

## *Understanding the Role of the Brokerage Firm Research Analyst*

Research analysts who prepare research reports must pass a test, the so-called Series 86/87. The test is designed to ensure that research analysts possess the requisite knowledge, skills and abilities associated with the critical job functions of a research analyst.

Investors should have a general understanding of the range of topics covered by the Series 86/87 for several reasons. First, the test outline will specify for investors how research analysts should meet their obligations. That may be quite a hurdle for some research analysts, such as the infamous ones (Merrill Lynch's Henry Blodget and Salomon Smith Barney's Jack Grubman, for example), to overcome. Second, the test outline will give an investor a basic sense of some of the factors that his or her financial consultant can or should consider before recommending a particular security.

The New York Stock Exchange has published a study outline for the Series 86/87 examination, and the Securities and Exchange Commission has approved the outline and the related rule changes. The study outline delineates four critical job functions for research analysts. They are: 1) Information and Data Collection; 2) Analysis, Modeling and Valuation; 3) Preparation of Research Reports; and 4) Dissemination of Information. Let's examine these in detail.

First, regarding information and data collection, the examination study outline states that, "The research analyst collects information and data from various sources to learn about the economy, the industry sector and the individual companies that he/she covers." Specifically, the research analyst must gather:

- Macroeconomic data, such as inflation, interest rates and demographic information;
- Information about the industry sector, such as products offered, customer demand and regulatory issues;
- Information about individual companies to understand such things as cost of production, risk tolerance and the business plan; and
- Information to identify what influences the performance of the industry and/or the subject company.

Second, regarding analysis, modeling and valuation, the examination study outline states that, "The research analyst analyzes the industry sector's key drivers as well as the individual companies that he/she covers to develop a forecast of the industry sector, make projections about the subject company, and determine the valuation of the company's stock." Specifically, the research analyst must:

- Analyze the data obtained about the industry sector, competition within the industry and supply and demand in the industry sector;

- Analyze the data obtained about the individual companies, including the company's financial statements and the company's corporate governance, and make projections about earnings potential using quantitative and qualitative data
- Value the company's stock by assessing the company's stock price, its price relative to the market and how it performs / trades relative to peer companies; and
- Look for investment criteria that alter the price of the stock, and identify patterns or events that make the stock price move.

Third, regarding preparation of research reports, the examination study outline states that, "The research analyst prepares a variety of reports summarizing the research conducted on the industry sector or subject companies." Specifically:

- The research reports must adhere to important regulatory requirements, including disclosure of conflicts of interest between the subject company and the brokerage firm, the meanings of the ratings and the percentage of each type of rating that the brokerage firm issues; and
- The research analyst prepares many types of reports, such as reports announcing changes in ratings, recommendations, or projected earnings, as well as reports announcing the elimination of a company's coverage.

Fourth, regarding dissemination of information, the examination study outline states that, "The research analyst [if licensed as a registered representative of the brokerage firm] presents the results of the analysis, orally and in writing, to various parties." Specifically, this activity includes presenting and discussing recommendations, meeting with clients, and responding to inquiries from clients and/or the public.

While this interaction still involves the retail and institutional sales forces of the brokerage firm, it does not include interaction with the investment banking department of the brokerage firm. Investors should welcome this reform in view of the recent research analyst debacle as exposed by securities regulators.