

RISK MANAGEMENT

(1.) Risk management classification

Risk management is integrated in the Company management system, thus ensuring risk management throughout the ELES organisational structure. Risks are identified, analysed and managed by administrators at the level of processes and work flows. At the operative level, that involves the “bot-tom-up” approach, on account of which responsibility for risk management is intrinsically linked with responsibility for the attainment of goals. Pursuant to such organisation, the key factors or impacts (e.g. regulatory, economic, technical, etc.) on the implementation of individual Company activities are also reported in the Business Report within the scope of the ELES Annual Report, indicating the activities conducted and results achieved in each activity (Chapter 2.1) along with aspects of the Company sustainable operations (Chapter 2.2: economic, social and environmental aspects of sustainable operations).

The activities, monitoring and development of the risk management system, which is discussed by the Management System Council, are run by the Company Director at the level of sector directors and/

or process sponsors. At the strategic level, i.e. “top-down”, a uniform risk management methodology is defined that clearly identifies the roles and responsibilities related with risks, measures, period of updating the risk structure and measures and for monitoring the progress made to manage them. Risk assessment and ranking ensures that the Company can deal with key risks, while other risks are analysed upon upgrading the structure relevance with respect to the attainment of goals and specific business circumstances.

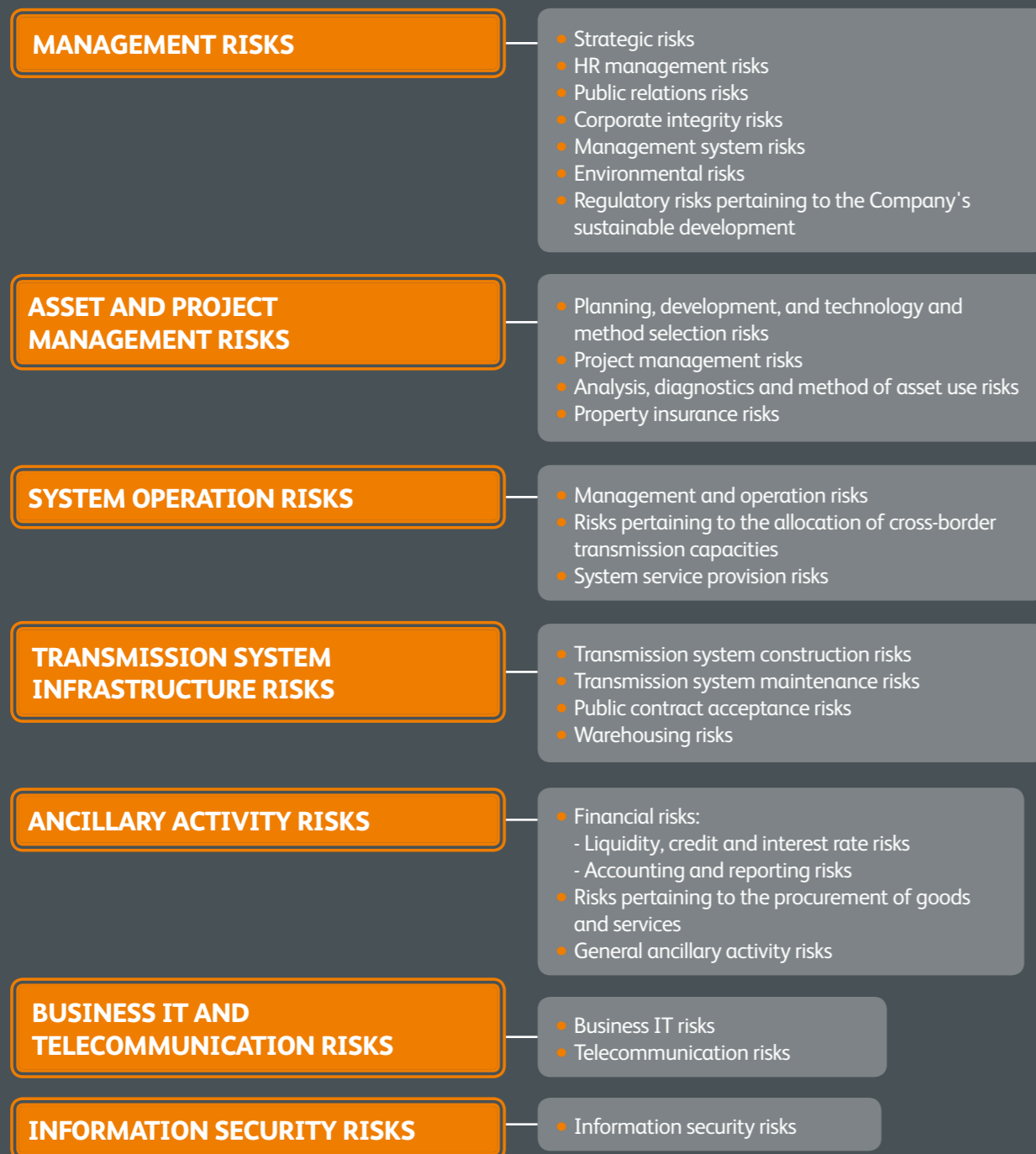
Risk management is regulated in detail in internal regulations (organisational regulation and instructions) and is carried out within the scope of the risk catalogue, which is digitally supported with the Silver Bullet Risk application. Exceptions are only occupational safety and health risks, which are kept in a separate catalogue due to a different methodology. Risk management at ELES is based on the fulfilment of the requirements laid down by the ISO 31000 standard, the Company Risk Management Policy and strategic risk management policies as adopted at annual strategic conferences.

