

ESG investing under fiduciary management

How the UK pensions fiduciary
management market is keeping pace
with evolving ESG practices.

June 2024



Introduction

ESG remains an important topic in the UK pensions sector, with intensified public scrutiny and regulatory pressures around the robustness of climate plans.

Increased focus on climate and nature

The predominant topic under ESG has been climate change, with an increasing focus on topics such as nature, biodiversity, and social factors. As part of the increased regulation in this space, the Pensions Regulator (TPR) in their Annual Funding Statement 2024 has urged stakeholders to consider the impact that wider sustainability issues outside of climate (such as nature loss) can have on the investment outcomes, liabilities, and resilience of a schemes' funding strategy, as well as strength of their covenant. It has therefore become increasingly important to consider climate as well as wider sustainability issues (like nature loss) when considering the possible long-term covenant, investment, and funding strategies of pension schemes.

EY teams approach

This is EY teams' fourth industry-wide survey looking at how ESG is being incorporated by the fiduciary management market. The survey covers 14 fiduciary managers who collectively manage over £150 billion of assets for UK pension schemes and focusses on their activities over the last 12 months. The fiduciary managers cover a range of client sizes and both those that mostly use external asset managers or offer in-house funds.

In this survey, we have assessed the participating fiduciary managers across six key areas: governance, risk management, investment integration, stewardship, climate change and nature, and reporting. As an independent oversight provider, we believe EY teams are uniquely placed to build a picture of the entire industry and assess the different stages of ESG maturity exhibited by different fiduciary managers.

Whilst this survey focused on the fiduciary management industry, the key conclusions also apply to the adviser market, given the overlap between the number of providers who provide both advisory and fiduciary management services and take a consistent approach across both.

Given the pace of change in both ESG and fiduciary management, it is often difficult to navigate these areas and be confident your provider is adopting current best practices. This is a key area EY teams look into when providing our fiduciary management selection and oversight services. We hope this survey provides insights to help you navigate the market and ensure your member outcomes are protected.

We would like to thank all respondents who participated in the 2024 annual ESG survey.

Scope

6 key areas

14 fiduciary managers

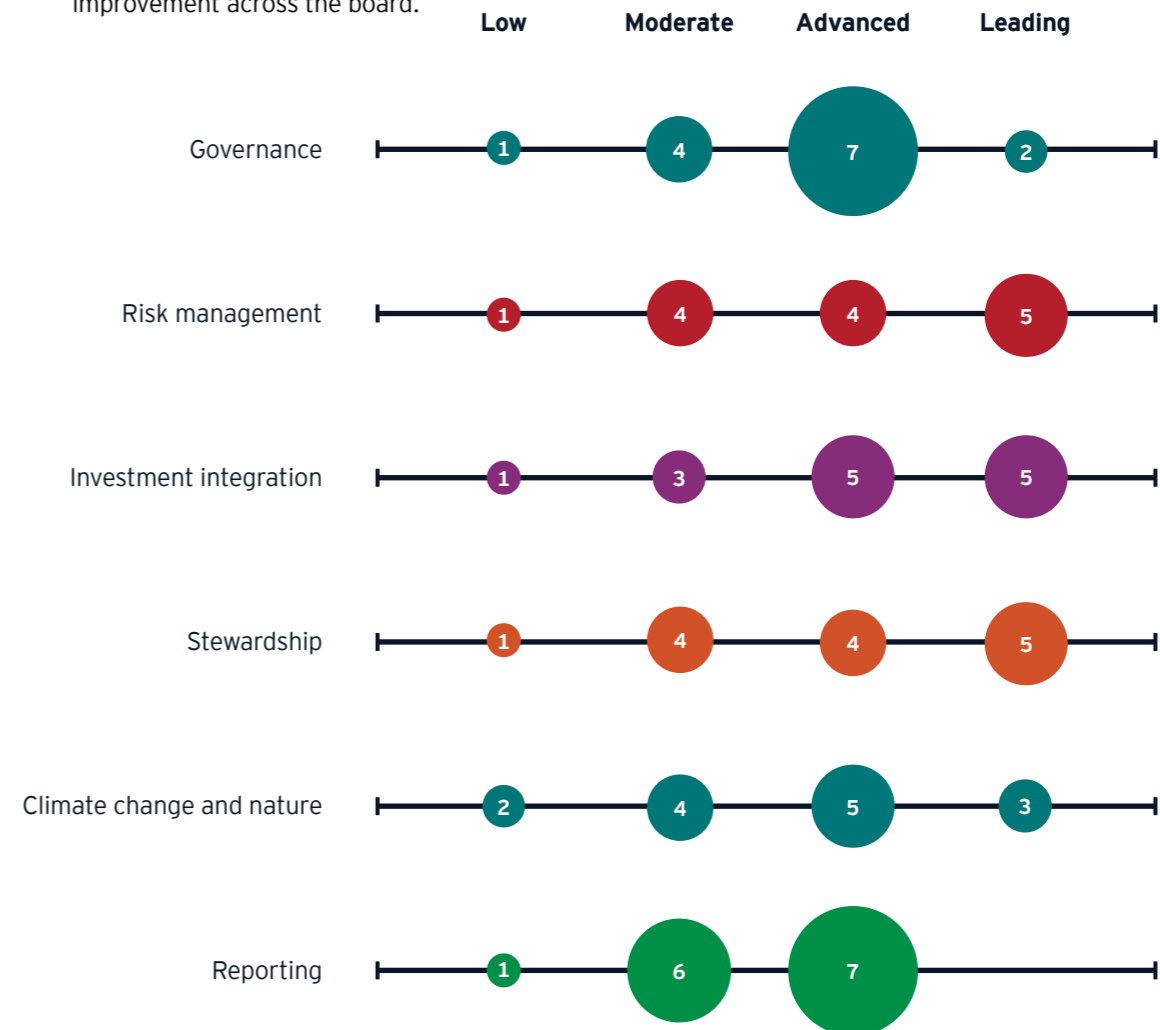
£150bn of assets in the UK

Survey highlights

From the survey results, and EY teams' continued research, we have assessed the maturity of each participating UK fiduciary manager across six key ESG areas. In comparison to the previous survey, we have seen that the overall approach to ESG continues to improve. In particular, investment integration and stewardship are two areas where we have seen a marked improvement.

