Treasury Key Issues Report
2Q 2011

Financial Markets

Global Markets

Economic activity slowed down worldwide during 2Q due to combined factors - supply disruptions caused by the Japanese earthquake and the rise in commodity prices during 1Q and tightened monetary policies in emerging markets. This weakening in cyclical data relative to expectations and the resurfacing of Greece's sovereign debt crisis weighed on risk sentiment. The S&P 500 index fell 6% from early April to the middle of June, although it erased most of these losses on the last two weeks of June. The US economic dataflow had begun to improve and the Greek parliament voted in favour of a new set of austerity measures – allowing the country to access funds from a new bailout scheme and averting an immediate default. Meanwhile, the Fed finished its QE-2 program in June but reiterated that rates will be held at the current low levels for an extended period of time. This policy divergence between the Fed and other central banks impacted the US dollar, with the trade-weighted USD finishing 3% lower in 2Q. Elsewhere, the IEA announced the release of 60mbls of oil reserves in an effort to offset the disruptions in Libyan oil output. This announcement caused oil prices to fall temporarily and was compared to engaging in further QE, as lower energy prices would increase disposable incomes in developed countries. Meanwhile, Chinese policymakers continued to hike interest rates and reserve requirement ratios in an effort to cool down the economy and tame inflationary pressures. Chinese inflation is expected to start coming off in 2H2011.

US

The US growth momentum clearly slowed down in Q2 but the Fed took the view that the adverse effects on growth were temporary and the economy would pick up again in the second half of the year. The unemployment rate edged higher to 9.2% in June as the labour market continued to disappoint. Treasury bond yields spent most of 2Q edging lower, with the yield of the 10-year note reaching 2.84% before the economic dataflow improved and yields jumped to 3.20% at the end of June.

Europe

Europe continued to be characterized by large divergences in economic conditions between the core and periphery countries: Germany continued to growth strongly, albeit at a slower pace than 1Q, while the periphery nations were faced with negative growth and lacklustre labour markets. Despite the tough austerity measures being implemented across the periphery nations and the inability of some European banks to fund themselves without help from the central bank, the ECB chose to tighten monetary policy. The bank hiked interest rates in April for the first time since October 2008 and added another increase this month, bringing the benchmark rate to 1.50%.

UK

The UK seemed to experience the sharpest slowdown in growth momentum across G-7 during 2Q. The manufacturing and services surveys all rolled over during the quarter and are now at levels consistent with growth around 0.3% q/q. The sharp weakening in cyclical data raised concerns amongst the Bank of England's policymakers, who started to focus on the downside risks to growth rather than above-target inflation. The minutes of the June MPC meeting revealed that further QE was still on the table if the downside risks to medium-term inflation materialized. The market is now pricing the first 25bp hike in June 2012.

Japan

The economic dataflow during April was a powerful reminder of the sheer scale of the disruption and the devastating effects on the economy of Japan's March earthquake. Industrial output fell by 15.3% in March from the previous month, while vehicle production dropped 57.3% m/m. However, the data quickly reversed by the end of 2Q, supporting evidence that supply chains were being restored and the economy would experience a V-shape recovery. Meanwhile, continued risk aversion helped the yen appreciate 5% against the USD dollar on the quarter.

Financial Information

$m	2Q'11	1Q'11
Gross Debt	46,890	47,102
Less FV of debt hedges	(1,173)	(870)
Cash	(18,749)	(18,726)
Net Debt	26,968	27,506
Net Debt Ratio	20%	21%
Income Statement	**2Q'11**	**1Q'11**
Interest Payable	285	285
Finance Costs	314	308
Qtr End Exchange Rates	**2Q'11**	**1Q'11**
USD/GBP	1.6023	1.6059
USD/EUR	1.4395	1.4092

Financial Commentary

Reported net debt decreased by $0.5bn from E1Q'11 position with gearing dropping to 20%, including the effect of provisioning for GoM.

Credit Risk

Total bank counterparty risk exposures are at all time highs due to high cash balances, increased debt hedging requirements and rising commodity prices. Treasury dynamically manages bank deposit limits to ensure diversification over 30+ bank/money market funds to avoid excessive concentration risk. Treasury cash is deposited with strong financial institutions rated A+ (or higher) or AAA rated money market funds. Tenor limits remain short to preserve liquidity and to maximise flexibility to react to unplanned events and uncertain timing of M&A transactions.

The bank credit environment is vulnerable to peripheral Euro-zone sovereign risk concerns. French and German banks have significant exposure to Greece. Contagion could expand over broader European banking environment if a disorderly sovereign default event happens.

