Treasury Key Issues Report
4Q 2010

Financial Markets

Global Markets

The year finished with a very similar tone from where it had begun, namely with concerns around EU sovereign debt levels and growing divergence in monetary policy between developed and emerging markets. The last quarter of the year was dominated by event risks such as the US midterm elections, the G-20 leaders' meeting in South Korea and by the Federal Reserve's decision to engage in a second round of quantitative easing (QE-2). The launch of QE-2 in the US was met by widespread criticism around the world, especially from emerging markets policymakers who accused the Federal Reserve Bank of purposely trying to weaken the US dollar. "Currency wars" became the hot topic around year-end, with several emerging countries implementing capital controls and intervening to weaken their currencies against the US dollar. However, the dollar reversed some of its losses in the last two months of the year, finishing 2010 barely unchanged. Equities were supported by loose monetary policies and improving growth momentum into Q4, with the S&P 500 Index closing the year 11.5% higher. After rallying during the summer in anticipation of further quantitative easing, Treasuries edged lower (higher yields) in the last quarter of the year, with the yield on the 10-year note finishing at 3.29%. Meanwhile, Chinese inflationary pressures increased to the highest level in more than two years, despite the efforts from policymakers to curtail lending, tighten monetary conditions and crack down on real-estate speculation.

US

Economic data continued to show that the economy picked up in Q4 after a soft patch during the summer. The unemployment rate remained stubbornly high at 9.4% and inflation remained low, but surveys on economic activity point to better times ahead. In the November mid-term elections Republicans won back control of the House of Representatives, an outcome that is forcing President Obama to move towards the political centre on economic policy.

Europe

Sovereign concerns in the euro area centred on Ireland during the quarter, with the country being forced to tap the European Financial Stability Facility set up in May to deal with Greece. Despite Ireland accessing funds from the bailout mechanism, the market continued to focus on the sustainability of the euro region and the contagion quickly reached the sovereign bonds of Portugal and Spain. The euro strengthened against the US dollar on anticipation of the Fed's latest round of QE, but ended the quarter 6% lower as worries about the fiscal problems in Europe's periphery returned to the focus of financial markets. Meanwhile, Germany's industrial sector continued to benefit from strong overseas demand and a weaker euro, making their industry the engine of growth in the euro zone.

UK

The UK manufacturing sector ended the year on a strong note, with activity expanding at the fastest pace in 16 years. However, manufacturing appeared to be the only sector of the economy maintaining the growth momentum in Q4 as the bad weather weighed on the construction and services industries. The last Bank of England inflation report revealed a high degree of uncertainty regarding the economic outlook and a "wider than usual range of views" among the Monetary Policy Committee. By November the annualized consumer price inflation rate was 3.3%, exceeding the target of 3%. The fact that inflation has been consistently higher than expected reduced the chances of further QE.

Japan

The Japanese economy expanded at a faster rate in Q4 than initially forecasted, with the final GDP release revealing growth at 4.5% from the previous year. This higher expansion in economic activity was fuelled by stronger capital expenditure by businesses and a temporary boost in consumer spending from government subsidies for energy-efficient cars. However, the market quickly moved to assess how sustainable this stronger growth was, with most market commentators pointing to the likely retreat in consumer spending in Q4 and weaker exports from the stronger yen.

Financial Information

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$m	4Q'10	3Q'10	4Q'09
Gross Debt	45,336	39,979	34,627
Less FV of debt hedges	(916)	(797)	(127)
Cash	(18,556)	(12,803)	(8,339)
Net Debt	25,864	26,379	26,161
Net Debt Ratio	21%	23%	20%
Income Statement	**4Q'10**	**3Q'10**	**4Q'09**
Interest Payable	297	271	195
Finance Costs	359	348	252
Qtr End Exchange Rates	**4Q'10**	**3Q'10**	**4Q'09**
USD/GBP	1.5389	1.5798	1.6010
USD/EUR	1.3280	1.3598	1.4300

Financial Commentary

Reported net debt increased by $515m in the quarter. Gearing decreased to 21% including the effect of provisioning for GoM.

Credit Risk

Total bank counterparty risk exposures have increased reflecting the high level of cash balances deposited with the banks. Treasury dynamically manages the bank deposit limits to ensure cash is well diversified and to avoid excessive concentration risk. All Treasury cash is deposited with strong financial institutions rated A+ or higher or with AAA rated money market funds. In 4Q, tenor limits for cash were kept short to preserve liquidity and to maximise flexibility to react to unplanned events.

Funding and Liquidity

Following BP's return to the conventional long term bond markets in October following the Deepwater Horizon incident, the Group's secondary spreads and CDS levels have tightened substantially. Our 5 year spreads are around USD Libor+80bp, around 100bp tighter than last October.

Throughout the quarter, we have continued to run with a very prudent balance, maintaining a sizeable cash buffer, in excess of $10bn. Including M&A deposits, cash totaled $18bn at quarter end.

To maintain the cash buffer, in response to potential increases in Group debt following the signing of Reliance acquisition, we returned to the bond markets in size in March. In a favourable market window, we issued around $5bn of debt in both the sterling and USD markets in a combination of 3, 5, 7 and 10 year tranches in successive days.

Post Deepwater Horizon, we put in place bank facilities of around $17bn. This level was appropriate in the aftermath of the crisis but it is too high on an ongoing basis as it limits general credit availability for BP. In March we have renegotiated all our bank facilities into a new 3 year set of standby agreements with 23 banks. In total our facilities are $7.2bn. Most importantly we have preserved the same favourable terms and conditions as our facilities prior to Deepwater Horizon

Key Issues

Pensions

After a strong 4Q 2010 performance, overall funding levels in our pension plans continued to improve in 1Q, driven by strong asset performance and small up-tick in bond discount rates. Overall our funded level of our funded plans rose over the quarter from 103% overfunded to 108%, the highest year end position in 3 years. The main UK plan is overfunded at 112% and the US plan's funding level is 96%.

