# Elements of risk and uncertainty

In 2013, Snam established the Enterprise Risk Management (ERM) unit, which reports directly to the CEO and oversees the integrated process of managing corporate risk for all Group companies. The main objectives of ERM are to define a risk assessment model that allows risks to be identified, using standardised, group-wide policies, and then prioritised, to provide consolidated measures to mitigate these risks, and to draw up a reporting system.
The ERM unit operates as part of the wider Internal Control and Risk Management System of Snam.

## INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM

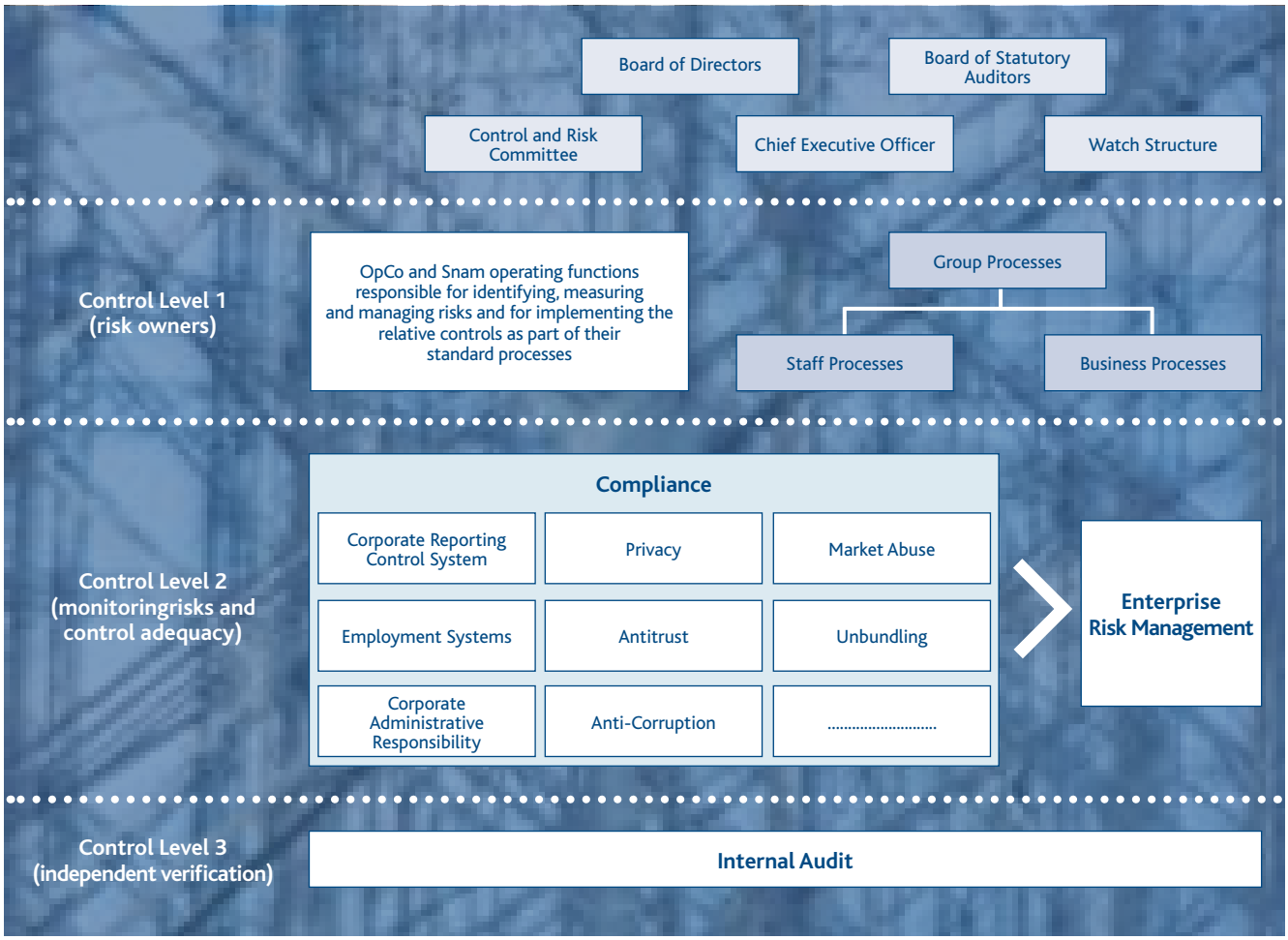
With the assistance of the Control and Risk Committee, the Board of Directors is responsible for the Internal Control and Risk Management System; the Board directs and assesses the adequacy of the system, identifying the Chief Executive Officer as the director in charge of establishing and maintaining an efficient internal control and risk management system.