Funding and Liquidity

Debt capital markets have generally been weaker in 2Q due to concerns over sovereign risk in peripheral Europe and the US budget deficit.

We took advantage of a favourable window in the Euromarkets in late May to issue €1.5bn in 5 and 9 year tranches. Our euro pricing swapped back to USD was inside the pricing of equivalent US dollar bonds for the first time since the 2008 financial crisis. Pricing has widened significantly since the issuance date.

In 2Q we maintained a sizeable cash buffer in excess of $10bn. Including M&A deposits, cash totalled over $18bn at quarter end including cash in transit.

We continue to maintain a very active dialogue with the credit rating agencies. S&P upgraded our long term credit rating in July from A negative outlook to A stable. Moody's made a similar move last September. The recent change reflects S&P's view that progress to complete the divestment programme and the supportive oil price environment indicate sufficient flexibility within the current rating to allow for the continuing uncertainty due to the final cost of the Macondo incident.

Pensions Funding

Equity markets weakened and discount rates fell in 2Q as Treasury and Gilt prices rose on risk aversion. Overall funding levels fell during the quarter but remain overfunded. The main UK plan is overfunded at 106%.

After last year investment strategy review, the de-risking frameworks are in place. We continue to monitor whether market trigger levels have been met. No trigger levels were met in 2Q.

Incremental funding was made to offset the impact on funding levels following the decision to amend the US plan terms to address the "wearaway" issue. Allowing for the "carryback" provisions for funding made to the US RAP in 1H 2011, funding levels (on a PPA basis as of January 2011) is at 100%.

Key Issues

Burmah Castrol Merger

The merger of the Burmah Castrol pension fund into the main BP UK fund was completed as of April 1. The assets in the Burmah Castrol fund ($2bn) have now been combined with the assets of the main BP fund ($25bn) managed by our in-house fund management team

Trade Finance

During 2Q, Treasury arranged an additional $1,275m committed letter of credit capacity with ANZ Bank, DnB NOR and Toronto Dominion, using BP's standard terms and conditions. This brings the Group's committed LC capability to around $4bn at the end of 2Q. Treasury is negotiating further committed lines either by extending existing facilities or developing new ones.

Treasury is also working with IST to renew and extend uncommitted LC capability to meet supply and trading needs. This included the migration of a $150m uncommitted line with ANZ to BP's standard terms and conditions, limiting exposure of the Group's balance sheet.

Following several pilots of secured LC transactions during 1Q, the Group's first secured LC facility was signed in April with BNP Paribas, creating another robust form of LC capacity for the Group. This $500m facility was then successfully utilised in 2Q to support IST's first fully secured back-to-back crude oil transaction. Treasury is building additional secured LC capability in 3Q, which will be used actively going forward to maintain operational readiness.

UK Car Plan Refinancing

The refinancing of the BP UK Employee Car Plan has been completed. The new funding will be provided by the existing car provider. The operator has received two years of committed funding from HSBC, which will be using an Asset Backed Commercial Paper Structure to fund BP's portfolio. The new funding mitigates operational risk of the car plan by ensuring committed funding for the duration of the contract and provides a more transparent pricing mechanism. The change of funder is transparent to employees as the operational processes of the car plan do not change.

Pre-Export Finance

During 2Q, Treasury successfully transacted voluntary prepayments under the Angola and Azerbaijan pre-export financings. Angola and Azerbaijan prepaid $340m and $285m respectively in addition to scheduled debt service. This brings the outstanding debt balance to $1.4bn for Azerbaijan and $1.6bn for Angola respectively.

UK Decommissioning Operating Standard

The Operating Standard "UK Decommissioning Liability Security" has been revised to reflect BP and banking sector credit rating downgrades. The range of acceptable securities from counterparties is unchanged, but AA rated security is no longer targeted.

Additionally, a Treasury review has been undertaken and recommendations made regarding the most appropriate Group company to provide all North Sea decommissioning obligation guarantees.

Deepwater Horizon Oil Spill Trust

Treasury coordinated the required 2Q 2011 funding ($1.25bn) of the Deepwater Horizon Oil Spill Trust (DWHOST) on May 16. Treasury also supported the planning for the two special funding contributions scheduled in 3Q arising from the settlements with Mitsui / MOEX USA and Weatherford. The next cash contribution of $1.25bn is planned for mid-August 2011.

Monthly cash distributions from Verano LLC to BPEP were executed during 2Q.

Discussions with the DWHOST Trustees on collateral revaluation are expected to begin in 3Q.