The UK and US investment strategy reviews were completed and agreed with both the UK trustees and the US fiduciary board. A framework has been put in place to moderate the plans' equity bias based on market triggers. The US plan met the first trigger during the quarter, resulting in a 5% switch from equities to bonds, reducing the equity bias down to 75%.

Total planned 2011 contributions are $1.25bn, in line with last year, $0.5bn being paid in 1Q.

The merger of the Burmah Castrol (BC) pension fund into the main UK fund was completed at the end on 1Q. The BC fund was the Group's third largest fund (£1.1bn). The assets have now been merged into the main BP fund under management of our in-house fund management team.

Deepwater Horizon Oil Spill Trust

Treasury co-ordinated the second required funding ($2bn) of the Deepwater Horizon Oil Spill Trust (DWHOST) on 15 November 2010. The next cash contribution of $1.25bn is planned for mid 1Q 2011.

Negotiations and logistics were completed leading to the signing in December 2010 of a Hydrocarbon Sales Agreement, which enables the commencement of the overriding royalty interest (ORRI) structure in 1Q 2011.

Letters of Credit

During 4Q, Treasury arranged an additional $500m of committed letter of credit facilities with Mizuho to ensure funding flexibility and to enhance BP's liquidity. This facility was arranged on a global basis, at competitive prices and using BP's standard terms and conditions. Treasury is negotiating further committed lines both through the extension of existing facilities and the development of new lines.

Treasury is also working with IST and a relationship bank to develop a secured documentary LC structure as an additional contingency measure. The first secured pilot transaction was successfully initiated in December 2010.

Obligations to satisfy EPA performance obligations of circa $350m were completed this quarter, through the issuance of letters of credit.

US Wind Financing

Treasury closed the Cedar Creek II wind project financing ($279m gross) on 21 December with a group of eight banks. This financing included the monetisation of Production Tax Credits (PTCs). Cedar Creek II was the third wind financing closed in 2010, bringing the cumulative gross funding arranged to around $1bn for the full year.

Shipping Financing Frameworks

Treasury conducted a review of the shipping financing frameworks with the Group CFO who endorsed them. These frameworks are designed to guide the decisions on funding future shipping requirements in a way that is aligned with the revised Group Financing Framework.

Ship Refinancing

Treasury closed the last of a series of ship re-financings by negotiating structured leases for four Aframax vessels for a further 5 years to 2020. The four vessels represent an undiscounted financial commitment of $160m. Importantly, completing this transaction prior to year end secured Group value for enhanced capital allowance benefits under specific UK tax rules prior their expiration at the end of 2010. The transaction is in support of BP Shipping's target of smoothing out its vessel replacement profile. Treasury led the lease negotiations and the transaction complied with the OBS Financing Principles and relevant financial frameworks.

Devon Asset Acquisition

To enable the future closing of the Brazil asset package, Treasury negotiated (1) a $250m uncommitted LC line with Banco Santander to replace Devon's obligations with ANP and (2) closing payment logistics.

Vietnam / Venezuela Divestments

Treasury supported the disposal of BP's upstream businesses and associated interests in Venezuela and Vietnam to TNK-BP for a total of $1.8 billion. Treasury supported a number of pre-transaction activities for the share and assets sales, including dividend payments and cash sweeps, as well as planning for and managing the complex lender consent processes as part of the transfer of the

Vietnam power generation assets. Due to the various government, partner and lender consents, final completion is not expected until 1H 2011.

Other M&A Activity

Continued providing due diligence and pre and post-closing support to a number of large M&A-led efforts which underpin the Group's announced divestment agenda, including (1) the announced divestment deals with Ecopetrol, Talisman, and Bridas (for PAE) and (2) numerous "in progress" acquisition and divestment transactions.

Insurance

The formation of a US Captive Insurance Company in Vermont has been approved. Implementation is targeted for end of 1Q 2011 to enable the company to become operational in 2Q 2011.

The pilot study to reduce historic insurance liabilities has been completed with recommendations on managing the portfolio going forward. This includes selling a portion of the portfolio where there is no recourse on BP. The recommendations will be implemented where appropriate during 2011.

A global regulatory review of the insurance purchases and processes that BP conducts has been completed. No compliance issues were found.

Jupiter Insurance Ltd has completed the first phase of implementing Solvency II (European Insurance Directive). This is a voluntary initiative for Jupiter as it is not domiciled in the European Union. However, as Jupiter transacts business in Europe this is deemed a prudent course of action. The second and final phase will be completed in 2011 although the directive only becomes effective at the end of 2012.

The insurance team continues to support the litigation for the DWH incident.

Impairment Testing

Treasury analysed and recommended a new pre-tax discount rate to Finance for use in financial reporting impairment testing, including support for the choice of countries deemed 'high risk' for impairment testing. Recommendations were accepted by E&Y and approved by the CFO.

China Funding

Liquidity was significantly tightened by the Government towards the end of 4Q as the country's annual loan growth had reached its limit of RMB7.5 trillion (~USD1.1 trillion). The Central Bank raised the required reserve ratio of the commercial banks to 18.5% and stopped commercial banks from lending in mid-Dec through the year end to curb excessive liquidity.

BP China was not affected as the large majority of the financings and refinancings were completed in the previous quarters. Note that the Chinese Government announced in December the shift to a "prudent" monetary policy for 2011 from the "appropriately loose" stance in the previous year. It is expected that interest rate increases and lending restrictions to control liquidity and inflation will herald in the New Year.

