Managing a global treasury and its challenges

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Good morning, Ladies and Gentlemen.

Emerging markets are an important source of growth for our industry and indeed, the world – from the vantage points of both supply and demand – and therefore, it is a particular honour to share some perspectives with colleagues at this conference.

With the great amount of change and turmoil that we have lived through recently in financial markets, I am reminded of the words of the great French writer Paul Valery:

“The trouble with our times is that the future is not what it used to be.”

In times like these we face the challenge of questioning and re-evaluating our actions and adapting them to solving the problems that we are likely to face in the future rather than the ones we have faced in the past.

I would like to cover three themes today.

- First, how we manage financial risks in the Global Treasury group within BP and the lessons we have learnt from the recent financial crisis.
- Second, some broad themes on how financial markets are evolving and the policy implications that this will have, particularly for Corporate Treasuries.
- And finally, I would like to leave you with some thoughts on the future.

I would like to emphasise that the views that I present here reflect my personal views and not necessarily BP’s position.

Simply put, the role of Treasury in BP is to manage the Group’s key financial risks and to provide funding and liquidity to the Group and its businesses. This broad remit means that we manage a diverse range of financial activities not always associated with Treasury functions - for example insurance, management of pension investments and structuring and financing transactions. We manage financial risks by centralising them to the greatest extent possible. This allows us to use the scale of the Group’s activities to net off exposures. It also enables us to utilise the scale and scope of the Group balance sheet to leverage capability and manage volatility and risk in an optimal way. I will return to both these themes in my comments.

In BP Treasury, we manage the liquidity risk of the Group by raising short term funds and investing available cash balances. These surpluses reached a high water mark of $ 8bn during 2009. We raise long term debt through capital markets; a total of some $11bn was raised in a range of international bond markets last year. The in-house bank is run by us so that we can optimise inter-company flows. BP Treasury actively manages foreign exchange risks with focused hedging programmes as well as executing foreign exchange transactions required by the Group. We determine and implement the

Group's Insurance strategy. Our worldwide pension funds which have some $40bn invested at the moment are managed by us as is the arrangement of structured finance solutions to fund projects in a range of business areas and geographies. And finally, we manage credit risk with financial counterparties.

At the core of our activities we have a set of guiding principles which we consistently apply:

- First, we centralise the management of financial risks. This allows us to have a clear line of sight to exposures and to have a holistic approach to handling risks based on the knowledge of the total effect of these risks on the balance sheet.
- Second, we embed the management of risks in the appropriate governance structure to ensure transparency and accountability in dealing with risks.
- Third, we net off exposures at a Group level and then actively manage the total exposure. Taking these net positions to the market prevents costs being incurred by hedging opposite exposures in different parts of the Group when the impact on the Group as a whole is negligible or indeed, non-existent.
- And finally, we seek the appropriate risk reward balance in all of the investment activities that we undertake, ensuring that the economic value for the Group is maximised

These long established principles served us well in managing though the turmoil of the recent past.

With the liquidity crisis now abating we can see more clearly the main factors that were essential to steer through the recent financial market turmoil.

The first challenge was to ensure that the Group maintained the necessary liquidity to support its funding requirements. As market liquidity dried up, companies reliant on short term funding found themselves exposed. Short term funding markets normally provide the flexibility to absorb fluctuating cash flows from operating and investing activities, but their short term nature proved to be an exposure at a time of restricted access to liquidity. Each Corporate Treasury – to different degrees of course – faced the challenge of managing liquidity risk at a time in which the market was in a state of fear and panic.

The key insights that allowed us to manage this risk were:

- First, understanding the critical role of cash on the balance sheet. The buffer provided by a cash reserve proved invaluable when dealing with a severely disrupted funding market. Holding cash can be viewed as a cost as generally the interest obtained on the cash is below the cost of debt. However, it can also be a lifeline if there are market disruptions which make it difficult to raise short term debt. The critical decision is to judge the appropriate level of cash by balancing these opposing factors and then dynamically reviewing them as conditions change.
- Second, pushing the boundaries of possibility. Market opportunities can arise from a broad range of sources. They can come from different markets and currencies as well as from varied instruments. They emerge during windows of availability which are, at times, transient. Creating the widest possible set of funding alternatives, in different markets and instruments, provides the route to obtaining the quickest access and advantaged pricing. Given their unpredictability, we can only take advantage of them if we are clear on our strategy and are able to get into action as the need arises.
- Third, by acting nimbly and decisively. A time of crisis is not the moment for experimentation. What is required is people taking decisions calmly and wisely based on judgement and deep

market insight. Judgement is critical as the benchmarks of the past might not necessarily be the benchmarks of the future.

