

RISK MANAGEMENT

With a view to secure sustainable faultless operations and evolution of the Company we have implemented the risk management system that identifies, evaluates and effectively manages risks threatening Company's reputation and operations, health of employees, environment and ownership interests of stockholders and investors. To develop the risk management system the Company's Board of Directors has adopted the Risk Management Policy⁸⁹.

The following entities participate in the risk management:

Board of Directors

1. Adoption of Company's bylaws stipulating arrangement and functioning of the risk management system.
2. Adoption of the risk management policy.
3. Examination of reports of the Company's executive bodies with regard to roll-out, functioning and efficiency of the risk management system, evaluation of its performance and preparation of recommendations to improve the system.
4. Examination of outcomes of external independent evaluation of the risk management system efficiency.

Board of Directors' Strategy and Development Committee

1. Oversight of the efficiency of procedures related to risk management and evaluation of the efficiency of activities related to risk management and RMS improvement.
2. Evaluation of the efficiency of activities related to risk management and RMS improvement.
3. Preliminary examination of reports of Company's executive bodies with regard to the roll-out and functioning of the risk management system prior to filing with the Board of Directors.
4. Analysis of proposals related to improvement of the risk management system, covering risk identification and risk parameters revision.
5. Preliminary examination, prior to filing with the Board of Directors, of Company's bylaws regulating roll-out and functioning of the risk management system, Risk Management Policies and their revisions.
6. Preliminary examination, prior to filing with the Board of Directors, of an annual report section and preparation of an opinion with regard to it.

Executive Bodies (Executive Board, General Director)

1. Enforcement of build-up and maintenance of the efficient risk management system, based on common approaches and standards, developed and adopted for the PAO Rosseti Group.
2. Guarantee of execution of Board of Directors resolutions with regard to the roll-out and functioning of the risk management system.
3. Setting of requirements to the format and adequacy of Company's risks disclosures.
4. Build-up of plans for the RMS development and improvement.
5. Analysis of the risk portfolio and development of measures related to risk response strategy and resource reallocation.
6. Preparation of an annual progress report with regard to the roll-out, functioning and efficiency of the Company's risk management system and proposals related to the RMS development and improvement to be filed with the Board of Directors for examination.
7. Examination of the progress report of the risk management unit with regard to risk management and evaluation of the RMS efficiency at least twice a year.
8. Examination of the outcomes of an internal evaluation of the RMS efficiency, preparation of measures to develop and improve the RMS.
9. Enforcement of the efficient risk management in day-to-day operations.
10. Adoption of the Company's regulatory and methodological instruments related to the roll-out and functioning of the risk management system, with the exception of bylaws falling under the Board of Directors purview.
11. Filing of an annual progress report with regard to the roll-out, functioning and efficiency of the Company's risk management system and proposals related to the RMS development and improvement with the Board of Directors for examination.

Risk owners (Deputy General Directors, directors with a direct reporting line to the General Director)

1. Responsibility for timely exposure and evaluation of risks, selection of risk responses, timely generation and conduct of risk management activities, regular risk monitoring.
2. Guarantee of timely distribution of information on the progress related to risk management among the Company's executive bodies.
3. Enforcement of efficient cooperation with the risk management unit on documentation and reporting, generated in the course of the risk management activities.

Performers of the risk management activities

Responsibility for timely exposure and/or minimization of risks, timely and duly execution of activities focusing on risk management.

Internal control and risk management section

General coordination of risk management processes.

Internal Audit unit

Conduct of internal independent evaluation of the risk management system efficiency and preparation of recommendations related to the enhancement of RMS efficiency and performance.

Core risk factors

Evaluation of risk materiality and dynamics, factoring in risk ID and expert evaluations, is disclosed hereof in line with the following scale:

 — crucial,  — important,  — moderate.

Risk materiality is a combination of risk occurrence possibility and value of consequences in money and other terms. Changes of risk materiality, as compared to 2017 and during 2018, are indicated by arrow: ▼ — reduced materiality of risk.

INDUSTRY RISKS

1. Tariff risks

State policy in tariffs lies in inflation control and stipulates revisions of regulated tariffs for 2017-2019 below actual inflation on the back of advanced wholesale price hikes. This creates a risk of regulators' setting tariffs below economically feasible levels.

