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The *Cammer* analyst factor in securities class actions

The 1989 case of *Cammer v. Bloom* established the five "*Cammer* factors" that are used as benchmarks for gauging market efficiency in securities class actions under Section 10b-5 of the 1934 Exchange Act. The *Cammer* factors require a showing of a sufficiently high average weekly trading volume, sufficient number of analysts following, sufficient number of market makers, eligibility to file a form S-3, and the presence of a cause and effect relationship between unexpected material disclosures and changes in the security's price.

In a previous article on **Bloomberg Law**, we presented statistics on how the turnover factor has evolved in the past 30 years since *Cammer*. In this article, we focus on the analyst coverage factor.

We focus our analysis on companies trading on NYSE, NASDAQ and AMEX (up to its acquisition by NYSE) for which analyst coverage information is available. Analyst coverage has increased significantly over the past three decades. However, there is still a non-trivial fraction of stocks that are covered by few, if any, analysts. Since there is no bright-line threshold for the number of analysts following a stock, in this paper we set an illustrative benchmark at the number of analysts that covered Coated Sales – the stock at the center of the *Cammer* decision. The vast majority of large exchange-traded companies exceed the number of analysts that covered Coates Sales. However, the finding that a significant portion of stocks have very few analysts contrasts with the claim that merely trading on a major US exchange ensures efficiency.

There is also evidence that, holding company size constant, companies targeted by 10b-5 actions are covered by more analysts than the companies that are not targeted by 10b-5 actions, suggesting that plaintiffs take into account the likelihood of satisfying the *Cammer* factors in filing a lawsuit.

Class certification and market efficiency

Class certification in Section 10b-5 matters requires a showing that questions common to the class predominate over questions affecting individual class members. In *Basic Inc. v. Levinson*, the US Supreme Court created a rebuttable presumption of reliance that the entire class can be presumed to have relied on a single source—the information incorporated in the price of a stock—if the stock trades in an efficient market. This presumption is based on the efficient markets hypothesis. The efficient markets hypothesis contends that in efficiently operating markets, all relevant information is quickly incorporated into the stock price. Plaintiffs are allowed to claim reliance on the stock price alone as long as they can prove that the market for the stock is efficient.