(2.) Types of risks

ELES considers several types of risks:

- operational risks in processes, work flows and individual activities;
- strategic risks as the most pressing risks of a specific period that threaten the realisation of strategic objectives;
- information security risks;
- environmental risks;
- risks threatening safety and health at work.

The mentioned risks are integrated in a set of 24 main risk groups in an umbrella risk structure and are broken down to 7 areas:



All identified risks are assessed. To assess risks, the Company uses a qualitative scale, where the scope of damage and risk frequency are assessed from 1 to 5. A risk assessment is the product of the estimated

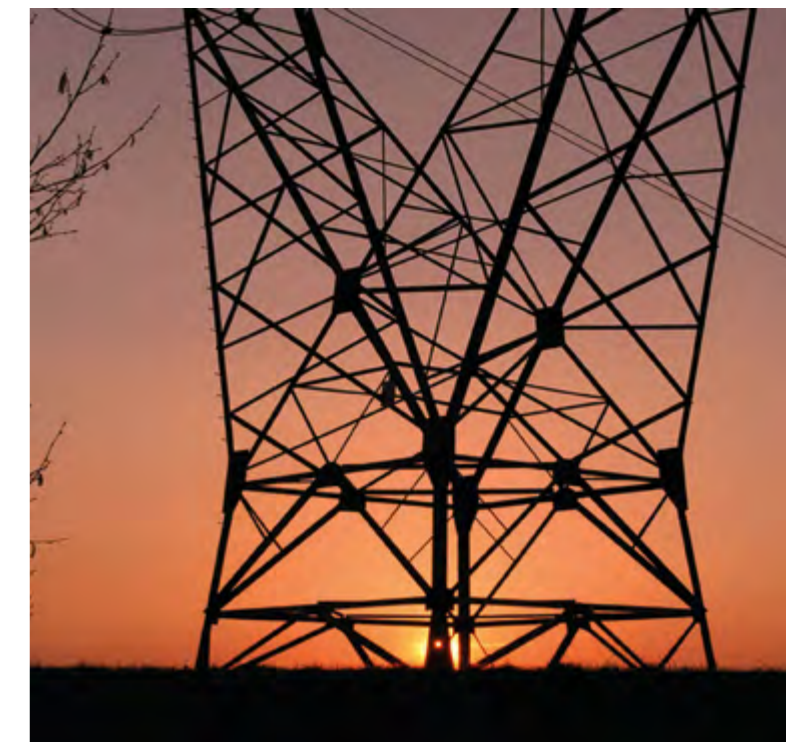
scope of damage and frequency. Based on such identified risks, the Management System Council also defines an acceptable risk level.