To reflect increasing industry focus on nature and biodiversity, and the introduction of the voluntary Taskforce on Nature-Related Financial Disclosures (TNFD), the climate change area of the survey was expanded to include questions about the approach that fiduciary managers take on this important topic.

As can be seen from the chart, there is a range of capabilities across the market, with a large spread in maturity amongst fiduciary managers in most areas. Despite a few fiduciary managers making enhancements to their reporting over the year, this is an area that still requires improvement across the board.



The chart shows how the fiduciary managers that we surveyed score against the six pillars

Survey highlights

What questions should scheme stakeholders be asking?

Governance

All fiduciary managers have some form of ESG policy in place, with leaders expanding their policies to take account of nature, biodiversity, and social factors.

Has your fiduciary manager developed an approach to nature?

Risk management

Leading fiduciary managers produce credible net-zero implementation plans for the short and medium term to achieve their portfolio net-zero targets.

Does your fiduciary manager have in place a net-zero implementation plan?

Investment integration

Most fiduciary managers can implement bespoke ESG preferences for clients, with 71% of respondents making new ESG-focused investments available to their clients over the last 12 months.

Has your fiduciary manager made ESG-focused investments available for your portfolio?

Stewardship

Almost 80% of UK fiduciary managers are signatories to the FRC's UK Stewardship Code. Leading fiduciary managers are taking a data-driven approach to identifying high-priority engagement areas.

Is your fiduciary manager engaging on asset classes outside of equities and fixed income?

Climate change and nature

Nature and climate are intricately linked, so it will be important for fiduciary managers to have an approach to both. The Department for Work and Pensions have at this stage not yet provided a view on whether they are planning to include Taskforce on Nature-related Financial Disclosures reporting in pension regulations, however the Pensions Regulator has encouraged Trustees to familiarise themselves with the framework.

Does your fiduciary manager continually update their climate analysis capabilities?

Reporting

Only a small minority of fiduciary managers have not yet had experience helping clients through a first round of Task Force on Climate-Related Financial Disclosures reporting.

What area of your fiduciary managers reporting needs improvement?



Governance

How ESG is embedded into the decision-making processes of a fiduciary manager and how it permeates through their business, culture and staff is critical to good governance. Having robust ESG governance in place increases the likelihood of achieving any decarbonisation, or other ESG targets, the fiduciary manager may have.

Key themes over the year

ESG Policy enhancements

All respondents have some form of ESG policy in place, with EY teams observing few respondents expanding their policies to include formalised frameworks for considering nature and biodiversity into the investment process. Specifically, a few fiduciary managers have selected deforestation and water usage as pillars under nature for which they have put in place policies and portfolio targets. Human and labour rights, as well “impact” investments with specific themes were further areas more formally embedded into ESG policies.

36%
of respondents
have a
deforestation
policy or
framework
in place

ESG training for clients

As in prior years, we continue to see the majority of fiduciary managers provide clients with ESG training, expanding from predominately climate change last year to cover other themes like biodiversity and nature.

EY teams have also seen the development of tools that fiduciary managers use to help their clients define net-zero ambitions.

Initiatives

EY teams observed three new initiatives that were popular this year for fiduciary managers compared to our last survey. This included the human rights initiative UNPRI Advance and the nature initiatives TNFD and Nature Action 100. Involvement in these initiatives reflects an increased commitment by fiduciary managers to managing risks associated with human rights, nature loss, and ecosystem decline.

Governance process

EY teams observed leading practice enhancement to ESG governance with the introduction of internal accreditation frameworks which show how well individual investment teams are integrating ESG. This process requires investment teams to detail their ESG philosophy, approach to active ownership and integration of climate risk along with case studies.

4/15
respondents are
UNPRI Advance
signatories, a
stewardship
initiative for
human rights and
social issues.





