

# Transparency and transactional fidelity for managing market risk exposure

## A defining point for commercial excellence

By Brad Anderson, CEO and president – SolArc Inc.

To achieve success and maintain competitive advantages, energy companies must make informed decisions regarding the management of risk exposure and business unit performance. They will be judged on the caliber of their actions to ensure commercial excellence in the face of volatile energy markets, performance management issues, and rigorous accountability measures.

In our work with SolArc customers across the energy industry spectrum, we have found that the success of these initiatives hinges on having accurate and comprehensive information on which to base risk management decisions. Among other things, that means seeing commodity price risk as the market allows you to trade, and thus, manage that risk. The market price exposures resulting from the movement and transfer of physical commodities, as well as the associated financial derivatives activity, must be holistically viewed to understand the true risk as it relates to market volatility.

This is commonly referred to as “seeing your physical and paper activity together.” This requires transparency and transactional fidelity to fully understand the market exposures presented by both physical and financial activities. Transactional fidelity pinpoints up-to-the-minute accuracy and transparency in prices, positions, exposures, and secondary costs – while simultaneously avoiding costly errors in bad data

entry, manual input, and missed market opportunities.

A comprehensive trade management platform offering transactional fidelity separates the players that are merely reactive (i.e., poor position visibility, unrecognized market exposure) from those who are proactive by having an understanding of all market risks, and the ability to mitigate those unwanted exposures.

### Lifecycle visibility

A company can achieve commercial excellence when a physical-to-financial “virtual view” is available for all transactions, along with a comprehensive analysis of risk exposure. In a single unified stream of transaction management and workflow processing, a best-in-class enterprise trade management solution brings all transactions - physical and financial - under a single umbrella for straight-through processing and robust analysis of price exposures and deal economics.

Companies using nominal homegrown IT systems can quickly discover that piecemeal IT is a market liability. They will be unable to meet the computational requirements of energy's increasingly complex supply routings, trades and optionalities; making it a fragmented system adrift in a mushrooming sea of traded volumes, calculations, and risks. Companies that rely heavily on spreadsheets often lack the ability to handle

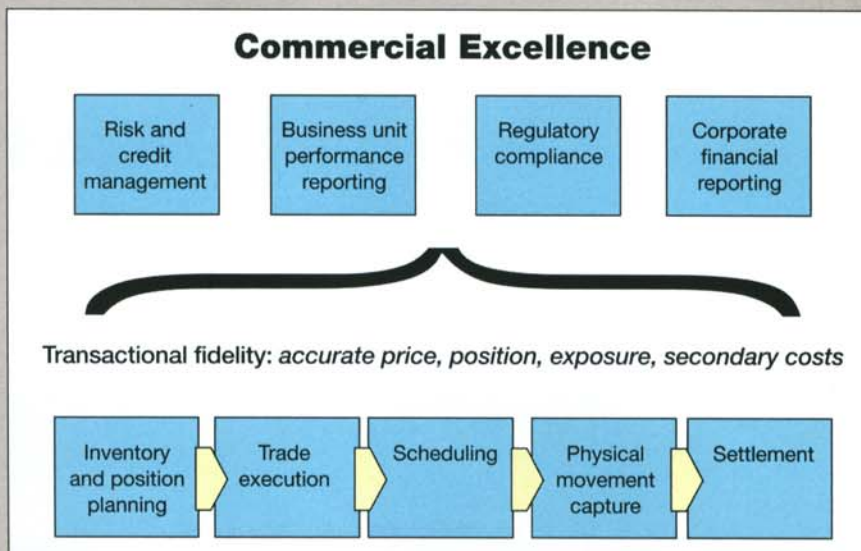
standards and controls, along with scalability issues to adhere to new market behaviors and business requirements.

For a company to correctly measure and manage exposures resulting from energy transactions, the trade management solution should:

#### Effectively capture, value and manage commodity volumes

- Assess the best-available volumes throughout the transaction cycle, at any place and time (by nomination, schedule, actualized, etc.)
- Tie commodity volumes to market value and changes in profit and loss due to location, quality, structure, time effect and exposures

Figure 1: Commercial excellence chart



#### Link cash flow management with risk management

- Deconstruct price risk exposure into components that can be managed
- Superior reporting flexibility

#### Manage overall company exposure, cash flow, and credit instruments

- Utilize direct transactional data for enhanced, experience-based credit control

#### Provide extended risk analytics

- Through tools, such as Value-at-Risk (VaR) analytics and appropriate stress and back-testing protocols

#### Provide a clear, end-to-end view of deal capture

- From deal input through risk management
- Capture, report, control and account for each and every transaction and resulting market exposure

### Non-stop risk assessment

Much as you would not consider driving down the street with your eyes closed, managing risk in the energy industry without a complete assessment of exposures presents an unacceptable level of danger in navigating the potholes and collisions of unwanted risk associated with energy commodities. Many energy commodities, by their sheer physical nature, exact minute-by-minute demands for non-stop assessment of market price, location, trading strategies, time period, scheduling, credit risk and more at multiple points in the transaction cycle.

A company must understand the basis risk of their physical position, as well as the underlying whole price exposure. The ability to decompose risks into individual components is crucial to identifying, quantifying and managing the exposure at all levels. However, a robust solution is required to produce and manage the necessary information at various levels of price data granularity. Although some functionality may be embedded in an IT system, it may not be easily reported and understood.

### Managing for excellence

Commercial excellence is the result when actionable analysis of the causes of day-to-day P/L changes may be "drilled down" to individual transaction/trader, counterparty, portfolio, strategy or scenario. Management has the information needed to adapt and take maximum advantage of changing circumstances when the enterprise trade management solution provides an accurate and forward-looking view of an energy transaction, and effectively captures the market exposures and any shifts in P/L due to price, credit, product quality and volume. This can be especially important in markets for crude petroleum, refined products, and coal where transportation time is significant and blending a commodity produces changes in quality and valuation.

Many companies focused on commercial excellence rely on a best-in-class enterprise trade management solution that combines the best of risk exposure analysis with high-fidelity physical and financial transaction management. This allows management to optimize commodity positions, avoid hidden exposures, and assess strategic market moves. In addition, a fully automated, integrated, and flexible enterprise trade management solution enables a company to implement corporate-wide procedures and modifications, define and regulate staff actions, and ensure compliance with corporate governance and external regulations.

#### About SolArc

SolArc Inc. is a leading provider of supply, trading and risk management solutions for global commodities companies. The flagship product, SolArc RightAngle, integrates deal capture, scheduling, inventory management, pricing, accounting, position reporting and risk analysis in a single platform solution. SolArc serves companies across the commodities industry including, Chevron, ConocoPhillips, Marquard & Bahls, Virgin Atlantic Airways, Getty Petroleum, Anadarko, Koch Industries, United Airlines, Merrill Lynch, Tesoro Corp., and Tyson Foods.

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