Table 7: A diagram of risk classification by relevance

		RISK FREQUENCY					
		VERY RARE (up to once every 10 years)	RARE (up to once every 5 years)	OCCASIONAL (up to once every 2 years)	FREQUENT (up to once a year)	VERY FREQUENT (more than once a year)	
		Score	1	2	3	4	5
EXTENT OF DAMAGE	CATASTROPHIC (>€5 million)	5	5	10	15	20	25
	HIGH (€1-5 million)	4	4	8	12	16	20
	AVERAGE (€100,000 - €1 million)	3	3	6	9	12	15
	LOW (€10,000 - €100,000)	2	2	4	6	8	10
	INSIGNIFICANT (<€10,000)	1	1	2	3	4	5

- Extremely high risk level (unacceptable) = 17-25
- High risk level (unacceptable) = 9-16 and extent of damage evaluation 4 or 5
- Medium risk level (permissible, endurable, tolerable, acceptable) moderate risk = 5-8
- Low risk level (acceptable) = 0-4

Selected risks are also **assessed in terms of quantity**. The Company calculates the worst possible negative impact of the realisation of the key risks selected from the highest estimated risks that may have catastrophic consequences on Company operations using the Value at Risk (VaR) method in terms of liquidity (impact on the cash flow) and solvency (negative impact on Company value). That is important for optimal maintenance of available cash assets and, therefore, prevention of major financial shocks and maintenance of an optimal size of capital for stable Company operations.



(3.) Key activities in 2017

In 2017, the Company pursued its strategic risk management policies, monitored external and internal factors and identified risks that could have an impact of Company operations. The risk catalogue was regularly updated, acceptable risk levels and deviations from acceptable levels were checked and, if required, appropriate measures were adopted that **provided undisturbed, stable, target-oriented Company operations**. The system ensured that **the key risks were identified, assessed and managed**. In 2017, the Company examined and adopted a model to quantify risks. The IT system was also tailored to all changes. Throughout the time, efforts were also made to **strengthen a responsible risk management culture**.

Within the scope of the adopted Long-Term Strategic Plan of ELES d.o.o. for 2016-2020, the following **risk management sub-goals** were adopted under the goal of the Attainment of Business Excellence:

- Coordination of categories and methodologies for various types of risks to manage major risks at Company level based on a common denominator within management systems and corporate integrity.
- Identification of the type and method of disclosure of risk management performance indicators and of target tolerance values.
- Activation and use of the Silver Bullet Risk application in risk management.

All goals set were realised in 2017.

Regular annual revision of the risk catalogue

A **revision of the risk catalogue was conducted** to identify the extent to which the Company keeps track of changes in the broader energy sector and at the Company that require adaptation and, hence, newly emerged risks.

At the 158th session held on 14 March 2017, the Management System Council adopted a decision not to change the acceptable risk level upon the regular revision of the risk catalogue, making it the same as in 2016, i.e. provided that the scope of damage is not assessed as 4 or 5.

Upon that catalogue revision, 455 risks were identified and assessed (in 2016: 479). After the identification of an acceptable risk level, sponsors and administrators considered in detail 118 risks or 26 % of all identified risks (in 2016: 173 or 36 %) and developed measures to manage them, while assessing residual risk that is the risk level following the measures taken.

The measures laid down **reduce the level of exposure of Company operations by 49%** (in 2016: 54 %) **from the original average risk estimate of 9.97** (in 2016: 11.10) **to 5.10** (in 2016: 5.05) of residual risk. Despite the identified measures, 35 (in 2016: 36) risks remain, 11 of which (in 2016: 11) are still assessed at a total score of 9 or more and 24 risks (in 2016: 25) with the scope of damage of 4 or 5. Those are mostly risks that the Company cannot manage alone with its measures, since the source or cause for such risks are external factors beyond the Company's control, although they derive from activities that must be carried out by the Company.

Verification of progress in risk management and progress report

After the implementation of a regular revision of the Risk Catalogue in March 2017, the Company also completed the verification of progress in risk management. Progress was measured by determining the level of the realisation of measures, based on the realised risks in the period following the regular annual Risk Catalogue update and based on the new risks detected in that period, identified needs for urgent changes to the already determined measures to improve the management of identified risks or the needs for determining new measures that were entered in SBR app by risk holders.

Based on the analysis of entered data, a progress report was prepared. The results of the verification of progress in risk management showed that the **Company successfully manages risks**. As at 27 September 2017, 63.78 % (in 2016: 68.3 %) **of all measures laid down to improve risk management** were realised on average, which **improved the Company's risk assessment from 9.86** (in 2016: 11.10) **to 7.2** (in 2016: 6.83).