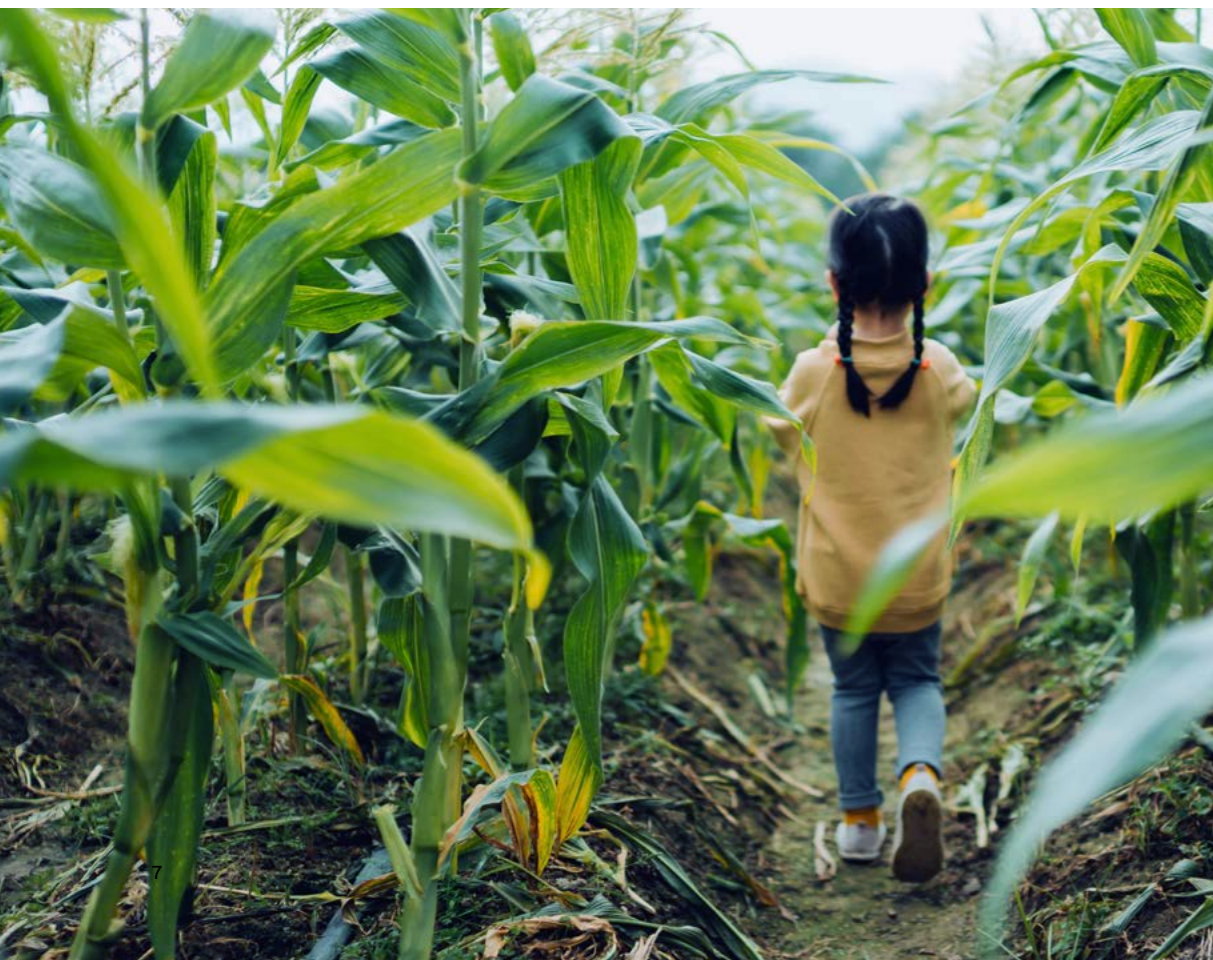
Risk management

ESG risk management covers the approach to using data and other modelling techniques to identify, assess, manage, and mitigate ESG (including climate) risks. This should ideally be embedded into a scheme's wider risk management and framework and be backed up with appropriate tools to monitor risks over time.

Key themes over the year

Many fiduciary managers are reflecting on the industry-wide challenges associated with current climate risk models and methodologies, with leading fiduciary managers working on solutions to these issues.

Fiduciary managers continue to enhance their tools, data, and resources to better manage climate threats, and review that their risk management and mitigations processes are in line with their firm's climate risk strategy.



EY teams have observed the following popular updates to ESG risk management:

Climate standards risk processes

To mitigate the risk of falling short of increasing ESG reporting obligations, some fiduciary managers have established working groups dedicated to climate standards. The aim of these working groups is to ensure that climate standards and methodologies applied are reflective of their clients' needs and best practice.

Net-zero implementation plans

EY teams view it as best practice to have in place net-zero implementation plans. Leading fiduciary managers produce credible net-zero implementation plans for the short and medium term to achieve their portfolio net-zero targets.



ESG scores

Almost all fiduciary managers use proprietary ESG scores for assessing the ESG capabilities of their external managers. Fiduciary managers have continued to update and refine these ESG scores to reflect developing areas, for example external managers' engagement capacities on climate and biodiversity, deforestation programmes, water management programmes and assessing external managers on their Science Based Targets initiative (SBTi) objectives.

ESG data assurance

Leading fiduciary managers are receiving assurance from third-party providers regarding ESG data quality as an ESG risk mitigation technique. The industry is seeking to understand the functions and development of the sustainability assurance market, with the FRC announcing in May 2024, the launch of a [market study](#) into the market for assurance of sustainability reporting.





Investment integration

Investment processes cover the investment strategy setting approach, asset allocation, manager selection and ongoing monitoring. Given that responsibility is delegated in a full fiduciary arrangement it is important to assess how the fiduciary manager is integrating ESG throughout the investment process, as well as their ability to reflect any bespoke ESG client preferences.