The Board of Statutory Auditors and the Watch Structure monitor the effectiveness of the System.

Snam's risk management process is broken down into three levels of internal control:

- **Level One:** identifying, assessing and monitoring relevant risks, within the context of individual Group processes. This level incorporates the Group departments that own individual risks, are in charge of identifying, measuring and managing them, and are responsible for implementing the necessary controls.
- **Level Two:** (i) monitoring the main risks in order to guarantee effectiveness and efficiency in relation to: (a) the management and handling of the risks; (b) the adequacy and functionality of the controls put in place to monitor the main risks; and (ii) support for Level One in defining and implementing adequate systems for managing the main risks and the relative controls.
  This level incorporates the Group departments in charge of coordinating and managing the main control systems (e.g. Corporate Administrative Responsibility, Corporate Reporting, Anti-Corruption and Antitrust).
- **Level Three:** independent and objective assurance concerning the adequacy and effective functionality of Levels One and Two, and all risk management procedures in general.
  This is carried out by the Internal Audit, the activities of which are directed and guided by the "Guidelines" defined and approved by Snam's Board of Directors.

The following graphic gives an overview of how the entire System functions.



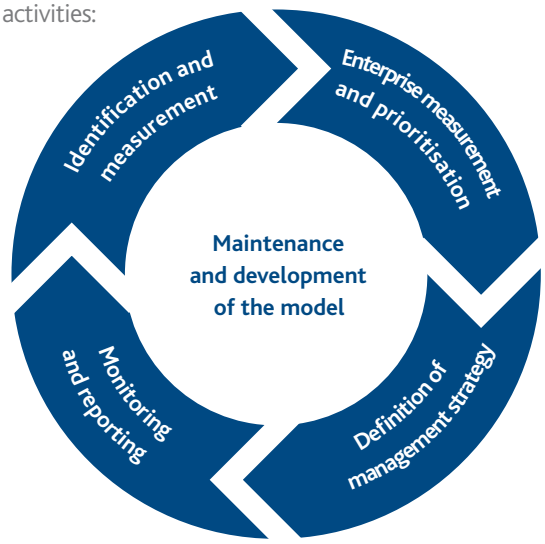

## SNAM'S ENTERPRISE RISK MANAGEMENT PROCESS

Snam has always known and managed its risks, but through ERM it has chosen to adopt a structured, standardised method of identifying, assessing, managing and controlling risks for all Group companies. The ERM model enables dynamic and integrated group-wide risk assessment that bring out the best of the existing management systems in individual corporate processes.

The findings, in terms of the main risks and the plans devised to manage them, are presented to the Control and Risk Committee so that an assessment can be carried out on the effectiveness of the Internal Control and Risk Management System with regard to Snam's specific characteristics and the risk profile it has taken on.

Snam's dedicated ERM department manages and oversees the following main activities:

- Risk identification and measurement;
- Enterprise valuation and risk prioritisation;
- Risk management strategy definition;
- Monitoring and reporting;
- Model maintenance and development.




The objective of the risk identification phase is to identify any risky events relating to the Snam Group's corporate processes and external processes that could affect the achievement of the corporate objectives.

