



Pensions review update

August 2017

Introduction

In July, we gave employees in the BT Pension Scheme (BTPS) more details about why we need to review their pension scheme.

Since then, we've been continuing our review discussions with the unions, and listening to your feedback, to help us understand the options for change. This has included meetings with representative groups from both the CWU and Prospect.

As part of these ongoing discussions with the unions, we've also agreed to consider potential improvements to our other main pension scheme – the BT Retirement Saving Scheme (BTRSS).

As a result, this guide is relevant to employees in both the BTPS and BTRSS as it sets out more information about the things we've been discussing with the unions, the benefits provided in both schemes, and the options for change that we're considering.

What pension am I a member of?

BTRSS members = members who've been paying into a Standard Life pension (the main scheme for new joiners since 2001).

BTPS Section A = BTPS members employed by the Post Office before 1 December 1971.

BTPS Section B = BTPS members who joined the scheme between 1 December 1971 and 31 March 1986 or Section A/B members who left BT and subsequently rejoined after 31 March 1986.

BTPS Section C = BTPS members who last joined the scheme on or after 1 April 1986.

Note: Both the BTPS and BTRSS are governed by rules. If there is a conflict between this document (or the BTPS/BTRSS websites) and the rules, the rules (as amended from time to time) will prevail.

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Our review objectives

We want to ensure all our people can build up retirement benefits that are fair and flexible. At the same time, we need to also ensure any changes are affordable to both BT and to you.

Fair

It's our aim to have pension arrangements that are fair for all, allowing our people to meet their retirement needs.

We need to achieve this across our two main pension schemes – the BTPS and the BTRSS. Most of our employees are in one of these schemes depending on when they joined BT, as the BTPS closed to new entrants in 2001. If we don't make changes, it's estimated that BT's costs of providing future benefits in the BTPS would be more than double those in the BTRSS. This is despite having fewer active members.

Flexible

Our pension schemes should allow employees to build up and access their benefits in ways that suit them best.

Pension freedoms introduced in 2015 for schemes like the BTRSS mean saving for and accessing retirement benefits has become much more flexible for people in that scheme. We've also introduced increased flexibility for members taking their retirement benefits in the BTPS with the introduction of a Pension Increase Conversion option. The review will look at how we might further improve flexibility across both schemes.

Affordable

We need to address the cost and risks we face in the BTPS to ensure the benefits are affordable to both BT and you.

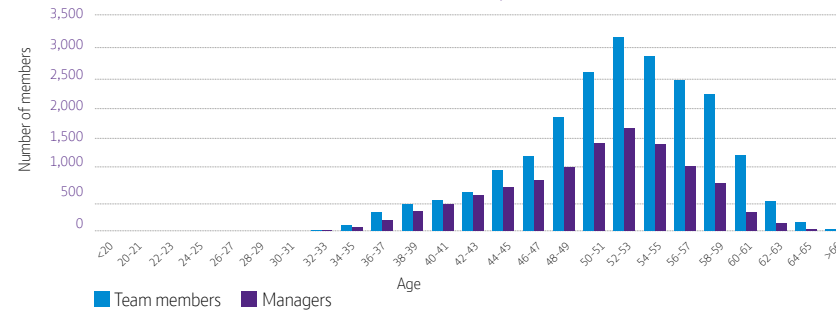
As we explained in July, BT's costs of providing future BTPS benefits are estimated to have trebled since our last significant review in 2009, mainly due to external economic conditions. BT also has to meet the costs of paying off the BTPS deficit, estimated at £13.9 billion at the end of June 2016. If we do nothing, BT will be facing hundreds of millions in extra contributions to the BTPS on top of our current costs. This could damage our ability to invest in our networks, customer experience and jobs.

The active memberships of our schemes

During our review with the unions we've discussed the differences between the two schemes. In particular, the fact that providing future benefits in the BTPS is now expected to cost BT a lot more than the BTRSS, despite having fewer active members (people still employed by BT and paying in to their scheme). So let's look at the two schemes side by side.

BT Pension Scheme (BTPS) – a defined benefit (DB) scheme, where benefits are based on how long you have been an active member of the scheme and your final pensionable salary. The number of people in DB schemes in the UK has drastically declined as these schemes create risk and uncertainty for companies.