Key themes over the year

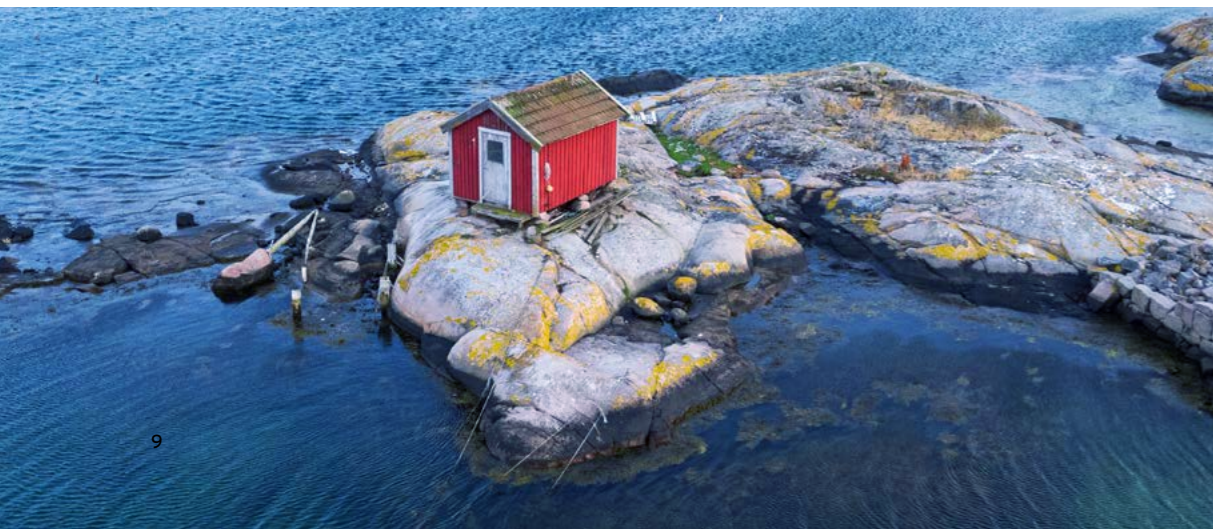
Many fiduciary managers have expanded their approach to integrating ESG into their investment process by focusing on themes outside of climate, such as biodiversity and social factors. Examples include updating proprietary ESG ratings of underlying managers to reflect these themes during due diligence and ongoing monitoring, and setting targets at the portfolio level.

Anti-greenwashing and fund labelling

What counts as a sustainable investment is currently loosely defined, but investment labelling regulations under Sustainability Disclosure Requirements (SDR) are expected to tighten requirements from 2024. Four labels for funds are available, that may be adopted on a voluntary basis from July 2024. The anti-greenwashing rule, which applies to all FCA authorised firms and requires that references to sustainability characteristics be clear, fair and not misleading, is in effect from 31 May 2024.

In April 2024 the FCA announced that SDR rules will be extended to portfolio managers. The aim of the SDR is to “improve the trust and transparency of sustainable investment products and minimise greenwashing”.

Most fiduciary managers are monitoring the developments of SDR, with some going further by conducting exercises that actively map how SDR labels would apply to their funds. Fiduciary managers with sustainable fund ranges indicated that they are looking to future proof these as far as possible to meet any new requirements that are introduced.



Bespoke client ESG preferences

Almost all fiduciary managers are able to reflect bespoke client ESG preferences. Some examples of these include:

- 1 Custom solutions with specific thematic ESG exposures
- 2 Minimum % allocation to “impact” funds
- 3 ESG tilts and exclusions
- 4 Decarbonisation and temperature alignment targets
- 5 Ensuring a client’s sustainability priorities are reflected in most significant votes and third-party managers’ voting decisions

EY teams observed only a small proportion of respondents not able to reflect bespoke client ESG preferences, or that limit helping clients set bespoke ESG metrics to those that are in scope for TCFD.

ESG focused funds

Fiduciary managers continue to increase the number of ESG focused funds available to their clients. Some examples of these include:

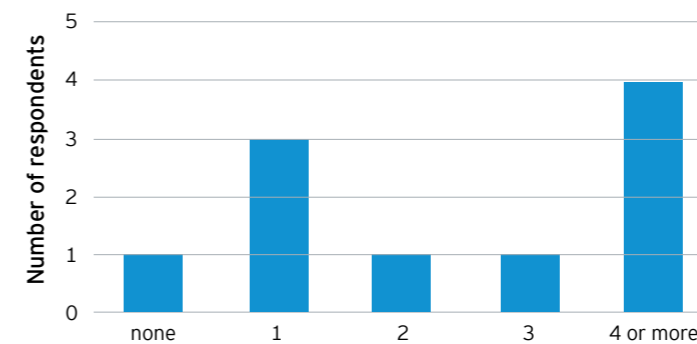
- 1 Index funds incorporating climate transition analytics and a decarbonisation pathway
- 2 Launching sustainable versions of model delegated portfolios
- 3 “Impact” funds as elective options for clients
- 4 Renewable infrastructure solutions
- 5 Adding green gilt allocations within LDI portfolios
- 6 Environmentally aware cash funds

93% of respondents are able to help clients set bespoke ESG preferences

10/14 respondents made new ESG-focused solutions available for their clients

The number of new ESG-focused investments made available to clients over 2023 varied from one to some as high as seven.

