

# Elements of risk and uncertainty



## Introduction

This chapter presents the main elements of risks and uncertainty characterising Snam's core business. The disclosure below takes into account the impacts of COVID-19, set out in a specific paragraph of this section.

The risks identified by Snam are divided up into financial and non-financial risks. The latter are then further classified as follows:

- strategic
- legal and non-compliance
- operating

Financial risks are described in Note 19, "Guarantees, commitments and risks - financial risk management", of the Notes to the condensed interim consolidated financial statements.

### RISKS AND UNCERTAINTIES ARISING FROM THE HEALTH EMERGENCY DERIVING FROM COVID- 19

The evolution of the pandemic linked to the spread of SARS-CoV-19, if not adequately contained, may continue to have significant health, social and economic consequences worldwide.

Although the lock-down measures introduced have collectively reduced the spread of the virus in Italy and Europe, transmission continues to be documented with varying incidence in different countries. There is, however, a progressive easing (total or partial) of these measures and many countries have begun a gradual reopening of economic and productive activities and public spaces.

However, considerable risks remain, both from an economic and financial point of view and for people's health.

In addition to the worsening global macroeconomic scenario and the risk of deterioration in the credit profile of a considerable number of countries (including Italy), the risk of slowdowns in many commercial activities persists due to negative impacts on supply chains, commodity prices, flows and capital demand.

There is also significant uncertainty in financial markets both nationally and internationally with potential impacts on the business environment.

Snam, which has taken protective measures since last 21 February, has equipped itself to take all the necessary steps to protect the safety of its people, both in compliance with the lock-down measures and by taking further precautions.

In particular, the company has set up an inter-functional team to manage the situation, in constant contact with

the Civil Protection, with two fundamental objectives: the health and safety of its people and the continuity of the essential energy security service for the country.

As early as 24 February, Snam has already ordered, as a precautionary measure, smart-working for workers whose activities did not require physical presence in the workplace, without prejudice to the necessary supervision of operational activities in the area and those relating to the dispatching of San Donato Milanese, the heart of Snam's infrastructure. As far as construction sites are concerned, works that cannot be postponed have been identified and all appropriate precautionary measures have been taken.

With the gradual resumption of Snam's activities, in line with the indications and provisions of the competent authorities, criteria and measures aimed at protecting the health and safety of workers in the workplace have been defined as a priority.

These criteria and measures are updated according to the indications that are progressively communicated by the Institutions and Health Authorities, as well as according to the results of the monitoring of the measures adopted and the health status of the workers that will be carried out by the competent figures.

To date, the company is unable to reliably determine the impacts of COVID-19 on 2020 and beyond.

However, on the basis of the latest information available, also due to the nature of the activities conducted by Snam and the containment measures promptly adopted by the company, limited impacts are expected on the economy and the investment

programme, proportionately to the speed of recovery of business.

The same considerations apply in respect of any potential effects on the development initiatives and suppliers or customers deriving from the slow-down to business and the current macroeconomic context consequent to the international reach of the pandemic, cannot yet be assessed. As indeed also to the assets held by the Snam Group outside Italy, in particular in France, Austria, Greece, Albania and the United Kingdom.

## STRATEGIC RISKS

### Regulatory and legislative risk

**Regulatory risk and legislative risk** for Snam is linked to the regulation of activities in the gas sector. The decisions made by the Autorità di Regolazione per Energia Reti e Ambiente (ARERA) and National Regulatory Authority in the countries in which the foreign associates operate, the regulations issued on the matter by the European Union and the Italian Government and, more generally, a change to the reference regulatory framework, may significantly impact the Company's operations, economic results and financial balance.

It is not possible to foresee the effect that future changes in legislative and fiscal policies could have on Snam's business and on the industrial sector in which it operates.

Considering the specific nature of its business and the area in which Snam operates, changes to the regulatory context with regard to criteria for determining reference tariffs are particularly significant.

