40:22:14 - 00:40:47:19
James Ratzer
So you're having to make kind of higher payments to HMRC. I mean even I know there's all the issues about kind of accelerated depreciation as well. But it just seems like that could have been again you're giving up. So just to kind of run through the economics there please. And then secondly, just an update on the whole discussion of the kind of strength of the covenant phrase which is often used when thinking about Openreach.

00:40:47:21 - 00:41:22:21
James Ratzer
So if over the next kind of three, five years or so, BT were to ever consider either a stake sale, an Openreach or a spin off in Openreach, could you just give us the kind of latest thoughts on where the pension trustees would fit into any type of discussion there? Thank you.

Neil Harris
Maybe if I start with the first one, the co-investment vehicle, I think it's a deferral of tax relief rather than a forgoing of tax relief.

00:41:22:23 - 00:41:48:04
Neil Harris
And the choice we make is that the valuing the cost of the deferral versus the likelihood of getting a refund back earlier than we would otherwise have done, that's the choice that we make. And you mentioned the accelerated tax depreciation at the moment. You'll see from our reports we're not paying UK tax and we have significant UK tax losses.

00:41:48:04 - 00:42:14:24
Neil Harris
So when we value the cost of deferring the tax benefits relatively small because we don't pay anything today, we would just have more losses as we move over time. The value of getting the tax deduction. If we move things from the co-investment vehicle into the pension scheme, we will factor that in and we will balance it against the possibility of getting the refund of surplus contributions back.

00:42:15:03 - 00:42:44:10
Neil Harris
So that's the maths that we go through to decide whether we put our contributions into the co-investment vehicle or directly into the pension scheme. The covenant strength. Again, I can let my colleagues answer that. But the highest level, you know that this is the discussion with the pension scheme about how much, how many growth assets, what proportion of the scheme can we invest in growth assets versus hedging assets.

00:42:44:12 - 00:43:34:17
Neil Harris
And the stronger BT is, the more the appetite there is from the trustees to invest in growth assets, all of which is tempered by the regulatory environment. So that's when we talk about the strength of the covenant. That's why we're saying a stronger BT means more appetite for investment risk. As it relates to the Openreach question, the pension regulatory environment is there to protect members and it's a very strong protection and there have been updates to much legislation, the last of which I think is the Pension Schemes Act 2021, which means in any kind of corporate transaction, you have to put the pensioners in at least the same position, which might either require, you know,

00:43:34:19 - 00:43:58:22
Neil Harris
an extra payment to the pension scheme or alternative forms of structuring. I don't know if my colleagues have other comments

Paul Rogers
No, I mean, I think that's explains it just right. I mean, the company covenant with a complete BT Group as it is today, will be a stronger proposition than a covenant if you start taking pieces out. So and I think you've covered that, go to ask quick follow up.

00:43:58:23 - 00:44:20:11
James Ratzer
Maybe it's one to take offline, but just the deferral of the tax relief. So, does that mean you would get the tax relief in full but just at a later date? And if so, when does that then kick in?

Neil Harris
Yeah. Yes. So it's a deferral I think you can see an annual report. There's various the co-investment vehicle has various dates for determining the funding position of the scheme.

00:44:20:11 - 00:44:37:08
Neil Harris
And at that time it's wired into there. If the scheme is still in deficit, the payment will move from the co-investment vehicle into the pension scheme and the tax deduction will be available at that point.

00:44:37:10 - 00:44:57:03
Robert Grindle
Robert Grindle from Deutsche Bank. Sorry for the voice. I've had a bit of a cold. Don't worry, I'm not infectious anymore. Just a point of clarity on the valuation of bonds. I think you said you valued them on a cash flow basis. So does that mean we don't have to worry about a gilt price change? Say, if the government changed, the Prime minister changed or something.

00:44:57:03 - 00:45:13:13
Robert Grindle
So is that a kind of look through? And we just shouldn't get worked up about that sort of stuff. And secondly, I think I was trying to remember when it was, but you did something interesting. I think you sort of semi monetised or hybrid monetised one of your pension assets a couple of years back. What was the thinking there?