Minimization of consequences

1. Close cooperation with regional regulators regarding economic feasibility of Company's expenses.
2. Filing with the Federal Antimonopoly Service of proposals regarding balance parameters for the next year to be approved in the consolidated regional forecast balance of electricity production and supply.
3. Preparation of initiatives related to improvement of the Russian laws on pricing in the energy sector.
4. Challenging of tariffs set in contravention of the law and infringing Company's rights and legitimate interests in administrative and judicial proceedings.
5. Execution of the cost control program, providing well-balanced planning of operations in line with approved tariff decisions.
6. Cooperation with local authorities on preparation of long-term territorial development programs and approval of funding volumes and resources for Company's investment programs.
7. Discharge of liabilities pursuant to investment and energy efficiency programs.
8. Cooperation with regional tariff regulators on preparation of supporting documents related to required ultimate electricity transmission tariffs.

2. Reduced supply risk

The risk appears as a result of reduced consumption and optimization of external power supply by large consumers.

Minimization of consequences

1. Monitoring of electricity consumption by large consumers that plan to construct and/or acquire generating and alternative facilities, generation of a 12M net supply forecast, adjusted for current electricity consumption.
2. Discussion and approval by consumers of target consumption volumes to be included into next year's contracts and filed with the tariff regulators (with a view to prevent approval of volumes ignoring current consumption dynamics).

3. Risks related to connection ▼

The risks derive from possible deficit of resources to fund activities related to execution of connection contracts; filers' failure to discharge their liabilities related to connection contracts; reduction of maximum capacity in connection requests by filers. These factors may have an adverse impact on connection revenues.

Minimization of consequences

1. Monitoring of requests to be used in generation of next year's forecast demand for connection.
2. The Company polishes its business processes related to processing of connection requests and execution of connection contracts. Thus, we deployed the automated connection control system designed to optimize connection-related procedures for employees.
3. We prepared measures focusing on enhancement of connection efficiency, included into the corporate connection-related roadmap.
4. We prepared control matrices for "Connection" process, stipulating causes of trouble, factors, preventive actions, control procedures and designated persons liable for each connection process stage.
5. We also provide methodological support, incl. arrangement of videoconference calls with branches to discuss issues related to organizational management in units engaged in connection process due to statutory revisions and revealed connection-related faults, opinion of courts and other watchdogs.
6. The Company cooperates with regional tariff regulators providing grounds for inclusion of privileged connection expenses into transmission tariff, as stated by the law.
7. The Company also participates in legislative initiatives promoted by PAO Rosseti and NP TSO Association to cater to the needs of grid companies, to promptly introduce required amendments to eliminate or reduce risks from regulated operations.
8. The Company conducts a tariff campaign focusing on enforcing approval of economically justified connection fees for all kinds of works, subject to statutory regulation.

4. Risk related to arrears in payments for electricity transmission services (disputed or undisputed overdue receivables) by consumers

The risk derives from still evolving mechanisms for stimulation of consumers to pay on time for electricity transmission services and adverse effect of macroeconomic factors (lowered paying capacity of consumers).

Minimization of consequences

1. Interaction with contractors to secure timely discharge of contractual liabilities and cancellation of overdue debt.
2. Legal collection focusing on debt collection (delay fees) and creation of favorable court practices.
3. Generation of proposals to be introduced to legislation in effect to strengthen payment discipline, including delay fees.
4. Implementation of direct-supplier-contract policy.
5. Elimination of conflict-originating reasons, reduction of disputed and overdue debt for the rendered services.
6. Collaboration with regional instrumentalities (commissions) that monitor payments for energy and its transmission to find a mutual debt-reducing solution.
7. Search for alternative solutions focusing on debt reduction caused by payment failures by providers of last resort (ESC).
8. The Company implements Board-approved programs related to perspective development of metering systems on retail energy market in grids.
9. Filing of statements with federal executive bodies, supervisors and watchdogs.
10. Cooperation with Rosfinmonitoring units, court bailiffs service.
11. Filing of reports on persistent non-payers with law enforcements to decide on prosecution methods.

FEDERAL AND REGIONAL RISKS

5. Risks related to political and economic situation

The risks derive from lowered economic activity of the regions of operation, increased cost of borrowings, impacted, in its turn, by unstable global environment, international sanctions, downgrade of credit ratings and inflation hikes. These factors may have an adverse impact on Company's revenues and market value.

Minimization of consequences

- We take measures to replace imported materials and equipment with domestic ones, expand access for small and medium businesses to procurements in line with the Federal Procurement Law.

