How crisis can shape the treasury for tomorrow's risks and opportunities

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Good morning, Ladies and Gentlemen.

It is a pleasure and an honour presenting today on the 20th Anniversary of the annual Eurofinance conference. This is one of the leading forums of its kind and this year, I gather, more than 2,000 delegates from prominent institutions are attending to discuss and share views with financiers, economists and fellow treasurers.

As I reflect on the current state of financial markets, I am reminded of how the word 'crisis' is written in Chinese characters: the first character represents 'danger' and the second one represents 'opportunity'.

While considering past crises – external or internal – it is imperative to rely on a Treasury organisation able to weather these two seemingly conflicting aspects of the word 'crisis'.

On the one hand, it is key to shape a Treasury organisation which is robust in both identifying and mitigating downside risks.

On the other hand, the most effective Treasury organisation needs to be capable of creating and taking advantage of opportunities as they arise.

At BP, our Treasury organisation has had first hand experience in dealing with events, both external – such as the financial crisis of 2008 – and internal – in the aftermath of the Deepwater Horizon incident in the Gulf of Mexico last year.

I will speak today on the importance of shaping a Treasury good for all seasons, not just the turbulent ones but also the promising ones.

But first, I would like to say a few words on last year's events for BP and where we are today.

The tragedy of the Deepwater Horizon incident has caused BP to re-think a number of areas. 2011 has been a year of re-set, a year of consolidation and of rebuilding trust in BP. We have committed to sharing the lessons we have learned with the industry, regulators and governments worldwide. We have made measurable progress, most notably in strengthening our processes in dealing with the so-called low probability, high impact events. This includes strengthening safety and risk management in BP. We have established a group-wide Safety and Operational Risk organisation with an independent line of sight and we are ensuring that our standards, in many cases, go beyond local requirements.

In financial terms, we have strengthened our balance sheet and have reduced our target gearing band. We have built a strong liquidity buffer to deal with unexpected calls and have stabilised our credit ratings. And in tandem with many parts of BP, Treasury has played a central role in delivering this progress.

In BP, Treasury acts as the in-house global bank. We centrally finance the group and provide liquidity to its businesses. We optimise value through the management of financial risks at the group level. Our teams – based in London, Singapore, Houston and Chicago – cover worldwide cash management as well as activities in debt capital markets; equity capital markets; in-house investment management for our Pension Funds – around $40 billion globally; insurance – through our two captive insurance companies; foreign exchange trading; corporate risk management; structured finance and advisory as well as policy and assurance on economic evaluation.

With our global operating model, we leverage the scale and balance sheet strength of the group. We manage risk and volatility on a net basis globally and optimise funding centrally. All of this is underpinned by professional capability and execution.

Our goal has been to design and manage an organisation that is able to astutely manage downside risk, while nimbly capturing opportunities. This is anchored in three key dimensions that I would like to cover today:

- The first dimension is policies, essentially the compass that guides how we operate;
- The second is governance, or more exactly a dynamic governance model, which is about how we put the policies into action;
- And, the third dimension is capability – the bond between policies and their implementation.

Before I expand on each one of these three dimensions, let me note that these reflect my personal views and are not necessarily BP's position.

Since the financial crisis, markets have experienced an unprecedented level of volatility. This is the 'new normal'. Since the beginning of this year, we are settling into an 'age of uncertainty', fuelled by the sovereign debt crises in Europe and the US as well as concerns over the ability of governments to resolve the current situation.

In this environment, Treasury organisations face challenges on multiple fronts with the inherent risks often inter-linked:

- First, counterparty risk – given the multiplicity of institutions impacted by current market dynamics;
- Second, market risk – resulting from volatility and the risk-on/risk-off environment so aptly characterising it; and
- Finally, execution risk – as a result of rapidly changing market conditions which can limit access to favourable windows.

How can Treasury cope, and indeed thrive, in this 'new normal'?

Let me start with the first dimension – policies, the compass that guides how we operate and deal with risks.

At a fundamental level, Treasury is in the business of managing financial risk. We take a holistic view which allows us to develop unique insights into markets and the totality of the group's financial risks. Within the context of this comprehensive understanding of financial risk, our policies provide clear and simple guidance to our business units. In particular, they define who is accountable for managing each type of financial risk, the boundaries within which these risks are to be maintained and the mitigation actions required to keep them within the boundaries.

Treasury can better arm itself to weather major crises by establishing clarity on policies such as credit and liquidity requirements in the context of the overall strategy of the group.

Policies do not exist in a vacuum. They need to be driven by an understanding of the context we operate under and, equally important, we need to distil this context into an informed point of view of the areas which can give rise to new risks.

