Financial Risk Management

The Company places great importance on activities related to financial risk management. The Company has set up a financial risk management system which it improves every year. The principal document underpinning this system is the Company's financial risk management policy.

The center for decision-making related to financial risk management is the Company's financial risk management committee — a collective body comprising representatives of a number of Company departments under the guidance of the Senior Vice President for Economy and Finance.

In 2012, a lending ceiling calculation technique for banks, which are not incorporated in the Russian Federation, was implemented as part of the improvements to the financial risk management system.

Financial risk management is performed by a team of highly qualified risk managers of JSC "RZD", who are results-oriented and share the same corporate values and objectives.

Risk management approaches used by the Company are based on financial risk management best practice, diversification principles involving the use of various risk management tools and operations with reliable counterparties and approaches to estimate risk and risk appetite ratios.

The risk management policy does not permit the use of speculative risk management instruments or operations with unreliable counterparties.

The Company seeks to improve and develop the risk management system both within JSC "RZD" and "RZD" Holding Company in general, apply a unified approach to financial risk management in relation to its subsidiaries and affiliates, and instil the risk management culture at all management levels.

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THE FINANCIAL RISK MANAGEMENT POLICY IDENTIFIES:

- Company's financial risks
- Principles of their management
- Management process:
- — identification;
- — analysis and assessment;
- — matching of risks to risk appetite;
- — decision-making (strategy management);
- — direct management, including application of hedging instruments, if necessary;
- — monitoring of results;
- — assessment of the effectiveness of financial risk management activities (self-diagnostics).
- Management tools, including hedging
- Concept of using risk appetite to make appropriate risk management decisions

The company focuses on the management of the following main financial risks:

Financial risks (related to property risks)

Property risks are transferred to large Russian insurance companies and are reinsured with major global insurance companies. The regulatory framework of JSC "RZD" with regard to insurance comprises: insurance coverage policy for JSC "RZD", regulations, guidelines. A uniform policy and principles of insurance coverage for "RZD" Holding Company are defined in a corporate insurance coverage concept for JSC "RZD" subsidiaries and affiliates. The concept requires a uniform approach to the creation of insurance coverage for companies of "RZD" Holding Company;

Credit risks

For the purpose of credit risk management, the Company has an approved lending ceiling calculation technique, and regulatory documents on operations with bank guarantees and sureties. Based on the above technique, the Company assesses financial institutions and calculates relevant lending ceilings that restrict deposit operations with banks and acceptance of bank guarantees subject to an assessment of the status of the relevant financial institution.

When co-operating with real sector companies, in order to insure JSC "RZD" against risks of a counterparty's default (improper or untimely performance) of its obligations, the Company uses bank guarantees of intent, performance bonds (including a warranty period for supply contracts), return of advance payments and sureties fr om parent companies. Financial institutions issuing bank guarantees and warrantors are chosen with regard to to their credit history and applicable lending ceilings.

Liquidity risks

The Company manages its operating liquidity through the balance of payments, schedule of payments and payment position based on daily information from business units on expected revenues and expenditures for the calendar month. As required, the Company promptly raises cash on the best terms available. Operating liquidity is managed using the Reuters terminal and other automated systems for electronic confirmation of transactions;

Market risks (currency, interest, commodity)

To evaluate these risks, rules are used to calculate the scope of the risks and to match their values set with risk appetite.

In particular, the evaluation of the Company's currency risk and the identification of instruments to manage currency risk are based on the analysis of the Company's open currency position for a horizon of up to four years, which is the difference between incoming and outgoing cash flows by foreign currency. To create a portfolio of currency-denominated requirements and liabilities and subsequently calculate the open currency position, Company transactions are analyzed and classified by investing, operating and financing activities. The amount and structure of the open currency position influences the Company's borrowing policy and establishes approaches to hedging.

Analysis of floating interest rate volatility and its corresponding influence on the Company's borrowing policy underlies the interest risk valuation.

Should the currency or interest rate risks exceed the risk appetite, the Company selects a risk management strategy, including hedging.

With regard to price risk, the Company seeks to establish settlement and indexation terms in contracts with counterparties, which help to mitigate this risk as far as possible. The Company also considers the possibility of using hedging instruments for price risk management. The closing of hedging transactions related to the Company's Eurobond borrowing in USD was a significant milestone with regard to financial risk management in 2012. Transactions were based on Russian documents and were closed within Russian jurisdiction with major international banks. The closing of hedging transactions not only allowed the Company to mitigate its currency risk but also allowed it to reduce the effective borrowing rate for the Eurobond borrowing through the difference between borrowing currency and hedging currency interest rates.

Operating risks

Effective management of the operating component of financial risks is secured by automated financial risk management systems, which, as well as improving the effectiveness of risk management, also lim it the risk of “human error” on results of calculations and implemented procedures.