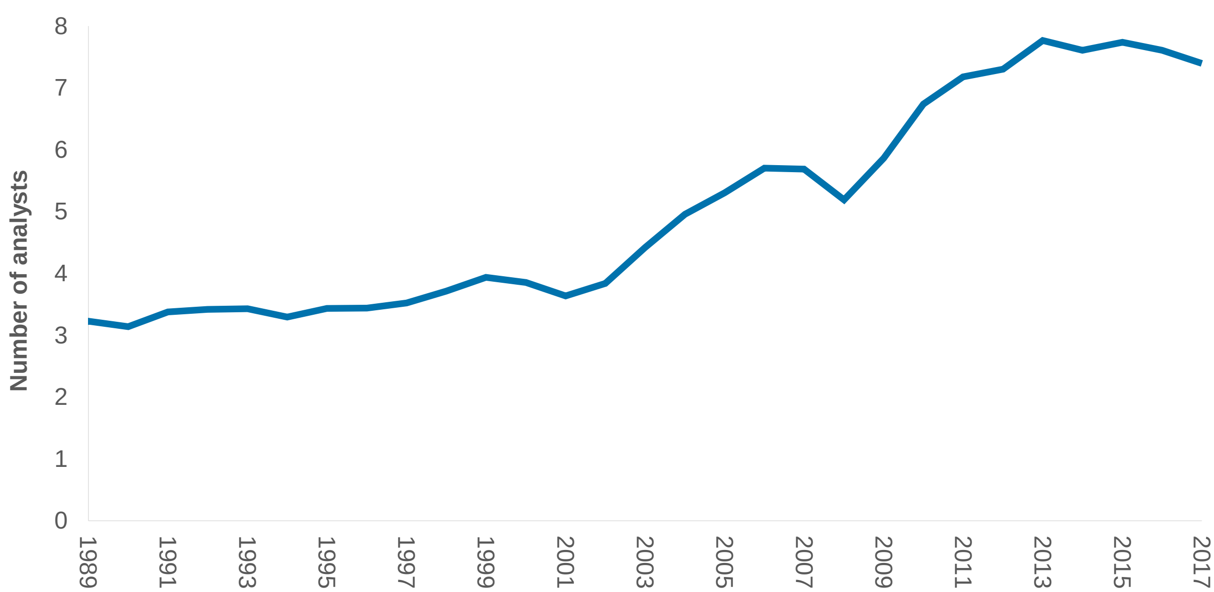
The analyst coverage factor

The *Cammer* Court considered that it "would be persuasive to allege a significant number of securities analysts followed and reported on a company's stock during the class period" under the rationale that the "existence of such analysts would imply" that new information was "closely reviewed by investment professionals, who would in turn make buy/sell recommendations to client investors." The Court concluded that "[i]n this way the market price of the stock would be bid up or down to reflect" the new information "as interpreted by the securities analysts."

Significant growth of analyst coverage

As shown in Figure 1, analyst coverage has grown considerably since 1989. When *Cammer* was decided 30 years ago, the average number of analysts covering each stock was near 3, whereas nowadays it is closer to 7.

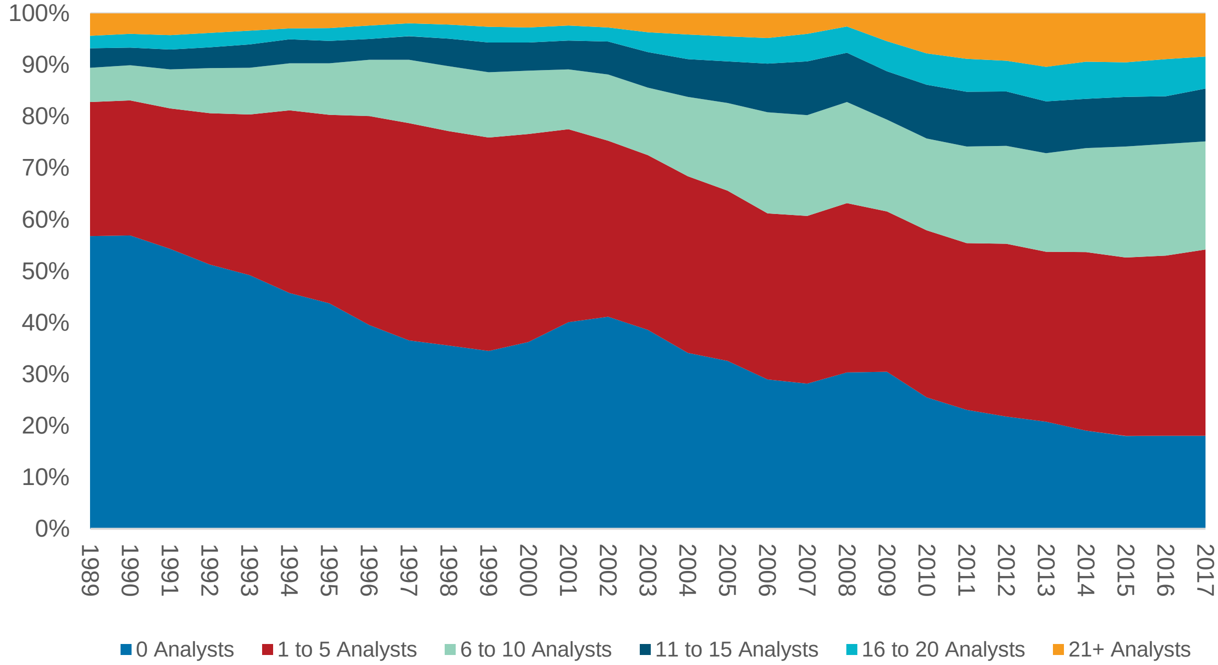
Figure 1: Average number of analysts



Source: Refinitiv, CRSP, CRA analysis

At the same time, the percentage of companies without coverage has declined almost without interruption since *Cammer*. As Figure 2 shows, more than half of companies had no coverage in the 1980s but now approximately 80% of companies are covered by at least one analyst.