Integrated group-wide risk measurement is carried out using scales for classifying probabilities and impacts concerning both quantitative aspects (e.g. economic and financial impacts) and more qualitative and intangible aspects (e.g. impacts relating to reputation, health, safety and environment).
Each event is assigned an "enterprise measurement". This measurement summarises the various assessments for each risk carried out by the risk owners and by centralised units with specialist skills. Risk prioritisation, on the other hand, is defined by combining impact and probability measures.
Management actions and any specific measures to be taken are identified for all risks, together with the relevant implementation schedule, and each risk is allocated one of the codified risk management types. Risk mapping is dynamic, and is therefore reviewed periodically. The frequency of these reviews depends on the enterprise valuation, but is at least annual, even for low-priority risks.
Periodic reporting guarantees that information on the management and monitoring of the risks encountered at each level of the Group is available and is disclosed.
The ERM model is maintained continuously and independently of the phases of the process, with the aim of constantly ensuring an effective model that reflects the technological and methodological progress made in the field of risk management.
The main corporate risks identified, monitored and, where specified below, managed by Snam are as follows: (i) market risk arising from exposure to fluctuations in interest rates and in the price of natural gas; (ii) credit risk arising from the possible default of a counterparty; (iii) liquidity risk arising from insufficient financial resources to meet short-term commitments; (iv) rating risk; (v) risk of default and debt covenants; (vi) operating risk; and (vii) risks specific to the business segments in which the Group operates.

## FINANCIAL RISKS

### MARKET RISK

#### *Interest rate risk*

Fluctuations in interest rates affect the market value of the Company's financial assets and liabilities and its net financial expense. Snam's risk management structure aims to optimise interest rate risk while pursuing the objectives defined and approved in the financial plan. The Snam Group adopts a centralised organisational model, and based on this model, Snam's structures ensure that its requirements are covered by accessing financial markets and employing resources in accordance with the approved objectives, whilst ensuring that the risk profile remains within the defined limits.
At 31 December 2013, 64% of financial debt was fixed rate (49% at year-end 2012) and the remaining 36% was floating rate (51% at year-end 2012).
At 31 December 2013, the Snam Group used external financial resources in the form of bilateral and syndicated loans with banks and other financial institutions, in the form of medium- and long-term loans and bank credit lines at interest rates indexed to the reference market rates, in particular the Europe Interbank Offered Rate (Euribor), and bonds, mainly fixed-rate, placed as part of the EMTN programme.

#### *Exchange rate risk*

Snam's exposure to exchange rate risk relates to both transaction risk and translation risk. Transaction risk is generated by the conversion of commercial or financial receivables (payables) into currencies other than the functional currency and is caused by the impact of unfavourable exchange rate fluctuations between the time that the transaction is carried out and the time it is settled (collection/payment). Translation risk relates to fluctuations in the exchange rates of currencies other than the consolidation currency (the euro) which can result in changes to consolidated shareholders' equity. Snam's risk management system aims to minimise transaction risk through measures such as the use of derivatives.

As at 31 December 2013, Snam's foreign currency items consisted essentially of a bond worth ¥10 billion, maturing in 2019, which was worth around €75 million as at the issue date and was fully converted into euro via a cross-currency swap. Snam does not have any cross-currency swaps in place for speculative purposes.

### *Natural gas price risk*

Up to the end of the second regulatory period on 31 December 2009, the transportation costs incurred for the acquisition of gas needed to operate the compression stations were included in overall operating costs and therefore updated using the price-cap mechanism[42]. As at the start of the third regulatory period (1 January 2010 - 31 December 2013) on 1 January 2010, the Electricity and Gas Authority, enacting the new tariff criteria laid down by Resolution ARG/gas 184/09, defined methods for payment in kind, by service users to the leading transportation company, of gas volumes to cover fuel gas, network losses and unaccounted-for gas (UFG), owed as a percentage of the volumes respectively injected into and withdrawn from the transportation network. As a result of these provisions, which were also confirmed for the fourth regulatory period (2014-2017)[43] with Electricity and Gas Authority Resolution 514/2013/R/gas, and in consideration of the mechanism for allocating gas to service users, the change in the price of natural gas to cover fuel gas and network losses no longer represents a risk factor for Snam. Uncertainty remains with regard to potential quantities of UFG in excess of the quantities paid for in kind by service users.