6. Risks related to potential conflicts, announcement of the state of emergency and strikes in the regions

The risks may arise from possible illegal interference into Company's performance, incl. terrorist attacks (transnational and national terrorism). These attacks may have an adverse effect on the Company's operations.

Minimization of consequences

- If political and economic situation in Russia or any region is unstable and may impact Company's performance, the Company shall take antirecession measures to reduce this negative impact (cost-cutting and cost optimization, reduction of investment plans, reduction of loans and borrowings to fund operations, well-balanced financial policy). The Company actively collaborates with state agencies and other stakeholders to diminish the influence of these risks. Possibility of a military conflict and announcement of the state of emergency in the country or regions is low. In case of a military conflict the Company may encounter risks when its property, plant and equipment are destroyed. These risks are covered by insurance.

7. Geographical risks, including additional exposure to natural disasters, possible suspension of transport connection

These risks derive from emergencies as a result of natural disasters (hurricanes, tropical downpours, floods, snow storms, icing, fires, explosions, etc.), disrupting electricity supply and transport connection in the region.

Regions of the Company's service area have a developed transport infrastructure and are not exposed to the risks related to transport connection stoppage due to their remoteness and/or inaccessibility.

Minimization of consequences

- The Company prepares for autumn-winter operations, each branch being certified in a proper manner. All branches have a long-term experience of successful quick liquidation of consequences from natural disasters, badly influencing facilities and network infrastructure.

FINANCIAL RISKS

8. Fx risks

An adverse impact on the Company's performance due to changes of Fx rates.

Minimization of consequences

Borrowings and payments with customers and suppliers are nominated in Russian currency.

But still, in light of possible imported components in goods or equipment purchased by OAO IDGC of Urals, the Company realizes its import-substitution policy focusing on project solutions to minimize usage of imported equipment and materials. Optionally, it considers conclusion of long-term contracts with stable equipment prices for projects depending on imported equipment and materials.

9. Interest rate risks

Influence on possible increase of Company's costs related to capital raising to fund its investment programs.

Minimization of consequences

Improvement of debt structure depending on current credit conditions; oversight of reciprocal discharge of liabilities on credit contracts in force.

10. Inflation-based risks

Influence of CPI growth on interest payable, costs, profitability and, as a consequences, financial profile and obligation fulfillment of the Company.

Minimization of consequences

1. Operating under inflation conditions the Company has developed the Enhanced Efficiency and Cost-Cutting Program.
2. The Company concludes long-term contracts (3-5 years) with fixed prices.

LEGAL RISK

11. Legal risks

Risks related to changes in legislation, court practices on Company's operations and balance of interests of other energy sector players.

Minimization of consequences

1. Ongoing improvement of tax calculation methodology and oversight of its compliance with legislation in force.
2. All operations undergo compulsory legal pre-examination.
3. Transactions undergo compulsory legal pre-examination to consider whether they fall under corporate procedures stated by laws and/or charter of the Company. If such approval is required, competent bodies of the Company examine such transactions.
4. Our register is administered by a professional registrar (AO STATUS).
5. The Company enforces its strategy related to consolidation of grid facilities on its service area that may increase electricity transmission volumes in the long run.

12. Compliance risk

Risks related to regulator's sanctions as a result of possible non-compliance of Company's operations with legislation, local regulatory documents and other enactments, subject to mandatory compliance.

Minimization of consequences

1. The Company monitors legislation.
2. Transactions undergo compulsory legal pre-examination to consider whether they fall under corporate procedures stated by laws and/or charter of the Company. If such approval is required, competent bodies of the Company examine such transactions.
3. Challenging of tariffs set in contravention of the law and infringing Company's rights and legitimate interests in administrative and judicial proceedings.
4. The Company regularly conducts compliance control and financial monitoring to manage its reputation.
5. The Company has adopted a set of bylaws regulating anti-corruption norms, their evaluation and implementation, settlement of competing interests, whistleblowing statement processing, Corporate Ethics and On-Duty Conduct Code.
6. The Company has established a unit liable for anti-corruption monitoring.
7. An anticorruption clause is included in all contracts concluded by the Company.
8. Expert (anti-corruption) evaluation of procurement participants.
9. Corruption whistleblowing hotline.
10. Oversight of timely disclosure of the Company's insider information. Inclusion of a section on keeping insider information confidential in contracts under which insider information is to be processed.

