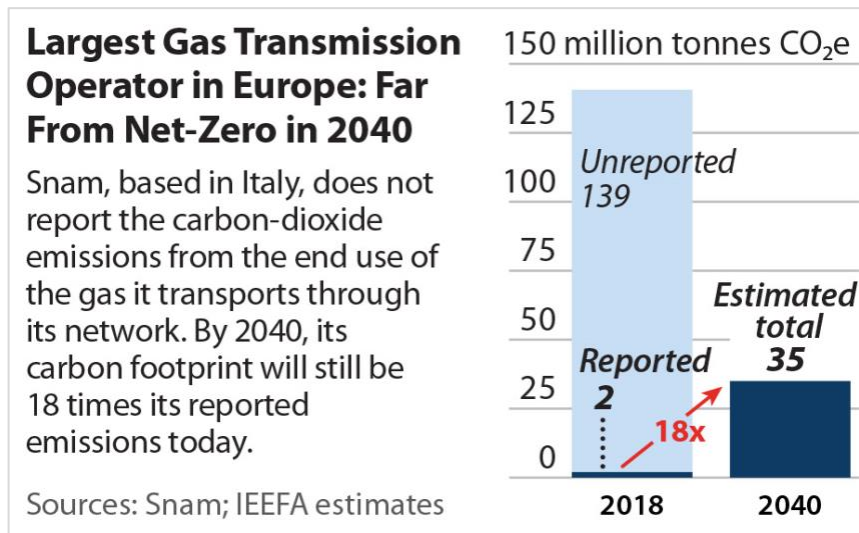


When Net-Zero Means Not-Zero

Bringing Perspective to Snam's 2040 Net-Zero and Sustainable Financing Claims

Executive Summary

This report finds that Snam's 2040 net-zero target and 2020-2024 strategic plan ultimately **fail to address the decarbonisation of Snam's gas grid** in line with recognised Paris-compliant energy transition pathways (well below 2°C global warming).



Instead, Snam's planned investments remain focused on the expansion and replacement of natural gas ("fossil gas") infrastructure, with only 9% allocated to "energy transition" between 2020 and 2024. The company is incredibly bullish on hydrogen, emphasizing its market positioning while acknowledging that cost-competitive production of renewable hydrogen is at least a decade away. We remind investors that hydrogen readiness alone does not lead to hydrogen volumes, decarbonisation, or carbon neutrality.

The company's aggressive push into the sustainable finance market arguably presents business-as-usual activities as laudable green initiatives, such as reduction of gas leaks, efficiency increases or hydrogen-ready pipelines. By issuing climate action and transition bonds, linking syndicated credit terms to sustainability key performance indicators (KPIs) as well as labelling commercial paper with environmental, social and governance (ESG) ratings solicited from a small London firm, Snam counts more than €7bn of 'sustainable financing' to date. These are funds that could be flowing to real zero-carbon solutions instead. We outline potential areas of concern for climate-conscious investors.

Based on these findings, we urge Snam to align its actions with its rhetoric by taking the following steps:

- Include emissions from the end-use of transported gas in Scope 3 greenhouse gas (GHG) emissions reporting;
- Implement measurable targets on reducing these broader Scope 3 emissions to net-zero, and work with its partners across the value chain to transition away from unabated fossil gas, along a Paris-compliant pathway;
- Publish a detailed plan for the transition of its network to net-zero emissions, along with information on a timeline for introducing increasing quantities of renewable gases;
- Commit more than 9% of its planned capital expenditures to energy transition activities and focus less on expansions and replacements of its regulated asset base (RAB); and
- Incentivise management to meet the new targets.

At this important juncture in European energy policy—with gas industry groups lobbying the European Union to include fossil gas as a transition fuel, as well as calling for binding EU targets around renewable gas deployment—it is vital that appropriate scrutiny is applied to fossil fuel companies' claims of sustainability. This will prevent further fossil fuel lock-in, minimize stranded asset risk, and ensure cost-effective use of public funds.¹

We ask if Snam's outdated regulated returns business model—one that incentivises infrastructure expansion over transition and passes demand/price risks onto consumers—is still fit for purpose in today's changing energy world.

¹ Gas for Climate. [New gas for climate policy paper calls for a binding target for 11% renewable gas by 2030](#). January 26, 2021.

Contextualising Snam's 2040 Net-Zero Target

Background

Italy-based Snam is the largest gas transmission system operator (TSO) in Europe and holds stakes in multiple international pipelines.

Figure 1: Snam Summary Highlights



Source: Snam,² Standard & Poor's.

In recent years, the company has pivoted its brand from its core regulated business of fossil gas transmission and storage. In February 2021, Snam updated its company bylaws by amending its corporate purpose.³ Previous explicit references to *hydrocarbons* have been removed in favour of simply *gas*, and additional text now includes its energy transition aims and activities, including the slogan, "Energy to inspire the world."⁴

Snam has publicised its commitment to hydrogen, noting its collaboration with Baker Hughes to test a "hybrid" hydrogen turbine designed for a gas network; its partnership and investment in ITM Power Plc aimed at developing joint projects and initiatives in the hydrogen sector; and its partnership and investment in De Nora, for the design, production, and supply of electrochemical technologies and water treatment systems.

Although these developments deserve credit, they are arguably ineffectual in the context of decarbonisation until they are backed up with a coherent, comprehensive plan to transition Snam's network away from fossil gas.

When Net Zero Means ... Not Zero?

As IEEFA reported last year,⁵ Snam and other major European TSOs do not report carbon dioxide emissions from end-use of the gas they transport through their networks. In Snam's case, these are **more than 70 times greater than Snam's reported greenhouse gas emissions**. (See Table 1). Our calculations also do not

² Snam. 2020-2024 strategic plan presentation. November 25, 2020.