## CREDIT RISK

Credit risk is the Company's exposure to potential losses arising from counterparties failing to fulfil their obligations. Default or delayed payment of fees may have a negative impact on the financial balance and results of Snam.
For the risk of non-compliance by the counterparty concerning contracts of a commercial nature, the credit management for credit recovery and any disputes are handled by the business units and the centralised Snam departments. Guidelines and methods for quantifying and controlling client riskiness are drawn up at corporate level. The rules for client access to the services offered are established by the Electricity and Gas Authority and set out in the Network Codes. For each type of service, these documents explain the rules regulating the rights and obligations of the parties involved in providing said services and contain contractual conditions which reduce the risk of non-compliance by the clients. In particular, the Codes require guarantees to be provided to cover in part obligations where the client does not possess a credit rating issued by one of the leading international agencies. The regulations also contain specific clauses which guarantee the neutrality of the entity in charge of balancing, an activity carried out from 1 December 2011 by Snam Rete Gas as the major transportation company. In particular, the balancing gives Snam Rete Gas an obligation to acquire, according to criteria of financial merit, the resources necessary to guarantee the safe and efficient movement of gas from entry points to withdrawal points, in order to maintain a constant balance in the network, procure the necessary storage resources for covering imbalances for individual users and adjust the relevant income statement entries.
Snam provides business services to a small number of operators in the gas sector, the largest of which by revenue is Eni S.p.A. It cannot be ruled out, however, that Snam may incur liabilities and/or losses due to its customers' failure to honour payment obligations, including as a result of the current economic and financial situation, which makes the collection of receivables more complex and critical.

42 Under this mechanism, core revenue components relating to operating costs, amortisation and depreciation are updated with financial statement figures at the start of a regulatory period, while they are updated with inflation and reduced by a productivity coefficient in the subsequent years.

43 For the fourth regulatory period an in-kind payment for a fixed annual amount was introduced to cover unaccounted-for gas (UFG).

## LIQUIDITY RISK

Liquidity risk is the risk that new financial resources may not be available (funding liquidity risk) or that the Company may be unable to convert assets into cash on the market (asset liquidity risk), meaning that it cannot meet its payment commitments. This may affect profit or loss should the Company be obliged to incur extra costs to meet its commitments or, in extreme cases, lead to insolvency and threaten the Company's future as a going concern.

Snam's risk management system aims to establish, under the financial plan, a financial structure that, in line with the business objectives, ensures sufficient liquidity for the Group, minimising the relative opportunity cost and maintaining a balance in terms of the duration and composition of the debt.

As shown in the section "Interest rate risk", when implementing the debt refinancing programme, the Company had access to a wide range of funding sources through the credit system and the capital markets (bond loans, bilateral contracts, pool financing with major domestic and international banks, and loan contracts with the EIB).

Snam's objective is to gradually achieve a balanced debt structure, in terms of the composition of the bonds and the bank credit and the availability of usable committed bank credit lines, in line with its business profile and the regulatory environment in which Snam operates.

At 31 December 2013, Snam had unused committed long-term credit lines worth around €5.2 billion[44]. As at the same date, in addition to the funding from the banking system, the Euro Medium Term Notes (EMTN) programme[45] permitted the issuance, by 30 June 2014, of additional bonds worth up to €1.3 billion[46], to be placed with institutional investors.

## RATING RISK

Moody's confirmed a Baa1 rating for Snam's long-term debt on 18 February 2014, raising the outlook from 'negative' to 'stable'. The revised outlook came after a similar decision was taken on 14 February with regard to Italian sovereign debt.

On 11 July 2013, rating agency Standard & Poor's downgraded Snam's long-term credit rating by one notch, from A- to BBB+.

This followed a one-notch downgrade of Italy's national sovereign debt rating on 9 July 2013 (from BBB+ to BBB with a negative outlook).

Snam's long-term rating is a notch higher than that of Italian sovereign debt. Based on the methodology adopted by the rating agencies, the downgrade by a notch of the current rating of the Italian Republic would trigger a downward adjustment of Snam's current rating by at least a notch.

## RISK OF DEFAULT AND THE DEBT COVENANT

The risk of default consists of the possibility that the loan contracts concluded contain provisions that provide the lender with the ability to activate contractual protections, which could result in the early repayment of the loan in the event of the occurrence of specific events, thereby generating a potential liquidity risk.

At 31 December 2013, Snam has entered into unsecured bilateral and syndicated loan agreements with banks and other financial institutions. Some of these contracts provide, inter alia, for the following: (i) a financial covenant based on which the Company ensures that the ratio between the net financial debt and the RAB will not exceed a contractually defined level; (ii) negative pledge commitments pursuant to which Snam and its subsidiaries are subject to limitations concerning the pledging of real property rights or other restrictions on all or part of the respective assets, shares or merchandise; (iii) pari passu and change of control clauses; and (iv) limitations on the extraordinary transactions that the Company and its subsidiaries can carry out.