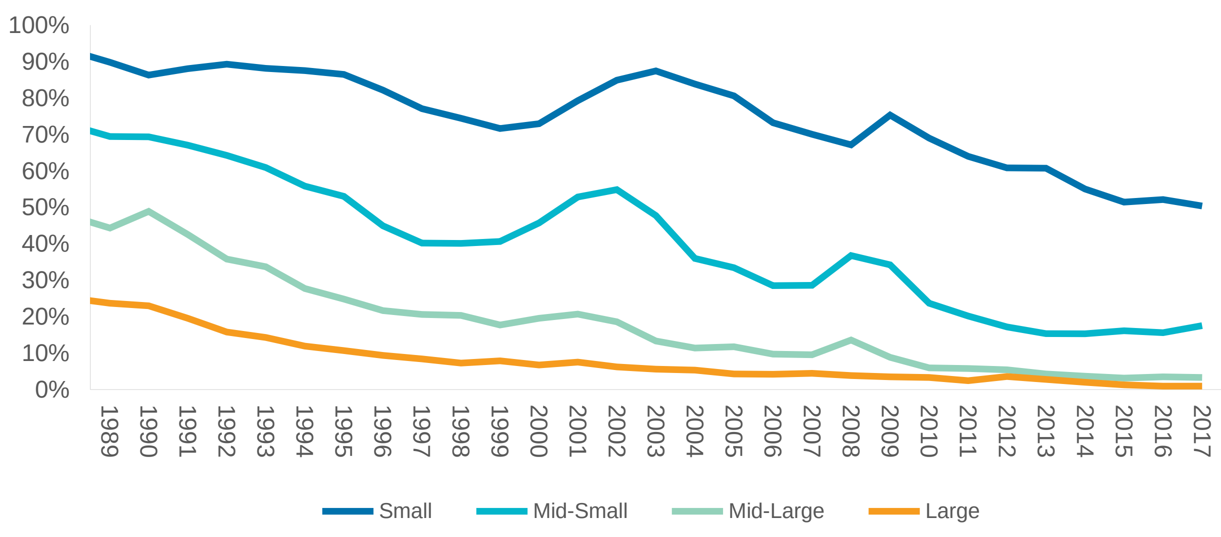
Figure 2: Breakdown of analyst coverage



Source: Refinitiv, CRSP, CRA analysis

The decline in the percentage of companies without analyst coverage occurred across all company sizes. Figure 3 places all stocks into one of four groups every year, with each group representing one quarter of the common stocks traded in the US in that year. We refer to the quartiles as “Large,” “Mid-Large,” “Mid-Small,” and “Small.” Figure 3 shows that the percentage of companies without any analyst coverage has always been higher with smaller companies but that percentage has declined continuously, except for the periods after the dot-com bust of the early 2000s and the financial crisis in 2008-2010.