Small number of realised risks (in 2017: 12 of the total of 441 of all identified risks, in 2016: 10 of the total of 479 of all identified risks), most of which cannot be managed by the Company alone with its adopted measures (e.g. conclusion of easement contracts, disagreement by owners of the land needed to access work sites, unclear legislation, stressed conditions on the market) and their consequences show **a quality and well-working internal control system and the efficacy of measures to improve risk management**.

Based on the identified new, reshaped and reassessed old risks and measures, one may conclude that the Company successfully adapts to the continuously changing internal and external factors, detects new potential risks in due time and successfully protects itself against their realisation. The results reveal that the Company's risk assessment due to risks caused by external factors remains at level from 2016. It may be concluded from the original risk assessment that the latter improves from year to year with annual improvements to the internal control system.

The established risk management system **enabled successful risk management in 2017 and, hence, the attainment of the set business and strategic Company objectives**.

Chart 2: Risk profile (current estimate) compared to the values laid down in the risk appetite by area in 2017

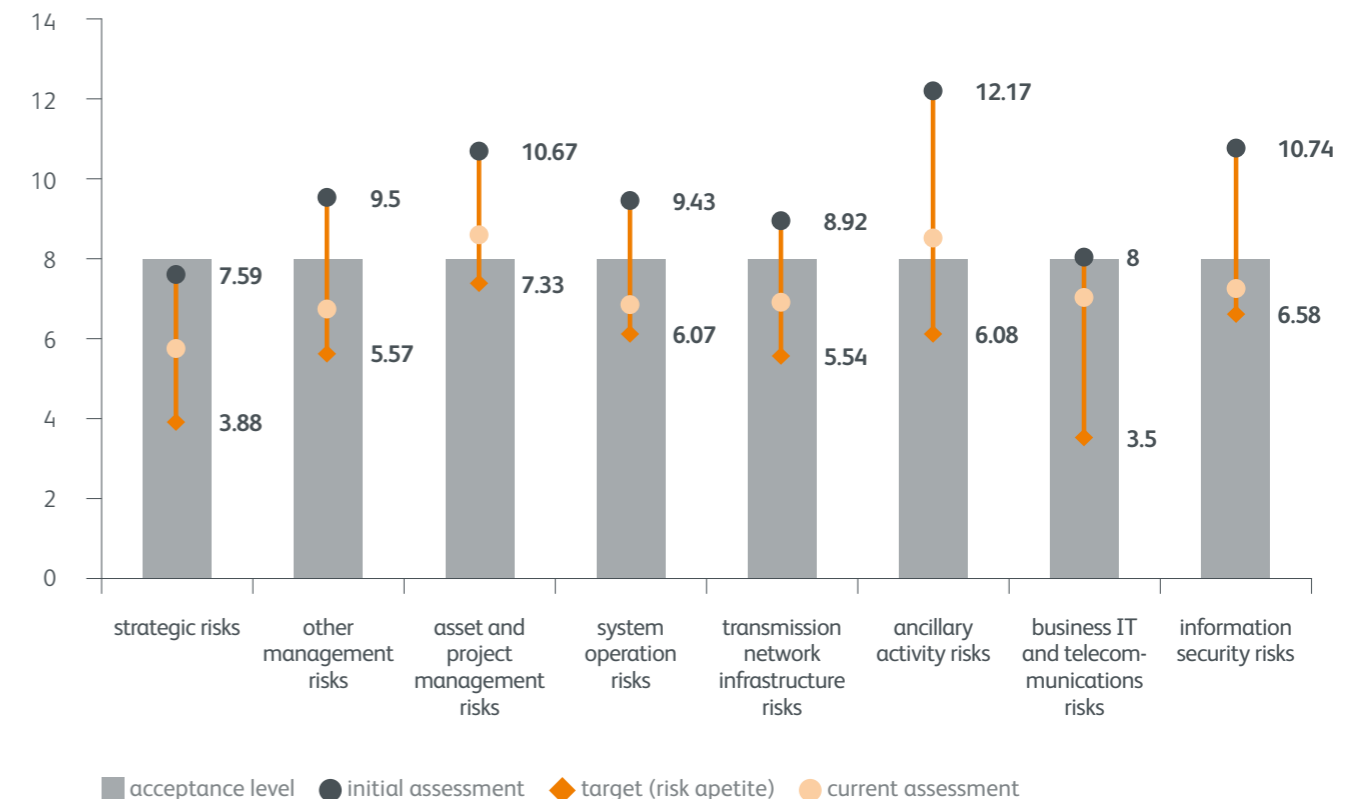
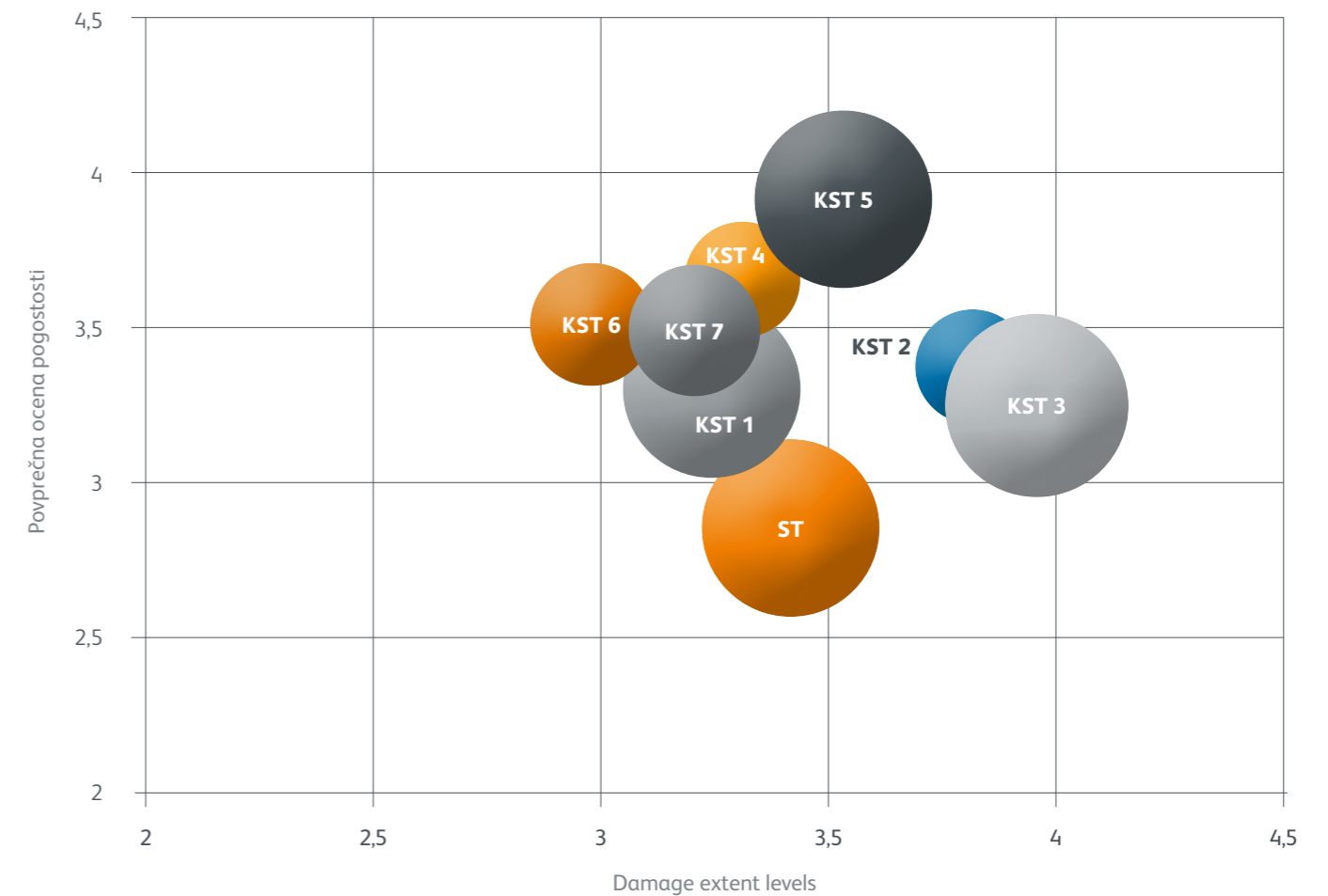


Diagram 3: Risk assessment in 2016 and 2017 compared to the acceptable risk level



Chart 3: Risk allocation Key to damage levels:



Damage extent levels:

- 1 Insignificant (<€10,000)
- 2 Low (€10,000 - €100,000)
- 3 Average (€100,000 - €1 million)
- 4 High (€1 - €5 million)
- 5 Catastrophic (>€5 million)

Key to damage frequency rates:

- 1 Very rare (up to once every 10 years)
- 2 Rare (up to once every 5 years)
- 3 Occasional (up to once every 2 years)
- 4 Frequent (up to once a year)
- 5 Very frequent (more than once a year)



Furthermore, the risk exposure indicator was defined and assessed (risk tolerance) $TdT = (\text{total estimate of residual risk/acceptable level of risk}) \times 100 = 5.1/8 \times 100 = 63.75$ (in 2016: 63). The target value of that indicator must not exceed 100. It is evident from the calculation that the target value of the risk tolerance determined by the Company was again achieved in 2017.

Quantification of risks (effects of the realisation translated into a monetary unit)

In 2017, the quantification of selected key risks was made for the first time in a manner:

- where potential effects of the realisation of individual risks were translated into a monetary unit,
- where risks were compared to one another and aggregated at the total Company level,
- where the results were related to the financial function.



The result was the worst possible negative impact of the realisation of such risks as calculated using the VaR method in terms of liquidity (impact on cash flow) and in terms of solvency (impact on reduced Company value), which is important for optimal maintenance of available cash assets and, therefore, prevention of major financial shocks and preservation of an optimal size of capital for stable Company operations.

The calculations show that the Company currently holds sufficient liquidity reserves and capital; however, the realisation of individual risks in the medium term may severely aggravate its operations. The Company's business model includes risks that may have a significant impact on its operations, which is why it cannot operate without financial reserves and also cannot be overburdened with above-average investments, debt or development investments. In that respect, it is necessary to be extremely careful not to impose additional (investment) obligations on the Company beyond its activities that may leverage the impact of risks and reduce the robustness of the Company and, hence, the system grid.

Access to the Silver Bullet Risk application

In 2017, risk holders were given online access to the risk catalogue in the Silver Bullet Risk application, allowing them to promptly enter any changes upon their occurrence. By promptly recording changes, the Risk Catalogue reflects the actual state of affairs in risk management at any moment. That ensured the monitoring of risk management results at any time and not only upon regular annual catalogue revision as at 31 March or verification of progress in risk management as at 30 September.

Production of reports and analyses for the Supervisory Board

In addition to all prescribed reports, all additionally required reports and analyses were also made for the Supervisory Board Audit Committee based on which the latter supervised risk management at the Company.

Cooperation with subsidiaries and associated companies

In 2017, the Company also assisted or gave advice in the establishment and upgrade to the risk management system at certain subsidiaries or associated companies.

(4.) Management of key risks by area in 2017

In 2017, the importance of a true understanding of what is a key risk to the Company robustness was highlighted and a position was taken that, broadly speaking, the key risks were those that may cause severe disruptions in the implementation of the Company's primary activity. They would not only affect the Company, but also the entire economy in the region and also other regions due to the inter-regional connection of national transmission systems. The following key risks to the Company were identified:

- inadequate definitions of organisational regulations and, consequently, inadequate implementation of processes by employees, and
- failure to observe the adopted Company management system in decision-making at various levels of management.

The most important risks at ELES remain to be the risks related with the fundamental activity of a transmission system operator – provision of stable and quality electricity transmission. They include in particular:

- the risks related with a change of competences of national system operators with further development of a common European market,
- the risks related with renewable energy sources that are connected to the transmission system and affect stable and quality system operation,
- the risks brought about by the electricity flexibility market.

They will be managed:

- by monitoring and actively participating in the preparation of legislation in that area,
- by actively participating in the development of innovations relating to safe and secure electricity transmission,
- by devoting more attention to the maintenance of critical infrastructure, which is not only locally important but also throughout Europe, due to its increased integration in the trans-European network and its failure may also have severe implications outside the area of its operations.

(5) The goals of the risk management system

In 2018, the most attention will be placed on:

- risks related to the implementation of the Company's primary activity, i.e. provision of secure electricity transmission,
- financial risks,

and efforts will be made to adjust to all coming changes in that area, so that they have no effect on the set Company goals.

Risks will be assessed in terms of quality and quantity, the risk management system will be improved and the IT support to risk management will be upgraded.