### Macroeconomic and geo-political risk

Because of the specific nature of the business in which Snam operates, there are also **risks associated with political, social and economic instability in natural gas supplier countries**, mainly related to the gas transportation segment. A large part of the natural gas transported in the Italian national transport network is imported from or passes through countries included in the MENA area (Middle East and North Africa, in particular Algeria, Tunisia, Libya and, in TANAP-TAP perspective, Turkey together with States bordering the Eastern Mediterranean) and in the former Soviet bloc (Russian Federation, Ukraine, and in the future, Azerbaijan and Georgia), national situations which are

subject to political, social and economic instability and which could constitute potential future crisis scenarios.

In particular, the importation and transit of natural gas from/through these countries are subject to a wide range of risks, including: terrorism and common crime, alteration of the political-institutional balance; armed conflicts, socio-economic and ethno-sectarian tensions; unrest and disturbances; deficient legislation on insolvency and protection of creditors; limits on investment and on the import and export of goods and services; introduction of and increases in taxes and excise duties; forced imposition of contract renegotiations; nationalisation of assets; changes in trade policies and monetary restrictions.

If a Shipper using the transportation service via Snam's networks cannot procure or transport natural gas from/through the aforementioned countries because of said adverse conditions, or in any way suffers from said adverse conditions, or to an extent so as to make it impossible or discourage the fulfilment of contractual obligations towards Snam, this could have negative effects on the Snam Group's operations, results, balance sheet and cash flow.

In addition, Snam is exposed to macro-economic risks deriving from relocation or tension on financial markets or situations deriving from exogenous phenomena, which could have an impact on liquidity and accessibility to financial markets.

### Commodity risk associated with changes in the price of gas

In relation to transportation activities, the Authority has defined, starting with the third regulatory period (2010-2013), procedures for payment in kind, by service users to the leading transportation company, of quantities of gas to cover unaccounted-for gas (CNG), due as a percentage of the quantities withdrawn from the transportation network. Specifically, the Authority, by means of Resolution 514/2013/R/gas, defined the permitted level of the CNG given the average value registered over the last two years, and decided to keep this amount fixed for the entire regulatory period in order to provide incentive to the main transport system operator to deliver further efficiency improvements. For the relevant regulatory period, amounts of CNG higher than the permitted level would not be compensated. This criterion also was subsequently confirmed for the years 2018 and 2019 of the transition tariff period.

By resolution 114/2019/R/gas, as part of the process of reviewing the criteria for determining the revenues recognised for the natural gas transportation and metering service for the fifth regulatory period (2020-2023), criteria will also be defined for the recognition of CNG. On the basis of these criteria, starting 2020, acknowledgement of the quantities of gas required for self-consumption, network losses and CNG will take place in monetary terms in lieu of the recognition in kind by shippers. However, the change in natural gas prices will continue not to be a significant risk factor for Snam, as a mechanism is envisaged to hedge the risk associated with the differences between the price recognised for the volumes of gas required for self-consumption, network losses and CNG and the effective price of procurement. With reference to the quantities recognised, said resolution confirmed the current criterion relative to gas for self-consumption and losses, whilst for CNG, the level admitted will be updated once a year and will equal the average of the quantities effectively recorded in the last four years available.

With reference to CNG, it notes that, as part of the dialogue established with the ARERA, in 2019 the ARERA recognised part of the higher charges incurred in 2018 and anticipated the recognition for the same phenomena on any quantities in excess of the quotas recognised in 2019.

In July 2020, with Resolution 291/2020/R/gas, it concluded its investigation, recognising an additional volume of CNG for the years 2018-2019 totalling 182 million cubic metres, equal to a total value of about Euro 42 million, which will be recognised, net of the amount already received on account for the year 2018, by the CSEA. In addition, it has initiated a procedure, to be completed by the end of 2020, to refine the CNG recognition criteria for the 5th regulatory period (2020-2023), aimed at strengthening the consistency of the mechanism's operation and its stability, providing that the incentive force of the mechanism is in any case determined on the basis of predefined unit fees proportionate to the remuneration of the metering service, rather than the price of gas.

In general, the change in the regulatory framework on the recognition of quantities of natural gas to cover self-consumption, network losses and CNG could have negative effects on the Snam Group's operations, results, balance sheet and cash flow.

