February 2019

Dear Member,

HERMES GROUP PENSION SCHEME: SUMMARY FUNDING STATEMENT BASED ON THE ACTUARIAL VALUATION AS AT 31 DECEMBER 2017

Here is your Summary Funding Statement for 2017. This Summary Funding Statement is based on the triennial Actuarial Valuation as at 31 December 2017.

Introduction

Every year we send members information about the funding of the Scheme. The Scheme Actuary carries out a valuation generally every three years. The most recent valuation was carried out as at 31 December 2017. Between triennial valuations, the Scheme Actuary updates the valuation annually on an approximate basis.

The actuarial valuation compares the value of the benefits earned up to the valuation date that the Scheme will have to pay in the future (the Scheme's liabilities) with the amount of money currently invested in the Scheme (the Scheme's assets).

Over time, the Scheme's 'funding position' (i.e. how its assets compare with its liabilities) will vary. In annual summary funding statements, we will tell you about the Scheme's financial position and how it has changed since the previous year's statement. This statement is based on the actuarial valuation as at 31 December 2017.

The Trustee hopes that you will find these statements useful and reassuring. If you do have any queries, however, please contact Inside Pensions, the Scheme Secretary.

The last actuarial valuation

The most recent valuation of the Scheme showed that on 31 December 2017 the funding position was as follows:

Assets	£234.5m
Estimated amount needed to provide benefits earned up to the valuation date (liabilities)	£215.3m
Surplus assets in excess of liabilities	£19.2m
Funding level (ratio of assets to liabilities)	108.9%

There are some important facts to bear in mind about the valuation:

- The funding valuation treated the Scheme as continuing, with the ongoing support of the Employer.
- The valuation used assumptions that were determined by the Trustee after considering actuarial advice and agreed by the Employer. The assumptions relate to future events, for example on investment returns or how long members will live in retirement, and the actual events will differ from those assumed.
- Since in practice assumptions are not borne out, there is a need to monitor the financial position regularly.

Employer contributions

Following the 31 December 2017 valuation, as assets exceed liabilities, there are therefore no deficit reduction contributions payable, and a Recovery Plan is not required.

The Trustee now holds a reserve within the value of the liabilities to meet anticipated expenses incurred in managing the Scheme over the 5 years following the 31 December 2017 valuation date, so there are no longer any contributions required in respect of these expenses.

The Employer pays any Pension Protection Fund levies.

Change in funding position since the last update sent to members

The funding position has improved over the year from 89% funded as estimated as at 31 December 2016 to 108.9% funded calculated as at 31 December 2017. This was due to various positive factors: the payment of deficit contributions; investment experience; the one-off payment of £35m as part of the agreement to removing Hermes as an employer supporting the Scheme (the Flexible Apportionment Arrangement) in December 2017.

In addition, the Scheme has completed a triennial valuation at 31 December 2017 based upon membership data at that date. As a result, the figure at 31 December 2017 reflects the member experience over the prior 3 years that was not previously allowed for in the 31 December 2016 estimate, and this has had a positive impact on the position.

These positive factors were offset to a degree by a strengthening of financial assumptions, placing a higher value on the Scheme's liabilities.

The variation in the numbers over time emphasises the fact that these are only snapshots at a particular date. In the kind of volatile markets experienced over the past few years, it is important to take a long-term perspective.

How is my pension funded?

The Trustee ensures that the Employer pays all contributions necessary so that when members retire the Scheme can pay the pensions due to members and pay all other benefits payable under the Scheme Rules.

The money to pay for members' pensions is held in a single fund separate from, and not controlled by, the Employer. It is not held in separate funds allocated to each individual member.

The importance of the Employer's support

The Trustee's main objective is to have enough money in the Scheme to pay pensions now and in the future. This relies on the Employer's legal obligation to continue to support the Scheme because:

- the value of assets and liabilities can fluctuate, and when there is a funding shortfall, the Employer will need to put in more money; and
- the target funding level may turn out not to be enough so that the Employer will need to put in more money.

The Employer is BT Pension Scheme Trustees Limited, which is the trustee company for the BT Pension Scheme. The Employer is responsible for the funding of HGPS. The BT Pension Scheme continues to be one of the largest occupational pension schemes in the UK.

Payments to the Employers

There has not been any payment to Employers out of the Scheme in the period since the 31 December 2017 valuation, or at any other time.

The Pensions Regulator

The Pensions Regulator has not modified the Scheme, given it directions, or imposed a schedule of contributions upon it.

What is the Scheme invested in?

The underlying policy is to invest in a broad range of assets. The detail of the Trustee's policy as at 31 December 2017 was in transition, as agreement to the Flexible Apportionment Arrangement (FAA) was made in late December 2017, along with the £35m payment.

As part of the FAA, the Trustee received agreement for a further de-risking from return seeking equity and multi-asset investments into liability matching LDI assets. This included:

- a reduction in the strategic equity allocation from 30% to 20%,
- a reduction in the multi-asset allocation from 20% to 15%; and
- an increase in the LDI allocation from 25% to 40% of assets.