The second challenge was to manage exposures to financial counterparties. Managing counterparty risk has been a staple of our processes for a long period of time. The crisis, however, intensified the pace. The essential enablers to successfully manage this risk were:

- First, our ability to see in real time the exposures we had globally with each counterparty. This included exposures arising from the full range of banking and trading activities. This way we could understand and evaluate immediately the extent of our worldwide exposures. The value of having the right systems and processes cannot be underestimated.
- Second, we actively managed exposures where appropriate. A multi-dimensional process of reviewing traded risk indicators, equity implied risk, credit ratings and the like resulted in risk appetites and exposures being adjusted accordingly. It is important not to rely on one set of data but to have different lenses as well as a holistic and consistent way of doing this through a centralised structure.
- Third, having a global understanding of exposures with financial counterparties allowed us to introduce mitigations and agreements which reduced exposures by netting them off on a global basis.

Let me now turn my thoughts to recent events in financial markets and their implications for Treasurers.

It has been widely recognised that there has been a fundamental change in the market – the so called 'new-normal'. Whilst we cannot be deterministic about the future, there are some elements to guide our understanding.

The symptoms of the 'new normal' are likely to include a period of slower growth, high levels of unemployment, higher taxation and possibly even stagflation. However, underlying these symptoms are deeper structural changes which will have a lasting impact.

First of all, there has been a change in the way we perceive and evaluate risk. It is not just a question of a higher risk premium on investment activities – or market risk, if you will. The crisis has highlighted the limitations of the financial system and the importance of the guarantors of stability – central banks and governments – to stem a crisis such as the one we have lived through. Sovereign risks have suffered in the process as governments have had to deal with the double impact of the debt raised to support stabilisation programmes and lower tax revenues. Operational and systemic risk – in other words, the provision of banking services – has become intrinsic to the way in which we holistically review our risks.

Corporate Treasuries are mitigating market risks by continuing the trend to strengthen balance sheets and by optimising their liquidity position – as we saw with the extraordinary levels of activity in debt capital markets during the past year. The techniques to measure and manage risks will need to be refined to deal with these new uncertainties. There has never been a better time to refresh a company's financial policies to ensure that they are effective in managing the risks that they are likely to face in the future.

Second, as a result of the crisis we are already seeing the effects of the increased influence of governments in the operation of financial markets. Governments around the world are stepping up the regulation of financial activities, responding to the need to prevent a recurrence of the crisis and also responding to public opinion. This has changed the trajectory towards the increasing liberalisation of markets.

The regulatory initiatives could impact Treasuries in a number of ways. Banks, under pressure to shore up their balance sheets, have already redrawn their business lines. In some cases, this has meant retreating from traditional areas. The challenge for Treasuries will be to maintain cost effective and competitive access to capital and services.

A third theme, which links into the theme of the conference, is the higher reliance on emerging economies to drive the world economy. At no time in the recent past has the effect of these rising economies been more essential to the health of the world economy. The dynamism of Brazil, Russia, India and China and other fast-growing economies is offsetting the lower growth in developed countries. This will, and indeed already is, having profound implications for investment allocations and capital flows.

Finally, I would like to address the future.

Corporate Treasuries have a key role in managing financial risks and providing liquidity for business to be transacted. To effectively manage the challenges of the future we will need to:

- Build the capability base of our organisations. To deal with both crisis and opportunity, nothing beats having the in-house resource of deeply knowledgeable and experienced professionals. This capability cannot be improvised; it has to be nurtured and maintained through the cycle. And very importantly, building capability is an energising and motivating force in organisations.
- Challenge the accepted knowledge or conventional wisdom. These times require flexibility to develop options which are the result of new and in many cases, unique circumstances. The nature of risk is that it is unpredictable – if we focus on the risks that have already materialised we may overlook the larger risks awaiting us. Understanding the changing paradigm will be key to capturing emerging opportunities.
- Create a culture of continuous improvement. By ensuring that performance is delivered in a progressive manner so that we remain competitive in an environment that continues to be challenging.

The recent financial crisis has created a new paradigm in financial markets. Our challenge is to decipher it so that we can manage the risks of the future.

There are no prescriptive answers.

There are, however, lessons that can be learnt and incorporated as we look forward.

As Albert Einstein so pithily put it:

“Learn from yesterday, live for today, hope for tomorrow. The important thing is not to stop questioning.”

Ladies and Gentlemen, thank you for your time. I would now welcome your comments and questions.