Number of new ESG-focused investments made available to clients



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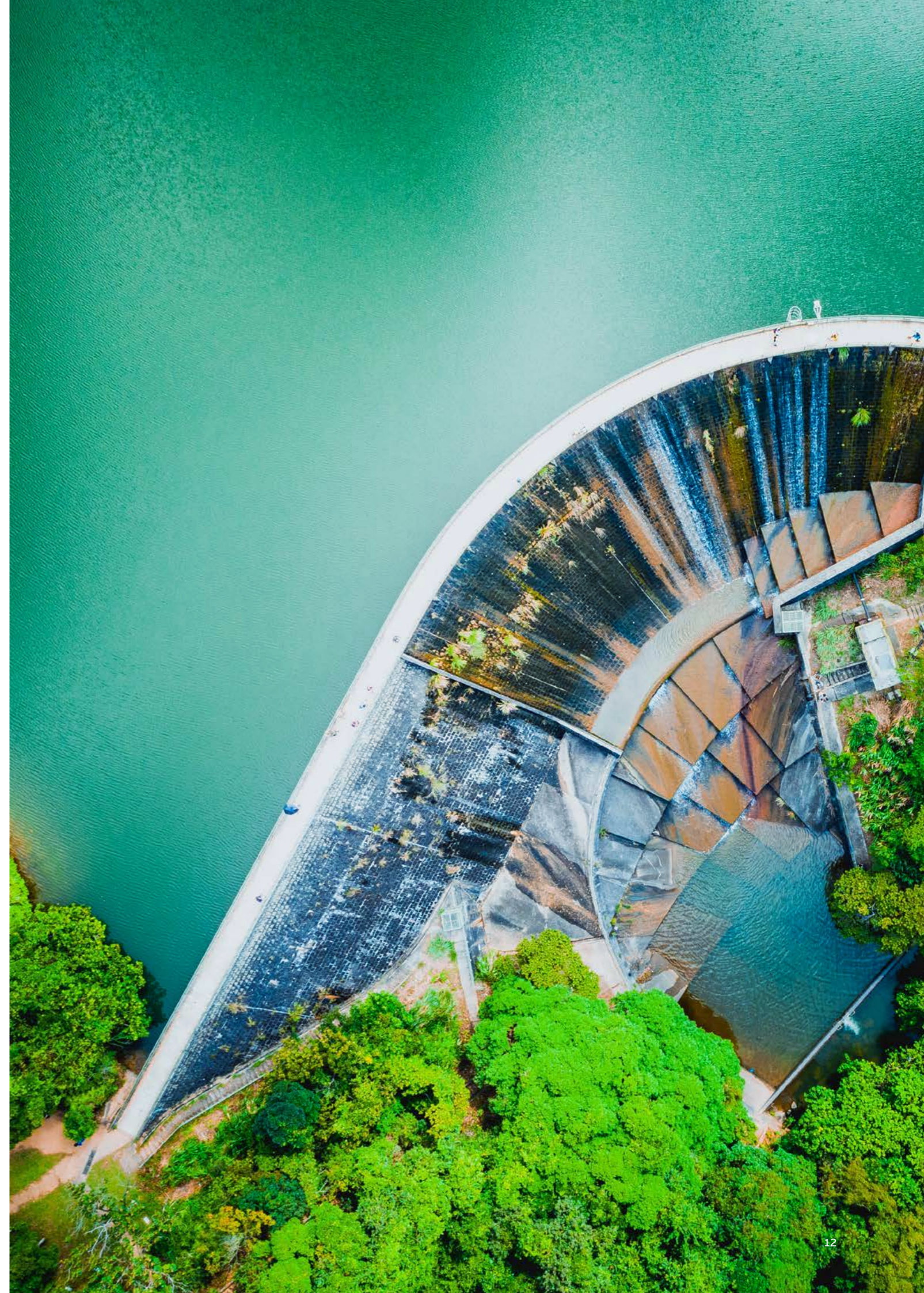
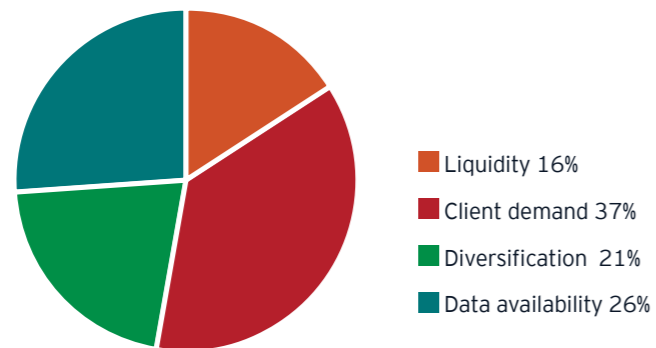
Barriers to increased allocation of ESG-focused investments

16% of respondents described liquidity as a barrier to increasing allocation of ESG-focused investments for UK fiduciary management clients in 2023. With more schemes exploring 'endgame' solutions due to improved funding positions, the portfolio asset allocations of many of these schemes shifted towards liquid asset classes like investment grade public credit and gilts. Many "impact" or ESG-focused investments are available in private markets, and hence highly illiquid. Due to their liquidity budgets, clients are therefore limited to increase allocations.

In response to this challenge, a few fiduciary managers are seeking to develop more liquid impact / ESG-focused investment options for clients.

Other barriers to increasing allocations included lack of data availability, client demand and suitability to include in portfolios for diversification reasons.

Barriers to increasing allocations to ESG-focused investments





Stewardship

Stewardship represents the use of influence by investors to maximise the overall long-term value of the assets they invest in and ultimately create value for pension scheme members. Depending on the nature of invested assets, varying levels of influence are possible, and stewardship can include voting and engagement on a range of ESG issues that pose a risk to investments. For best practice in this area, we encourage clients to familiarise themselves with the FRC's UK Stewardship Code.

Stewardship, including engagement and voting, form some of the most important tools in which fiduciary managers can bring about actual positive change within the industry.

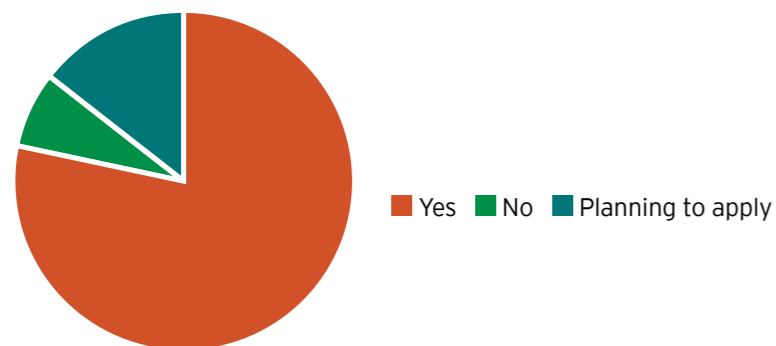
Key themes over the year

Of the only three respondents not signatories to the FRC's UK Stewardship Code, two indicated that they were planning to apply / re-apply.

We are seeing a differentiation between leading fiduciary managers who engage with underlying external managers and investments in asset classes outside of equities and fixed income, and those that only focus their engagement efforts on equities and fixed income.