Figure 3: Percentage of companies without analyst coverage, by company size

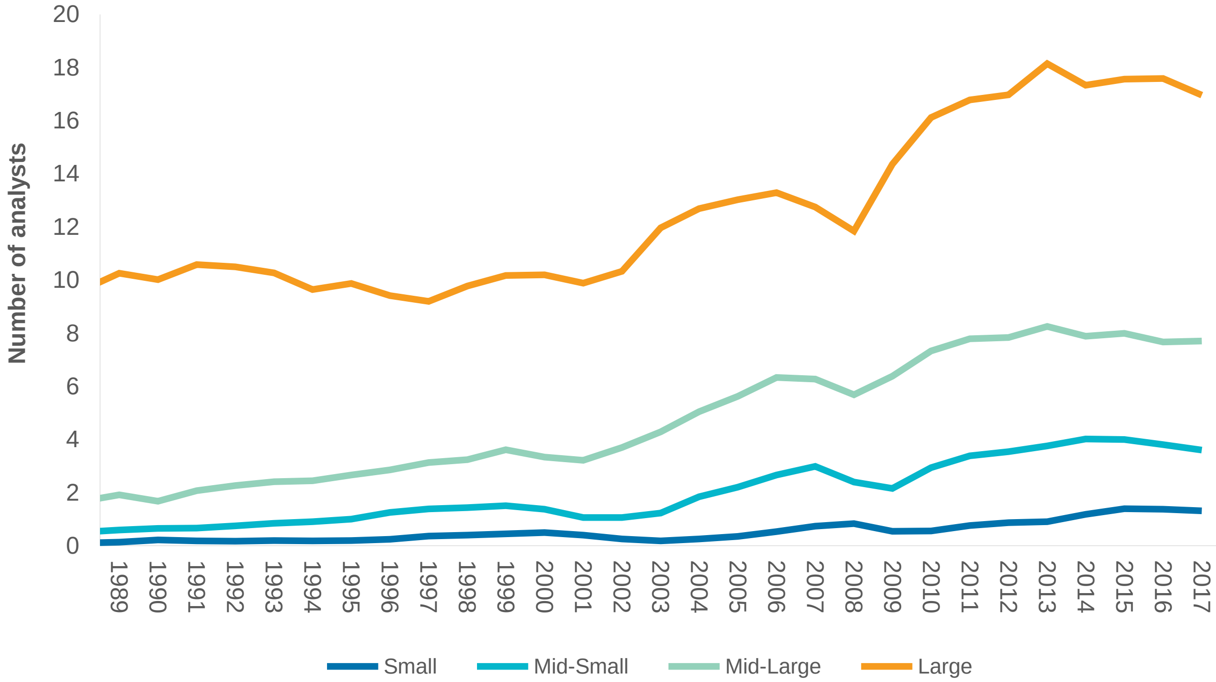


Source: Refinitiv, CRSP, CRA analysis

Figure 3 also shows that, among the 25% smallest companies (Small quartile), approximately 50% of companies still have no coverage, even though that percentage has declined since 1989.

Overall, the increase in coverage across company sizes is also visible in the average number of analysts following Small and Large stocks (Figure 4.) Figure 4 shows how the number of analysts covering each company has increased continuously and across essentially all groups. The group of the 25% largest companies (Large quartile) has seen a dramatic increase in analyst coverage from an average of near 10 until 2001 to over 16 since 2010.

