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THE EVOLVING WORLD OF RESEARCH

The world of research sure has changed over the last few decades. When I first started in the field in 1987, equity research analysts worked primarily for investment banks and broker dealers and landing a gig at a bulge bracket firm meant that as long as you delivered good product, created buy-side relationships, and made sure your bankers were well-served, your paycheck was pretty secure for the foreseeable future.

But a lot has changed since then. It's hard to imagine now, but prior to 2000, publicly traded companies could (and did) selectively disclose material information. In analyst conference calls, institutional investors and sell-side analysts might hear about market-moving news before the general public. It was not unheard of for some star analysts or mega-investors to have significant access to the C-suite and be privy to much more actionable information than the average investor. In August 2000, the United States Securities and Exchange Commission (SEC) mandated that all public companies must disclose material information to all investors at the same time (Regulation Fair Disclosure, or Reg FD), thereby attempting to level the playing field.

In April, 2003, the SEC, the Financial Industry Regulatory Authority (FINRA, then NASD), and the New York Stock Exchange (NYSE) reached an enforcement agreement against 10 of the US's largest investment firms, resulting in the Global Analyst Research Settlement. This was the culmination of a several year investigation by New York Attorney General Eliot Spitzer, who was looking to uncover conflicts of interest in the investment banking industry, and to make a name for himself in the political arena.

The result of the Global Analyst Research Settlement was that analyst compensation could no longer be a reflection of investment banking business, the so-called "Chinese wall" was reinforced with new regulations, making it impossible for analysts and bankers to have communication unchaperoned, research analysts could not help bankers to market deals, quiet periods were extended, and analysts had to disclose a lot more information about their historical ratings.

While the settlement didn't necessarily create one intended outcome of increasing the number of sell recommendations or increasing the breadth of recommendations coming out of research departments, it did, by taking away access to investment banking revenues, significantly change

the manner (and scale) in which research analysts were compensated. It was no longer as lucrative a career move to be an equity research analyst on the sell-side.

That's not to compare research analysts with starving artists. Most were still making well into six figures. But the ability of an analyst to differentiate himself or herself from the pack became much more challenging. It could no longer be driven by relationships – that the analyst from the biggest investment bank doing the most deals had access to the best information.

In 2015, FINRA's rule 2241 began requiring further disclosure of the absence of any conflict of interest. Research reports written by FINRA registered analysts at FINRA registered firms now had to include in their reports explanations of ratings, the percentage of positive and negative ratings, information about investment banking relationships, whether the analyst or any member of his or her household owns the subject security, among other things.

And now, MIFID II (Markets in Financial Instruments Directive), which was launched in Europe in January, 2018, and may well play out here in the States, is about to change the economics of the research business again.

MIFID requires that investment banks and broker/dealers unbundle the fees they charge clients for trade execution and research. According to a McKinsey survey, the net effect of MIFID could be an industry-wide 30% (or more) drop in equity research revenues. While this is not an immediate concern of US-based equity research analysts, it should be on the radar of anyone working in the space to plan accordingly.

Last fall, the SEC released a formal statement, assuring US banks and brokerages that for 30 months (until April 2020), it won't levy any fines against US firms that break out trading and research expenses for their European clients (against US regulations). In the meantime, we'll get a glimpse of how MIFID will change research, certainly in Europe. Those who believe there is too much mediocre research out there speculate that quality of the research product will increase, while overall numbers of equity research analysts may decrease.

As we watch the latest changes to the world of research, this is a great time for analysts or analysts-to-be to be considering their next (or even first) move. Thankfully, there are several options now, some that didn't even exist just a generation ago. Now, there are many ways to grow your own portable research franchise. And as you map out your ideal career, it's worth exploring each of them to determine your best fit.

NO SCHOOL LIKE THE OLD SCHOOL

It may be old school but working for a research firm or a broker/dealer or investment bank is still a great way to establish yourself as a credible source of industry information. Having a brand name on your letterhead gives an analyst access to buy-side clients, who can help an analyst make a name for him or herself. It also can sometimes make it easier for an analyst – especially one just starting out – to develop a relationship with CEOs and CFOs of companies that they follow.

Analysts that work for a FINRA registered broker/dealer or an investment bank will also need to be registered with FINRA. This means passing the Series 7, Series 63, Series 86 and Series 87 exams in order to publish.

With an existing salesforce that already has buy-side relationships, an emerging analyst can set up shop in a broker/dealer or investment bank, and immediately benefit from the branding of that firm. The salesforce introduces the analyst to buy-side clients and promotes his or her research, giving the analyst instant credibility. Of course, the analyst's work will ultimately speak for itself, so an analyst putting out low-quality or uninspired ideas will not last long in this environment.

Another benefit to working for an established research firm, investment bank or broker/dealer is that the companies that you'll be following will already know the name. Getting a CEO to take your call when you're Joe Schmo from Jane's Investment Bank and Storm Door Repair is not so easy. Getting a CEO to take your call when you're the newest industry analyst at a brand name firm is quite a bit easier. This is especially true if your firm has an investment banking relationship with the company, even in the post-Eliot Spitzer/Global Analyst Research Settlement world. While the analyst is not permitted to get on the phone with his or her investment banker *and* the CEO, the CEO will likely recognize the name of the analyst before he or she even calls.