BTPS MEMBERSHIP 2017 (TOTAL MEMBERS: 32,100)



BT Retirement Saving Scheme (BTRSS) – a defined contribution (DC) scheme, where you and BT pay contributions into a personal account which is then invested. The benefits you receive in retirement will depend on the amount of contributions, the investment returns and the choices made about how benefits are taken. This means you experience both the upside and downside as the value of your investments change.

BTRSS MEMBERSHIP 2017 (TOTAL MEMBERS: 32,400)



Fact file: The BTPS

- 32,100 employees are active members in the BTPS (and decreasing).
- The scheme was closed to new joiners in 2001.
- Average age: 52.
- Average tenure: 29 years.
- The estimated average total value of benefits built up (per member) is around £400,000 for team members and £650,000 for managers.
- The average BT contribution rate is 11% of pensionable pay. If we don't make changes (and subject to the 2017 valuation) this percentage could potentially double.

Fact file: The BTRSS

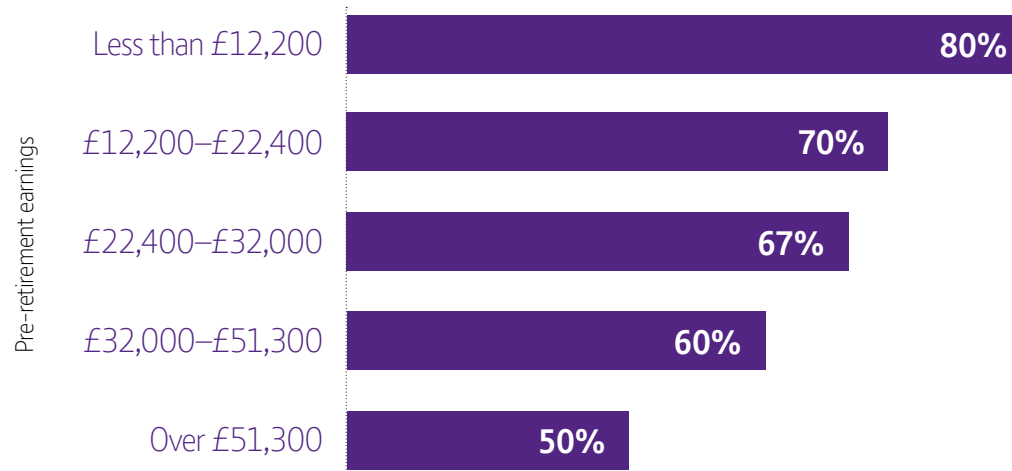
- 32,400 employees are active members in the BTRSS (and increasing).
- Our primary pension scheme for new joiners since 2001.
- Average age: 36.
- Average tenure: 6 years.
- The most common contribution rate paid by employees in the BTRSS is 5% of pensionable pay.
- Where an employee contributes 5%, BT pays an additional 8% of pensionable pay into the employee's personal pension account. BT also covers the cost of providing death and medical retirement benefits.
- If an employee contributes more, so too does BT (up to certain limits).

How much do I need in retirement?

There's been a lot of research to identify what income you might need in retirement. The amount will be down to individual circumstances, but some independent research has suggested 'replacement rate benchmarks' for different income levels to give an idea of what income you might need to maintain your standard of living.

Replacement rate benchmarks for different income levels

The chart below shows the different replacement rates for a variety of incomes. For example, if you are earning £30,000 a year before retirement, the research suggests that you might need at least 67% of this (an income of £20,000 per year) in retirement to maintain your standard of living.



Sources: Department of Work & Pensions, 'Scenario analysis of future pension incomes', August 2014. Pensions Policy Institute, 'what level of pension contribution is needed to obtain an adequate retirement income?', October 2013. Based on research from the Pensions Commission.

Why don't we need the same income in retirement as we do today?

Research shows that many living expenses in retirement are likely to be lower. For example, mortgage payments, costs of travelling to and from work, and the cost of raising children.