Figure 4: Average number of analysts by company size

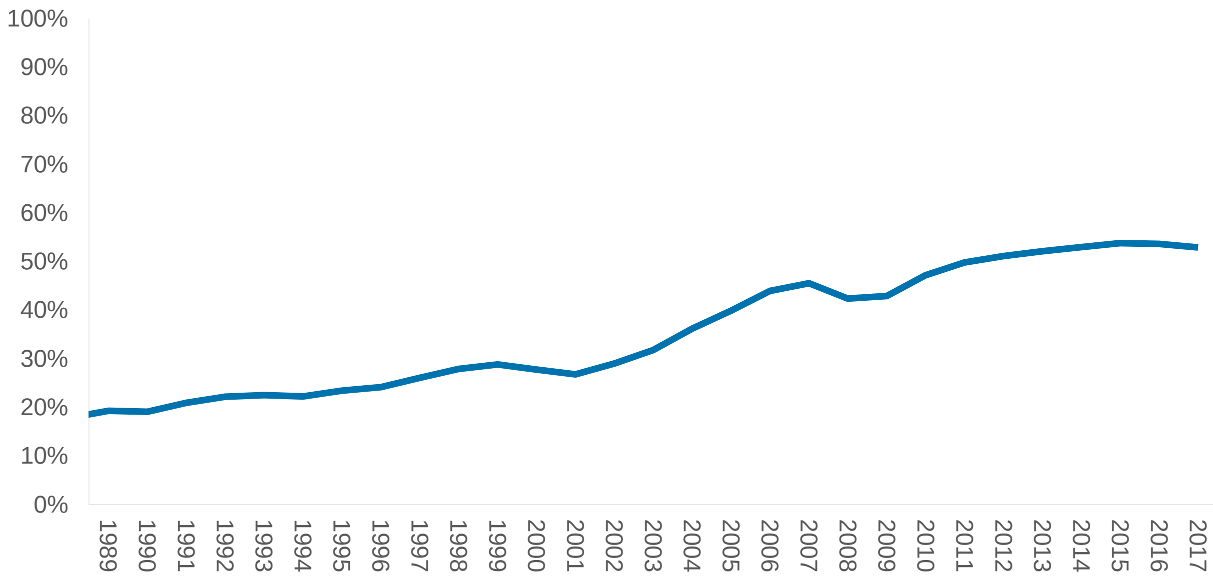


Source: Refinitiv, CRSP, CRA analysis

The *Coated Sales* benchmark

Cammer did not set a threshold for the minimum number of analysts that have to follow a stock to be consistent with market efficiency. Courts since *Cammer* have also not set a consistent threshold. To give a historical perspective, we examine the stock at issue in *Cammer*, Coated Sales. Coated Sales was covered by approximately 5 analysts on average during the respective class period (May 6, 1987 to June 14, 1988). With that benchmark in mind, we examine the percentage of stocks with more than 5 analysts. As shown in Figure 5, that percentage increased significantly since *Cammer*. Fewer than 20% of stocks had 5 or more analysts following them in the 1980s but that percentage has been over 50% since 2011.

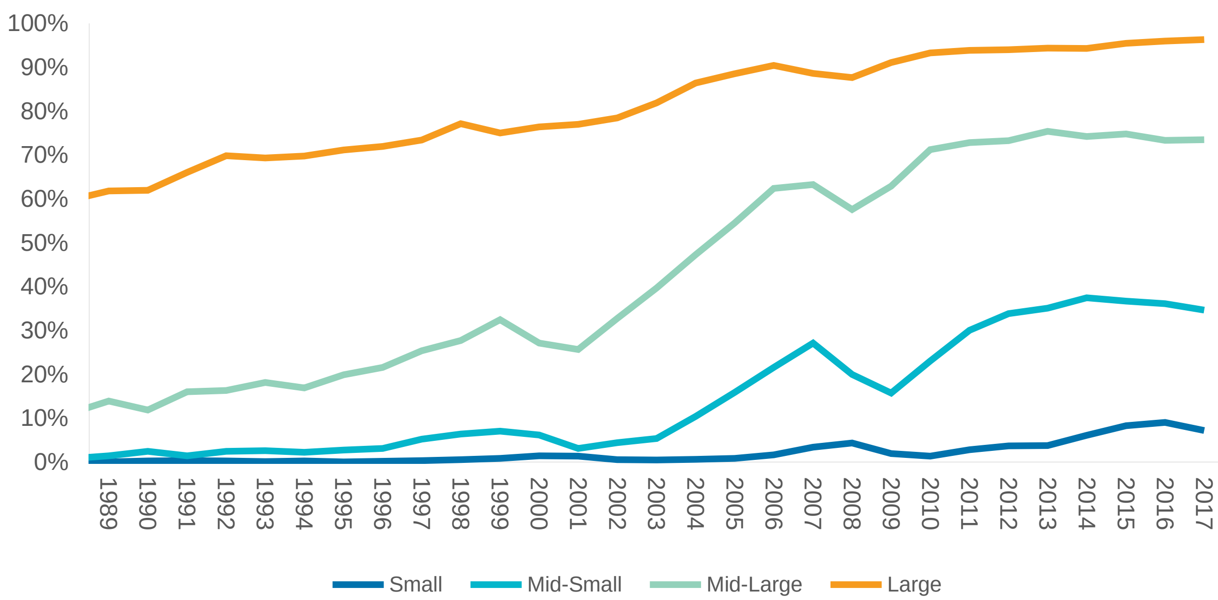
Figure 5: Percentage of companies covered by 5 or more analysts