## Market risk

With reference to the **risk associated with demand for gas**, based on the tariff system currently applied by the Authority to natural gas transportation activities, Snam's revenue, via the directly controlled transport companies, is partly correlated to volumes withdrawn. The ARERA, however, confirmed for the fifth regulatory period (2020-2023), with resolution 114/2019/R/gas, the guarantee mechanism with respect to the share of revenues related to volumes withdrawn already introduced in the fourth regulatory period on volumes transported. This mechanism provides for the reconciliation of major or minor revenues, exceeding  $\pm 4\%$  of the reference revenues related to the volumes withdrawn. Under this mechanism, approximately 99.5% of total revenues from transportation activities are guaranteed.

Based on the tariff system currently applied by the Authority to natural gas storage activities, Snam's revenue, via Stogit, correlates to infrastructure usage. However, the Authority has introduced a mechanism to guarantee reference revenue that allows companies to cover a significant portion of revenues recorded. Until the fourth regulatory period (2015-2019), the minimum guaranteed level of recognised revenues was approximately 97%, while for the fifth regulatory period (2020-2025) Resolution 419/2019/R/gas extended the level of guarantee to all recognised revenues (100%). The same resolution also introduced an enhanced incentive mechanism (defined by subsequent resolution 232/2020/R/gas) with voluntary participation that provides for an increase in profit-sharing of revenues from short-term services from 50% to 75% against a reduction in the portion of recognised revenue subject to a hedging factor.

Finally, with reference to the tariff regulation criteria for the LNG regasification service for the fifth regulatory period (2020-2023), Resolution 474/2019/R/gas confirmed the mechanism to cover reference revenues at a guaranteed minimum level of 64%.

In general, the change to the regulatory framework in force could have negative effects on the Snam Group's operations, results, balance sheet and cash flow.

Abroad, market risk protection is afforded by French (Teréga) and Greek (Desfa) regulation, long-term Tap contracts and Austria (different scheduling for TAG and Gas Connect as from 2023). In Austria and the United Kingdom (Interconnector UK), the regulation does not guarantee cover of the volume risk.

## Risk of climate change

Compliance with greenhouse gas regulations in the future may require Snam to adjust its facilities, and to control or limit its greenhouse gas emissions or undertake other actions that could increase the costs of complying with applicable law, and therefore have negative effects on the Snam Group's operations, results, balance sheet and cash flow.

The **risks associated with the emissions market** fall within the scope of the European Union Directives on the sale of permits relating to carbon dioxide emissions and the rules on controlling emissions of certain atmospheric pollutants. With the start of the third regulatory period (2013-2020) of the European Emissions Trading System (EU - ETS), the main objective of the update of the sector's regulations has been to issue greenhouse gas emissions permits and a steady reduction in emission allowances issued free of charge, and this trend will continue in the next ET regulatory period, which will start in 2021. The allowances will be assigned to each plant on a gradually decreasing basis, and will no longer be constant, and will also depend on the actual functionality of the plants. The allowances assigned free of charge to Group plants no longer suffice to comply with the regulatory conformity obligations relative to ETS mechanisms, hence Snam will procure the additional allowances required on the market.

By Resolution 114/209/R/gas of 28 March 2019, the ARERA defined the regulatory criteria for the fifth regulatory period (2020-2023) of the natural gas transportation and metering service, providing, among other things, for the recognition of costs related to the Emission Trading System (ETS). Resolutions No. 419/2019/R/gas and No. 474/2019/R/gas introduced the recognition of ETS-related costs for the storage service (regulatory period 2020-2025) and the regasification service (2020-2023).

Climate change scenarios could also lead to a change in the choice of energy mixes of the different European countries, and in the behaviour of the population and could have an impact on the demand for natural gas and the volumes transported, as well as affect the development of alternative uses of gas, encourage greater penetration of renewable gases (biomethane, synthetic methane and hydrogen) and the promotion of new businesses.

Climate change could also increase the severity of extreme weather events (floods, droughts, extreme temperature fluctuations) causing worsening of the

natural and hydrogeological conditions of the territory with a possible impact both on the quality and continuity of the service provided by Snam, and on the demand for Italian and European gas. With reference to the effects of the change in the gas demand on the balance sheet, income statement and financial position of the Snam Group, see the previous paragraph "Market risk".