The FRC is reviewing the [2020 UK Stewardship Code](#), with a consultation expected in summer 2024. The outcome is likely to be a further increase in standards for signatories.

Signatory to the FRC's UK Stewardship Code?



Data-driven engagement approach

The building out of data capabilities to monitor and inform engagements has been a common improvement to the stewardship approach of fiduciary managers. For example, by employing a data-driven strategy, the biggest underperformers in a portfolio are identified and engagement activities concentrated on these underperformers. Underperformers are typically identified based on their emissions impact, transition alignment, and public decarbonisation disclosures. Another example has been a strengthened approach to monitoring instances of UN Global Compact breaches, which is a popular metric monitored by fiduciary managers.

Fiduciary managers are allowing for voting expectations for external managers in their Stewardship Policy, for example requiring external managers to review climate-related disclosures, challenge boards that display inaction on climate change, and to consider voting against directors not supportive of the climate transition.

5/14 respondents have joined Nature Action 100 to support biodiversity preservation.

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Biodiversity and natural capital

Biodiversity and natural capital were priority engagement themes for c.33% of respondents in EY team's last survey, and this number has increased to c.79% of respondents this year. This has resulted in several respondents engaging with their underlying external managers on their approach to the Task Force on Nature-related Financial Disclosures.

EY teams observed stronger commitments to vote on environmental issues (particularly relating to biodiversity) in fiduciary managers' Proxy Voting Policies, with leading fiduciary managers encouraging their proxy voting service provider to prioritise biodiversity.





Climate change and nature

Climate change is a fast-evolving and increasingly scrutinised area of fiduciary management, particularly with the Task Force on Climate-Related Financial Disclosures (TCFD) regulations applying to many schemes. Estimating the potential future impacts of climate change relies on complex scenario modelling and climate metrics, with evolving levels of data available. Best practice is to use the available data and modelling to set clear decarbonisation strategies and consider the impact of climate change across investments, funding, and covenant holistically. To reflect increasing industry focus on nature and biodiversity, and the introduction of the voluntary Taskforce on Nature-Related Financial Disclosures (TNFD) this area of the survey was expanded to include questions about the approach that fiduciary managers take on this important topic. Nature and climate are intricately linked, so it will be important for fiduciary managers to develop an approach to both.

Key themes over the year

Unsurprisingly, given increased regulatory and public scrutiny on climate change, this is the primary focus for most fiduciary managers' approach to ESG.



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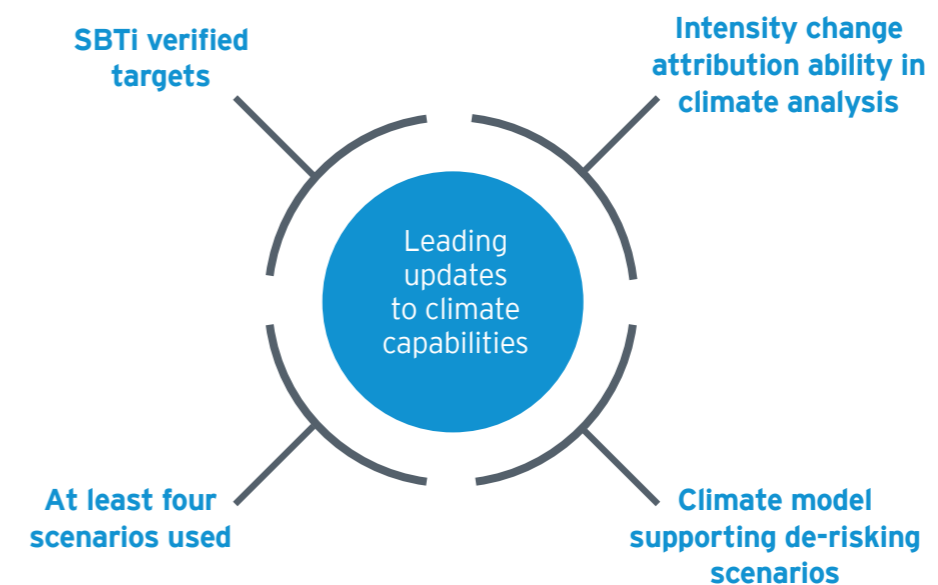
By now, climate reporting should be business as usual for those in scope, and fully integrated into day-to-day governance.

The Pensions Regulator from the publication titled “Trustees, take stock and plan for wider ESG risks and opportunities” (February 2024).

Climate change continues to be a fast-evolving area with increasing numbers of pension schemes having to report under TCFD. According to the [Annual Funding Statement 2024](#) by The Pensions Regulator (TPR), around **250** DB schemes currently have to produce TCFD reports. For large schemes, TPR has indicated that reporting should be moving to “business as usual” with improved metrics and scenario analysis. The Transition Plan Taskforce’s final framework for climate transition plans will lead to increased focus on how pension schemes plan to reach their net-zero commitments. We have also seen the first TCFD climate change reporting fine issued by TPR.

In the Annual Funding Statement 2024, TPR warns of the potential impacts that climate change and wider sustainability issues (including nature loss) can have on investment outcomes, liabilities, resilience of schemes’ funding strategies and strength of the covenant and therefore to bear this in mind when considering possible long-term covenant, investment, and funding strategies.

Over the year, EY teams have seen the following updates that leading fiduciary managers have made to their climate capabilities:



Climate scenarios

1 There is currently no consensus on which climate scenarios to use, but EY teams have observed many fiduciary managers use between four and six scenarios, up from between three and four scenarios according to the last survey. In line with Network for Greening the Financial System categorisation, climate scenarios are typically categorised into one of four transition types including an “orderly” transition to a net-zero economy, “disorderly” transition, “hot house world”, and a “too little, too late” transition.

