IN THE NEWS

Senate Banking Committee Studies Centralization Of All Stock Quotes While NYSE And NASDAQ Talk Merger

Will our 19th century trading systems make the leap into the 21st century? A meeting of the Senate Banking Committee in New York earlier this month offers insight into how close we are to providing investors with the best price available and in putting firm price and time priority on orders both within the exchanges, between exchanges, and with electronic communications networks. Sounds pretty simple, doesn't it? But it's not. At risk is the survival of the specialists, traders and market makers on the exchanges and perhaps even the exchanges themselves.

Electronic communications networks have become faster, cheaper and better trade execution than the proven but outdated methods used by the exchanges to facilitate the sale and purchase of securities. Across the world, stock exchanges are moving to totally electronic trading, yet here in the U.S., the foremost capital market and the center for free enterprise around the world, there is actually an ongoing high level discussion among legislators, regulators and members of the exchanges on whether the investor's best interests should be put first.

To the investor, there is no question that faster, cheaper, better trade execution can be obtained through electronic communications networks (ECNs), resulting in the best price available. Thus, the best price available on the NYSE is rarely the best price available. But, it is the best price available on the NYSE. Clearly, no investor is well served by slower, more expensive, inefficient trade execution that has been outdated by innovation and technological advances. SEC chairman Arthur Levitt has called on the exchanges to "become more aware of the economic realities and interests of the investor. If not, there is a real chance that within a short period of time, the exchanges will lose substantial marketshare and never regain it." Levitt would like to see a more centralized system where all the exchanges and ECNs are linked together into one system under one regulatory body which would see the NYSE acquire the NASDAQ. From a public policy standpoint, Levitt is intent on serving the public's best interests, which are not necessarily the best interests of the market makers, specialists and traders who own the seats on the NYSE that control the exchange's destiny.

The central premise of the stock exchanges, which is the basis of the public's trust, is that all orders will be executed as quickly and as fairly as possible, and the exchanges will assure both the buyers and the sellers the best price available. With the advent of electronic trading and ECNs, buy-

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Fidelity's On-Line Investors Help Lehman Brothers Become A Major IPO Underwriter

Fidelity has found a strategic partnership that works brilliantly and raises the specter of merger talk. After an unsuccessful alliance with Salomon Brothers in 1997 which gave Salomon Brothers access to Fidelity brokerage services' 15 million retail investors, Fidelity has had spectacular success with Lehman Brothers. Lehman credits the Fidelity strategic alliance with its huge underwriting gains, and Fidelity credits access to Lehman Brothers' IPO business as a huge draw in winning on-line trading clients with $500,000 or more in investable assets. The alliance has been of extraordinary benefit to both firms.

The alliance formed in June of 1999 provides Fidelity's investors with access to Lehman Brothers highly regarded stock research and access to a portion of Lehman Brothers' initial public offering and secondary stock and bond underwriting business offered through it syndicate desk. What has since happened was a pleasant surprise to all. Lehman Brothers has gone from underwriting no IPOs in the fourth quarter of 1998 to handling more IPOs than all but three firms in the fourth quarter of 1999. Lehman was lead underwriter on 13 deals on four continents totaling $1.56 billion in the fourth quarter 1999, which contributed to 306% increase in the firm's earnings for the quarter. What was the difference between the fourth quarter 1998 and the fourth quarter 1999? It was the three million clients of Fidelity's 15 million clients who invested on-line. This was a huge factor in Lehman winning the brutally competitive, global, egocentric investment banking competition for the lucrative lead underwriting position of many significant offerings. Seventy percent of last year's underwritings were with technology and internet companies whose biggest boosters were on-line traders. Fidelity's on-line traders have attracted Net-type investment banking clients to Lehman like a magnet. Fidelity's on-line traders were not only more attuned to technology and internet company offerings, but their enthusiasm often drove the price of these offerings up. Interest by Fidelity's on-line investors was so great in Lehman's underwritings that on many occasions the interest from Fidelity exceeded the total stock offered in the underwriting.