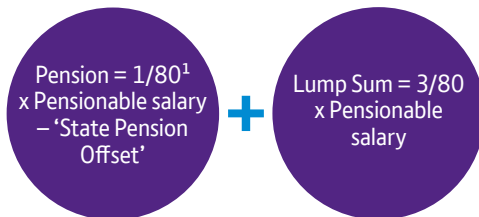
Why do the replacement rate benchmarks vary for different salaries?

The reason for this is because there are certain fixed costs required in order to maintain a certain standard of living (for example, bills, food, etc). All else being equal, these costs are likely to form a higher proportion of your salary if you earn, say, £15,000 than if you earn £35,000.

More information about BTPS benefits

Let's look at how BTPS benefits currently build up each year.

Employees in Sections B and C currently build up pension and lump sum benefits on a Career Average (or 'CARE') basis each year using the calculation:



¹ $\frac{1}{80}$ th is known as the 'accrual rate' or 'build up rate'. Some members have opted for $\frac{1}{90}$ ths.

These benefits are normally paid from your 65th birthday, although you can choose to take them earlier than this.

Each annual 'block' of CARE benefits is increased before retirement by the lower of: 1) a change in Retail Price Index (but never below zero), and 2) any change in pensionable salary.

In Sections B and C benefits built up in a different way before April 2009. Different rules apply to a small number of people in BTPS Section A.

[More information on the BTPS.](#)

What is the State Pension Offset?

Since 2009, an offset is applied to BTPS members' pensions when they reach State Pension Age. When your State Pension starts to be paid, you get an additional amount because in 2009 we stopped 'contracting out' of the State Second Pension, and you started to build up that extra benefit. Because you get this extra amount from the Government, your BT pension is reduced, the intention being that you get the same amount of pension overall (though, due to 2016 State pension changes made by the Government, this will not necessarily be the case in practice). The application of the State Pension Offset means that your actual BTPS build up rate ('accrual' rate) is less than $\frac{1}{80}$ th once your State Pension starts to be paid, and is approximately $\frac{1}{105}$ th on average.

What benefits have typical members in the BTPS built up?

We've shown below what benefits some typical BTPS active members have built up in the BTPS to date, and how they compare with the [replacement rate benchmarks](#) for the relevant salary.

These examples only show benefits built up to date and expected State Pension benefits. They don't include any future service to retirement or additional pension savings the example members might have.

SECTION C MEMBER, AGE 50, 30 YEARS' PENSIONABLE SERVICE, PENSIONABLE SALARY OF £30,000 PER YEAR, INTENDING TO RETIRE EARLY AT AGE 60

Total member benefits when they reach State Pension Age	Pension per year	+ £7,000 lump sum¹ <small>payable at retirement</small>
BTPS pension, minus the State Pension Offset (see left)	£12,500	
Plus State Pension ²	£8,300	
Total	£20,800	
Member's replacement rate as a percentage of pensionable salary (BTPS pension plus State Pension)	69%	
Replacement rate benchmark (for comparison)	67%	

OTHER TYPICAL EXAMPLE BTPS MEMBERS (ASSUMING RETIREMENT AT AGE 60)

Pensionable salary	£30,000	£40,000	£60,000
Member's replacement rate as a percentage of salary (lump sum payable in addition)			
Section B, age 55, 35 years' service	67%	60%	53%
Section C, age 50, 30 years' service	69%	62%	56%
Section C, age 45, 20 years' service	53%	46%	39%
Replacement rate benchmark at State Pension Age	67%	60%	50%

Your expected retirement benefits will continue to increase as you keep working and building up future benefits. (For example, the 45-year-old Section C member shown in the above table could still build up a further 15 years of benefits.)

¹ Lump sum would be payable at retirement and you would also have an option to exchange some of your pension for a bigger lump sum.
² The State Pension shown is the current full 'single tier' State Pension, payable from State Pension Age. Lump sum has not been included in the members' replacement rate calculation.

Note

– The pension provided by the BTPS includes a spouse's pension and inflationary pension increases. The BTPS also provides benefits until members die. This is different from the BTRSS examples shown on the next page.

More information about BTRSS benefits

How do benefits build up in the BTRSS?

BTRSS benefits are built up through a combination of your contributions, BT contributions (If you contribute more, so too does BT – up to certain limits), and the investment returns achieved. This makes up your pension 'pot'. As you can see from the table below, BT more than matches the contributions you make.

