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Trian and the Bank of New York Mellon

A highly engaged shareowner and a welcoming company

BY 2014, Trian Fund Management, L.P. had become one of the largest shareholders of The Bank of New York Mellon. Many activists are anathema to CEOs, boards of directors, and management teams. Not this time. The firm, which has been labeled as a "highly engaged shareowner", was welcomed by the Chairman and CEO Gerald Hassell, and without a fight Ed Garden, Trian's Chief Investment Officer and a Founding Partner, got a seat on the trust bank's board.

Together, the bank and Trian worked together to increase earnings per share at the bank by more than 40 percent from the end of 2013 to 2016, a time of slow growth, low interest rates and with high margin sectors of the business severely weakened by turns in the banking cycle. They set up three-year plans, rather than quarterly goals. They refreshed the board, as the process of adding and subtracting directors is termed. They revamped management's compensation system.

And there is more. "All this didn't happen by accident," said Trian's Mr. Garden, who founded the firm in 2005 with Nelson Peltz and Peter May. "Our relationship is a unique one," Mr. Hassell said. "It's a good story. If you're willing to embrace change, if you're willing to embrace trying to be best in class at what you do, everybody can have a good outcome. That's the bottom line of our story."

Mr. Hassell has spent his career at the bank, starting off in its management development program, followed by various positions in operations. In 1994, he joined the executive committee and four years later he joined the board and became its president. Since 2011, he has been both chairman and CEO. He also serves on the board of Comcast and is a trustee at Duke University. Mr. Garden is Trian's chief investment officer, which has in excess of $12 billion in assets under management, and has served on the board of The Bank of New York Mellon since late 2014, where he is chair of the Human Resources and Compensation Committee. He is also on the board of Pentair plc, where he is on the Compensation Committee, and has served as a director at Family Dollar Stores, Inc. and The Wendy's Company.

Ethan Klingsberg, of Cleary Gottlieb's New York office, led a discussion at the Tulane conference earlier this spring about this rare and happy long-term relationship between an engaged shareowner and its so-called target. With Mr. Klingsberg as the moderator, Mr. Garden and Mr. Hassell discussed their partnership, from the first dinner to what has evolved into what may become a prototype for such relationships in the future.

Mr. Klingsberg first noted that The Bank of New York Mellon is a global SIFI (GSifi), a global systematically important financial institution subject to piercing regulatory scrutiny. "This is not going to be a tale of proxy contests and angry letters threatening

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to unseat the entire board and fire the CEO with lots of flares being thrown, nor is there going to be a lot of discussion about incurring leverage or pulling apart companies or forcing consolidation for some quick accretion," Mr. Klingsberg add. "When you're dealing with a global SIFI, those types of menu items are not available." What's more, such strategies have also lost favor and to many shareholders are now passé.

This discussion addressed not only the relationship between Bank of New York Mellon and Trian, but also the concept of active shareholder engagement itself and its future in corporate America. "This," said Mr. Klingsberg said, "foreshadows the way change will continue to occur at a lot of publicly traded companies."

Getting to Know You

In 2014, Trian had become one of the largest shareholders at the bank, but constructive aspects of the relationship between the investor and the company all began with a dinner. "My goal at that dinner was to make sure Gerald understood Trian," Mr. Garden said. "What we do, how we do it, our philosophy. We're very long term. We hope to be very constructive. We think that we add a lot of value in the boardroom. What's more, we really loved the business and wanted Bank of New York and Gerald to be successful."

The two men discussed little of the bank business at their first meeting. Instead, it was the beginning of "a period of getting to know you," Mr. Garden said. A second dinner brought in a few more colleagues from each side. It wasn't until they had been together a few times that they began getting in to the analytics—"the nitty gritty, what's bad, what's good, what could change." Six months after the first dinner, Mr. Garden joined the bank's board.

Mr. Garden brought to the table Trian's knowledge of the trust bank business model. Trian had invested in State Street from 2010 to 2013, for example, and felt that it had added value to management's work and that of the board through interaction as a large shareholder. More importantly, Mr. Garden said, Trian learned "to appreciate the trust bank model." Not many investors truly understand "what a great business it is."

Firstly, he noted, there is a core group of industry leaders. Also, unlike most banks, trust banks do not take credit risk. It is a safe model, driven by fees, that typically generate "prolific cash." Trust banks also face fundamental challenges, particularly since the financial crisis. Key lines of businesses, foreign exchange and securities lending, for example, have changed forever. As always, change brings both challenges and opportunities, Mr. Garden said.

