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Press Release

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Hermes Pensions Management (Hermes) today announces the finalisation of a £1 billion investment into commodities on behalf of its owner and major client, BT Pension Scheme (BTPS). The investment has been made by way of an open ended Guernsey registered and listed fund, The Hermes Commodity Index Fund (HCIF). The BTPS investment is the largest single allocation to commodities of any institutional investor in the UK. HCIF is therefore already one of the largest commodity funds ever created. The fund has share classes in Sterling (for UK schemes) but also US\$, € and Yen.

HCIF is an index tracking fund, and will track the price performance (by the use of futures and swaps) of twenty four different commodities which make up the Goldman Sachs Commodities Index (GSCI). Specifically, the BTPS investment will track the GSCI Light Index. Compared to the regular GSCI, this index has a modified weighting to the overall energy component (oil and gas) based more on the historic weight of the energy sector. This decision was made to reflect current concerns around the recent run up of energy prices and their aggregate weighted effect on the index.

The investment represents 3% of BTPS's total funds of £34 billion and follows the decision by BTPS in the 3rd quarter of 2005, on the advice of Hermes. This investment follows and complements recent investments into (or increased allocations to) other alternative investments, including hedge funds, private equity and PFI.

Hermes has built up in-house expertise in commodities in order to assess the impact of commodity investment over the longer term and how it would fit in a portfolio of other investments. The findings, supported by research from Yale School of Management*, show that an investment in commodities, with other alternative investments, will result in an overall improvement to returns and a significant reduction in volatility across a portfolio of investments.

Over the last 50 years commodities and equities have provided similar real returns in excess of 5.0% pa (compared to bonds at approximately 1.5%). However the correlation of the performance, especially over the longer term, has been quite different – with commodities stronger for instance in inflationary periods and at moments when equities (and bonds) come under severe pressure. Commodities have also historically achieved a higher rate of excess monthly returns than equities (or bonds). As a result the inclusion of commodities in a portfolio of investments can significantly decrease the downside risk of the portfolio. By contrast bond investment may lock in lower returns.

Hermes' advice to the Trustees of BTPS, which was accepted, was to start with a passive allocation to commodities. This methodology is not only simple, efficient and highly cost effective, but provides a scheme with the key market characteristics and benefits of commodities as an asset class. Seeking to generate significant out performance from commodities, at this early stage of the allocation, was deemed to be overly complex, expensive and reliant on finding skill-based managers.

James Walsh, Head of Strategy and Alternatives at Hermes, said:

"This is a major step for us and one which, in the long term, will have a substantial impact on the BTPS performance. It has become evident that schemes should not rely on bonds and equities alone to deliver consistent returns in order to meet the long term promise to members, while simultaneously reducing the burden on the sponsor. Adding commodities is especially effective at diversifying a fund's investments and counterbalancing equity volatility, but potentially capturing high returns. All schemes with a substantial allocation to equities should seriously consider adding in commodities – initially through tracking an index. This is cheap, efficient and can be done in size. We hope that other UK schemes will join BTPS in making this important asset allocation."

Hermes, via HCIF, has been directly responsible for executing all commodities trades with various counterparties, which has kept the cost of the HCIF to a minimum. The investments have been made over the last 12 weeks.

*Facts and Fantasies about Commodity Futures by Gray Gorton, University of Pennsylvania and K. Geert Rouwenhorst, Yale School of Management, June 2004

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Notes to Editors

GSCI components:

Energy

Crude Oil
Brent Crude Oil
Unleaded Gas
Heating Oil
GasOil
Natural Gas

Industrial Metals

Aluminium
Copper
Lead
Nickel
Zinc

Precious Metals

Gold
Silver

Agriculture

Wheat
Red Wheat
Corn
Soybeans
Cotton
Sugar
Coffee
Cocoa

Livestock

Live Cattle
Feeder Cattle
Lean Hogs

Hermes Pensions Management (Hermes) - Hermes is a leading pension fund investment manager, independent of any broader financial services organisation. Hermes' market-leading investment strategy has for many years been based on the index/specialist approach and is increasingly being adopted by other large pension funds. Hermes currently invests approximately £55bn on behalf of over 200 clients including pension funds, insurance companies, government entities and financial institutions, as well as charities and endowments. However, Hermes' largest client is the BT Pension Scheme (BTPS), who as owner of Hermes, gives its investment management perspective a unique insight and close alignment to the needs of other long-term investors and pension funds. Some of Hermes' other major clients include the pensions funds of Royal Mail, Sainsburys, Unilever, Nippon Life (Japan), CalPERS (USA), PGGM, ABP (Netherlands), OTPP (Canada) and over 30 UK Local Authorities.

Hermes places great emphasis on exercising stewardship rights in all the companies in which it invests, particularly because it has long-term holdings in index stocks and is therefore necessarily exposed to under-performing assets. As a result, it is at the forefront of the corporate governance movement in the UK. Hermes is the first major investment institution in the world to have established both UK and European shareholder engagement funds - the Focus Funds. Having identified companies underperforming their indices, Hermes' intervention and involvement as long-term shareholders aims to unlock the latent value that exists within the companies in which it invests.