Member contribution	BT contribution	Total
5%	8%	13%
6%	8.5%	14.5%
7% or more	9%	16% or more

Certain different contribution rates remain for former legacy pension arrangements, for example BT Retirement Plan members and TUPEd employees. BT also contributes a minimum of £1,500 per year (pro-rated for part-time) for members contributing at least 5%. (Note this does not apply to TUPEd members.)

BTRSS members have flexibility and control in how they take their benefits. For example, you can:

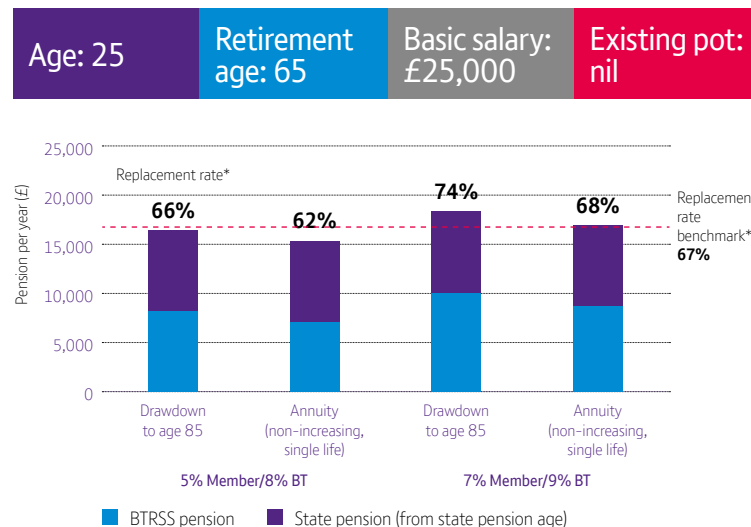
- Take some or all of your benefits as cash (though you might have to pay tax).
- Take your benefits a bit at a time whilst keeping the remaining funds invested, also known as 'drawdown'.
- Buy different types of annuities which provide a guaranteed income for life.

What benefits might a typical BTRSS member build up?

We've shown some examples here of the benefits you might expect to receive in retirement, either by buying a pension (an annuity) or by taking some of your pot a bit at a time (drawdown). We've shown this in the table below for a BTRSS member after a full career at BT, alongside the relevant [replacement rate benchmarks](#).

[Discover more about how the BTRSS works.](#)

BTRSS MEMBER EXAMPLE 1: EARLY CAREER

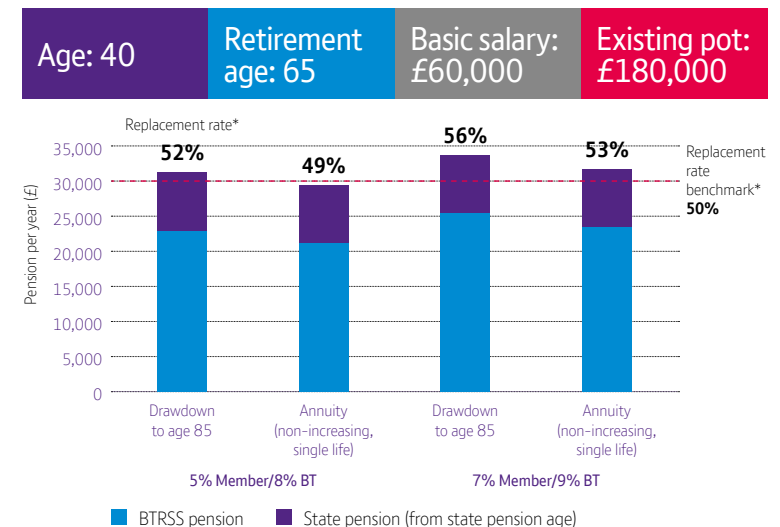


* Replacement rate does not reflect any pension built up before joining the BTRSS.

Notes / assumptions:

- Figures are shown in real terms.
- Assumes members invest in the BTRSS default fund, SL Passive Plus III Universal lifestyle, with returns of 1.3% pa above inflation and net of expenses based on KPMG projections that allow for 'lifestyling'.
- Salary growth assumed to be in line with CPI inflation.
- Projections assume member does not take tax-free cash at retirement. In practice, member can currently take up to 25% of pension pot tax free, with a reduced pension.