Mr. Hassell remembered when he first got Mr. Garden's call. Activists can have a certain reputation, he noted. But he also knew that not all activists are alike. "My attitude was if an investor could bring better ideas about how we could be successful, then I'm all ears," Mr. Hassell said. "That's the approach Ed and his team came to the equation with—'We think we've done a thorough analysis of your firm. We think we have some very good ideas about how you can improve your performance. We recognize some of the challenges you've had after the Mellon merger, after the financial crisis and the decline in some of your activities. But that being said, you've got a great franchise that we think should out-perform. And right now you're not.' And by the way? I agreed. That was the start of our journey together. Many of the things that Ed and the team were referring to, particularly as we got to know each other more, it became just that—'I agree. I agree. I agree.' The goal was how can we, together, get a better outcome for shareholders, for employees and for clients."

It all took some time. There were concerns. There were debates. There was a learning curve for the new investor and board member as well as the company. What is the highly engaged shareowner going to bring to the table? What kind of disruption might it cause? "One of my concerns," Mr. Hassell said, "was the fact that we have regulators. We already have an enormous spotlight on our firm. Trian's involvement might make that spotlight brighter and hotter from a regulatory point of view." Trian, for its part, did not break through the city gates demanding beheadings. "We wanted to get the smartest people we could around the table to figure out how to fix problems," Mr. Garden replied. "There was no looking back. It was always looking forward. Our mantra became, 'How do we become best in class.' "

Joining the Board

Trian generally looks to join the board of approximately two-thirds of the companies in which it invests "We think one of our core competencies is being in the board room, working constructively with management and other board members with perfect information/material non-public information and helping the business through its challenges," Mr. Garden said. "We think that we're time-tested in that regard and we think we can add value and contribute to a good long-term outcome. That was our mind-set."

Mr. Klingsberg noted that boards are often less than enthusiastic about a newcomer. Other boards, in Mr. Klingsberg's experience, might have reacted to Mr. Garden as follows: "This guy's going to come in from Trian, which has over fifty employees, he's already been studying the company. Is he going to usurp the role of management? Are we going to have a shadow management?" What's more, an outsider on the board simply can't know as much about the company as those already in senior executives positions. Will management step up to the challenge and use its superior knowledge to move the company forward?" "How did that tension play out? How did you deal with your directors on that issue?" Mr. Klingsberg asked Mr. Hassell.

Board dynamics are complex and critical to the success of a company. Often the first question existing directors will have about a new outside director is whether or not he or she will be an engaged investor or just another new board member. "There is always some level of cynicism or concern around an activist joining the board," Mr. Hassell conceded. Will the existing board up its game? Will they stiff-arm the new director? "I think our board responded generally well, in terms of better information, better analysis, additional thought processes was seen as value-added to the board," Mr. Hassell recalled. "But there are always some interesting dynamics out of the box."

One two-in-the-morning thought came to Mr. Hassell, one of a series of what he called "sometimes wild-ass ideas, some of which work; more often they don't." In this case, Mr. Hassell said, it worked. Before hearing from Mr. Garden, the company had taken a hard look at itself to find out where gaps lay, what needed to be done to excel. "We had a pretty good financial analysis to match up against Ed and his team," Mr. Hassell said. "That was an interesting process—comparing notes." The wild-ass idea was to dig in further on these analyses through the vehicle of a new finance committee of the board on which Mr. Garden would serve along with existing non-management directors, one of whom would chair the committee. "The good news is every member of that finance committee felt challenged and really engaged and stepped up. Now I'm blessed with a four-person committee with the brightest financial people on the planet."

Interestingly, the committee meets off-cycle from the normal board meeting "to allow us time to be focused on the financial aspects of running the bank," Mr. Hassell said. Mr. Garden said the scheduling may seem as if it's a small detail, "but at a board meeting there is so much information that you're trying to get through in a couple of days. The fact that we meet off-cycle means you're really focused. You're going into that meeting with unlimited time and we are able to drill down."

In addition to Mr. Garden, the finance committee includes Joseph Echevarria, the CEO of Deloitte from 2011 to 2014; Jeffrey Goldstein, an executive at the private equity firm of Hellman & Friedman and a former under-secretary of the Treasury for domestic finance and counselor to the secretary of the Treasury from 2011 to 2016; and Elizabeth Robinson, the global treasurer at Goldman Sachs from 2005 to 2015.