In relation to the new climate agreements in force at global level (including the "Paris Agreement" adopted in the context of the 2015 Climate Conference (COP21) where governments agreed to keep the average global temperature increase well below 2°C compared to pre-industrial levels as a long-term objective) aimed at fostering the transition to a more sustainable economy favouring zero emission energy sources, may pose a regulatory and legislative risk related to the possible implementation of increasingly stringent regulations at European and national level, which may also have an impact on the evolution and related financing of energy infrastructure worldwide.

Finally, in June 2020, Snam took part in the Energy Community (an international organisation based in Vienna that brings together the European Union and neighbouring countries to create an integrated pan-European energy market) where the "Methane Emissions in the Gas Sector" meeting was held to raise awareness and share knowledge on methane emissions with particular reference to policies, scientific and strategic aspects. Snam intervened to illustrate the strategy implemented against Climate Change, including the best practices implemented to reduce its carbon footprint. The meeting was attended by the European Commission, the Florence School of Regulation, ACER as well as GIE and MARCOGAZ. The activity is part of the wider range of interventions that Snam has held in recent months at the European Commission in Brussels, the United Nations Economic Commission for Europe (UN-ECE) in Geneva and the International Gas Union in Korea.

## LEGAL AND NON-COMPLIANCE RISK

The **legal and non-compliance risk** concerns the failure to comply, in full or in part, with the European, national, regional and local laws and regulations with which Snam must comply in relation to the activities it carries out. The violation of the laws and regulations may result in criminal, civil, tax and/or administrative sanctions, as well as damage to Snam's balance sheet, financial position and/or reputation.

With reference to specific cases, *inter alia*, violation of the regulations protecting the health and safety of workers and the environment, and violation of the rules established for the fight against corruption, may also lead to sanctions, even substantial, against the company based on the administrative liability of the entities (Legislative Decree no. 231 of 08 June 2001). With regard to the **Risk of Fraud and Corruption**, Snam believes it is of vital importance to ensure a climate of fairness and transparency in corporate operations and repudiates corruption in all its forms in the widest context of its commitment to abiding by ethical principles. Snam's top management is strongly committed to pursuing an anti-corruption policy, trying to identify possible areas of vulnerability and eliminating them, strengthening its controls and constantly working to increase employees' awareness of how to identify and prevent corruption in various business situations.

Reputational verification and acceptance and stipulation of the Integrity Ethical Pact are the pillars of the system of controls aimed at preventing the risks associated with illegal behaviour and criminal infiltrations concerning our suppliers and subcontractors, with the aim of ensuring transparent relations and professional morality requirements in the whole chain of enterprises and for the whole duration of the relationship.

Snam has been working since 2014 in partnership with Transparency International Italia and joined the Business Integrity Forum (BIF) and, in 2016, became the first Italian company to join the "Global Corporate Supporter Partnership".

As part of this collaboration, in October 2018, Snam renewed its partnership with Transparency International, the Secretary General of Berlin, during the eighteenth International Anti-Corruption Conference of Transparency International held in Copenhagen. On this occasion, Snam took part in a restricted round table that saw, for the first time, the participation of 4 private companies too, including Snam as the only Italian representative.

During 2019, Snam further strengthened its cooperation with other main bodies active in the fight against corruption. In particular, in October Snam also joined the Partnering Against Corruption Initiative (PACI) of the World Economic Forum, an initiative with the aim of bringing together at least twice a year the main Compliance & Anticorruption Officers of some of the most important companies in the world to share

and strengthen best practices and preventive measures; and in November it was included in the "Integrity & Compliance Taskforce" of the Saudi B20 Presidency, whose work began in January 2020 with an "inception event" and will continue throughout the year, until the October Summit, where the results of the work and proposals to bring to the G20 will be presented.