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US Tax Exempt Debt

During 2Q 2011, Treasury continued to implement agreed upon 2011 actions to reposition the US Tax Exempt programme.

First, Treasury redeemed circa $215m of outstanding bonds which offered negligible term-out potential. Second, Treasury reissued in termed-out mode an existing US tax exempt bond of circa $ 346m. The 10 June 2011 reissuance was accomplished through three tranches of 3, 5, and 10-year durations. It was well-received by the market, with significant oversubscription as well as favourable pricing across the tranches.

US Wind Financing

Treasury progressed the planned early 3Q conversion of the Cedar Creek 2 construction financing to a term loan.

During 2Q, Treasury also supported the US Wind Funding Model review conducted in tandem with the business. In addition, Treasury provided input and assurance in the drafting of (1) the Define FMs (including IJV Finance Plans) for the Mehoopany and Flat Ridge 2 projects and (2) the AtNs for certain PPAs as well as the revised Turbine Supply Agreement with GE.

Devon Brazil Acquisition

Treasury facilitated the April 2011 closing of the Devon Brazil acquisition. Close required the sending of eleven separate wires and the receipt of one. Treasury also enabled the conversion of Devon's existing letters of credit (LoC) into BP LoCs through Santander and notified key insurers of the change of ownership and obtained endorsement of existing policies.

Brazil Biofuels Acquisition

As a core member of the transaction team, Treasury supported the April 2011 acquisition of CNAA in Brazil, providing structuring and funding advice as well as assurance and deal due diligence. The initial shareholder loan put in place at closing was successfully converted into equity in June 2011.

Other M&A Activity

Treasury 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, the now-completed sale of Venezuela to TNK-BP, the pending closings of the PAE and ARCO Aluminum divestments, and finally the planned divestments of (1) the Canada NGL business (including the procurement of a required consent from METI in exchange for a BP Plc guarantee), (2) the Carson and Texas City refineries, and (3) Wytch Farm (advice given on decommissioning security provided by Perenco). Finally, BPI issued guarantees in support of SPA obligations and decommissioning liabilities for the Neptune Acquisition

Malaysia cash release

Treasury led a project to release over $100m of cash trapped in BP Chemicals (Malaysia) due to exchange controls. The team secured approvals from the Central Bank of Malaysia to allow the transfer of surplus USD to BPI, integrating BPCM's cash balances into the Group's on a permanent basis.

Reliance Joint Venture

Treasury continues to support the integration of BP's new business in India through the alliance with Reliance Industries announced in 1Q. The cash and banking architecture for the upstream business and the funding process for preliminary establishment expenses are now in place.

RMB dividend optimization

Treasury successfully optimised the conversion of the Group's dividends from China into USD realising a profit of over USD $0.5m YTD. With the development of an offshore RMB market, it is now possible to remit RMB dividends cross the border to Hong Kong and then convert them at an advantageous offshore RMB exchange rate (CNH). A total of USD$305m equivalent of RMB dividends have been processed so far this year and a further USD$70m equivalent of RMB dividends are expected in 3Q.

China Liquidity

With increasing inflationary pressures in China, the government further increased the bank reserve requirement ratio to 21.5% (increase of 150bps) and the interest rate to 5.85% (increase of 25bps) in 2Q to reduce market liquidity. These measures, together with the monthly lending quotas imposed this year, has affected the cost and availability of bank loans.

Treasury continues to work with businesses and partners on ways to mitigate the funding risks in

China which includes the use of shareholder loans to ensure funding continuity.

Jupiter Insurance

Jupiter Insurance Company has now completed the management transfer from Marsh to Willis Captive Management Group in Guernsey. This decision was taken after a tender exercise involving 4 participants of which Willis was the successful applicant.

Marsh Insurance Contract

The Insurance Team has successfully renegotiated the Marsh Global services contract. This contract covers the day to day insurance services that BP companies require to comply with local regulations and any specific contracts with local insurance provisions. The contract is for a four year term. Objectives are fully aligned with the BP Insurance Strategy and 25% savings have been achieved from the negotiations.

Shipping P&I Clubs

Insurance together with BP Shipping Legal have successfully re-tendered the management services for the Protection & Indemnity Clubs. This contract manages the negotiations with the clubs ensuring insurance compliance for BP Shipping vessels. The new manager for these services is Jardine Lloyd Thompson Broking Company.

Insurance Collateral

Negotiations have been successful in reducing collateral requirements in two areas. The US Primary Casualty Insurance Programme reduced collateral requirement by $14m with potential further reduction pending current negotiations. In respect of the collateral required for the issuance of surety bonds, this has been successfully reduced by $13m.