"You've got a lot of brain power and people who understand financial analysis," says Mr. Garden. "It's worked incredibly well. It always comes down to the people. One of the things that we talked about, which I talk about with CEOs all the time—if you view something like this finance committee as troublesome board members meddling, it's probably not going to work. If you view it the way Gerald did, you acknowledge that the world is changing quickly, that markets are changing quickly, technology is changing, behavior is changing, and that the company needs to navigate through all of that. You want the smart people around the table to know what you know as the CEO, to see them as trusted advisers helping the firm going forward. If you view it that way, it can work terrifically well. That's exactly how you, Gerald, viewed this from the beginning—hand over heart."

Refreshing the Board

Once he joined the boardroom, Mr. Garden became both an example and determined proponent of board refreshment, a delicate process that the company already had on its agenda. This is never an easy accomplishment. "You have people who have worked together for, in this case, decades. They have established close relationships and close friendships," Mr. Garden said. "Now you have some of them saying to others that it's time to move on. It's a very thorny process. I'm proud of the board for doing it because it's not an easy thing. I can understand why it's something you put off for another day. This involves human beings and their feelings."

Few board members, it is safe to say, jump at the chance to be replaced. The Bank of New York Mellon had board members of long-standing, which complicated matters. In addition, the merger with Mellon was a recent memory

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when the combined boards numbered as many as twenty-eight directors. What's more, the board, which stood at around eighteen directors after the merger was complete, had just replaced the bank's CEO. "That's a hard process for the board to do and they then felt they should stick together to make sure it worked," Mr. Hassell said. "That was another reason why they hadn't been willing to start thinking about refreshment."

The bank had started the process and added a few new directors before Mr. Garden joined the board. "I will say with Ed coming onto the board," Mr. Hassell recalled, "we were able to refocus on bringing the board composition back to best in class, and it was very easy to point to the proposition that our board tenure in particular was not best in class. Board members were wonderful people who had been there for a long period of time but boards need to be refreshed just like management teams need to be refreshed. This is where I have to give some credit to Ed and the team for saying, 'Look, we really need to do something here.' That became very helpful in the process because, we could point to statistics, but also an increased will to get there." The bank realized that this was not going to be accomplished "in one night" or "in one year," as Mr. Hassell put it. "We set out a plan that through retirements and new additions and through a recruitment process, we could have a refreshed board over time. That's what we set out to do and I think it has worked."

In the board room, Mr. Garden and Mr. Hassell stressed that refreshment was a responsibility owed to the owners of the company to have the best possible board. "We needed to make that happen," Mr. Garden said. "People in this room [at Tulane] need to make that happen too. What does that mean exactly? It means we need to work to assure that boards have members who are motivated, right? We have a lot of board meetings, we have a lot of off-cycle calls. It's a lot of work being on the board of a GSIFI." The average set of board materals at The Bank of New York Mellon is 1,100 pages long, Mr. Hassell pointed out. "I'm embarrassed to say that." One director was heard to say that it was like having to read *War and Peace* every other month. "And that's true," Mr. Garden said. "It's a ton of work. You need people who can bring something to the table. And you need people who can be truly independent of management. Those were the governing principles as we thought about board refreshment." Now, more than half of the non-management directors on the board have joined since at least 2014.

Paying Management

The bank not only reconfigured the board of the directors but also the entire system of management compensation. "I always explained to the other shareowners that the goal is not to *not* pay management," Mr. Garden said. "The goal is to make sure that management is incentivized to build the business the right way for the long term, and to make sure that management is not being paid a lot of money just for showing up."

A central principle at The Bank of New York Mellon's compensation system was LTI, or long-term incentive. "That's number one," Mr. Garden said, "Number two is to drive that long-term incentive off of performance. We also wanted to simplify the plan so it would be easy for all the employees to understand the metrics. We wanted management to perform and to be paid well when they did so." Mr. Hassell pointed out that "the *vast* majority of my net worth is one stock." He said that is how it should be. "In running the company I should put my chips on the table every single day."

Federal regulators were also deeply involved, since the bank is a GSIFI, to ensure that whatever was done would not encourage bad behavior and that safety and soundness were paramount. One of the highest hurdles to clear with the regulators was the effort to set up leverage with those the company would be paying. "I think we struck the right balance in order to have some positive leverage and some negative leverage," Mr. Hassell said. "If we out-perform the budget, there is some leverage to that, and if we under-perform there is leverage down. Everyone is highly incentivized to meet a long-term plan without putting the firm at risk and while meeting regulatory standards."