In addition to new partnerships, during 2019 Snam also participated in a series of events dedicated to transparency, integrity, business ethics and best practices and good governance for the prevention of corruption. Among the most significant events in which Snam participated during 2019, those held at the OECD, the Global Anti-Corruption & Integrity Forum in March on "Tech for Trust: risks and opportunities of new technologies for anti-corruption & integrity", the Trust in Business Forum and the October Working Party on State Ownership and Privatisation Practices at the OECD and, finally, Snam also spoke at the December 2019 Working Group on Bribery, an annual consultation that was preceded by a restricted meeting of members of the Permanent Representation of Business at the OECD (BIAC). In addition to this, in October, the General Counsel of Snam was also appointed Vice-Chairman of the Anti-Corruption Committee of BIAC, a very important recognition that will see Snam - the only Italian company in the Leadership of BIAC - even more committed and involved in the activities of the OECD on issues of integrity and anti-corruption.

Finally, in December Snam took part in the Italian Business Integrity Day - an initiative sponsored by the Anti-Corruption Coordination of the Ministry of Foreign Affairs - held on the occasion of the 8th Conference of the Member States of the United Nations Convention against Corruption in Abu Dhabi. At the event, Snam intervened to describe the challenges it faces on a daily basis in the area of anti-corruption and the best practices implemented to manage the various complexities. In this context, Snam also took part in a round table organised by the United Nations Office on Drugs and Crime entitled "Private sector as a Partner in Anti-Corruption Education", in which it spoke about its experience and commitment also in the field of training, which is aimed not only at its own people but also at the outside organisation.

## OPERATING RISKS

### Ownership of storage concessions

The risk linked to **maintenance of the ownership of the storage concessions** is attributable by Snam to the business in which the subsidiary Stogit operates on the basis of concessions issued by the Ministry of Economic Development. Eight of the ten concessions (Alfonsine, Brugherio, Cortemaggiore, Minerbio, Ripalta, Sabbioncello, Sergnano and Settala) expired on 31 December 2016 and can be renewed no more than twice for a duration of ten years each time. With regard to these concessions, Stogit submitted - within the statutory terms — the extension request to the Ministry of Economic Development and the proceedings are currently pending before the Ministry. Pending said proceedings the Company's activities, as provided for by the reference regulations, will continue until the completion of the authorisation procedures in progress envisaged by the original authorisation, which will be extended automatically on expiry until said completion. One concession (River Treste) will expire in June 2022 and has already been renewed for the first ten-year extension period in 2011, and another concession (Bordolano) will expire in November 2031 and can be extended for a further ten years<sup>21</sup>.

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.

### Malfunction and unexpected service interruption

Operating risks consist mainly of the **malfunctioning and unforeseen interruption of the service** determined by accidental events, including accidents, breakdowns or malfunctions of equipment or control systems, reduced output of plants, and extraordinary events such as explosions, fires, earthquakes, landslides or other similar events outside of Snam's control. Such events could result in a reduction in revenue and could also cause significant damage to people and property, with potential compensation obligations. Although Snam has taken out specific insurance policies to cover

some of these risks according to best industry practices, the related insurance cover could be insufficient to meet all the losses incurred, compensation obligations or cost increases.

### Delays in the progress of infrastructure implementation programs

There is also the concrete possibility that Snam could incur **delays in the progress of infrastructure construction programmes** as a result of several unknowns linked to operating, economic, regulatory, authorisation, competition and social factors or health emergency situations, regardless of its intentions. 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 time frames than those originally planned, affecting Snam's financial position and economic results.

Investment projects may be stopped or delayed due to difficulties in obtaining environmental and/or administrative authorisations or to opposition from political forces or other organisations, or may be influenced by changes in the price of equipment, materials and workforce, by changes in the political or regulatory framework during construction, or by the inability to obtain financing at an acceptable interest rate. Such delays could have negative effects on the Snam Group's operations, results, balance sheet and cash flow. In addition, changes in the prices of goods, equipment, materials and workforce could have an impact on Snam's financial results.

### Environmental risks

Snam and the sites in which it operates are subject to laws and regulations relating to pollution, environmental protection, and the use and disposal of hazardous substances and waste. These laws and regulations expose Snam to potential costs and liabilities related to the operation and its assets. The costs of possible environmental remediation obligations are subject to uncertainty regarding the extent of contamination, appropriate corrective actions and shared responsibility and are therefore difficult to estimate.