³ Snam. Extraordinary Shareholders Meeting has approved the amendments to the Company Bylaws. February 2, 2021.

⁴ Snam. Snam's purpose: "Energy to inspire the world." October 6, 2020.

⁵ IEEFA. IEEFA: European gas pipeline companies mislead investors by underreporting CO₂. December 14, 2020.

take into account additional upstream/fugitive methane emissions, which are higher and have a greater impact on global warming than previously thought.⁶

Table 1: Emissions, Reported vs. Unreported (Million Tonnes of CO₂ Equivalent)

Year	Reported Emissions Scope 1, 2 & 3 Combined	Unreported (IEEFA Estimate) Transported Emissions	Comparative Multiple
2019	1.9	143.4	74.8x
2018	2.0	138.6	70.5x
2017	1.7	142.0	81.3x

Source: Snam, IEEFA Estimates.⁷

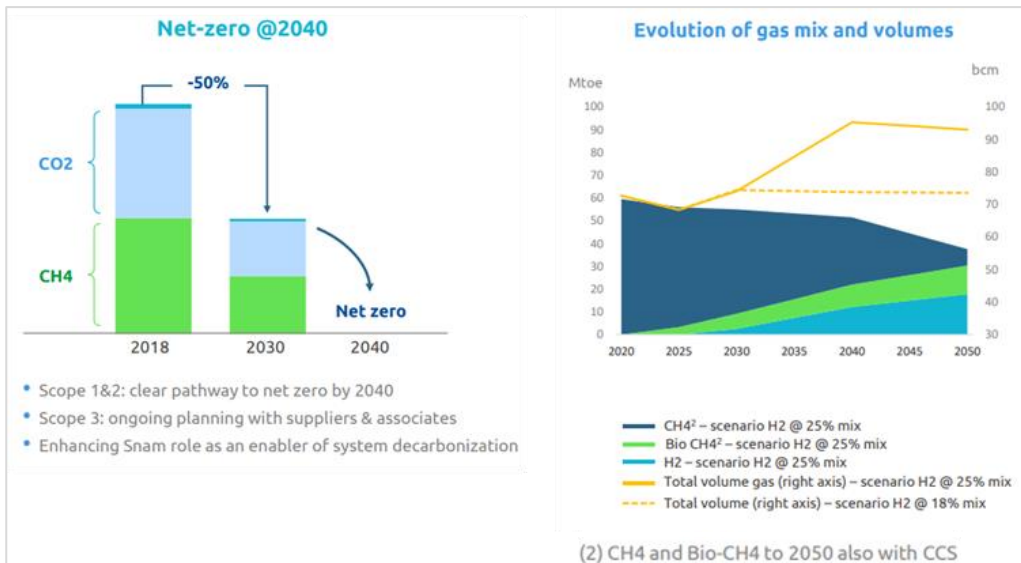
Snam’s net-zero plan, which charts a path for reduction of its scope 1 and 2 emissions to zero, reveals that the company still expects fossil gas to make up 50% of the fuel it supplies (by energy content) in 2040. It has no substantive plan to curb these emissions (bar a footnote “CH₄ and Bio-CH₄ to 2050 also with CCS.” Figure 2). Instead, it relies on these being reduced over time by Europe and Italy’s climate policies, commenting: “Italy has stated that it will target “net zero” by 2050. That means that, by definition, the gas that we carry by 2050 will either be renewable, abated or offset.” We note recent concerns that scientific evidence suggests Europe’s 2050 neutrality targets are not Paris-compliant.⁸ In addition, the EU goal of carbon neutrality is economy-wide, and the energy sector is widely expected to transition first, ahead of more difficult carbon mitigation in the transport and land use sectors.

⁶ Nature. [Preindustrial ¹⁴CH₄ indicates greater anthropogenic fossil CH₄ emissions](#). 19 February 2020.

⁷ Assume full combustion of Snam’s annual transported gas volumes (as reported), with an emissions intensity of 1.9032 million tonnes of carbon dioxide per billion cubic metres of gas.

⁸ Energy Watch Group. [Policy Paper 2021 Climate Neutrality 2050](#). February 2021.

Figure 2: Extracts From Snam’s 2020-2024 Strategic Plan



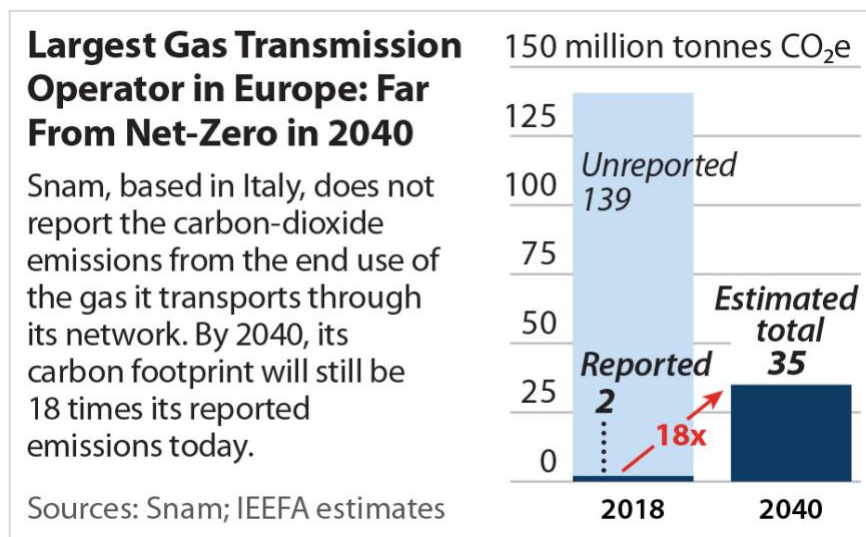
Source: Snam.

