



***Center for Financial Research & Analysis, Inc.***

**Testimony of Howard M. Schilit**

**President and Founder  
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**United States Senate  
Committee on Governmental Affairs  
Washington, DC 20510-6250**

**February 27, 2002**

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Senator Lieberman and your esteemed colleagues, I am pleased to appear before this Committee to describe my role as an independent financial analyst and some of the important differences between Wall Street (or “sell-side”) research and our independent boutique.

Before proceeding, I want to emphasize that my comments are based solely upon personal observations over the last decade, rather than on an comprehensive study of the Wall Street establishment or other independent research boutiques.

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My name is Howard Mark Schilit and am founder and President of the Center for Financial Research & Analysis (“CFRA”) in Rockville, MD. Prior to that, I was employed for seventeen years as an accounting professor at American University. I also authored the book, FINANCIAL SHENANIGANS: How to Detect Accounting Gimmicks and Fraud in Financial Reports.

### **About CFRA**

My organization, CFRA, has been writing research reports since 1994, warning institutional investors about companies experiencing operational deterioration or using unusual accounting practices. Our reports are published daily and distributed over our web site <http://www.cfraonline.com>

We use a variety of quantitative and qualitative screens to initially select companies for review. Then, a CFRA analyst reviews the financial reports and other public documents to search for any problems. If any are found, we interview the Company management to discuss these issues. If concerns remain, we publish a report on our web site. We make no buy or sell recommendations; rather, we simply discuss the issues of concern.

Our clients are mainly institutional investors who purchase the research on a subscription basis. We are paid a fixed fee based on the number of actual users at a firm, similar to a license fee on software. Subscribers receive an e-mail each morning with a notification of the companies profiled and the reports are posted on our web site each morning at 9:00 A.M. EST.

All CFRA subscribers receive the information in the same way and at the same time. In addition, all subscribers have equal access to discuss issues with our analysts.

CFRA has a variety of strict editorial policies and ethical guidelines that protect clients’ interests and ensure

CFRA employees receive no remuneration based on stock price performance of companies they profile. (I have attached our policies and guidelines.)

In short, we have no brokerage, investment banking, or money management operations. We have no conflicts-of-interest. We have one client class (those who make economic decisions based on financial disclosures). And, we have one overarching goal – to help them make the best decisions.

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### **About Wall Street (“Sell Side”) Research**

In contrast to our independent research boutique, Wall Street research is fraught with real or potential conflicts-of-interest.

Wall Street brokerage firms have at least two major client groups; they include companies purchasing investment banking services and institutional investors. Typically, a company needing funding will hire a brokerage firm to underwrite securities in a public offering. The brokerage firm receives a fee (generally 6 percent or higher) for this investment banking service. Shortly thereafter, the research analyst at the brokerage firm will begin coverage on this new client with a positive research report. Generally, future reports on this investment banking client will remain positive. Future investment banking fees on stock or bond offerings depend on a close relationship with the corporate client.

If CFRA, or another critic raises concerns to investors, the brokerage firm often publishes a rebuttal to show support for its investment banking client.

This shows the inherent conflict-of-interest; the brokerage firm serves both the underwriting client (the subject of the report), and the investor, who must be informed when problems arise.

The method of payment for research also differs substantially at Wall Street firms. Whereas CFRA receives a cash payment for selling subscriptions, brokerage firms are paid by investors in commission dollars. The trading volume affects the amount, the timeliness of information and the access to speak to research professionals. That is, bigger clients typically get “the first call” from institutional brokers and salesmen, while smaller clients have lesser access.

Moreover, non-institutional investors who generate no commissions often have no (or very limited) access to such research. CFRA, for example, was not permitted to purchase brokerage research from First Call (a distributor of brokerage research) because we generate no commission. They refused our offer to purchase the research for cash.

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**Comparison of CFRA and Wall Street Research**

The following table summarizes ten important differences between my independent research boutique and the typical Wall Street research groups.

	<b>CFRA</b>	<b>Wall Street Firm</b>
<b>Decision to write initial report based on</b>	<b>Screening for and identifying problems</b>	<b>New investment banking client of the firm</b>
<b>Typical client</b>	<b>Institutional investors</b>	<b>Corporation paying underwriting fees; institutional investors</b>
<b>Method of payment</b>	<b>Subscription-based fee</b>	<b>Brokerage commissions</b>
<b>Scope of services provided</b>	<b>Research and training</b>	<b>Securities underwriting and advisory services for corporations; asset management; brokerage; research</b>
<b>Financial interest in company profiled</b>	<b>None</b>	<b>Usually provide services for the company profiled and/or own stock in that company</b>
<b>Distribution to clients</b>	<b>Simultaneous, regardless of size of client</b>	<b>Variable, in part based on size of client</b>
<b>Personal trading permitted</b>	<b>No</b>	<b>Usually</b>
<b>Warn investors about problems</b>	<b>Regularly</b>	<b>Rarely</b>
<b>Write rebuttals on reports of other analysts</b>	<b>Never</b>	<b>Occasionally, to support clients paying investment banking fees</b>
<b>Offer investment opinion</b>	<b>No</b>	<b>Yes</b>

**In Conclusion**

As result of the conflicts-of-interest and internal policies, Wall Street research has regularly failed to regularly warn investors about problems at companies. I would be happy to answer any questions at this

time.