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Statement of Investment Principles

Introduction

This Statement of Investment Principles (SIP) has been prepared by the Trustee of the Scheme in compliance with the requirements of the Pensions Act 1995, as amended, the Pension Protection Fund (Pensionable Service) and Occupational Pension Scheme (Investment and Disclosure) (Amendment and Modification) Regulations 2018 and the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019. It has been prepared following written advice from BT Pension Scheme Management Ltd (BTPSM), the Scheme's principal investment advisor, and consultation with the principal sponsoring employer of the Scheme, BT. The SIP is reviewed at regular intervals or following any significant change in the investment policy of the Scheme. Amendments to this Statement will only be made with written advice from a suitably qualified person and following consultation with BT.

Objectives

The main objective of the Trustee is to ensure that there are sufficient assets to pay benefits to members and their beneficiaries as they fall due and that all members and beneficiaries receive the benefits to which they are entitled under the Rules of the Scheme. In considering their approach to meeting this objective, the Trustee takes into account the expected progression of the Scheme's total annual benefit payments relative to the projected level of Scheme assets as the proportion of retired members increases over time.

The Trustee takes an integrated approach to the management of risk in the Scheme. The Trustee therefore invests the assets of the Scheme consistent with funding a defined level of benefits within an acceptable level of risk, having appropriate regard to the affordability of both the immediate and longer term cash cost to BT, and the funding obligations which BT (and other entities where relevant) may have from time to time to the Scheme. The Trustee recognises the importance of establishing and maintaining stability in the Scheme's funding position and understands that continued 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 level of future contributions that may be required from BT.

Investment beliefs

The Trustee has established a core set of investment beliefs that provide a framework for consistent and effective investment decision making. This includes beliefs that are related to the nature and characteristics of the Scheme, such as the importance of having an appropriate governance structure, the need to take into account the liabilities when setting investment strategy, and having an understanding of both the competitive advantages and disadvantages facing the Scheme. In addition, the investment beliefs recognise the importance of being a responsible investor and includes market-related beliefs, such as those concerning the relationship between risk and return, the importance of diversification, and the belief that markets can be inefficient. The Trustee, supported by its Investment Committee and BTPSM, regularly reviews its investment beliefs against the investment outcomes being delivered by the Scheme.

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Investment risk and return

The Trustee considers that a strong employer is the best support for the Scheme and takes independent advice on the quality of the covenant of BT and thus its ability to meet its obligations. Given the ongoing commitment of BT to the Scheme, the Trustee considers that a degree of investment risk can be taken in the expectation of generating higher returns, particularly in the short to medium-term when it has clearer visibility over the covenant provided to the Scheme by BT. In setting the appropriate level of investment risk and return the Trustee considers a range of factors, including the impact and probability of a worsening of the funding position, the financial strength or covenant of BT and the financial strength and cash flow profile of the Scheme.

Overall risk in the Scheme is diversified across a range of different types of risk, asset classes, geographical areas, sectors and industries. Assets held by the Scheme from time to time reflect the Trustee's views on the appropriate balance between risk and return and the outcomes it expects should be available from the assets. Investments are made on the expectation that greater long-term returns will be made through a prudent exposure to a range of asset types, including equities, corporate bonds and property. In addition, investments are allocated across a range of investment managers to further spread risk. The Trustee also takes into account the liquidity profile of the Scheme's investments. The Trustee's liquidity policy is that there will be sufficient investments in liquid or readily realisable assets to meet cashflow requirements in foreseeable circumstances so that, where possible, the realisation of assets will not disrupt achievement of the Scheme's investment objectives, and that the Scheme will hold sufficient cash to meet anticipated benefit and other payment obligations.

In light of the expected progression of the Scheme's annual benefit payments as the proportion of retired members increases, the Trustee has set an objective to reduce the level of investment risk gradually over time and to increase the level of matching between the assets and liabilities. The Trustee's current intention is to move to a substantially lower risk investment strategy over time. By no later than 2034, the Trustee currently intends that the Scheme will be invested in a portfolio consisting predominantly of appropriate bond and bond like investments, such that it would be reasonable and prudent to expect the assets to provide adequate income plus capital repayments each year to enable benefit payments to be met in full as they fall due. In addition, the Trustee may if it considers appropriate by 2034 have sought to hedge out risks to the Scheme's ability to meet its future cashflows from its own assets. Given the size of the Scheme compared to the markets in which it invests, the Trustee intends building steadily towards this bond, bond like and hedging portfolio over the period to 2034 (at the time of writing the Scheme's cashflow coverage ratio, which is the proportion of the Scheme's projected benefit payments that are expected to be met by assets invested in this way, is 43%). However, a flexible approach may be taken to take advantage of efficient and cost-effective opportunities to achieve this strategy more quickly. The Trustee will consult with BT on strategic changes in its approach to asset risk.