Applying Snam’s own projected fuel mix to its current unreported emissions implies that Snam will reduce its carbon footprint at best by three-quarters,⁹ to approximately 35 million tonnes of CO₂ equivalent (MtCO₂eq) by 2040—which, because Snam does not include these in its Scope 3 emissions today, is actually ~18 times its total reported emissions. Presenting this visually tells a very different story to the one currently being offered by the company to investors (Figure 3).

Far from becoming net-zero, in 2040 Snam will be contributing at least 18x its total reported emissions today.

⁹ Generously assuming that in 2040 100% of Snam’s transported hydrogen is produced from renewable sources with net-zero carbon emissions, bio-methane (shown as Bio-CH₄ in Figure 2) is considered to be carbon neutral, and emissions from combustion of CH₄ are halved, via carbon capture and storage (CCS) or otherwise.

Figure 3: Snam's GHG Emissions Pathway to 2040



If current energy trends are extended to 2040:

1. Coal will be fully phased out in Europe;
2. The EU will have reduced its GHG emissions by 60% to 80%;
3. At least 1-in-3 cars will be electric;¹⁰ and
4. The carbon price will rise from to €40/tonne to €100+/tonne.^{11,12}

In this scenario, Snam could well be one of the major polluters in Europe by 2040, if it sticks to its current plan.

In response to IEEFA, Snam commented:

Current accounting rules (GHG Protocol) about what constitutes scope 3 for infrastructure companies specify that accounting for GHG emissions linked with the final use of transported gas is not mandatory for Gas TSOs.

With regards to scope 3 emissions as currently reported, a benchmarking analysis based on a panel of more than 40 companies suggests that we have one of the most extensive and complete scope 3 emissions reports, including categories less reported on by our peers such as Investments and Fuel, and energy-related activities (not included in Scope 1 or Scope 2). For Snam, most of our CO₂ scope 3 emissions largely refer to the supply chain and from associate companies, and we are working to be able to announce targets on these. For instance, with regards to our supply chain we have

¹⁰ BloombergNEF. [Electric Vehicle Sales to Fall 18% in 2020 but Long-term Prospects Remain Undimmed](#). May 19, 2020.

¹¹ Green Tech Media. [BP Adopts \\$100 Carbon Price Assumption for 2030, With Big Implications for Clean Energy](#). June 16, 2020.

¹² Wood Mackenzie. [Significant increase in carbon pricing is key in 1.5-degree world](#). March 4, 2021.

been collaborating with CDP and our suppliers over the past 2 years to encourage an increasing number of them to calculate, report and reduce their emissions and this collaboration continues.

With regards to the emissions from the gas that we transport, these are already reported by the upstream companies that own the gas, and would therefore entail double-counting. We have discussed with the SBTi the question of including use of sold products in our emissions and are awaiting further guidance from them on our sector.

That said, we are well aware that the sustainability of our business depends on it being fully compatible with, and enabling, complete decarbonisation. To facilitate this, we ensure that the investments we make on the gas network today are “hydrogen ready” – meaning that they will not need replacement in a switchover to hydrogen. Please also consider that while we are investing to make our network hydrogen ready, switch over to hydrogen, both in terms of timing and percentage of blending, is not a variable directly under a TSO's control. At the same time, we are working with the value chain to promote green gases, for example we participated in a report published by Gas for Climate calling the European Commission to include an 11% renewable gas target in the RED II as soon as possible.

Capex: When Grey Turns Green

Bullish Messaging on Hydrogen

In November 2020, Snam published its 2020-2024 strategic plan, showcasing a spending increase of 14% from its 2019-2023 plan. The company painted 50% of its capital expenditures as green, simply by invoking the label of “hydrogen ready procurement standards.” Accompanied with the title “contributing to a carbon neutral economy” (Figure 4), it implies that 50% of Snam's total capex plan, or €3.7bn, will help to build a hydrogen future and support the energy transition. Meanwhile, its traditional segmentation slide, demoted to the end of the presentation in the “backup” section, or appendix, showed a meagre 2%, (21% of €0.7bn) going into hydrogen investments, with business-as-usual regulated infrastructure investments comprising 90% of total capex.

Although it is not unusual for a company to draw investor attention to certain activities, investors must be wary of sweeping high-level rebrands and buzzwords. Having a network that is part-ready to transport hydrogen gas does not mean it is transporting it, or that it will be in the future. Moreover, hydrogen is *far from carbon neutral*—less than 1% of hydrogen is produced from renewables or fossil fuel plants equipped with carbon capture technologies, and global hydrogen production is responsible for around 830 million tonnes of carbon dioxide emissions per year, equivalent to Indonesia and the United Kingdom combined.¹³

In February 2021, Climate Action Network Europe, a coalition of over 170 organisations fighting climate change, published a paper on hydrogen, highlighting their concerns: “*there is a significant risk that the European hydrogen sector could fail*