The metrics of the revised compensation system are tied to yet another innovation at The Bank of New York Mellon: three-year performance plans. Mr. Klingsberg noted that in 2014 the firm had an investor day at which it gave three-year targets and operating metrics, with plans for another set of announcements later in 2017. Companies are often reluctant to take such a step. "What went into your thinking there?" Mr. Klingsberg asked. Was it in part a reaction to shareholder pressure? Was that a driver for change?"

Mr. Hassell said the bank had long realized that it was under-performing financially and that it needed to improve its relations with shareholders. "We felt we needed to coalesce around a common set of goals that were easy to understand, that were fully supported by the board, and that were aggressive enough but also executable. You don't want to put out a set of goals that are so false that they are unachievable and that therefore disappoints everyone. We felt that by putting them out there publicly they would become a rallying cry for the management team and for the whole company. It actually made it easier for me to sit in executive meetings, town halls or even walking the halls and to be able to point back to those goals. We then tied compensation to them as well. By putting them out there in the public area, we could be holding ourselves accountable, as would the rest of the world. That's what it's about."

Mr. Klingsberg wondered if this practice of moving past an obsession with reporting of quarterly and annual guidance toward disclosure of longer-term metrics and targets might be a policy Trian would encourage at other companies with which it might invest. "I think it's an important exercise and I'll tell you why," Mr. Garden said. "Number one, it forces management to really think about how they're going to run the business and execute over the next three years. That's a good discipline. It forces you to think through the business. Secondly, it's a platform for the board and the shareholders to hold management accountable. It's great for shareholders to have that algorithm and that transparency and I think it's a healthy thing."

Mr. Klingsberg asked whether Bank of New York Mellon is ever concerned about the potential for conflicts between how long Trian will desire to hold onto its stock and Mr. Garden's representation on the board. Mr. Garden said that Trian hopes to put the company in a good position for decades. What's more, as a long-term investor, Trian, "because of [its] place in the world," can give management cover to take action that might lower results in the short term but benefit the company over time.

Mr. Klingsberg noted that Mr. Garden has not been shy about speaking publicly about the bank or addressing Trian's fellow shareholders, including those who are outspoken. "I can see why in many cases corporate America doesn't like activists," Mr. Garden said. "One of the ways I can add value is by helping management and the rest of the board communicate to the shareholder base because Trian is one of the largest shareholders and because the other shareholders have seen what we have done at other companies we have been involved with. I like to think we have a certain amount of trust and credibility with other shareholders. I like to think that they believe that when we get involved we'll be constructive and we'll make the business a better business for the long term. Our ability to get on the road or get on phone calls and help communicate the vision can be helpful."

It has become increasingly common for non-management directors to communicate with shareholders. "Ed, as he has pointed out, has skin in the game. He's a repeat player with these shareowners," Mr. Klingsberg noted, turning to Mr. Hassell. The bank has a schedule for directors to meet with major shareholders, with and without management, depending on the issues of concern to a range of investors, Mr. Hassell said. "I think it's good practice," he added. "Sometimes managements, including ourselves, get tone deaf around what investors are really saying and sometimes investors really don't tell us what they really mean but they'll share that information with other directors or, more importantly, they'll share it with other investors. To have another investor who is a board member can add to the equation. You get good honest feedback. Other CEOs should embrace this. Nothing is perfect. They don't always have it right. They have cuckoo ideas sometimes. They go off on tangents and they can have imperfect information, but you should still listen because you will find pearls of wisdom in that process."

Mr. Klingsberg noted the fact that an activist shareholder can show up with certain ideas that are already percolating at the company. "How do you handle who gets credit?" he asked. Mr. Hassell said, "I'll speak for myself—I just want great outcomes. Mr. Garden added: "We let the power of the argument win. Everyone checks their ego at the door."

Trian did its research before buying its stake and found "a lot of common ground" when they got inside the company. Mr. Garden said. "Gerald showed the willingness at the top that we need to rethink how we're doing things, that we need to win. Gerald galvanized an entire organization of fifty thousand people to adopt that attitude. It's a great story." Mr. Hassell described the experience of Trian's arrival at the 232-year-old firm as a welcome jolt that broke a certain sense of inertia and exposed a wide swathe of common ground between the bank and Trian.

"We were able to embrace it."

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