To facilitate the move to the revised target asset allocation, of the £35m cash injection from the FAA, £34m was invested in the LDI portfolio on LGIM's first trading date of 2018 (2 January 2018), with £1m held back in the Trustee bank account to meet benefit outgo.

Over H1 2018, various trades were made to bring the asset allocation closer in line to the targets, and the positions at both 31 December 2017 and 30 June 2018 are shown below.

	Investment Objective/ Portfolio style	Long Term Strategic Asset Allocation as at 31/12/2017	Actual Asset Allocation as at 31/12/2017	Actual Asset Allocation as at 30/06/2018
Global developed market equity	**Return seeking, index matching**	**16.0%**	**20.9%**	**16.8%**
Emerging market equity	**Return seeking, active**	**4.0%**	**4.7%**	**4.3%**
Multi Asset	**Return seeking, active**	**15.0%**	**15.7%**	**15.3%**
Property	**Liability matching, active**	**10.0%**	**9.0%**	**9.3%**
Diversified Credit	**Liability matching, active**	**15.0%**	**13.0%**	**14.3%**
LDI	**Liability Matching**	**40.0%**	**22.1%**	**40.0%**
Cash		**0.0%**	**14.6%**	**0.0%**

The actual proportion invested in any particular class of assets at any time will differ from the targets.

The Trustee appointed Hymans Robertson LLP as investment advisors from 1 January 2013 (to replace BT Pension Scheme Management Limited). The Trustee appointed LCP (Lane Clark and Peacock) as investment advisers to the Scheme over the summer of 2018, replacing Hymans Robertson.

The position on ‘winding up’

The funding position reported in this communication assumes that the Scheme will continue in operation in the future. However, sometimes pension schemes are wound up, which means that the accrued benefits for all members are bought out with an insurance company.

If the Scheme had started winding up on 31 December 2017 (the date of the last formal valuation), the estimated amount needed to ensure that all members’ benefits could have been secured in full with an insurance company would have been about £317.8m. As the assets at that date were £234.5m there would have been a deficit on this basis of about £83.3m. Inclusion of this information does not imply that the Employer is thinking of winding up the Scheme.

It is important to note that, whilst the Scheme continues (as it is now), even though funding may temporarily be below target from time to time, benefits continue to be paid in full. If the Scheme were to start to wind up, the Employer is required to pay enough into the Scheme to enable the members’ benefits to be secured in full with an insurance company. It may be that it is not possible for this full amount to be paid, but this is very unlikely as the BT Pension Scheme is very large. In the unlikely event that there is a shortfall, the Pension Protection Fund may take over the Scheme and pay certain benefits to members. There are limits on the amounts paid by the Pension Protection Fund and this would not give exactly the same benefits as those provided by the Scheme.

Further information and guidance is available on the Pension Protection Fund's website: www.pensionprotectionfund.org.uk. Alternatively, you can write to the Pension Protection Fund at: 12 Dingwall Road, Croydon, CR0 2NA.

Why does the Scheme not call for full winding up solvency at all times?

The full winding up solvency position assumes that benefits will be secured by buying insurance policies. Insurers are obliged to take a very cautious view of the future and need to make a profit. The cost of securing pensions in this way also incorporates the future expenses involved in administration. By contrast, our funding scheme assumes that the Employer will continue to support the Scheme.

Additional documents available on request

The following documents are available to members. Many are available on the member website, but if you want us to send you any of these documents please let the Scheme Secretary know.

Actuarial Valuation. The full report as at 31 December 2017.

Statement of Funding Principles. This sets out the policy of the Trustee in relation to scheme funding and other related matters.

Schedule of Contributions. This shows what money is paid into the Scheme.

Statement of Investment Principles. This explains how the Trustee invests the money paid into the Scheme.

Annual Report and Accounts. The report shows the Scheme's income and expenditure in the year to 31 December 2017, and the half year to 30 June 2018.

Annual Benefit Statement – This statement will provide you with an illustration of your likely pension. The Scheme Administrator routinely provides Annual Benefit Statements. Alternatively, if you are an active or deferred member, you are able to request one for a particular date.

Where can I get more information?

If you have any other questions, or would like any more information, please contact Inside Pensions, the Scheme Secretary. The HGPS member website also contains helpful information about the Scheme.

Please also help us to keep in touch with you by telling the administrators if you change your address.

Important: If you are thinking of leaving the Scheme for any reason, you should consult a professional advisor, such as an independent financial advisor, before taking any action.

The Trustee of the Hermes Group Pension Scheme

Contact Details

Should you need any details on your pension benefits or have changed your personal circumstances, please contact Capita Employee Benefits, the Scheme Administrators:

hermes.pensions@capita.co.uk

01227 771445

Capita Employee Benefits, PO Box 323, Whitstable, CT5 9BY

If you have any further queries with regard to this communication or the management of the Scheme, please contact Inside Pensions, the Scheme Secretary:

hermes@insidepensions.com

01727 733150

Inside Pensions, First Floor, Trident House, 42-48 Victoria Street,
St Albans, Hertfordshire AL1 3HZ