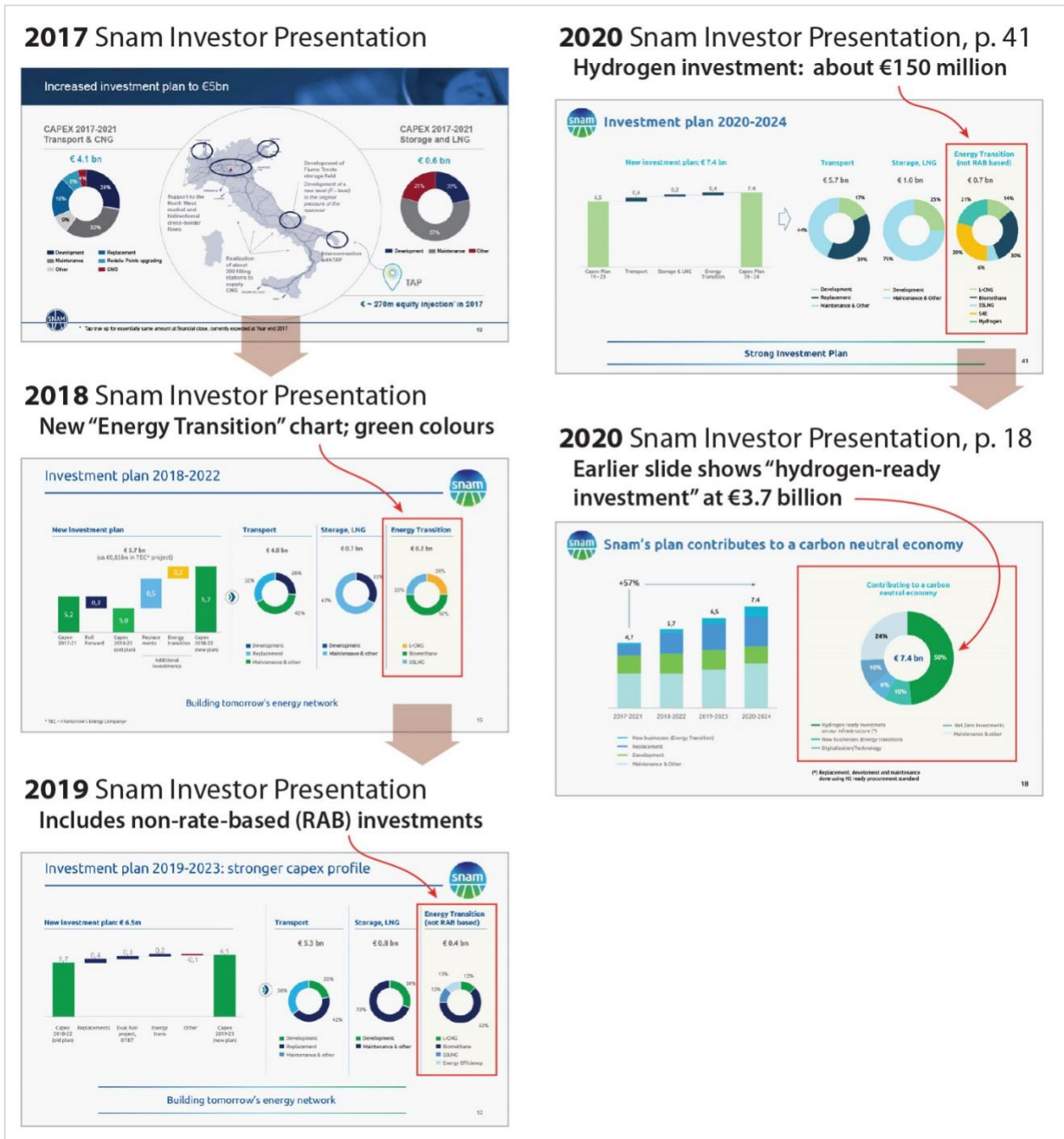
¹³ IEA. [The Future of Hydrogen](#). June 2019.

to shift completely to renewable hydrogen and instead becomes a way to justify continued investments in fossil fuels and maintaining legacy or building new infrastructure that should instead be decommissioned.”¹⁴ When viewed through this lens, one can see how Snam's so-called hydrogen-ready investments, if they divert investor capital away from renewables and increase gas lock-in, could in fact impede our progress towards carbon neutrality.

Without a unified standard for sustainability accounting, the onus is on all market participants to ask the uncomfortable questions and determine exactly what phrases like “hydrogen-ready” and “net-zero investments” actually mean (*e.g.*, what is the expected emissions reduction per euro invested over the next 10 years?)

¹⁴ CAN Europe. [Position Paper on Hydrogen](#). February 16, 2021.

Figure 4: Snam's Capex Facelift



Source: Snam.

In its November press release, Snam made the bold claim that:¹⁵

“Snam’s position in the capex supercycle benefits from infrastructure assets that are 70% hydrogen-ready, and that will enable the energy transition.”

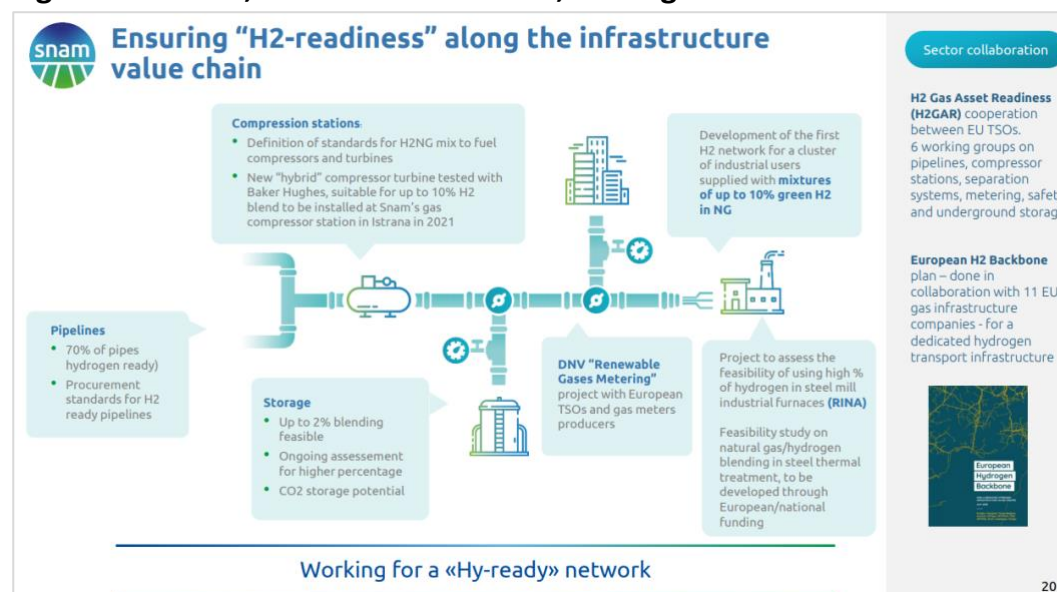
Again, investors should be clear that hydrogen readiness does not equate to hydrogen volumes, decarbonisation, or carbon neutrality.

