



KPMG Conference on risk

London

10 September, 2015





Thank you for the invitation to join you this evening.

There are not many salons that would meet on an autumn evening and agree that risk is a fascinating subject!

However, I suspect I am in in that very selective group today!

The industry that I represent – oil and gas – provides life's essentials – heat, light and mobility.

But to do so, we have to do many things well – exploring, producing, refining, distributing and marketing our products.

And all of this needs to be within a context of managing risks effectively, and at scale.

Radio 4's James Naughtie this week spoke of "the tantalising uncertainty that flows through the story of oil" in his programme about the history of the North Sea.

Actually, we live in a world of constant uncertainty – the one constant is change.

August is normally a quiet time of year.

Journalists call it the 'silly season' when nothing of significance happens. But it did not feel that way this year.

I can think of at least five issues that emerged or escalated – ones with potential to impact our thinking on risks.

- The Chinese stock market experienced a period of severe volatility. The Shanghai Composite Index fell by 43% over the summer from a high in June.
- The oil price bounced then fell again to \$42 (Brent) its lowest point since February 2009.
- With a sudden velocity, over a third of a million migrants were on Europe's borders and 2,500 tragically died attempting the crossing over the Mediterranean. That is in addition to the millions of Syrian refugees in Turkey, Lebanon and Jordan.

- The headline of the previous month – Greece and Grexit – receded and the yield on Greek 10-year bonds fell from 19 to 9%.
- Rather than Grexit, Brexit grabbed the headlines, with the first opinion poll this week showing a 51% majority saying they would vote to leave.

We live in a very fast changing world. These were not the top five issues at the beginning of the year.

And forecasting the future has got a whole lot harder – the recent UK general election forecast is a case in point.

As the American economist, Kenneth Arrow, observed: “Vast ills have followed a belief in certainty.”

Dealing with uncertainty is now the norm.

However, there is also more positive corollary – vast opportunities can be realised by effectively managing uncertainty.

That is what each of you and your businesses are engaged in.

We will have some different perspectives on this, but let me share what I see as the key risks we face in oil and gas.

I will then review how we seek to deal – practically and pragmatically – with those risks.

And I will conclude with some themes for your consideration.

Oil and gas risks

First, how do we define the key risks that we face?

There are three overarching areas of risk:

First, is geopolitical risk

In many places, our business operates along the fault-lines between politics and societies.



Geopolitical instability has always been a backdrop in many parts of the world. But it is not always war that causes instability. It could be expropriation in the extreme, or disadvantageous or punitive changes in legislation.

After all, our company was originally the Anglo-Persian oil company before our assets were nationalised. An extreme case of geopolitical risk.

Second, is commercial or financial risk

I need to point no further than the disparity between the oil price this morning, of \$44, and the price of \$96 on the 10th September 2014.

In practice we operate in a world where the change in the underlying commodity price changes many aspects of our costs and fiscal terms.

And it is not just legislation.

We have operational and financial exposures that exceed the capacity of the insurance industry to underwrite them. This is why we carry this risk on our balance sheet.

Third is technical risk

We are a high-hazard business. We do some extraordinary things:

- We drill wells in 10,000 feet of water and to total depths of over 30,000 feet
- We ship 3.5 billion barrels of oil between 800 ports in over 100 countries every year
- We boil almost 2 million barrels a day of oil in our refineries, the list goes on.

The downside can be significant. This is why we have invested so significantly in risk management – notably codifying our operations through an Operations Management System or OMS and building capability in the front-line and functionally.

Managing risk

Risk management is the key phrase.

Avoidance is unrealistic. Mitigation is important.

But risk management is crucial.

And in terms of management I would identify five pillars of risk management.

1. Principles

This first pillar is principles.

It is important to have clearly set-out rules. They need to be codified and incorporated in day-to-day activity.

It is a condition precedent for our operations.

But there cannot be a rule for every single eventuality.

We also need people to make sound judgements – driven by professional expertise.

In a dispersed company such as ours, we also need our people to conduct themselves in a consistent manner. They need to have an ethical compass that directs them to the right decision. We do this through a Code of Conduct setting out BP's expectations.

2. Capability

Next comes capability.

In a crisis, success or failure comes down to the actions of individuals – individuals with the ability to judge a situation at hand, to take appropriate and proportionate action, and to track those actions through to a successful conclusion.

These capabilities need to be at the heart of the organisation.

You can in-source good ideas but you can never outsource good decision-making.

That's why, even in tough times, we continue as an organisation to invest significantly in developing people's capability, and bringing new capability where the potential is missing in-house.

3. Governance

The third pillar is governance – by which I mean the architecture of checks and balances – the structures, standards, policies, practices and committees that are used to manage the organisation.

The right governance structures and processes facilitate sound risk management. Without it, your best people with the highest capability are unable to work to their full potential.

Let me identify some principles of governance that I believe are critical.

The first is what we call ‘functional excellence’. This means creating structures and standards that lead to consistent performance globally in a given functional area or discipline.

We have worked extensively on this in recent years to systematise, standardise and, to a degree, centralise the way we work. We are doing this in risk management, in drilling, in operations, in project management – in multiple areas of work across the company.

To take the area of finance as an example, we have global policies which provide clear and simple guidance to our business units. They define who is accountable for managing each type of financial risk as well as setting out credit and liquidity requirements.

The second principle is that governance of the company needs to be constantly checked and re-checked.

This requires a systematic process of ‘checks and balances’ – setting up multiple controls and contingencies and confirming their effectiveness through checking, double checking and triple checking. As one of our board members puts it, “you get what you inspect, not what you expect.”

A final point on governance is that we have reviewed and updated the way we manage and describe risk across BP – not just safety-related risk, but all risks – financial risk, compliance risk, legal risk, and so on.

We have introduced a common reporting system and a standardised matrix for documenting risks. This means that risks are assessed against common criteria and can be ranked in a way that enables us to prioritise them effectively. It also allows multiple risks to be examined at the same time.

In other words, it allows for a systematic review of individual and collective risk. It, therefore, seeks to anticipate and address these risks in a dynamic way.

4. Assessment of risk

The fourth pillar is assessment – having the right mechanisms and degree of understanding to categorise and assess risks in order to allocate the appropriate resource to their management.

So much of our risk is asymmetric. For example, as I said earlier, we are unable to insure assets because of their scale.

Or consider the current low oil price situation. International Oil Companies have seen their income cut in half. Assuming that lower will be for longer, we have to be able to negotiate a new distribution of financial risk – both between companies and governments and between companies and the supply chain.

When it comes to managing risk on the ground, it starts with process – having the right framework or system.

This begins with the Operating Management System I spoke of, which is our common group-wide framework designed to provide a basis for managing our operations in a systematic way.

5. Values

Last but far from least come values.

If anything values are the most critical of the pillars.

They are the bedrock of any company. Who you are. What you believe in. How you behave. What you want to be.

These are fundamental in determining how you respond to risk; how you decide what the appropriate action should be.



It is the key responsibility of management to shape the values – and shape the processes that entrench those values across the company.

In BP we have five simple, personal qualities that we believe the company stands for at its best – safety, respect, excellence, courage and one team.

Conclusion

In conclusion, the successful management of risk is dependent on a clear strategy.

A clear strategy defines the bookends, or the boundaries of your business.

Good risk management provides the agility to respond to uncertainty within those boundaries.

Warren Buffett once said that “risk comes from not knowing what you are doing.”

I would argue that those five pillars of principles, capability, governance, assessment, and values – applied within a clear strategy – is a very good indication that you do know exactly what you are doing.

Thank you, Ladies and Gentlemen, I would now like to hear your perspectives.