Source: Refinitiv, CRSP, CRA analysis

Further, this increase has happened across all company sizes. As shown in Figure 6, the percentage of companies covered by 5 or more analysts is now over 95% across Large companies, but also approximately 75% among Mid-Large companies. So, a quarter of the Mid-Large companies are still covered by fewer than 5 analysts. As expected, the percentage of companies followed by fewer than 5 analysts increases with smaller stocks. Two-thirds of the Mid-Small stocks are covered by fewer than 5 analysts, and over 90% of Small stocks are covered by fewer than 5 analysts.

Figure 6: Percentage of companies covered by 5 or more analysts, by company size



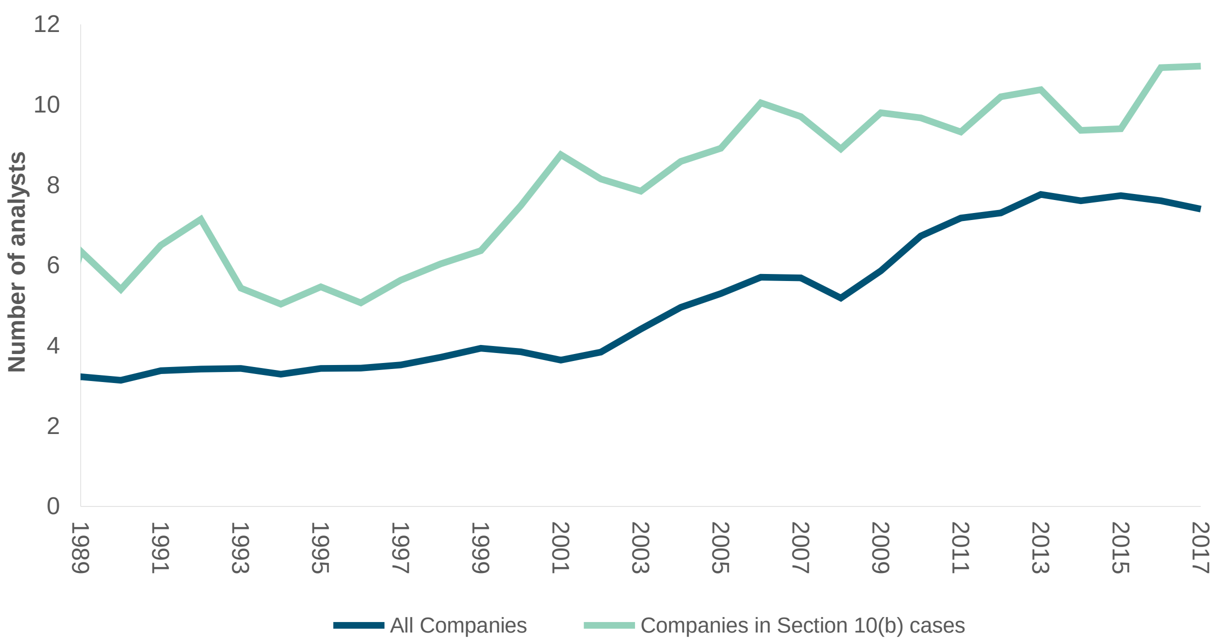
Source: Refinitiv, CRSP, CRA analysis

Stocks in 10b-5 Actions

We showed in our previous **article** that class actions appear to be filed against companies that are more likely to pass the volume thresholds. The same conclusion holds for the analyst coverage factor. Even without a pre-defined threshold for analyst coverage, we can still examine whether companies with higher coverage tend to be more heavily targeted by securities class actions under Section 10b of the 1934 Exchange Act (10b class actions). Figures 7 through 9 show the