In its presentation, Snam dedicates a slide to “H2-readiness” (Figure 5), intended to show Snam’s progress, including percentages of hydrogen that the different components of the network can currently accept. Alongside 70% hydrogen-ready pipes, we see “up to 2%” and “up to 10%” blending, as well as ongoing working group collaboration with other TSOs on “pipelines, compression stations, separation systems, metering, safety and underground storage.”

Our takeaway: Snam’s network has a long way to go before it will be safely transporting renewable hydrogen in any meaningful volume.

Our simple takeaway is that Snam’s network has a long way to go (perhaps a decade and billions of euros in investment) before it will be safely transporting renewable hydrogen in any meaningful volume.

Figure 5: Extract, “H2-readiness” Slide, Strategic Plan 2020-2024



Source: Snam.

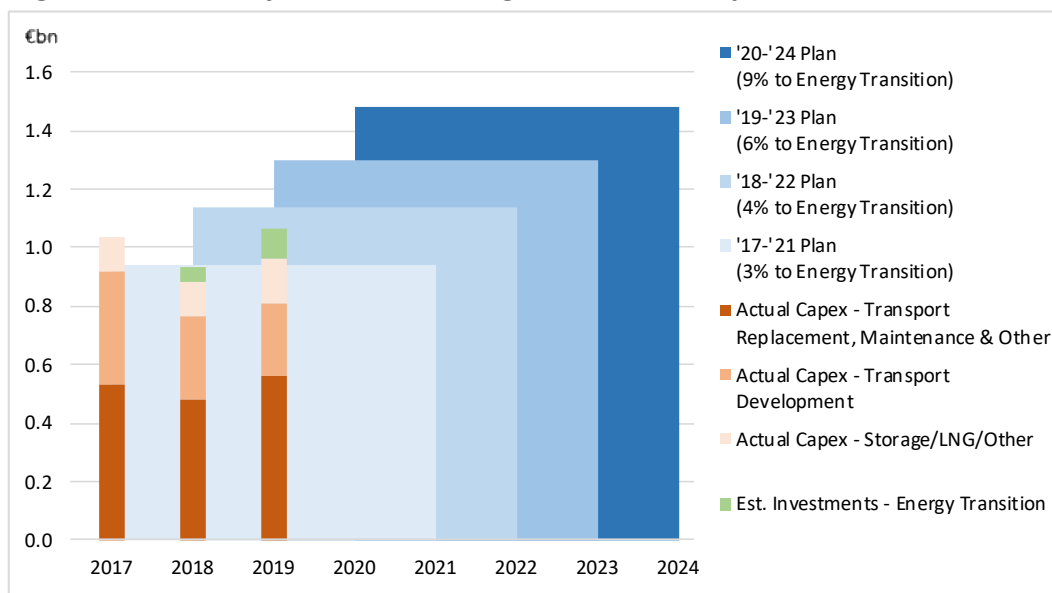
¹⁵ Snam. Increased Investments in the 2020-2024 Plan and Net Zero Emissions Target by 2040. November 25, 2020.

Snam’s Actual Investments Into Energy Transition Remain Low

Snam’s historic investments (Figure 6) show the vast majority of its spending has had nothing to do with energy transition or hydrogen. Instead, the company has continued to spend on its core regulated business of expanding and maintaining fossil gas infrastructure, primarily in Italy. Snam’s 2020 annual report has not been published yet, but previous years are summarized below. To be on track with its current plan, Snam should be investing at least €1.4bn each year through 2024, with 9%, or €0.7bn going towards energy transition businesses or activities.

Snam commented that these investments have typically been into start-ups, hence the relatively small base, but are growing fast, with planned investment already double what it had been in the previous plan.

Figure 6: Summary of Snam Strategic Plans and Reported Investments



Source: Snam, S&P Market Intelligence.

Notably, Figure 6 does not include more than €700 million spent by Snam to acquire additional equity interests in fossil gas infrastructure, including the Greek gas network operator DESFA in 2018, the offshore LNG Toscana regasifier in 2019, or the Abu Dhabi National Oil Company (ADNOC) pipeline assets in 2020. When these three purchases are included, the proportion allocated to energy transition falls further.

In 2019, Snam invested €963 million in transport, storage, liquefied natural gas (LNG) regasification, corporate and other categories. Snam’s annual report reveals only one line item (Table 2) that was *partially attributed* to supporting biomethane, with the rest spent on maintaining and expanding Snam’s fossil gas network. This €963 million compares with approximately €100 million of Snam’s non-RAB acquisitions associated with new energy transition business (including companies

Renerwaste, Iniziative Biometano, and an allocation towards compressed CNG refuelling stations).

Snam spent €50 million in 2018 to purchase IES Biogas, ENERSI Sicilia, Cubogas and TEP Energy Solution—the same year it re-launched its brand with the slogan, “Energy to Inspire the World.” Meanwhile, core regulated capex totalled €882 million.