In late 2007, given our views on markets we decided to establish a liquidity buffer, something we had not done before.

BP usually runs with a modest degree of short-term borrowing. Prior to the financial crisis of 2008, we moved quickly to a situation where we had a significant amount of accessible cash to protect ourselves against liquidity risk.

During last summer, in another context, we increased the liquidity of the group by raising short-term financing while always keeping in mind the long-term financial consequences for the group. We raised funding with terms and conditions that reflected, and reinforced, the inherent financial strength of the group.

In other words, it is important to ensure actions have well thought through consequences, both intended and unintended.

We continue to maintain a prudent financial framework reinforcing the group's balance sheet – usually its strongest asset. The financial framework is linked to, and informs, the capital structure of the group. It also takes into account BP's investment strategy based on its views on the balance between risk and reward.

Ultimately, the financial framework is the conduit that enables the delivery of corporate strategy.

Last summer, we also reviewed our existing financial framework to ensure that it was comprehensive in light of our requirements. It is not a static document; in our case, we stress test it to ensure its robustness on a regular basis.

This allows for better choices.

The second dimension is governance. This enables the policies to be put into action.

We have a centralised Treasury structure which we seek to leverage. It allows BP to present one face to the markets. We are able to assess our exposures on a real time basis with financial institutions worldwide. This allows us to dynamically manage our position in financial markets.

Being global is not enough. When you operate at scale, you also act and learn at scale. This perspective has allowed us to look at fast emerging trends and – on occasion – unique sets of events in a truly holistic way.

We saw an opportunity earlier this year to access a new market, the Chinese Renminbi or the so-called “Dim Sum” bond market. This enabled us to tap into a new and attractive funding source for our growing requirements in China.

Similarly, we have established 24/7 currency trading capabilities, recognising the increasing importance of non-OECD countries in traded markets and our industry.

We have dynamic review processes for, amongst others, liquidity management, credit exposures, investment risk and market access.

Technology has played a vital role in this respect. We have invested consistently in this capability. As a result of this long term investment, at a time when it was most needed, we had a clear line of sight of the group's exposures and therefore were able to make decisions in real-time based on real-time data.

This was absolutely vital in the fast-changing context of 2008 and in 2010.

As events move in ever faster cycles, a dynamic model of governance allows for adaptation and nimbleness but within the clear boundaries of the financial framework and its policies.

This is a continuum. You cannot change policies or governance for every crisis.

The final dimension is capability.

This was especially tested during the past few years. In extraordinary circumstances, when there is no benchmark, you need people to take the best decisions based on judgement and experience. Because, ultimately, you can always in-source good ideas but you can never outsource decision making.

It is, therefore, absolutely essential to continue to attract the very best people in your organisation.

In BP, we use a combination of three ingredients to ensure sustained organisational capability:

- we seek to attract and retain the best people. To do this, we have a global organisation with a scale that allows for career development and progression;
- we bring in external recruits when there is a need for specialised capability or as a complement to our existing suite of capabilities; and finally,
- we invest in a strategic approach to capability development through career ladders, external training and inter-regional opportunities.

Treasury requires a specific mindset in everything we do given the pace of change in markets. As I reflect on our experiences, I would observe a few key characteristics which are essential to building muscle in the organisation.

- Firstly, think global – especially as the availability of funds is global and markets are moving faster and in more unpredictable ways than before.
- Secondly, instil a culture of continuous learning, often from the challenging times. The law of evolution applies here – "out of difficulty arises resilience".
- Thirdly, be pragmatic – apply the rigour of corporate finance theory in developing policies but deploy them with a recognition of the commercial environment.
- Fourth, be market agnostic and price evangelical – by which I mean position the group to take funding opportunities whenever they arise and try not to be trapped in a market window due to a short term need.
- Fifth, be nimble and efficient – only the fit companies will be able to both capture the new emerging opportunities and react quickly and decisively to emerging risks.

- Sixth, the old cliche of “prepare, prepare, prepare” – you can never be prepared enough. It is vital to stress test the robustness of your organisation in peace time, not in wartime.
- And finally, be an optimist; maybe the one feature that can be forgotten in the current context. It is key to see the opportunities that the current environment brings, equally important as it is to see the risks.

As I conclude, I would reiterate that the ultimate success of a Treasury organisation is based on the following combination of:

- clarity of policies;
- dynamic governance; and
- exceptional professional capability.

And within a mindset of optimism; the capacity to not only assess risks but to also see and grasp opportunities.

Winston Churchill put this very appropriately: “A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty.”

Ladies and Gentlemen, thank you.

I will now be happy to take your questions.