The bonds issued by Snam on 31 December 2013 as part of the Euro Medium Term Notes programme provide for compliance with covenants that reflect international market practices regarding, inter alia, negative pledge and pari passu clauses, but which do not encompass financial covenants.

44 In January and February 2014, as part of the process of optimising its debt structure, Snam reduced its available committed credit lines by €0.5 billion.

45 On 11 June 2013, the Snam Board of Directors decided to renew the EMTN programme for up to €10 billion, to be issued in one or more tranches by 30 June 2014.

46 Following the bond issues carried out in January 2014, the EMTN programme permits issues worth a maximum residual value of €0.55 billion.

Failure to comply with these covenants, and the occurrence of other events, some of which are subject to specific threshold values, such as cross-default events, may result in Snam's failure to comply and could trigger the early repayment of the relative loan.
All the checks carried out in 2013 on the financial covenants provided for under the contracts in place confirmed compliance with the said covenants.

## OPERATING RISK

Snam is required to comply with rules and regulations at EU, national, regional and local level.
The expenses associated with the actions required to fulfil its obligations constitute a significant cost item now and for the years ahead.
In addition to minimising the risks from its activities, compliance with rules and regulations is required in order to obtain authorisations and/or permits relating to health, safety and the environment. Violation of current regulations may result in criminal and/or civil sanctions and, in specific cases where safety and environmental rules are violated, companies may be liable on the basis of a European model of corporate social responsibility adopted in Italy by Legislative Decree 231/01. The possibility of Snam incurring significant costs or liability cannot be entirely ruled out.
Current regulations highlight the value of organisational models aimed at preventing offences in the event of violation of environmental and workplace health and safety laws, specifying corporate liability.
Snam uses organisational instruments and internal regulations to establish the responsibilities and procedures to be adopted with the Group when designing, constructing, operating and disposing of all corporate assets, thereby ensuring compliance with laws and internal regulations on health, safety and the environment.
Snam and the companies it controls have implemented environmental and workplace health and safety management systems based on the principles of its own Health, Safety, Environment and Quality Policy, which has been consolidated in the Company for several years.
The documentation and application of the Snam Management Systems are certified according to international regulations.
2013 is the first year in which all the Group companies are operating with OHSAS 18001 certification, which certifies corporate risk control and reduction, accident prevention and compliance with legislation in force.
In 2013, Snam Rete Gas extended the certification of its Environmental Management System to all companies, in accordance with the UN EN ISO 14001 standard. The "Gas pipeline management" and "Stations" processes had been certified previously.
By adopting management systems and procedures that take into account the specific characteristics of its business, and by continually improving and modernising its facilities, Snam ensures that it can identify, assess and mitigate risks as part of a cycle of continual improvement.
Snam pays the utmost attention to all its operational processes: from designing and constructing plants to operating and maintaining them. For the purposes of business management and operational control, the Company uses specific techniques that are continually being updated and are developed in compliance with international best practices.
Snam develops and maintains technical regulations and management systems for the environment and workplace health and safety based on an annual cycle of planning, implementation, control, reviewing results and setting new objectives.

Management system control is conducted by monitoring health, safety and environmental indicators, periodic reporting and inspections of operating sites and the registered office, which involve:

- a technical audit, designed to ensure that the management systems are applied correctly in compliance with the Code of Ethics and Organisational Model 231;

- management system checks on certification, maintenance and renovation (conducted at least annually by an external certifying body);
- health, safety and environment checks on outsourced activities.

The findings are examined together with the results of the operating checks, providing basic information for planning future activities and setting new objectives, in accordance with Snam principles.
Snam has adopted organisational and regulatory measures for the prevention (availability, goods and services contracts, training, etc.) and management of any operational crises which may impact assets, people and the environment, identifying the actions required to limit damage.
Snam participates in international working groups which conduct benchmarking activities, draw up guidelines and carry out studies aimed at identifying ways in which gas transportation processes can be improved.
In addition to the risk response, monitoring and management system and the HSE measures adopted across the Group, Snam has taken out insurance to limit the possible negative effects on its assets of damage caused to third parties and to industrial property, whether onshore or offshore (Messina strait, Offshore LNG Toscana (OLT) connection at Livorno), that could occur during operations and/or investment works. The insured amount varies according to the type of event and is determined by current market best practice in risk assessment.