Table 2: Breakdown of Snam’s 2019 Capex (€m)

Works maintaining security & quality of plants, including pipeline replacements	418
Information systems	100
3rd parties	19
Purchase of operating assets	18
Upgrading redelivery facilities	6
Total Replacements and Maintenance	564
Regional & National Network*	107
Trans-Adriatic Pipeline (TAP)	95
Po Valley (Cervignano-Mortara pipeline and Sergnano & Minerbio compression plants)	32
Massafra-Biccari pipeline	13
Total Development	249
Storage site maintenance & other	77
Development of new storage fields & upgrading of capacity	35
LNG Regasification	19
Total Storage/LNG	131
Corporate & other activities	19
Total Technical Investments	963
*Includes Cornegliano Laudense storage connection; Apostolo-Caulonia pipeline; "certain biomethane and CNG connections"; Gavi-Pietralavezzara pipeline	
N.B. line items do not sum to totals due to rounding (presented as reported)	

Source: Snam Annual Report 2019.

Snam’s Sustainable Financing

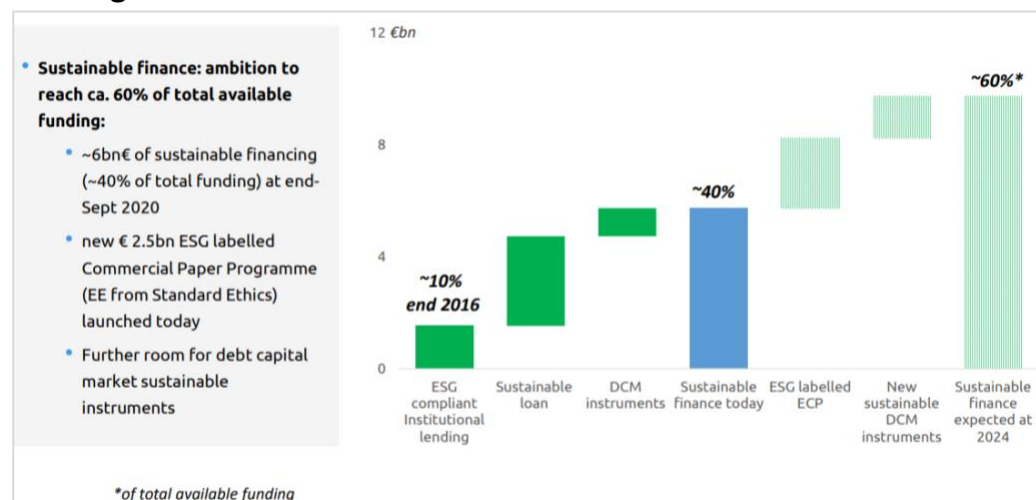
In its November strategy presentation, Snam claimed to have raised €6 billion, or 40% of its total corporate funding, from sustainable finance sources. It hopes to increase the amount to 60% by 2024 (Figure 7). Since there is no industry standard definition for sustainable finance, more investigation is required to determine the materiality of such claims.

Per market standard, Snam’s prospectus for its Euro medium-term note programme, under which its transition bonds are issued, dedicates a full page to disclaimers highlighting that investors must “determine for themselves” whether Snam’s definitions of sustainable finance meet their requirements, and that third-party opinion providers are currently “not subject to any specific regulatory or other regime or oversight.”¹⁶

¹⁶ Snam. *Prospectus*. November 30, 2020.

As a fossil gas company, Snam’s core activities are not considered green—although a debate on how gas should be treated is being hotly contested by the industry.

Figure 7: Snam Aims to Draw Increasingly on “Sustainable Finance” Funding Sources



Source: Snam.

Although there is no single definition for sustainable finance, different categories of issuance have emerged in recent years (*e.g.*, green bonds, social bonds, etc.) and are continuously being evolved and refined. The International Capital Market Association (ICMA), and the Climate Bonds Initiative (CBI) are two of the most widely recognised industry benchmark organisations for sustainable finance. Only one of Snam’s labelled bond issues, a €500 million climate action bond issued in 2019, has qualified as a green bond under ICMA’s sustainability bond principles.¹⁷ CBI noted in July 2020 that transition bonds require “*additional scrutiny to ensure sufficient ambition in targets, and ultimately significant contribution to decarbonisation.*”¹⁸

By drilling deeper into Snam’s debt issuance, we find that its labelled notes often lack stringent restrictions, particularly around the use of proceeds and consequences for failure to meet relevant ESG targets. Individual categories and issues are discussed in more detail below.

Sustainable Loan

In 2018, Snam transformed its existing €3.2bn syndicated credit facility (formed with 19 banks) into a sustainable loan by linking margin increases/decreases to a set of climate change and social key performance indicators (KPIs), including: A reduction in natural gas emissions; the recovery of the natural gas released each year during transport network maintenance activities; and an increase in the

¹⁷ ICMA. [Sustainable bonds database](#).

¹⁸ Climate Bonds Initiative. [Markets Monthly #6](#). July 8, 2020.

dissemination of the performance management system within the company.¹⁹ The resulting two lines of credit have since been extended to 2024 and 2025, and KPIs revised. KPI performance is reported every year by Snam in its Sustainability Report and Financial Disclosure on Climate Change report. If they are achieved/not achieved, Snam is entitled to a bonus/malus interest revision of -2.5bps/+2.5bps. In response to IEEFA, Snam commented that this mechanism is market standard.

ESG-Labelled Euro-Commercial Paper (ECP)

This €2.5bn multi-currency programme for short-term (<1 year maturity) notes replaces and expands a previous programme, which was not ESG-labelled and had been fully drawn at €2bn (*i.e.*, a business-as-usual facility).

