CIBC

“Creating Value in Uncertain Times"

A speech by John Hunkin, Chairman and CEO of CIBC to the National Club in Toronto
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It’s a pleasure to be here today. What I want to focus on is the character of CIBC’s senior management group and how it translates into shareholder value. Then I’d like to describe a specific example of this at work in one of CIBC’s key drivers of shareholder value: our treasury, balance sheet and risk management group.

When I took on the role of chairman and CEO of CIBC nearly three years ago, the very first thing I did was select a senior management team. I did this before I made any pronouncements about CIBC’s strategic direction or any commitments to shareholders about financial performance. From my perspective, the question of where to take a business requires a look first at ‘who’ and then a look at ‘what’. In other words, find the best talent and then work together to figure out your strengths.

I want people I can trust. And I want people who can do the best job possible. Any success that I’ve had at CIBC over the years has come from the quality of people I’ve been able to convince to work with me.

You know the old cliché: surround yourself with the best. It can sound like motherhood, but it’s not. The litmus test for me is this: I ask myself if I could do a better job than any of the people who report to me, the answer is no, I couldn’t. Wayne Fox, who’s here with me today, is a perfect example of this. He runs our Treasury, Balance Sheet and Risk Management and I don’t know anybody who does a better job in this area.

And since David Kassie isn’t here – he replaced me as head of CIBC World Markets -- I will admit this: just between you and me, he is far more qualified to do that job than I ever was.

Of course, the people on my team all think they could do my job better. But they’ll have to be patient. ‘Who’ your executive team is - has another important effect on where you take your business. People tend to do what they’re good at, and most of my team comes from the investment banking and capital markets world. They have a deep understanding of capital markets and have formed the habit of looking at things with that perspective. The investor mindset they’ve developed has permeated their approach to the businesses they run. Programmed deeply into their psyche is the mission of growing shareholder value.

That mission affects the three basic things they do as business leaders. It affects the way they run their businesses on a day to day basis. It affects the way they deal with the bank’s assets and liabilities. Decisions to improve, sell, or invest in a business are filtered through the same clear prism of shareholder returns. And it affects the way they evaluate opportunities for transformational change – significant organic growth opportunities or strategic moves in the M&A area.

I firmly believe that CIBC's competitive advantage is this organization-wide application of an investor mindset. Let me give you some examples.

It's no accident that CIBC has a merchant banking portfolio far larger than any other Canadian bank. Our bank is run by people very comfortable with this investment paradigm. And that's why CIBC derived more than half a billion dollars in revenues from merchant banking in the last two years.

Other examples: our sale of our property and casualty insurance business, our sale of our private banking business in Switzerland and Guernsey, and our partnership with Barclays to create FirstCaribbean International Bank. Christine Croucher in our cards business used an investor mindset to bring another opportunity to us. CIBC had a very profitable merchant card business – the largest in Canada and a significant contributor to profits. But it was clear that we were going up against US monolines with the size and technology that would soon dominate us. So we proactively sought out a partner. The partner turned out to be Global Payments, a US player. We sold the business for a 27% stake in the company. Aside from the profit we took on the sale, the value of our stake increased significantly last year.

My point is this. There is a certain personality, a certain <u>propensity</u> to make the decision to sell a profitable business because of a longer-term bet. My team has that personality and that propensity. And to ensure it sticks, the team is paid primarily with CIBC shares.

We have also chosen to take a very measured and exacting approach to the way we manage our businesses on a day to day basis. Measure and manage is our mantra.

CIBC used to be organized around our retail bank and our wholesale bank. We wanted a more specific understanding of our performance to help us achieve one goal – the best total return to shareholders of all Canadian banks. Tom Woods, our CFO, worked with business leaders to break down CIBC into 37 different businesses and decided that we would measure each business according to one common denominator: capital… using RAROC and EVA.

This sounds pretty straightforward. But as this audience knows, banks historically have not been organized to make it easy to measure individual components. They intertwine like ivy. Some businesses are segmented by customer – the retail customer and the corporate customer. Some businesses are segmented by product – credit cards for example -- and some businesses are segmented by delivery channel – like branches.

It took more than a year. In fact, it's an ongoing process. But we can now measure 37 businesses on a RAROC and EVA basis.

When I first got this job, I recognized the need to have a framework to manage our capital better. I didn't know 'how', but I did know 'who'. It had to be somebody from the capital markets, and someone who was comfortable with wearing the black hat and losing popularity contests on an ongoing basis. It had to be Wayne Fox, then head of our global capital markets business.