### RISKS CONNECTED WITH FAILING TO MEET INFRASTRUCTURE DEVELOPMENT OBJECTIVES

Snam's effective ability to develop its infrastructure is subject to many unforeseeable events linked to operating, economic, regulatory, authorisation and competition factors which are outside of its control. Snam is therefore unable to guarantee that the projects to upgrade and extend its network will be started, be completed or lead to the expected benefits in terms of tariffs. Additionally, the development projects may require greater investments or longer timeframes than those originally planned, affecting Snam's financial position and results.

### RISKS DERIVING FROM MALFUNCTIONING OF PLANTS

Managing regulated gas activities involves a number of risks of malfunctioning and unforeseeable service disruptions due to factors which are outside of Snam's control, such as accidents, breakdowns or malfunctioning of equipment or control systems; the underperformance of plants; and extraordinary events such as explosions, fires, earthquakes, landslides or other similar events beyond Snam's control. These events could also cause significant damage to people, property or the environment.
Any service interruptions and subsequent compensation obligations could lead to a decrease in revenue and/or an increase in costs. Although Snam has taken out specific insurance policies to cover some of these risks, the related insurance cover could be insufficient to meet all the losses incurred, compensation obligations or cost increases.

### RISKS DERIVING FROM THE NEED TO MANAGE A SIGNIFICANT FLOW OF INFORMATION TO OPERATE REGULATED SERVICES

The regulatory framework in which Snam operates involves continually collecting and processing a significant flow of information from its service clients. The information received by Snam includes, inter alia, capacity bookings, details of where gas is coming from and going to each day, physical and commercial balancing mechanisms and forecasts on demand and transportation capacity usage. This flow of information, partly managed by extensive use of IT systems, is broad and complex. Therefore, Snam cannot guarantee that its management will not lead to operating and planning difficulties which could affect its business.

### RISKS DERIVING FROM THE SEASONAL NATURE OF THE BUSINESS

Based on the current regulatory framework, Snam's overall business is not affected by seasonal or cyclical factors which could have a significant impact on its annual or interim financial position and results.

# RISKS SPECIFIC TO THE SECTORS IN WHICH SNAM OPERATES

## RISKS RELATED TO REGULATORY CHANGES

Snam operates in the regulated gas sector. The relevant directives and legal provisions issued by the European Union and the Italian government and the resolutions of the Electricity and Gas Authority and, more generally, changes to the regulatory framework may have a significant impact on the Group's operations, results and financial stability.
Considering the specific nature of its business and the context in which Snam operates, changes to the regulatory context with regard to criteria for determining reference tariffs are particularly significant. In 2013, with Resolutions 438/2013/R/gas, 514/2013/R/gas and 573/2013/gas, the Electricity and Gas Authority defined the criteria for determining reference tariffs, respectively, for liquefied natural gas regasification, natural gas transportation and natural gas distribution services for the fourth regulatory period[47].
In addition to this, Decree-Law 138 of 13 August 2011, which was converted into Law 148 of 14 September 2011, extended the application of additional IRES to the natural gas transportation and distribution business segments, with a tax rise of 10.5% for 2011-2013 and 6.5% as at 2014. It also prohibited companies from passing on the tax rise to customers via tariff increases and mandated the Electricity and Gas Authority to enforce this rule.
Future changes to European Union or Italian legislative policies, which may have unforeseeable effects on the relevant legislative framework and, therefore, on Snam's operations and results, cannot be ruled out.

## RISKS ASSOCIATED WITH THE END OF GAS DISTRIBUTION CONCESSIONS HELD BY ITALGAS AND ITS SUBSIDIARIES AND ASSOCIATES

### Risks relating to tenders for new gas distribution concessions

At 31 December 2013, Snam, through Italgas, had a portfolio of 1,435 natural gas distribution concessions spread throughout Italy. On the basis of current regulations applicable to Snam's concessions, new gas distribution contracts will be awarded not by individual municipality but exclusively by areas determined by the Ministerial Decrees of 19 January 2011 and 18 October 2011, and also according to the timeframes indicated in Annex 1 of the Ministerial Decree on bid evaluation and auction criteria, issued on 12 November 2011.
As the tender process unfolds, Snam may not be awarded one or more of the new concessions, or it may be awarded them on less favourable terms than is currently the case. This could have a negative impact on Snam's operations, results, balance sheet and cash flow, notwithstanding, should the Company not be awarded concessions for the municipalities it currently manages, the reimbursement to the outgoing operator.