The ESG label was purchased from Standard Ethics Ltd.,²⁰ a private, self-regulated, agency registered in London. The rating requires the company to meet targets for percentage of natural gas emission reduction (27% reduction from 2015 levels by 2022 year-end) and the percentage of women involved in training (85% by 2022 year-end).

Proceeds from this programme are to be used for general corporate purposes. Furthermore, if the ESG conditions are missed and the programme loses its rating, notes already issued still retain their ESG label. The only penalty would prohibit new notes from being labelled as “ESG notes.”

In response to IEEFA's observations, Snam commented: “It is market standard, we can provide multiple examples of it. For its nature, commercial papers are short term instruments and cannot be use-of proceeds. Moreover, again for its short term nature (typically 3 months), it is not possible to apply a step up mechanism mirroring the structure of a SDG [sustainable development goal] Linked Bond. We consider this instrument as a way to optimize our financial structure and ultimately to pursue our sustainable finance strategy. Not labelling any more a note as ESG notes would constitute a reputational penalty, in our view.”

Debt Capital Market (DCM) Instruments: Climate Action and Transition Bonds

In February 2019, Snam issued its first and only climate action bond. Proceeds can only be used to finance or refinance “eligible projects” covering four categories: *Carbon & Emission Reduction* (*i.e.*, upgrading industrial facilities to newer, more efficient equipment, with some electrification); *Renewable Energy* (biogas developments or acquisitions); *Energy Efficiency* (corporate or supply chain efficiency projects); and *Green Development Projects* (*e.g.*, constructing new low-energy buildings). Proceed uses are reported annually.

Snam's transition bond framework was created in June 2020 as an expansion of its previous climate bond framework. The new framework was designed to better align

¹⁹ Snam. [Sustainability Day – Borsa Italiana](#). July 2020.

²⁰ Standard Ethics. [Profile](#).

with the EU's sustainable taxonomy mitigation and to reflect the company's updated emissions reduction targets. The eligible projects have been updated and expanded to include a new fifth category, *Retrofit of Gas Transmission Network*, which covers projects or studies into hydrogen/low-carbon gases. Snam has issued multiple bonds under this framework. Proceeds are allocated to financing or refinancing eligible projects and are reported annually.

Table 3: Summary of Snam's Climate Action and Transition Bonds

Bond	Issue Date	Maturity Date	Amount, € Millions	Coupon	Pricing
Climate Action Bond	28-Feb-19	28-Aug-25	500	1.25%	99.489% (mid swap + 103bps)
Transition Bond 1	17-Jun-20	17-Jun-30	500	0.75%	99.856% (mid swap + 80bps)
Transition Bond 2	7-Dec-20	7-Dec-28	600	0.00%	99.728% (mid swap + 38bps)
Transition Bond 3	15-Feb-21	15-Aug-25	500	0.00%	100.198% (mid swap + 37bps)
Transition Bond 1b	15-Feb-21	17-Jun-30	250	0.75%	103.545% (mid swap + 50bps)
			2,350		

Sources: Luxembourg Stock Exchange and Bloomberg data.

There are three potential areas of concern for investors. First, the funds raised via these instruments are held as general cash or cash equivalents on the balance sheet,²¹ not as restricted funds. In its eligibility assessment opinion,²² DNV GL stated: "DNV GL can confirm that the net proceeds from Climate Action Bond issuances will be deposited to a general account and an amount equal to the net proceeds will be earmarked for allocation to the Eligible Projects as selected by SNAM's Climate Action Bond Committee. SNAM confirmed it will, pending the allocation of the Climate Action Bonds proceeds, either use the proceeds to reimburse outstanding credit facilities / pay-down existing debt or keep it in cash, overnight or other short-term financial instruments."

Snam stopped short of committing these funds exclusively to the eligible projects, instead opting to earmark the same total amount for investment over the term of the bond. This means actual investment into eligible projects may not happen until months or years after the bond was issued. This is not unreasonable; projects take time to develop. However, it means the funds can enter Snam's working capital until they are allocated to eligible projects, indirectly financing or refinancing non-eligible activities.

In February 2020, Snam reported that by the end of 2019,²¹ some 10 months after issuing its climate action bond, 48% of the proceeds had been allocated to eligible projects, with the rest expected to be allocated "in the next few years." In March 2021, Snam reported that this proportion had risen to 82% by the end of 2020, and that in total, ~60% of the €1.6bn raised from climate action and transition bonds had been allocated to eligible projects, with ~47% related to the fifth category *Retrofit of Gas Transmission Network*.²³

²¹ Snam. [Climate Action Bond Report](#). February 20, 2020.

²² Snam. [Snam S.P.A. Climate Action Bond](#). November 2018.

²³ Snam. [Climate Action and Transition bonds Report](#). March 1, 2021

Regarding this point, Snam commented: *“The unallocated proceeds, as per market standard, can be held in cash and cash equivalent or to temporarily repay debt maturities. Snam cash available at September 2020 is equal to approx. €3.2 billion: as a result the unallocated proceeds of the climate action and transition bonds issued at the latest reporting date (€1bn as a total issued as at 30 September) constituted only a small portion of the total available cash of Snam group”.*

The second potential area for concern is that some of these projects could be viewed as “business-as-usual” investments. The need to upgrade and replace energy devices with latest and most efficient technologies, such as replacing traditional lamps with LEDs (an example given in the Energy Efficiency category of Snam's Transition Bond framework), is arguably standard cost management that might be expected from any large company. An investor would need to scrutinise the individual projects to form a view, as the framework for choosing eligible projects does not stipulate any threshold of materiality towards Snam's decarbonisation targets or towards transition of its core activities away from unabated fossil gas.

