CASE 15

CIBC Mellon: Managing Cross-Border Joint Venture

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Thomas MacMillan leaned back in his chair and glanced out of his office window down onto Bay Street, the epicenter of the Canadian financial industry. During his 10-year tenure as president and CEO of CIBC Mellon, MacMillan had presided over the dramatic growth of the jointly owned, Toronto-based asset servicing business of CIBC and The Bank of New York Mellon Corporation (BNY Mellon). However, now it was an overcast day in mid-September 2008 and MacMillan had a front-row seat to witness the onset of the worst financial crisis since the Great Depression.

CIBC Mellon was facing this oncoming global financial storm with a solid balance sheet and was secure in the knowledge that both of its parents were also well capitalized. However, the well-publicized impending collapse of several long-standing financial titans threatened to impact all players in the financial services industry worldwide. Despite the fact that joint ventures (JVs) were uncommon in the financial sector, MacMillan believed that the CIBC Mellon JV was uniquely positioned to withstand the fallout associated with the financial crisis and that it would be able to weather the most significant risks facing the JV—execution risk and the potential exodus of assets and clients who were panicked by the wider financial pandemonium. MacMillan and his team recognized that it would be critical for the JV to continue to deliver a high level of client service and to avoid any major operational missteps.

MacMillan's moment of introspection was interrupted by a knock on the door. He was scheduled to meet with three members of the company's executive management committee, Paul Marchand, Mark Hemingway and James Slater, to discuss two pressing issues facing the JV. First, they needed to discuss how to best manage any risks confronting the JV as a consequence of the financial crisis. Given the massive size and global reach of the largest financial service giants, and the likelihood that some of these behemoths might now be teetering on the edge of bankruptcy, CIBC Mellon, like other players in the financial services industry, would be forced to move adeptly to protect its operations from any potential exposure to the larger players' fates. While the systems, structure and culture that prevailed at CIBC Mellon served as evidence of MacMillan and his team's diligent efforts over the past 10 years to focus on risk management and to foster a culture of synergistic cooperation, the question remained—how could the policies and practices developed during the past decade be leveraged to sustain the JV through the broader financial crisis? Second, the four men were scheduled to continue discussions regarding options for refining CIBC Mellon's strategic focus, so that the JV could emerge from the financial meltdown on even stronger footing. Notwithstanding the immediate urgency of the financial crisis, the JV's management team recognized the need to continue to manage the business with a view towards future growth.

Professor Paul Beamish wrote this case with the assistance of Michael Sartor solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Background

The Asset Servicing / Global Custody Business

When the JV was conceived in 1996, its principal emphasis was on asset servicing—the global custody business—which was generally viewed as "a dull business, with dull services, in a dull little corner of the financial services sector." Asset servicing delivers securities-related administrative services to support the investment processes and goals of clients. Such services include global custody, securities lending, cash management, multicurrency accounting and reporting, global performance measurement and analytics, transition management, commission recapture and foreign exchange. Clients include pension plans, investment managers, mutual funds, insurance companies, and global financial institutions. The fees charged to provide such administrative services would typically be much less than one half of one per cent of the value of the asset being supported.

In 1996, CIBC was one of the big five Schedule 1 (domestic) banks in Canada. At that time, it had an average custodial operation, with approximately 14 competitors, principally trust companies and the security departments of the major banks. CIBC had $100 billion in custody assets and a handful of clients. Its technology platform was poor and needed significant investment. It had three choices to make:

1. Invest—the problem there was that it would have had to invest a lot of money ($300, $400, $500 million)—to come up with a world-class custodial system. It was concerned that the revenue potential from the Canadian marketplace would not have resulted in it receiving adequate returns for its investment.
2. Exit the business—as a lot of companies in Canada subsequently did.
3. Form a joint venture if it could find the right partner. CIBC believed there was the potential of creating a good, viable Canadian-based business, but it needed a partner.

In 1996, Pittsburgh-based Mellon Bank had a Schedule II (Canadian bank which was a subsidiary of a foreign bank) banking operation in Canada, which MacMillan ran. Its Canadian custody market share was about one per cent—specifically one client, Cdn$8 billion in assets under administration, which was being administered out of Boston. However, Mellon had a world-class technology platform, had scale (in a scale business) and was committed to growing its market share but was having difficulty breaking into the Canadian marketplace. It knew it would be a difficult and slow process to get established in Canada by setting up a greenfield operation.

CIBC approached several potential partners, but it was Mellon's technology and people that impressed it the most. CIBC had a Canadian presence and a client base, but no technology and its service was average. Mellon had great technology, products and services, but no presence in Canada and few clients in the country. And it was receptive to CIBC's overtures. It seemed the ideal circumstance for the birth of a joint venture—a great fit. Both parties needed each other and there was very little overlap. The opportunity to create a world-class Canadian asset servicing company—when not many existed in Canada at the time—was too enticing to pass up for both organizations. CIBC Mellon was the first significant JV for either parent.

Given the relative rarity of JVs in the financial services sector, the two sole shareholders in the proposed JV (CIBC and BNY Mellon) devoted a considerable amount of thought and planning during 1996 to the design and structure of the entity. A significant volume of legal agreements was negotiated to establish the parameters that would govern the relationship between the two shareholders. Buried within the reams of legal documents were provisions drafted to prohibit each of the shareholder parents from competing against the JV; to detail the limitations surrounding the JV's use of the parent shareholders' trademarks and other intellectual property; to outline the basis upon which each parent would provide services to the JV, including, in the case of BNY Mellon, the basis upon which it would provide and "Canadianize" its technology for the JV; and to require each of the shareholders to utilize the JV as a supplier of asset servicing and global custody services.

One of the most critical governance clauses pertained to voting rights. Under the JV's shareholder agreement, each of the parties would enjoy a 50 per cent vote on every issue. In effect, this eliminated the need to vote on any issue—only consensus could yield a decision and the JV managers needed to secure the approval of both shareholders before taking any major issues to the board. Accordingly, at the outset MacMillan and his team recognized that in order for the JV to execute on its mission both strategically and operationally, it would be critical for the two shareholders, their employees and the JV's employees to develop an acute understanding and respect for the unique capabilities that each shareholder brought to the JV. MacMillan acknowledged that "the governance processes developed for this JV effectively facilitated our ability to leverage the expertise of each shareholder." While both parties were strong players in the credit

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