<sup>21</sup> The Stogit concessions issued before the coming into force of Italian Legislative Decree no. 164/2000 can be extended by the Ministry of Economic Development up to twice for a term of ten years each time, in accordance with Art. 1, paragraph 61 of Italian Law no. 239/2004. Pursuant to Article 34, paragraph 18 of Italian Decree Law no. 179/2012, converted by Italian Law no. 221/2012, the duration of the only Stogit concession issued after the coming into force of Italian Legislative Decree no. 164/2000 (Bordolano) is thirty years with the possibility of an extension for another ten years.

Snam cannot predict if and how environmental regulations and laws may over time become more binding and cannot provide assurance that future costs to ensure compliance with environmental legislation will not increase or that these costs can be recovered within the tariff's mechanisms or the applicable regulation. Although Snam has also taken out specific insurance contracts to cover some of the environmental risks, according to industry best practices, substantial increases in costs relating to environmental compliance and other related aspects and the costs of possible sanctions could have a negative impact on the business, operating results and financial and reputational aspects.

### Employees and staff in key roles

Snam's ability to operate its business effectively depends on the skills and performance of its personnel. Loss of "key" personnel or inability to attract, train or retain qualified personnel (in particular for technical positions where the availability of appropriately qualified personnel may be limited), or situations in which the ability to implement long-term business strategy is negatively influenced due to significant disputes with employees, could have an adverse effect on the business, financial conditions and operating results.

### Risk linked to foreign holdings

The foreign investee companies owned by Snam may be subject to regulatory/legislative risk, under conditions of social and economic political instability, to a market risk, cyber security, credit and financial risk and other risks typical of the business of the transportation and storage of natural gas highlighted for Snam, such as to adversely affect their activities, economic results and the equity and financial situation. This can have negative impacts for Snam on the contribution towards the profits generated by such investments.

### Risks connected with future acquisitions/equity investments

Each investment made as part of joint ventures and each future investment in Italian or foreign companies may entail an increase in the complexity of Snam Group operations and there can be no guarantee that such investments will generate the expected return in the acquisition or investment decisions and will correctly integrate in terms of quality standards, policies and

procedures, consistently with the rest of Snam's operations. The integration process can be costly and require additional investment. Improper management or supervision of the investment made may adversely affect the business, operating results and financial aspects.

### Cyber security

Snam carries out its activities through a complex technological architecture relying on an integrated model of processes and solutions capable of promoting the efficient management of the entire country's gas system. The development of the business and recourse to innovative solutions capable of continuous improvement, however, requires increasing attention to be focused on aspects of cybersecurity. For this reason, Snam has developed its own cybersecurity strategy based on a framework defined in agreement with standard principles on the subject and focusing constant attention on Italian and European regulatory developments, especially as far as the world of critical infrastructures and essential services is concerned. First and foremost, this strategy involves adapting one's own processes to the provisions of standards ISO/IEC 27001 (Information Security Management Systems) and ISO22301 (Business Continuity Management Systems) and the formal certification of conformity to the listed standards. Alongside this and in accordance with technological developments, solutions aimed at protecting the Company from cyber threats and malware are assessed and, where deemed appropriate, implemented.

More specifically, Snam has defined a model of cybersecurity incident management aimed at preventing and, when necessary, ensuring timely remediation in the event of events that could damage the confidentiality and integrity of the information processed and the IT systems used. At the base of the activity is a Security Incident Response Team which, using technologies that allow collecting and correlating all the security events recorded on the entire perimeter of the company's IT infrastructure, has the task of monitoring all the anomalous situations from which negative impacts may result for the company and to activate, where necessary, escalation plans suitable to guarantee the involvement of the various operating structures.

With reference to the management of information in support of the business processes, it is considered appropriate to stress that the company owns the asset

(fibre) used for the transportation of data to and from the territory; this results in intrinsically greater security thanks to the lack of dependency on the service provided by third parties and the possibility of making exclusive use of the communication channel. Lastly, as part of cyber incident management (preventive and reactive), information-sharing with national and European institutions and peers is used in order to improve the capacity and speed of response following various possible negative events. A great deal of attention is also paid to increasing awareness and specialist training of personnel, in order to facilitate the identification of weak signals and raising consciousness about risks of a cyber nature that could occur during the course of normal work activities.