2 EY teams have observed some fiduciary managers updating their model to allow for the impact of schemes de-risking their investment strategies. TPR’s Annual Funding Statement 2024 has additionally encouraged the trustees of schemes considering an insurance solution to take account of sustainability during their due diligence. EY teams have produced a separate paper covering ESG in the bulk purchase annuity provider market, which you can [read here for further detail](#).

Nature and biodiversity

During COP28, held at the end of 2023, nature was recognised with a first-of-its-kind joint statement on climate, nature, and people. This statement recognised that

“

the growing and projected impacts of climate change critically threaten biodiversity and the billions of livelihoods dependant on high-integrity ecosystems

as well as noting that

“

continued loss and degradation of nature increases climate vulnerability, contributes to significant greenhouse gas emissions, and impedes sustainable development

The UK is a signatory country to this statement.

Nature and climate are intricately linked, so it will be important for fiduciary managers to have an approach to both. DWP have at this stage not yet provided a view on whether they are planning to include TNFD reporting in pension regulations, however TPR have encouraged Trustees to familiarise themselves with the framework. Combined nature and climate-related disclosure reports are already in existence.

Some fiduciary managers are furthering their knowledge of nature loss and how to develop suitable solutions by collaborating with industry initiatives. Examples include the Cambridge Centre for Sustainability Leadership (CISL), Revalue Nature, and Nature Action 100+.

This has resulted in:

Production of industry guide for biodiversity and nature loss

Developing due diligence questionnaires for underlying external managers that include biodiversity topics

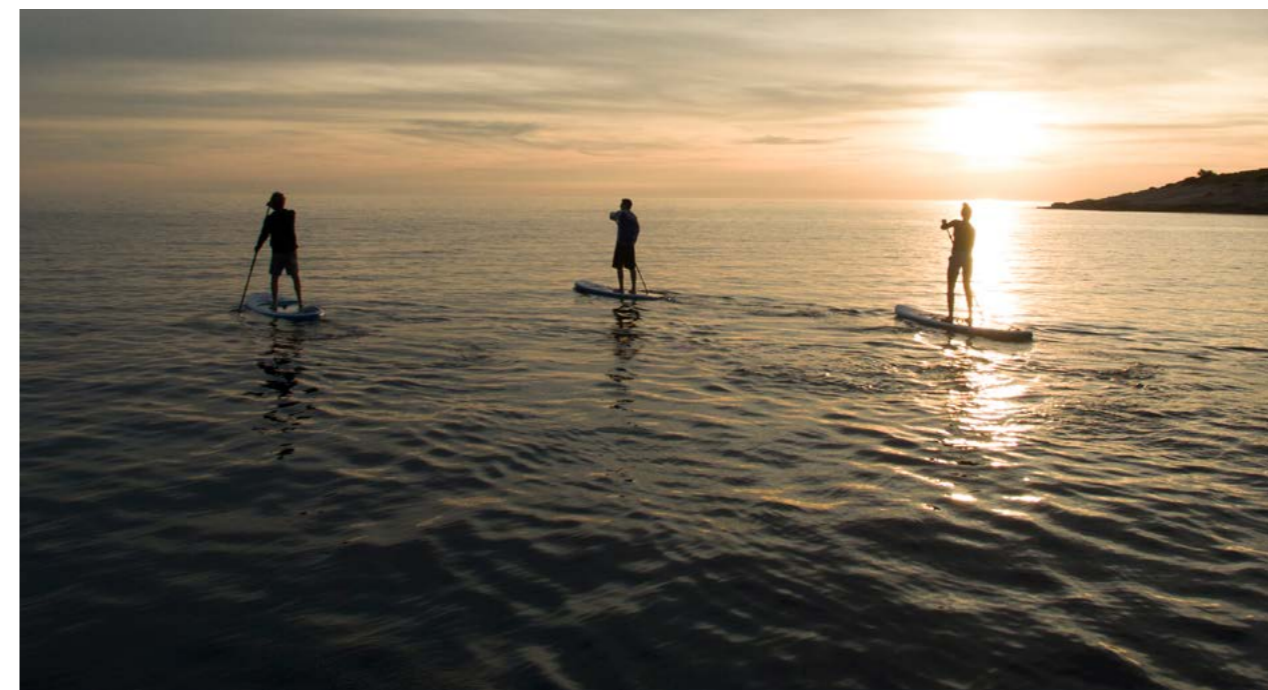
Encouragement of innovation for nature-based solutions that deliver climate mitigation benefits, improve biodiversity, and benefit local communities in alignment with the Paris Agreement

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Social factors

In October 2023, The Taskforce for Social Factors set out how to consider social factors in investments.

While there are no mandatory requirements to adopt recommendations from the UK Transition Plan Taskforce (TPT), Taskforce for Nature-related Financial Disclosures (TNFD) or Taskforce for Social Factors (TSF), EY teams recommend Trustees familiarise themselves with these recommendations. We also plan to cover this in more detail as part of future ESG surveys.





Reporting

In conjunction with the regular reporting provided to clients by fiduciary managers across areas such as asset performance, funding level developments and market outlooks, trustees should also receive high-quality, digestible, and meaningful reporting that both informs and, if necessary, promotes actions around ESG considerations, risks, and outlooks within their portfolio.

Key themes over the year

Despite a few fiduciary managers making enhancements to their ESG reporting over the year, reporting remains the least developed area. Effective reporting is reliant on the robustness of the earlier five areas. While there have been some developments across these areas, without clear targets and policies that guide investment and stewardship activity, in our view, it is difficult to report the outcomes of these activities and positions of the investment portfolio.

By now, only a small minority of fiduciary managers have not yet helped clients through a first round of TCFD reporting. Most fiduciary managers have continued to make improvements to their climate reporting capabilities.