To improve the stability of the Scheme's funding position and to help provide a balanced risk profile the Trustee uses derivative overlays and other techniques to help offset the impact on the funding position from changes in market and liability linked variables, including (among other things) interest rates, inflation and longevity. The Trustee is targeting a ratio of interest rate and inflation hedging of around 60% on a gilts basis (on a funding basis at the time of writing this is equivalent to a hedge ratio of c85%) to reduce the Scheme's exposure to these

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risks and consequently the volatility of the Scheme's funding position and by 2034 (at the latest) may if it considers appropriate have moved to a substantially or fully hedged approach on the Scheme's funding basis.. The Trustee also uses insurance and other arrangements to reduce the impact on the funding position of the Scheme from changes in life expectancy.

Over the longer term, the Trustee expects the aggregate investment returns delivered by the Scheme's assets to exceed the discount rate assumptions set out in the Scheme's Statement of Funding Principles.

In seeking to meet the investment objectives, the Trustee will invest in a range of asset classes and instruments as permitted in the Scheme Rules. The Trustee will consider a range of asset classes, including:

- Equity instruments
- Bonds and other debt instruments
- Private equity and infrastructure
- Property and land
- Commodities
- Hedge funds
- Currencies
- Cash
- Derivatives
- Insurance contracts

The Trustee recognises that different asset classes are likely to produce different risk and return profiles, and the balance between the various types of investment will be kept under periodic review with the aim of investing in a diversified way to achieve the Scheme's short-term and longer-term risk and return objectives.

The Trustee's policy is to have separate management and custody of assets, which minimises the risk of a misuse of Scheme assets. Custody arrangements are reviewed regularly to ensure that the custodians continue to have appropriate control and checking procedures in place.

Taking decisions

The Trustee is responsible for the stewardship of the assets of the Scheme. All of the Trustee Directors are therefore involved in decisions on the overall level and shape of the Scheme's risk profile and the preferred outcomes from the Scheme's assets. In making these decisions the Trustee is assisted by BTPSM and other advisers. Training is undertaken where appropriate so that all Trustee Directors have the necessary expertise to take the decisions required of them and to evaluate critically the advice received.

The Scheme's Investment Committee has responsibility for the oversight of BTPSM's implementation of the Scheme's investment strategy delegating matters as appropriate to the Implementation Oversight Committee and makes recommendations to the Trustee Board on the management of the Scheme's funding risk through the use of derivatives and the Scheme's approach to responsible investment.

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Further details of the Trustee's approach to decision making and, more generally, the governance arrangements for the Scheme are set out in the Trustee's Report and Accounts (which can be found on the BTPS website https://www.btpensions.net/information/useful-documents).

Choosing investments

The Pensions Act distinguishes between investments where the management is delegated to a fund manager with a written contract and those where a product is purchased directly, e.g. the purchase of an insurance policy. The Trustee's approach is to review its direct investments and to obtain advice about them at regular intervals. When deciding whether or not to make any new direct investments the Trustee will obtain advice. The advice will consider whether the investment is satisfactory having regard to the requirements of the regulations, the Trust Deed and Rules and the suitability of the investment, and to the principles contained in this statement.

Use of derivatives and insurance contracts to manage risk

The Trustee may use derivatives and insurance contracts for efficient portfolio management and to manage the Scheme's risk profile, including among other things the Scheme's longevity, inflation, credit and interest rate exposure. The Trustee consults with BT when assessing the strategic use of derivatives and insurance contracts to manage the Scheme's risk profile

The Trustee authorises the use of derivatives within certain parameters by BTPSM, some of the Scheme's investment managers, and certain subsidiary undertakings. BTPSM is also authorised to use derivatives to rebalance the Scheme's asset allocation and currency exposures on such basis as may be required from time to time to keep within any guidelines set by the Trustee.

Mandates for investment managers

BTPSM on behalf of the Trustee has appointed a number of investment managers to manage the Scheme's assets. Alignment between a manager's management of the Scheme's assets and the Trustee's beliefs, policies and objectives are a fundamental part of the appointment process of a new manager and of the ongoing oversight of the activity undertaken by managers on behalf of the Scheme.

Before appointing an investment manager, BTPSM seek to understand the manager's philosophy and approach to determine their suitability for the mandate being awarded. This includes an assessment of the alignment between Trustees beliefs and goals with those of the manager. In addition, clarity is sought on the manager's investment time horizon, approach to responsible investment, and engagement with underlying companies.

Where segregated mandates are used, guidelines and reporting requirements are included within the Investment Management Agreement which reflect the Trustee goals and beliefs. All investment agreements with managers detail the services to be provided and, where appropriate, the performance objective, risk expectations, and how they will be measured. In addition to reporting on performance relative to these objectives, managers also provide information on portfolio composition changes, turnover (defined as the % of the portfolio that is transacted), transaction costs, engagement activity and proxy voting. When investing in a pooled investment vehicle, BTPSM ensures the investment objectives and guidelines of the vehicle are consistent with the Trustee's own objectives.

