

Risk management system of Zarubezhneft Group of companies

Zarubezhneft JSC Group of Companies is aiming to boost its shareholder value to the maximum level, working on improving the efficiency of its activities by ensuring its sustainable development and enhancing its competitiveness in providing for the state's interests. Zarubezhneft JSC pursues long-term objectives, carries out analyses of the current problems, threats and opportunities within all areas of activities and considers potential risks when making.

A unified approach to the risks management process has been developed and is constantly improved in Zarubezhneft GC, jointly with the unified tools and methods of risks analysis in forms the risks management system integrated with the management processes.

Internal regulatory documents governing the risks management system's operation:

- Zarubezhneft Group of Companies' risk management policy dated June 27, 2016 (approved by order of Board of Directors No 125);
- Standard for the Zarubezhneft Group of Companies risk management business process (order No 480) dated November 14, 2016;
- Major upstream project risk management standard (order No 208) dated May 30, 2016;
- Regulation of the Zarubezhneft JSC Corporate risk management committee (Order No 159 dated April 26, 2016).

Company's objectives in the field of risk management:

- increasing the efficiency of management solutions by analyzing the intrinsic risks;
- ensuring the maximum effectiveness of risk management measures during the implementation of solutions adopted.

The Company's objectives in risk management are:

- Cross-functional consideration of risk information in structural divisions of the Group of Companies and the joint development of risk management measures;
- Using systematic approach to the identification, analysis and assessment of risks specific for the activities of the Group of Companies;
- Building a risk management culture in the Group of Companies to achieve a common understanding of the basic principles and approaches to risk management between management and employees;
- Providing information to support decision-making at all levels of the Group of Companies management.

The risk management system of Zarubezhneft JSC Group of Companies provides a structured approach to assessing the opportunities and risks that allows for making informed management decisions and represents a set of processes, policies and procedures

integrated into Zarubezhneft Group of Companies business processes, including business planning strategic processes carried out by the Board of Directors, management and employees at all management levels and aimed at achieving the goals of Zarubezhneft Group of Companies.

The responsibility for risk management and reporting is determined as per the linear and functional management system: for each risk assigned to an owner responsible for its management. In each Segment, as well as in all key business processes, risk coordinators are determined among managers who distribute and support the application of corporate risk management principles. The terms and tasks of risk analysis consider the features and requirements of each business process against which the risk management is carried out. Responsibility for the methodological support, development and maintenance of the risk management system is reserved to the Perspective and Organizational Development Office.

This approach allows forming areas of responsibility for risk management and monitoring the risks at all levels of the Company's management, as well as ensuring the development of targeted plans of responding to significant risks both in each subsidiary and in Zarubezhneft JSC as a whole.

RISK COMMITTEE

Group of companies level risks

The most significant segment risks

Risks of business development unit

Supervisors: DGD for economics and finance, DGD for organizational development and corporate communications

Supervisors: DGD supervising a segment (GRiD, NPIS, Services)

Supervisors: DGD for business development



Detection method: "top-bottom", the management strategy is determined by the corporate center



Detection method: "bottom-top" as part of business planning (risks are consolidated by assets)



Detection method: "top-bottom and bottom-top"

Current assets risks

Gas exploration stage risks

RISK MANAGEMENT SYSTEM DEVELOPMENT

The risk management system is being improved as per the requirements of legislation, and international standards, taking into account the best practices of risk management.

The risk management system is being constantly developed and improved in Zarubezhneft Group of Companies. The work with the Group of companies' key risks is being performed systematically. They are used for quantity assessment of the impact on the company's key performance indicators, and the monitoring is carried out on quarterly basis by the Risks Committee chaired by the General Director.

RISK MANAGEMENT SYSTEM PERFORMANCE ASSESSMENT

As per the Guidelines on Internal Audit Arrangement in a Joint-Stock Company Partially Owned by the Russian Federation approved by Order No. 249 of the Federal Property Management Agency dated July 4, 2014, the Internal Audit Department performed assessment of risk management system performance for Zarubezhneft JSC GC. The check included assessment of CRMS maturity with criteria defined in the Letter of Bank of Russia – Concerning the Corporate Governance Code (No. 06-52/2463 dated April 10, 2014).