results of this analysis. In the figures, we refer to "Size Quartile – 10b" as the statistic applicable to the particular quartile of companies targeted by 10b class actions. We maintain the quartile reference to "Small," "Mid-Small," "Mid-Large," and "Large" for all exchange listed companies.

The first observation on Figure 7 is that the companies targeted by 10b class actions have consistently been followed by more analysts than the typical exchange-listed firm.

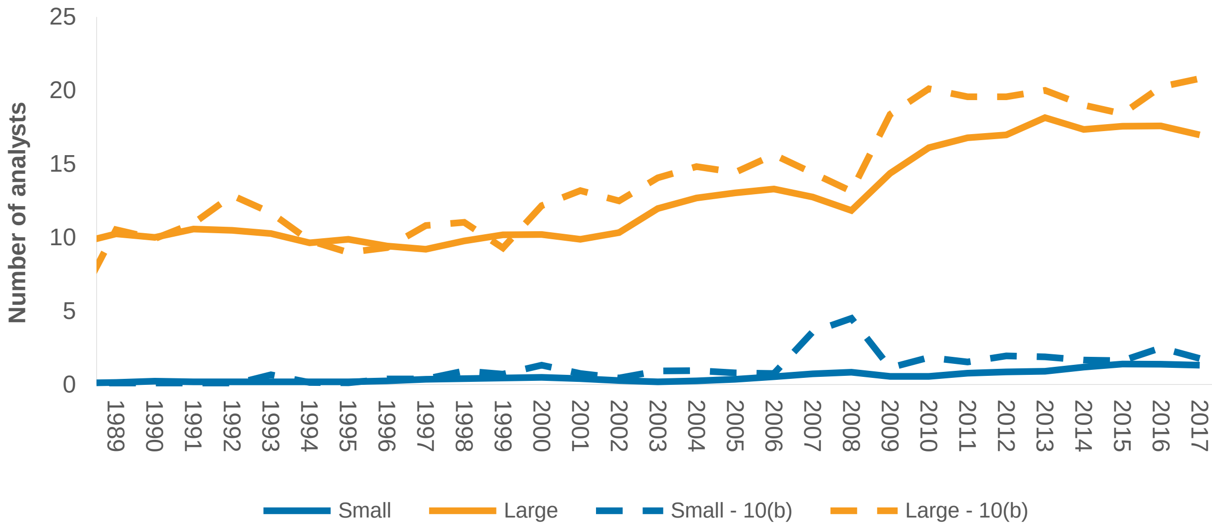
Figure 7: Average number of analysts – all companies and companies targeted by 10b class actions



Source: Refinitiv, CRSP, CRA analysis

This result also holds also within each size quartile as Figure 9 shows. For any given size category, the average number of analysts following companies targeted by 10b class actions is higher than the number of analysts following a typical exchange-traded company. As shown in Figure 8, Large companies that were recently targeted by a 10b class action were covered by 21 analysts on average, whereas the average Large company was covered only by 17 analysts. Among Small companies, those targeted by a 10b class action were covered by 2 analysts on average, while the average Small company was covered only by 1 analyst.