Access to C-suite executives is paramount in the world of equity research. An analyst with access has more credibility to his or her clients than those without the same relationship, and while Reg FD has eliminated selective disclosure of material information, it can be very hard to regulate business relationships that evolve over time into friendships, where nuance and subtleties can help an analyst to "read into" the words of a CEO or CFO.

While there are a lot of benefits to working for a big firm, the downside is that if MIFID is inevitable, an analyst could be in a position of doing the same job for a lot less money or finding that their research services are no longer needed.

STARTING YOUR OWN RESEARCH FIRM

Just a decade or so ago, it seemed like a huge leap of faith for an analyst to leave the relative comfort and steady paycheck provided by a larger firm and venture out on his or her own. But in the last several years, we've seen the emergence of consortiums that bring on independent research analysts or firms and provide those analysts and firms with back office functions, making the transition from big firm to independence a little less daunting.

In these situations, the infrastructure platform company or consortium provides the analyst with compliance, billing, marketing, in some cases corporate access support, in some cases institutional sales, and even, in some cases, registration with a broker dealer so the analyst can keep his or her licenses current.

This is a path for an established analyst, who has a proven track record and a strong following of buy-side clients who would pay for his or her research. If you believe that MIFID is an inevitability, this scenario could be ideal for the seasoned analyst.

The potential downside of taking this path is that unlike a position at a large firm, the monetary value of your research must be established. For analysts who are unsure of their value, or who do not have the firm, committed, backing of at least a handful of buyside clients (at a minimum), the ability to sustain an independent research firm is limited.

There are still those who take the leap without the back-office safety net of a consortium or an infrastructure platform company. This path should really be limited to those analysts with global reputations, as the start-up costs to provide your own infrastructure *and* develop research is prohibitively expensive, without several initial contracted clients.

INDEPENDENT THIRD-PARTY RESEARCH

A similar notion of going-it-alone, is providing independent third-party research. Not unlike the "starting your own research firm," this path requires no small amount of courage, and contacts, in order to sell your research product. Only in this case, a research analyst might work as an independent consultant to a sell-side firm, rather than selling research to a buy-side firm. For the analyst creating the research product, the transaction is with the sell-side firm, and the analyst may be paid per piece, or may be paid in a percentage of commissions.

The sell-side firm, in this instance, would hold the licenses of the analyst, and maintain the compliance and back office. The analyst would, in many cases, work from home, so the sell-side firm is not paying for office space. It's a profitable arrangement for the firm, which can choose just how much to lever the research department. The analyst's name is on the cover of the research, but most interaction with the buy-side is with the sales force here.

Benefits to the analyst of this arrangement include the potential for a well-known analyst to generate significant commissions, and in the case of a commission split, this arrangement can be very lucrative. The upside potential for both the analyst and the firm can be significant. Also, in the cases where a firm is splitting commissions with an analyst, this could most closely resemble the MIFID model, which would be a net positive if the US moves in that direction insofar as it could make the price of research clear.

The long term challenge is that, when the analyst's arrangement is with the sell-side firm, and only the sales force of the sell-side firm is engaging regularly with the buy-side, (because the arrangement may be that when the analyst "markets", he or she charges an hourly fee) the onus is on the analyst to continue to keep his or her profile high in the investment community. Analysts are always charged with the job of maintaining their reputation, but in this case, it may be a little more challenging than being in a position of interacting with the buy-side regularly.

THIRD PARTY CO-BRANDING RESEARCH

A second method of providing third party research that FINRA allows is through third party co-branded research. In this case, a broker/dealer or investment bank or research firm may purchase research product from an independent research analyst or from another research firm and wrap its own branded cover page and letterhead around the research. The third party's name is still on the research, and the third party writes the research and manages the compliance/supervisory aspect of the research, including its own disclosures.

This method certainly benefits the firm purchasing the research, in that it can offer its clients a research product without having to invest in a research department, or even a supervisory analyst. And for analysts with a following, it is a way to get your research product out through someone else's brand name/image.

The downside for research analysts is that, depending upon your agreement, this could limit the operating leverage of your research product if the sell-side firm doesn't want the analyst to sell directly to the buy-side as well. Additionally, if you're the analyst providing the research, you're also the person (or your firm is the firm) investing in compliance and supervisory analyst work.

While research has changed and evolved over the years, and on the surface the changes seem to have made the industry harder for analysts while at the same time limiting their income, the reality is more complex. If you're working as a research analyst or you are an aspiring research analyst, it's best to explore all types of opportunities to enter and grow your business. Research the industry like you would an industry you're covering – then, make the best choice for you.

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ABOUT THE AUTHOR: ***JEANINE OBURCHAY***

Jeanine Oburchay has 17+ years of Wall Street experience and 10+ years of experience as an entrepreneur and an industry consultant. Jeanine began her career in the Equity Research Department at Smith Barney, covering special situations. During her tenure on the Street, she also worked in the equity research departments of Oppenheimer, BT Securities and Bear Stearns, covering primarily telecommunications services.

Later, Jeanine moved to the convertible bond market, and worked in the convertible research department at Wachovia Securities. At Wachovia, Jeanine was also a Supervisory Analyst charged with reviewing and approving all written research.

Over the course of her career, Jeanine's research covered companies from various industries including wireless and wireline telecommunications services and equipment, cable, defense and aerospace, and technology.

Jeanine holds a BS in Finance and an MA in Public Communications from Fordham University, and an MBA from Pace University.

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