Such high demand by Fidelity's on-line investors is a very persuasive selling point

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substantially automated and managed by call centers open seven days a week, 24 hours a day, and virtually 99.9% of all questions and inquiries will be answered immediately on the first call. Citibank's old branch customer service representatives, now called client financial analysts, would man the call centers for these core account relationships and would be salaried employees. Indeed, only 12% of investors with more than $250,000 invest through a bank compared to 44% who invest through brokers. Only 20% of investors with more than $250,000 said a bank is their primary service provider, according to Oliver Wyman, a New York-based bank consulting firm. Clients with less than $100,000 are served by Citibank's branch brokers. They would be compensated on the revenues they generate. Clients having investable assets of more than $100,000 and less than $1.2 million, not entailing estate tax problems or ERISA considerations, would be handled by today's Salomon Smith Barney's financial consultants who are well-versed in investment products and the investment process. For clients with more than $1.2 million, Salomon Smith Barney senior investment management consultants who are adept at estate planning and ERISA issues would be in the vanguard of providing the highest level of financial counsel in the industry. The ultimate transformation occurs when there is no difference in Citigroup branch brokers, Salomon Smith Barney's financial consultants and senior investment management consultants.

> SANDY WEILL'S CHALLENGE IS TO CREATE A UNIFYING VISION AND TO BUILD THE PROCESSES AND TECHNOLOGY WHICH WILL BOTH EMPOWER THE FIRM TO ADD VALUE AND STREAMLINE ITS ORGANIZATIONAL AND COST STRUCTURES, WHILE DEVELOPING A CLIENT-DRIVEN SERVICE CULTURE THAT IS GEARED TO ADDING VALUE

Sandy Weill's challenge is to create a unifying vision and to build the processes and technology which will both empower the firm to add value and streamline its organizational and cost structures, while developing a highly motivated client-driven service culture that is geared to adding value. Citigroup has more potential than any other financial services firm to build a new financial services business paradigm because of the breadth of its product and service menu, because its Salomon Smith Barney Consulting Services Division has more industry-leading senior investment management consultants than any other firm on the street, because Citibank has made higher level advice their primary focus in in-branch client service, and because they have Sandy Weill who is not shy about marshalling and aggressively managing the resources of the entire organization. Mr. Weill doesn't have to ask for permission and is a master at execution. There is a tremendous opportunity to create an industry-leading franchise here. ■

Fidelity's On-Line Investors Help Lehman Brothers Become A Major IPO Underwriter

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to investment banking clients as it translates into higher prices and more capital for the issuers without having to sell a bigger piece of the company to the public in order to get it.

To drive this point home, Fidelity executives accompanied Lehman Brothers investment bankers to pitch meetings with prospective IPO clients, and the pitch is definitely working. Tracey Curvey, executive vice president of Fidelity On-Line Brokerage, says, "We think we are one of the most powerful distribution channels in the world. We have relationships with 15 million consumers, and that is the power Lehman wants to unleash on these issuers." The more IPO business Lehman wins, the more IPO shares Fidelity can offer its best clients. This is important to Fidelity because access to IPOs has become a crucial selling point for customers with $500,000 or more in investable assets. "We cannot be in this business without access to IPOs," says Ms. Curvey. Issuers see the same dynamic at work on the other side of the equation. Mark Hirschorn, CFO of DeltaThree.com, Inc., a New York company that Lehman took public in November, said, "If Lehman had not been able to deliver Fidelity, co-managers like Merrill Lynch, would have had stronger economic interest in our deal." Clearly, Fidelity has become an important factor in Lehman's investment banking success.

Since Lehman's 1994 spin-off from American Express and its brief assemblage into what was Shearson Lehman Hutton, Lehman has not had access to retail investors. Lehman has also completed its transformation from a bond house to a full-service investment bank, having expanded its Equity Division since 1997, attracting many top equity research and investment banking teams.

With the fall of Glass-Steagall, Lehman Brothers has become a most attractive acquisition target for progressive, internet savvy firms like First Union Securities, Wells Fargo Securities, Charles Schwab and even Fidelity. Thus, with the wonderfully symbiotic relationship between Fidelity and Lehman, one could certainly understand the interest on both firm's part to work more closely together, possibly entailing the acquisition of part, if not all, of Lehman before someone beats Fidelity to the punch. Rarely does synergy like this manifest itself in even the best conceived mergers. It would be a shame if some organization other than Fidelity actually capitalized on the Lehman Brothers' new found prowess in investment banking by making Lehman an offer it couldn't refuse. ■

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