Wayne visited the major US banks and investment banks to understand best practices. And in the end, we put our own model together, which meant putting everything under one roof: capital raising, liquidity, capital allocation, balance sheet management and risk management.

This requires a very close partnership among Wayne's group, the CFO and our business leaders. The historical fragmentation had to end in order to efficiently and effectively manage our capital and balance sheet.

We established hurdle rates for each of the 37 businesses. Each business' results are produced monthly and thoroughly reviewed quarterly. And businesses had to justify why they deserved the capital they wanted.

As I mentioned, we now measure businesses with risk-adjusted return on capital, or RAROC. This is a very flexible and accurate yardstick. For instance, it lets us compare the shareholder value of 4500 ABMs in Canada against the shareholder value of our European corporate loan portfolio. RAROC takes what is in essence apples and oranges and makes them all apples.

We also introduced economic value added accounting, which means that we built a capital charge into each P&L at the business level.

This centralized approach to judging performance and capital usage was a new experience in our bank. We shone a light on business processes that had never had that degree of transparency before. I can tell you that some businesses reacted painfully to this light. But for the first time, we could measure each business with the same yardstick: how well they use capital, rather than how much revenue they generated. In other words, we have moved away from the old funding model, which some people called the "field of dreams model": if you do it, they will fund it!

By making our businesses comparable, all of a sudden it was a lot easier to make decisions about what businesses should get economic capital, what businesses should be deprived of economic capital, and in some cases, what businesses we should exit altogether.

This approach guided our decisions to exit several businesses: our private client operations in Europe, personal and casualty insurance and our corporate real estate assets. Throughout this effort, relationships among treasury and balance sheet management, finance and risk management became closer and closer, until much of the work we did overlapped.

It became obvious that Risk Management should be added to TBM. And so today, we have a group with the acronym TBRM – treasury, balance sheet and risk management.

We need all of these skill sets in one place to properly allocate our balance sheet resources among our businesses.

We've also learned that capital management is something much more than a regulatory obligation. After our people, capital is our scarcest resource. If it is not jealously protected, it's not likely to be used efficiently. And there are huge benefits in managing it well – benefits like low cost of capital and keeping our favourable debt ratings.

Another important change has been in our philosophy about credit. It's only been in recent years that banks have recognized that the regulatory environment makes banks inefficient holders of credit. Rather than the traditional buy and hold model, which has us hold loans and rely on net interest margins for revenues, it makes much more sense for us to originate loans with the goal of selling them. This is all about treating loans as securities—as liquid, tradable assets. In other words, a sea change in our approach to credit.

Today we want to underwrite and distribute loans, not invest and hold to maturity. To do this, we set up a centralized group within TBRM. Its mandate is efficient, bankwide loan portfolio management. We have many very bright people focused entirely on seizing opportunities in the market to manage CIBC's credit risk. They use sophisticated financial modeling to identify inefficiencies and mispriced credit assets. They also monitor the rapidly developing liquid credit markets to find opportunities to sell, hedge or securitize loans.

While loan sales and trading is still in its formative stages in Canada, it is an active market in the US. Here we trade in the secondary loan market and we've done several benchmark deals consisting of distressed credits. Last year, we completed a US$1.5 billion securitization of distressed loans held by FleetBoston Financial and also sold US$848 million of our own distressed US corporate loans.
We also budget $20 million per quarter to cover the cost of trading and hedging in the secondary loan market in order to efficiently manage our loan portfolio.

So in a nutshell, what we've done is create a treasury and balance sheet management function entirely committed to improving the productivity of our capital. We've also been moving to change our business mix to achieve steady and sustainable earnings growth, and we've reduced risk-weighted assets by more than $10 billion since late 1998.

By making each business pay for their capital and be responsible for their risk-adjusted returns on capital, we've seen reduced market and trading room risk, better portfolio management and the increased use of hedging strategies.

Clearly, disciplined balance sheet management is essential to achieving the best total return to shareholders. We believe it has been a major contributor to our share price performance over the past two years, a period where we have achieved our goal of the best total return to shareholders.

We've been able to do an aggressive share buy-back program. Since the end of 1998, we've repurchased more than 55 million shares while maintaining a very high tier 1 capital ratio. We're continuing this program.

In an industry where growth opportunities are costly and often constrained, TBRM was an important accomplishment.

Wayne Fox and I would be pleased to take any questions at this time.