BTRSS MEMBER EXAMPLE 2: MID-CAREER



- Drawdown period used is 20 years (i.e. from 65 to 85) and assumes the pension pot and the amount drawn both grow in line with CPI inflation in retirement.
- Annuities are based on Statutory Money Purchase Illustration assumptions in line with pension regulations.
- Full State Pension assumed of £8,300 for 2017/18 (assumed to increase in line with CPI inflation).
- The pension provided by the BTPS includes a spouse's pension and inflationary pension increases. The BTPS provides benefits until members die, which could be after age 85. This is different from the BTRSS examples shown here.

What are the change options?

To help us achieve our fair, flexible and affordable objectives, we've started discussing several potential change options for the BTPS and BTRSS with the unions.

1. Make changes to the BTPS for future service

We're considering combinations of change options, many of which other organisations have used to help maintain a DB pension. However, there's limited scope to amend the scheme due to the cost and risk challenges we face. The range of options include:

- increasing the normal retirement age beyond 65 for future service benefits.
- increasing member contributions.
- reducing the amount of pension and lump sum building up each year, and reviewing how the State Pension Offset works (see page 5).
- changing the level of future pension increases in retirement for future pension build up.
- introducing an annual limit to pay rises that count towards pension.
- implementing a pensionable pay salary cap, where BTPS benefits would only build up for pensionable pay below a certain limit.

2. Close the BTPS and move to the BTRSS for future service

We're considering what might happen if we close the BTPS to future accrual. For example:

- active members would become deferred members of the BTPS.
 - they would no longer build up additional BTPS benefits, but would retain their past BTPS benefits, which are protected and would generally increase with CPI inflation until retirement in accordance with the BTPS rules.
- in order to build up future pension savings, employees would have the opportunity to join the BTRSS.
 - we could put in place some transition arrangements which support people in moving to the BTRSS.

3. Make changes to the BTRSS

We're considering potential improvements to the BTRSS.

For example, changes to:

- contribution rates and structure.
- the minimum payment BT makes for lower-earning employees.
- charges paid by BTRSS members.
- other benefits including medical retirement benefits, death in service arrangements and allowances.

4. Other options

We're also reviewing other arrangements associated with our pension schemes and ways to give members further flexibility in how they take their pension. These include:

- how members may access their BTPS pension whilst continuing to work for BT.
- the terms on which BTPS members retire before normal retirement age and benefit from flexible access to their pension.

At this stage, we're in discussions with the unions and no decisions have been made. We'll keep you informed of any formal proposals put forward.

Important information: BTPS Section C

As part of the pensions review, we're also reviewing the use of RPI as the index for calculating increases to pensions in payment for Section C members, and liaising with the BTPS Trustee about this. The scope of this review includes the future increases received on benefits already built up in the BTPS, including members who have left BT and those who are currently receiving a BTPS pension.

We've agreed with the Trustee that we'll shortly seek clarity, through a Court application, on whether it's possible under the BTPS rules to change the Section C index.

Increases to pensions in payment for Sections A and B are currently calculated by reference to CPI. This will not be impacted by the Court application.

In summary

1. The BTPS and BTRSS are both now part of the review.
2. Our review objectives are aimed at ensuring all our people can build up retirement benefits that are fair and flexible. At the same time, we need to also ensure any changes are affordable, both for BT and you.
3. BT and the unions are discussing the options for change.
4. No firm decisions or proposals have currently been made. We'll keep you informed of any formal proposals put forward.

Next steps

Over the next few weeks, we'll be continuing our discussions with the unions, and working through the different options available to achieve our review objectives.

We'll keep you updated, and any formal proposals will be explained in detail as part of a 60-day consultation period.

As part of any consultation process we'll make information and tools available to help you understand the proposals and how they might affect you, including:

- online modelling tools to show the possible impact of any proposals on your pension
- written materials explaining the changes, sent to your home address
- regular updates to frequently asked questions on the [pensions review website](#)
- ways for you to ask further questions and provide feedback.

If you have any questions about anything you've read in this guide, simply visit our [website](#) and FAQ.