ACCEPTABLE RISK LEVEL

Zarubezhneft JSC defines the preferable risk level as an acceptable – maximum allowable risk level, which Zarubezhneft JSC and its subsidiaries shall pursue or maintain (as per the Zarubezhneft JSC Risk Management Policy approved by Resolution of Zarubezhneft JSC Board of Directors No. 125 dated May 27, 2016).

Zarubezhneft JSC establishes and documents the acceptable risk level and risk management requirements for financial and operating performance indicators.

This approach is governed by the following internal regulations:

- Provision on the Zarubezhneft JSC Key Performance Indicators approved by Zarubezhneft JSC Board of Directors (Minutes No. 131 dated November 25, 2016);
- Occupational Health, Safety, Environment Protection, Security and Social Responsibility Policy (Minutes No. 133 dated December 27, 2016) as part of the Zarubezhneft JSC Quality Assurance Policy;
- The Zarubezhneft JSC Risk Management Business Process Standard БП ОБ-06, Risk Management (approved on November 14, 2016, No. CT ОБ.УР.06-001).

Description of the most significant risks specific for the activities of the Company and the response measures taken.

Risk group	Risk name
Production safety risks	
<p>Description: Risks in the field of industrial safety are the most significant group due to legal requirements and the presence of a large number of hazardous production facilities. Include:</p> <ul style="list-style-type: none"> • Accidents with employees and third parties; • Industrial accidents and disasters; • Non-compliance with legal requirements in the area of industrial safety; • Failure to comply with environmental safety legislative requirements. 	Risks in the area of industrial safety (including with damage to the environment, human life and health).
Subsurface uncertainties	
<p>Description: Risks (uncertainties) associated with insufficient information about the geological structure of deposits, reserves, etc.</p>	Insecurity of production volume with reserves. Failure to comply with the planned production volume based on current assets.
Risks of investment projects implementation	
<p>Description: All risks of the Company's investment projects, including lack of infrastructure ensuring the year-round activities, lack of experience in implementing analogous projects in similar conditions, increasing the technological complexity of projects, a different vision statement for the project development strategy among participants, and so on.</p>	Reducing the efficiency of oil and gas projects (new projects and oil and gas exploration projects). Overrun on the cost of arranging the infrastructure in capital construction. Noncompliance with reserves growth plan from entering new projects.
Market risks	
<p>Description: Risks associated with industrial competition in the region of presence (change in the structure of demand, market capacity, etc.)</p>	Decrease of efficiency in Downstreamsegment.
License risks	
<p>Description: Risks of reclamation by state regulatory authorities due to the infringement of license terms (licenses for hydrocarbon exploration and production), to the extent of license revocation.</p>	Failure to comply with license commitments.
Logistical bottleneck	
<p>Description: Breaks /disruptions in oil transportation due to infrastructure restrictions</p>	Infrastructure risk. Lack of opportunity of oil sales.



Risk group	Risk name
<p>Change in macroeconomic parameters</p> <p>Description: Likelihood of changes in cross rates of major currencies and their negative impact on financial statements indicators and (or) cash flow.</p>	<p>Change in macroeconomic parameters: oil price, ruble/dollar rate.</p>
<p>Corporate fraud and corruption</p> <p>Description: Involvement of the Company or employees in corruption activities, as well as non-compliance with the legislation of the Russian Federation and countries of presence entails the employment of legal sanctions and/or other corrective actions on the part of supervisory authorities, which will lead to significant financial losses and loss of the Company's reputation.</p>	<p>Corporate fraud and corruption.</p>
<p>Political risk</p> <p>Description: Zarubezhneft JSC activities are carried out in Asia-Pacific region countries, Eastern Europe, as well as in the territory of the Russian Federation.</p>	<p>Political risk.</p>
<p>Risks in the IT area</p> <p>Description: Risks associated with the operation of IT systems (primarily production and settlement systems), projects on their development, as well as the risk of the inability to purchase and use foreign software.</p>	<p>Risk of loss (leakage) of confidential data. Risk of failure, malfunction of information systems, software and IT equipment.</p>



All risks were assessed, owners were appointed at the level of Deputy General Directors and responsible for activities, and the management strategy was defined. Developed preventive and reactive measures are taken into account in the production program of the Group of Companies.