REPUTATION RISK

13. Reputation risk

The risk may arise from possible failures to discharge liabilities before customers and contractors. The risk may derive from possible loss of effective communications with various target audiences, incl. as a consequence of failures to execute key production plans and discharge liabilities before customers and contractors in full.

Minimization of consequences

1. Development of Company's stakeholder-related priorities to define priorities related to reputation management and in-depth analysis of risk management priorities.
2. Strict compliance with the Company's Regulations on the Uniform Communications Policy stipulating PR rules.
3. Timely response to situations related to technological disturbances in the Company's service area and other production-related upsets.
4. Consistent positive messaging about Company's operations.
5. Disclosure of at least 600 releases on Company's operations, at least 8.0 thous. positive media mentions, achievement of KPI "Quality of messaging" at a minimum of 5% (negative mentions/total mentions).
6. Timely disclosure of information as an issuer and natural monopoly.
7. Participation in large Russian exhibitions, supported by regional authorities, to arrange efficient dialogue with business partners and form a positive image of the Company.
8. Regular oversight of compliance and financial monitoring for reputation management.
9. Timely congratulations of authorities, partners and other stakeholders to form a positive image of the Company.
10. Arrangement of activities in social media and blogosphere, regular update of Company's accounts on popular web-sites. Special attention is paid to communications with general public and mass media through social media and blogosphere during restoration of power supply after natural disasters. SNS accounts are also used to keep the target audience aware of prevention of injuries from electric equipment, non-contracted and unmetered electricity consumption, connection and power engineer job prestige.

STRATEGIC RISK

14. Strategic risk

Risk of failure to achieve strategic goals and objectives of the Company due to potential changes in internal and external environment of the Company.

Minimization of consequences

Management of strategic risks is interpreted as a totality of actions aimed at implementation of activities and minimization of risks related to the implementation of the energy sector development strategy in light of regional development strategies. As strategic risks impacts the achievement of goals set by the energy sector development strategy and PAO Rosseti's long-term development program, covering also Company's development-related activities, management of the key operating risks and risks of Company's business processes is one of the elements managing strategic risks under the adopted Risk Management Policy.

RISKS RELATED TO COMPANY'S OPERATIONS

15. Operating and technological risk

Deteriorated reliability of energy supply caused by accidents of natural or technogenic character resulting in equipment faults; high level of equipment with excessive service life; failure to comply with requirements in terms of excess of set values of technological exploitation parameters.

Minimization of consequences

The Company performs activities to enhance reliability of electricity supply and prevention of technological risks that include:

1. Clearing and widening of 0.4-220 kV power lines corridors.
2. Reconstruction of grid facilities.
3. Enhancement of reserve power supplies, machinery and special-purpose vehicles for emergency recovery works.
4. Revised program of grid facility upgrade (revamp).
5. Upgrade of communications and telematics.
6. Improvement of systems, liable for collection and transmission of information, analysis of technological failures, forecast of consequences, incl. implementation of the automated recovery resource management system.
7. Improvement of the system managing emergency inventories during emergency recovery works.
8. Increase of quality of equipment in mobile emergency recovery teams.
9. Training, supervision and examining of operating personnel.

16. Investment risk

Reduction of sources to fund Company's investment programs if its financial profile is deteriorated and, as a result, reduction of revenues from tariffs on the back of non-execution of investment programs. Violation of deadlines for commissioning of facilities from investment programs due to failures to discharge or discharge on time liabilities by contractors and suppliers.

Minimization of consequences

1. When the Company includes investment projects into its investment program, it aligns the projects with regional development plans. The Company files investment and funding volumes with the Russian Ministry of Energy for approval.
2. The Company cuts per-unit investment expenditures by optimizing program structure, performing in-house works, generating typical technical solutions, annual monitoring of per-unit costs of investment projects as well as by reducing project value during planning (use of consolidated indices of construction costs, analysis of project solutions at incomplete facilities).
3. The Company enhances quality of projects and investment efficiency by reducing per-unit construction costs, high loading of commissioned facilities, generating and implementing systems for comparative analysis of per-unit CIW costs and automation of investment management system.
4. The Company continues its efforts to align investment plans and territorial development plans. Maximum integration of strategic documents, territorial development schemes, information exchange help optimize terms and price of connection.

Evaluation of risk materiality