Reporting enhancements

Many respondents have invested significant resources into developing sustainability dashboards to provide their clients with regular and more granular ESG reporting. Overall, EY teams have observed a marked improvement on the reporting capabilities of fiduciary managers' quarterly ESG reporting to clients, in particular for climate and stewardship activities. However, there still remains a spread in the maturity of the ESG reporting provided to clients, particularly concerning the asset class coverage and breadth of metrics included.

As in prior years, several fiduciary managers are lagging leading practice in that they can only report on a limited number of asset classes (typically equities and fixed income).

79%
of respondents
have done at
least 1 round
of supporting
clients with
TCFD reporting.

Reporting enhancements included:

- | | |
|---|---|
| <ol style="list-style-type: none"> 1 Increased coverage of ESG reporting (outside of equities and fixed income) 2 Updated stewardship reporting that allows clients to have better visibility of their investment managers' stewardship processes and activities 3 Adherence to clients' own sustainability guidelines, objectives, and targets 4 Diversity, equity, and inclusion (DEI) data of underlying managers and investments 5 Sustainable bonds and LDI sustainability reporting | <ol style="list-style-type: none"> 6 Proprietary ESG ratings for underlying managers from fiduciary managers' manager research process, with some exhibiting full asset class coverage 7 Leading fiduciary managers have started to report on nature metrics – for example top water footprint, and land use holdings in the portfolio 8 Portfolio exposure to controversial sectors 9 TCFD and Net-zero monitors |
|---|---|

In closing

The world is asking for change. Although progress continues to be made on the approach to climate, more needs to be done. Nature loss and biodiversity are intricately linked to climate change, and it is positive to see these important topics receiving increased focus by UK pensions stakeholders.

EY teams openly collaborate with fiduciary managers and other large asset owners on ESG, and as part of this survey have offered feedback sessions to the survey participants to discuss their areas of relative strengths and weaknesses observed through this survey.

With higher expectations from the FRC and increasing ESG regulation, it is more important than ever to consider an independent review of what your scheme is doing.

With a 20+ year legacy in sustainability and ESG services, EY teams combine deep technical skills across a breadth of business issues to help business create value for sustainability as well as help sustainability create value for business. We are supporting trustees and corporates in navigating ESG and climate change and helping EY clients meet their ESG objectives with confidence by helping ensure their approach is aligned with emerging and leading practices. We have supported numerous schemes to set ESG and climate strategies and helped trustees and corporates assess how their ESG processes and reporting compare to the wider industry. We can also help schemes with meeting TCFD disclosure requirements, assisting with drafting or reviewing your existing reporting against the regulations and leading practices.

Please get in touch for more information on how we can help you.

Assessment methodology

EY teams' ESG market practice assessment is based on the maturity matrix methodology, which sets out four levels of maturity: "Low", "Moderate", "Advanced" and "Leading". In defining the characteristics of the four levels of maturity, EY teams have considered the features of the different ESG approaches adopted by not only fiduciary managers but also by other asset owners that EY teams have engaged with in relation to ESG. A "Low" maturity level means that the fiduciary manager is yet to fully adapt their processes and solutions to enable clients to comply with minimum ESG requirements. A "Leading" maturity level implies that the fiduciary manager is a market leader and is actively driving ESG developments within the industry. Based on the survey analysis and individual feedback meeting discussions with UK fiduciary managers, EY teams have assessed the ESG capabilities of fiduciary managers and positioned each fiduciary manager within a maturity bracket across the six dimensions. EY teams expanded the climate change section to include nature, now called climate change and nature in the latest survey, to assess in more detail this emerging area. It is essential to recognise that the maturity matrix captures a snapshot market position as of March 2024. As the industry evolves, EY teams expect the maturity matrix methodology to evolve and the position of different fiduciary managers to change.

Key sustainability questions that EY teams help pension scheme clients and their sponsors to address

Stewardship, reporting and disclosures

Benchmarking

How is our stewardship and governance approach vs. market practice?
Are we ahead or behind?

Gap completion

As an FRC Stewardship Code signatory, what gaps do I need to fill?
How do I fill those gaps?

Disclosure compliance

How do I meet ESG climate and TCFD reporting hurdles?
How do I fulfil corporate carbon accounting demands?

Net-zero and strategy

Net-zero strategy

What is the plan and timeline for my scheme to reach net-zero?
How do I “justly” design and execute this transition?

Management actions

What is my joint company-trustee plan for net-zero?
How do I best measure, monitor and manage this plan?

Financed emissions

As the primary enterprise-wide source of financed emissions, how do I measure the scheme’s contribution to this key metric?

Risk-led transformation

Risk appetite

How do I set controls and risk appetite for ESG considerations?
How do I measure and manage climate risk?

Integrated frameworks

How do I design an integrated ESG and climate risk framework?
How do I implement this in a practical manner?

Modelling and understanding

How do I raise stakeholders’ familiarity with climate risk exposure?
How can modelling or stress testing help?

EY teams

EY pension ESG contacts



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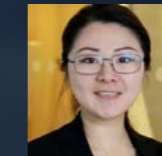


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EY | Building a better working world

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Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

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About EY-Parthenon

EY-Parthenon teams work with clients to navigate complexity by helping them to reimagine their eco-systems, reshape their portfolios and reinvent themselves for a better future. With global connectivity and scale, EY-Parthenon teams focus on Strategy Realized – helping CEOs design and deliver strategies to better manage challenges while maximizing opportunities as they look to transform their businesses. From idea to implementation, EY-Parthenon teams help organizations to build a better working world by fostering long-term value. EY-Parthenon is a brand under which a number of EY member firms across the globe provide strategy consulting services. For more information, please visit ey.com/parthenon.

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