00:45:13:14 - 00:45:35:06
Robert Grindle
I guess it was liquidity. Is, is I'm not sure you talked so much about liquidity. A lot of the scheme is in public assets, but is there a liquidity problem or an issue at all with any of the assets? And then the last question was pensions freedom. BT employees taking their pensions, taking money out of the scheme. Did that boost the scheme? Is there a tail risk there. Is it very prudently accounted? Thanks.

00:45:35:06 - 00:46:11:08
Shan Abdullah
Thanks. Let me let me try and tackle them in order. So, where there are bond or bond like assets held for the underlying cash flows, the valuations are still done on a mark to market basis because that's what's required under the accounting standards. But then when we value the liabilities, when the scheme actually goes to value the liabilities, the scheme actually then looks to what the yield on those assets is and then builds that into the discount rate directly when valuing the liabilities.

00:46:11:08 - 00:46:40:04
Shan Abdullah
And therefore there's more of a consistency between the assets and liabilities. We have quite a lot of liquidity. I won't go into exactly how much we can bear, but the Bank of England provided guidance of how much liquidity pension schemes should have after the 2022 mini budget, and we are operating at substantial levels above that.

00:46:40:06 - 00:47:14:00
Paul Rogers
So was the question on the structure that was put in place by the pension scheme in terms of realizing value? I think the pension scheme will over time is we've explained, sort of looking to de-risk out of growth assets. And that was an opportunity the pension scheme saw to take a valuation. They saw as fair for a portion of some of their private assets and enabled them to continue reinvesting those in the longer term portfolio.

00:47:14:00 - 00:47:46:05
Paul Rogers
So it was an opportunity they saw at the time. And I think pension freedoms, the last one. Yeah, I mean, in terms of the BT pension scheme, members at retirement will typically take pension and a cash lump sum. There is the option to take a transfer out. Typically for this scheme most it's a relatively small amount taking money out of the pension scheme.

00:47:46:07 - 00:48:05:23
Carl Murdock-Smith
Carl Murdock-Smith from Citi. I was just wondering if you could expand a little bit more just in terms of the new regulatory requirements. So on the chart, you talked about the kind of low dependency funding basis. And also we've got the long term objective as well. So kind of what can we be expecting within the announcement.

00:48:05:24 - 00:48:39:10
Carl Murdock-Smith
You know, will we be getting effectively kind of multiple deficit figures and multiple payback or potential payback schedules depending on the various discount rates or what can we expect?

Shan Abdullah
So the new guidance by the regulator says there is a maximum level of investment risk mature schemes should be running. It therefore provides more guidelines as schemes get to the point that they are significantly mature and also how quickly they need to be funded.

00:48:39:12 - 00:48:58:06
Shan Abdullah
We believe that we're largely within those parameters, but that's a piece of work that we and the trustee need to go through to verify that that is the case and that we offer the compliant. There's also quite a lot of additional paperwork that it needs to be put in place. So it's not just a tick the box.

00:48:58:06 - 00:49:21:23
Shan Abdullah
We're agreeing sort of the long term strategy. But again, we have quite a lot of those processes in place. So in terms of the announcement, you'll see something very similar to what you've seen in the past. You'll see the headline deficit and what the outstanding contributions that we've agreed with the pension scheme.

Paul Rogers
Yeah I mean you look at the guidance and it's saying de-risking over time.

00:49:21:24 - 00:49:48:19
Paul Rogers
We've sort of explained that's what we're doing. It's a long term portfolio with limited risk. That's what we're moving towards. So yeah, as Shan says, it's all directionally where we we're heading. And yeah, we don't expect to see reams of different numbers and different schedules. It's going to be one outcome, one conclusion.

Carl Murdock-Smith
So there won't. So there won't be material additional disclosure from the low dependency funding basis.

00:49:48:19 - 00:50:01:22
Carl Murdock-Smith
Because in other schemes we are seeing a bit more information in terms of flex around what hat certain aspects mean. But you're saying that won't be coming in yours.

Paul Rogers
Not for us.

00:50:01:24 - 00:50:16:03
Nick Delfas
Any further questions? If anyone wants to ask online, you have to put it in the chat rather than the Q&A function. But there's nothing showing at the moment. Any last questions in the room?

00:50:16:05 - 00:50:19:22
Nick Delfas
We can close there then. Thank you very much indeed, everybody. Thank you very much.