Regarding this point, Snam commented: *“Through SNAM's Transition Bond Framework, we are able to go far beyond business as usual, to ensure that we maintain our key position in the industry via the capital markets to support the energy transition. The investments mentioned (LEDs) refers to a small portion (2%) of the investments included in the Energy Efficiency category, which accounts for just 8% of the total eligible projects under the Transition Bond Framework. More than 98% of the energy efficiency category is for capex reserved for our current and future acquisition of companies, which so far are committed to up to 100% of the capital of the Energy Service Company (“Esco”) TEP Energy Solution, one of the leading Italian companies in the energy efficiency sector with more than 200 leading companies as customers. We are in the process of analyzing our framework towards the latest version of the EU Taxonomy, and we can deduce that most of the categories identified under the Framework (notably Retrofit of Gas Transition Pipeline, but also Energy Efficiency and Renewable Energy such as Biomethane) will likely be considered as EU Taxonomy aligned.”*

A third potential area for concern is transparency regarding the credentials and decision process of the committee members who decide the eligible projects. In its frameworks, Snam describes both the climate action bond committee and transition bond committee as comprising *“members of the Finance Department, the CSR Department, the Technical Department and the P&C Business Unit Asset Italia Department.”* It is not clear if any of these members have climate science-related backgrounds, or what (if any) technical studies are carried out to inform the committee's decisions as to whether the projects will contribute to Snam's emissions reduction or efficiency targets.

Regarding this last point, Snam commented: *“The composition of our Committee, as confirmed by reputable banks, is in line with best market practice. CSR Department is in the Committee, together with Technical Department, which provides support also for environmental KPIs.”*

Recommendations for Transition Financing Disclosures

In an effort to address some of the issues around transition financing, ICMA published the Climate Transition Finance Handbook in December 2020.²⁴ The publication makes recommendations to issuers seeking capital for energy transition projects that cover four key areas:

1. Issuer's climate transition strategy and governance
2. Business model environmental materiality
3. Climate transition strategy to be "science-based," including targets and pathways
4. Implementation transparency

ICMA also states that reduction targets should include Scope 3, noting "*it is acknowledged that development of an appropriate methodology to calculate Scope 3 emissions associated with certain industry sectors is still under way, and Scope 3 emissions may need to be estimated on a 'best-efforts' basis in the interim.*"

We urge Snam to show leadership by incorporating the vast end-use emissions of the gas it transports into its Scope 3 reporting, and by publishing a meaningful science-based transition pathway to complete net-zero emissions, in line with a 1.5-degree global warming scenario. Only then can the company and its investors truly begin to frame the scale and timing of the huge investments that will be needed to support this transition.

Table 4: Top Bondholders of Snam's Climate and Transition Bonds

	Climate Action Bond	Transition Bonds		
Issue date	February 2019	June 2020	December 2020	February 2021
#Holders	46	30	27	5
1	BlackRock Inc	Credit Agricole Group	BNP Paribas SA	BlackRock Inc
2	Banco Popular Espanol SA	BNP Paribas SA	Capfi Delen Asset Mgmt	Meeschaert FCP
3	Banco Santander SA	BlackRock Inc	Danske Bank A/S	State Street Corp
4	BNP Paribas SA	Intesa Sanpaolo SpA	BPI Asset Mgmt	Deutsche Bank AG
5	Credit Agricole Group	Union Investment Lux. SA	Credit Agricole Group	Invesco Ltd

Source: Bloomberg data, as of February 26, 2021.

Notwithstanding the above, Snam's bonds appear to have been well received by investors. Both the transition bonds issued in 2020 were oversubscribed, with ESG accounts making up approximately three-fourths of the order book. A cursory review of bondholder data (Table 4) highlights three investors that appear repeatedly: BNP Paribas, Credit Agricole and BlackRock.²⁵

²⁴ ICMA. [Climate Transition Finance Handbook](#). December 2020.

²⁵ Such data usually is not complete but nevertheless provides a good window into the number and type of participating institutional investors.

The Question of Regulated Returns and Pursuing RAB Growth

Snam has provided steady returns to its shareholders in recent years, thanks to its regulated asset base (RAB) business model, which essentially lowers its cost of debt by passing on risk to energy consumers, and enables a higher cost of equity (*i.e.*, dividends). Under this arrangement, the Italian regulator ARERA guarantees a high proportion of Snam's revenues.²⁶ This is calculated based on pre-agreed, multi-year regulated rates of return, which are applied to Snam's investments and RAB, with limited exposure to the physical volumes of gas being transported or used. Consumers ultimately foot the bill for any overbuilt capacity or construction delays. Furthermore, the company is incentivised to grow the network with new infrastructure capacity. In 2019, the average capacity utilisation across Snam's network was 64%.²⁷

With this regulatory backdrop, it is perhaps not surprising that Snam's plan only targets a 9% investment in energy transition businesses over the next four years, and includes a dividend policy that continues to prioritise near-term shareholder returns, built on a target of 2.5% RAB growth to 2024.

Given the major structural shifts happening across the energy landscape, with increasingly urgent decarbonisation targets requiring action from European regulators, we see increasing risks to this business model. For example, in 2019, leading Spanish gas and electricity companies shed more than €6bn in market capitalisation after the Spanish regulator announced plans to cut agreed rates of return for gas distribution, transport and regasification during the 2021-2026 regulation period.²⁸ In 2020, the UK regulator Ofgem announced similar plans to halve returns for national gas and electricity operators, saying that "less of consumers' money will go towards company profits, and more towards building a better, greener network for the future."²⁹

²⁶ Autorità di Regolazione per Energia Reti e Ambie.

²⁷ Snam. *Annual Report 2019*. May 11, 2020.

²⁸ Financial Times. *Investors warn against Spanish plan to cut utility returns*. August 2019.

²⁹ Financial Times. *Ofgem proposes cutting energy companies' returns by half*. July 2020.

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