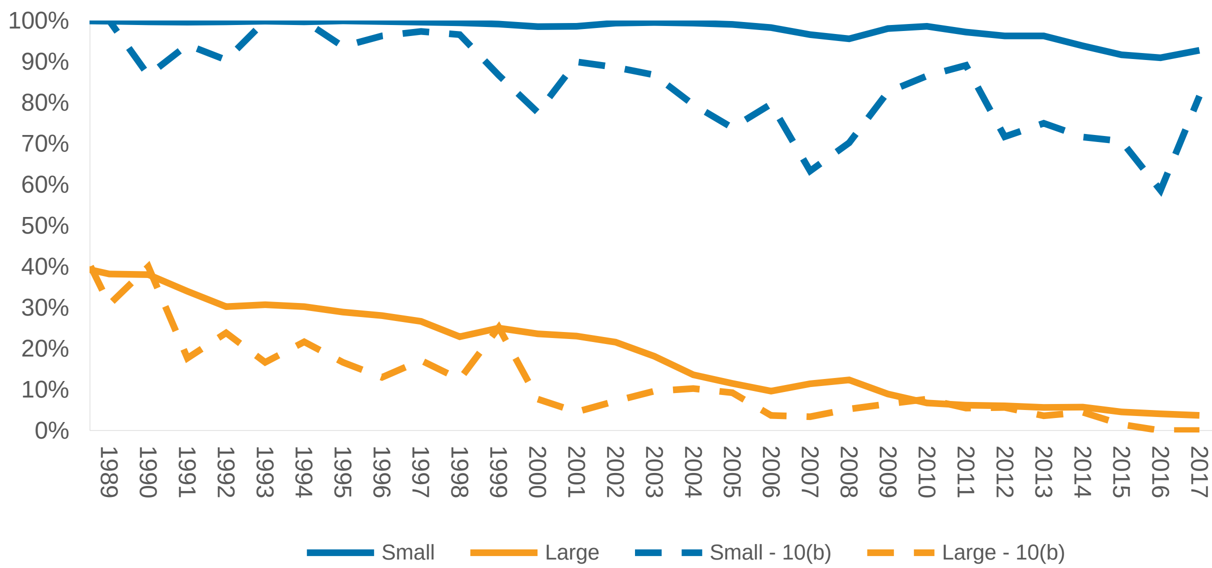
Figure 8: Average number of analysts by company size – all companies and companies targeted by 10b class actions



Source: ISS, Refinitiv, CRSP, CRA analysis

Figure 9 shows that although recently 4% of the Large companies were covered by fewer than 5 analysts, *no* Large company targeted by 10b class actions has fewer than 5 analysts covering them. Among all Mid-Large companies (not shown), 40% have up to 5 analysts covering them, but that percentage drops to 15% among the companies in that group that are subject of a 10b class action. Among Mid-Small companies (not shown), 80% have up to 5 analysts covering them, but that percentage drops to 40% among the Mid-Small companies that are subject of a 10b class action. Lastly, among Small companies, 92% have up to 5 analysts covering them, and that percentage only drops to 82% among the Small companies that are subject of a 10b class action.

Figure 9: Percentage of companies covered by fewer than 5 analysts – all companies and companies targeted by 10b class actions



Source: ISS, Refinitiv, CRSP, CRA analysis

Conclusion

While analyst coverage has increased over time, there is still a non-trivial fraction of companies that are covered by fewer than 5 analysts, which was the coverage of the shares at issue in *Cammer v. Bloom*. Back in 1989, only 20% of stocks were covered by 5 or more analysts but that percentage has now increased by 50%. Although virtually all Large companies now exceed that illustrative benchmark, only 40% of the stocks in the bottom half of companies by size exceed it to this day. Based on the proportion of companies across company sizes that are the object of securities class actions under Section10b of the 1934 Exchange Act, those actions appear to have been filed with a notion that the *Cammer* analyst factor needs to be satisfied.

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Contacts

Tiago Duarte-Silva
Vice President
Boston
+1-617-425-3128
tduarte@crai.com

Assen Koev
Principal
New York
+1-212-520-7280
akoev@crai.com

CRA Charles River Associates