BTPSM actively monitors and engages with investment managers to ensure their ongoing resilience, adherence to mandate expectations and alignment with Trustee objectives. Should the monitoring process reveal deficiencies or concerns as part of this process which in the view of BTPSM cannot be remediated, the mandate will be terminated. The monitoring process includes ongoing evaluation of the environmental, social and governance characteristics of the portfolio and managers' engagement, stewardship and voting activities.

The Trustee expects its relationships with investment managers to reflect the long-term investment horizon of the Scheme. This reduces Scheme costs through the lower fees that generally result from multi-year or multi-decade manager partnerships, as well as lower turnover costs associated with changes to investment managers. In turn, this long-term approach allows investment managers to take a similarly long-term view with the underlying investments they make on behalf of the Scheme. Furthermore, it also enables managers to engage with companies to drive better long-term sustainable outcomes.

The Trustee retains flexibility to invest with certain managers or strategies where desired outcomes have a shorter time horizon or are less conducive to engagement activity. Typically, the role of these investments is to narrow the range of Scheme outcomes over the longer term or for shorter term risk considerations.

The fees paid to investment managers for these active mandates may comprise a base fee plus, where appropriate, an additional fee calculated as a proportion of the amount by which the manager exceeds a performance target. Linking fees to performance in this way can help align the investment managers' interests with the interests of the Scheme.

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

BTPSM regularly reviews, on behalf of the Trustee, the costs incurred in managing the Scheme's assets, which includes the costs associated with portfolio turnover. In assessing the appropriateness of the portfolio turnover costs at an individual manager level, BTPSM will have regard to the actual portfolio turnover and how this compares with the expected turnover range for that mandate given the prevailing market conditions.

Performance measurement

The Trustee receives regular reports, at least quarterly, on investment performance from BTPSM, who monitor the position on an ongoing basis. These reports include an update on progress towards meeting the Scheme's strategic investment objectives and may include detail on Scheme level risks, assets by asset type, Scheme level cash flows, the performance of individual managers and such other matters as may be required by the Trustee from time to time.

Responsible investment

Given the time horizon of the Scheme, the Trustee recognises that emerging, long-term risks, including for example climate change and technology disruption, may have a material adverse impact on the Scheme. These risks are monitored by the Trustee as part of their regular review of the Scheme's risk register. Day-to-day implementation and monitoring of the controls in place to manage these risks is delegated to BTPSM.

In relation to climate change, the Trustee believes that reducing exposure to carbon emissions over time will improve investment outcomes and reduce the impact of potential adverse outcomes associated with future climate risk. Consequently, the Trustee has established a goal for the Scheme's investment portfolio to achieve net zero carbon emissions by 2035.

The Trustee is committed to being a responsible investor and articulates this commitment through its responsible investment mission statement:

"The Scheme's investments should be managed to create sustainable long-term value, supporting the generation of optimal investment returns to ensure the Scheme can pay all benefits in full."

To do this effectively, the Trustee believes that all financially material considerations, including environmental, social and governance (ESG) factors must be integrated throughout the investment process. This means that ESG credentials and capabilities are incorporated into the process for selecting and monitoring investment managers. Furthermore, where appropriate investment managers appointed by the Trustee are expected to consider both the risks and opportunities that arise from ESG factors in the selection, retention and realisation of the investments they manage on behalf of the Scheme. As part of this process, external managers are expected to provide evidence and ongoing reporting on the responsible investment integration process. The Trustee also believes that active stewardship (i.e. exercising ownership rights and undertaking engagement activities) can improve long-term risk-adjusted returns and has appointed an external adviser as the Scheme's primary provider of stewardship services. The Responsible Investment Policy, which is publicly available at www.btps.co.uk , sets out the key aspects of the Scheme's responsible investment approach including strategy, governance, implementation, stewardship and reporting.

The Scheme has in place a number of mechanisms that provide a link between the Trustee and members. This includes having member nominated trustees, an annual presentation by the Trustee Board and its advisers to BT's recognised trade unions (CWU and Prospect) and the National Federation of Occupational Pensioners (NFOP) and inviting feedback from members through regular newsletters and surveys. The Trustee believes this is an appropriate and proportionate way for a defined benefit scheme of its size to engage with, and gain an understanding of, its members and their concerns. A collective understanding of member views, including consideration of non-financial matters, helps inform the Trustee's approach to ESG considerations and stewardship.

Additional Voluntary Contributions

The Scheme's AVC arrangement provides for benefits to be accrued on a money purchase basis, with the value of members' funds being determined by the value of accumulated

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contributions adjusted for investment returns net of charges. In selecting and monitoring appropriate investments, the Trustee is aware of the need to provide a range of investment options, which broadly satisfy the varying risk profiles of members, given that members' benefits will be directly determined by the value of the underlying investments.

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