### Risks relating to quantifying repayment to the outgoing operator

With reference to the gas distribution concessions of which Italgas also owns the networks and plants, Decree-Law 145 of 23 December 2013, which was converted with amendments into Law 9 of 21 February 2014 (published in Official Gazette No. 43 of 21 February 2014), stipulates that the amount to be reimbursed to outgoing operators that hold concessions and contracts in place during the transitional period shall be calculated on the basis of the provisions set out in agreements or contracts between the parties and, where this is not possible, the calculation shall no longer be based on the criteria set out under Article 24, a) and b) of Royal Decree 2578 of 15 October 1925, but should use the methods set out in Article 14, paragraph 8 of Legislative Decree 164/00, as subsequently amended. In any case, private contributions relating to local assets, as valued according to the current tariff regulation methodology, shall be subtracted from the amount to be reimbursed.

47 Further details can be found in the section "Business segment operating performance – Regulation".

The Decree of the Minister of Economic Development of 12 November 2011 stipulates that the incoming operator will acquire ownership of the system by paying the outgoing operator the redemption value, with the exception of any parts owned by the local municipality.
Eventually, i.e. in subsequent periods, the reimbursement to the outgoing operator shall be the value of local net fixed assets, net of government grants for capital expenditure and private contributions relating to local assets, calculated on the basis of criteria used by the Electricity and Gas Authority to determine distribution tariffs (RAB).
In the light of the aforementioned legal provisions, it is possible that the amount to be reimbursed may be less than the amount agreed with the local authorities.

### Risks relating to gas storage concession ownership

Through Stogit, Snam holds ten gas storage concessions. Of these, eight (Alfonsine, Brugherio, Cortemaggiore, Minerbio, Ripalta, Sabbioncello, Sergnano and Settala) expire in December 2016, one (Bordolano) in November 2021 and the other (Fiume Treste), which was extended for a decade for the first time during 2011, in June 2022. Each Stogit concession may be extended by the Ministry of Economic Development no more than twice for a duration of ten years at a time, pursuant to Article 1, paragraph 61 of Law 239/2004. If Snam is unable to retain ownership of one or more of its concessions or if, at the time of the renewal, the concessions are awarded under terms less favourable than the current ones, there may be negative effects on the Company's operations, results, balance sheet and cash flow.

### Risks connected with certain socio-political situations in natural gas production and transit countries

A large part of the natural gas which travels through the Snam transportation network does, or may, come from or travel through countries which present risks arising from certain socio-political situations. Importing and transiting natural gas from or through such countries may present risks such as: higher taxes and excise duties; production, export or transportation limits; enforced contract renegotiations; nationalisation or renationalisation of assets; changes to national political and governing systems; changes to commercial policies; monetary restrictions; and loss or damage owing to the actions of rebel groups. If shippers are unable to access the natural gas available in these countries as a result of the aforementioned or similar situations or they are damaged in any other way by said situations, there may be a risk of the shippers being unable to fulfil their contractual obligations to Snam or there may be a reduction in volumes of gas transported. Such events may therefore have a negative effect on operations, results, the balance sheet and cash flow.
The European Community, through Regulation (EU) No. 994/2010 of the European Parliament and of the Council of 20 October 2010 ("Regulation SOS"), established an obligation for each Member State to identify, through predetermined guidelines, measures intended to guarantee the security of its gas supply or to meet demand for gas. In implementation of the aforementioned Regulation, in accordance with the provisions of Legislative Decree 93 of 1 June 2011, (Legislative Decree 93/11), the Ministry of Economic Development shall carry out an assessment of risks every two years on the security of the domestic natural gas system, and define a preventive action plan and an emergency and monitoring plan for the security of natural gas procurement.

Quantitative information about financial risks as required by IFRS 7 "Financial instruments: Notes to the financial statements" is provided in Note 30, "Guarantees, commitments and risks", of the notes to the consolidated financial statements.