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CREDIT RATING AGENCIES & FREE SPEECH

by

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INTRODUCTION

The economic crisis that emerged in late 2007 continues to occupy an important place in many political and non-political discussions and can be traced to a number of players. The role many financial institutions, mortgage brokers, appraisers, and speculators played is well documented. Individual borrowers also contributed to this sub-prime lending crisis either knowingly or unwittingly through participation in the fraud committed by other parties. Several experts have put the blame squarely on the politicians who promoted home-ownership as the ultimate measure of success in American society and the government agencies (e.g. Fannie Mae) that were charged with assisting in the process of making these home ownership dreams come true.

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Even the most respected Federal Reserve ex-Chairman, Alan Greenspan, has not escaped criticism on account of his policy of keeping interest rates low for a long time. Recently, some investors and economists have pointed to the pivotal part credit rating agencies played in the meltdown. This paper will examine that role, focusing on whether credit rating agencies should be able to avoid liability by virtue of their traditional protection under the First Amendment, and whether new regulatory reforms designed to curtail conflicts of interest and promote greater disclosure will suffice.

WHAT ARE CREDIT RATINGS & WHY ARE THEY IMPORTANT?

The easiest way to understand credit ratings is to compare them to the grade point averages (GPA) given out by most schools. Earning a GPA of "A" is excellent whereas receiving a GPA of "D" is bad. Each of the major rating agencies have their own categories akin to the As and Bs a student gets in his/her coursework. For example, Standard & Poor’s (S & P) gives the highest rating of AAA for a debt issuer with stellar financial performance. A rating of "B" is given to an issuer whose debt issue servicing may be considered speculative. Moody’s follows a similar method with Triple A (Aaa) as the best possible rating and a rating of "B1" indicating questionable ability of the borrower to pay interest and principal on the debt in a timely manner.

These ratings are usually paid for by the issuers instead of by the investors of debt. Scannell & Lucchetti report in their 2008 article that about 98 percent of the ratings are paid for by the issuers.1 Some issuers routinely shop around for a better rating. A high rating can translate into lower interest rate and significant savings over the life of the debt issue. Acceptable ratings can also lead to a larger pool of investors who would be interested in buying these bonds, thereby creating a liquid secondary market. It is not uncommon for the debt issuer to buy additional insurance to make its debt issue with a lower credit rating more acceptable for the prospective investors.2

Investors rely on these ratings to get an objective assessment of the debt’s quality. Some debt investors who are regulated are prohibited from investing in non-investment grade bonds. “The Federal Reserve defines investment-grade securities as those rated BBB- or higher by at least one of the three principal credit ratings agencies and no lower than that by the others.”3 For banks choosing to invest in non-investment-grade bonds, the penalty comes in the form of higher capital ratios. Prior to the creation of the new derivative products like the Collateralized Debt Obligations (CDOs) and Collateralized Mortgage Obligations (CMOs), assigning a rating to a bond issue was a relatively simple process.

In a traditional credit analysis, the ratings agencies focus on the four major C’s of credit. The four C’s refer to: capacity, collateral, covenants, and character. The questions about “Capacity” revolve around the issuer’s ability to pay back the debt as promised. The ratings analyst may look at a variety of financial and nonfinancial information about the issuing company. Rating agencies examine the historical financial statements, calculate relevant traditional and cash flow based ratios, and compare the issuer’s performance over time to its peers, and to the industry in which the issuer operates. In addition, qualitative judgment is used to evaluate several factors which could affect a company’s ability to service its debt such as the trends in the industry in which the company operates, its competitive position and any relevant regulatory factors which could impact its operations. The second “C” in
the analysis, namely collateral, is based on the examination of the creditors' rights in the event the issuer goes bankrupt or files for a reorganization plan. A study of "Covenants" focuses on any limitations that may be imposed on the borrower's activities. The last "C" refers to the character of the borrower. This part of the evaluation is based on the qualitative judgment of the company's management. A range of factors such as the ownership structure, shareholder rights, public disclosure, and the structure of the board may be used to assign a character score to the issuer. 

Ratings have been used by regulators since the thirties, but in the seventies, the Securities Exchange Commission (SEC) gave them new power. There are ten Nationally Recognized Statistical Rating Organizations (NRSROs), including the big three, Standard and Poor's (S&P), Moody's and Fitch. Their role is to channel funds into supposedly safe and secure investments. Issuers must obtain a rating, which in turn dictates where banks, insurance companies, money-market funds and the like can place their money. While these regulatory requirements were intended to protect investors, the net effect was to turn the "opinion" rating agencies into essential gatekeepers. Then in the late 1990s, the role of rating agencies underwent a significant change as the newly created derivative products were introduced.

THE NATURE OF DERIVATIVE PRODUCTS AND THE RATINGS GAME

Mortgage-backed securities (also known as CMOs) come into existence when a financial institution puts many of the mortgages they own or bought into an investment pool. These pools are sometimes sliced and diced into different classes of securities with varying levels of risk and return. The risk levels, for example, may be based on the probabilities of default and which class of investors would bear the first x percent of the default. One of the major advantages of securitizations is creation of liquidity which allowed lenders to keep giving out loans after selling the loans already on their books. It was believed that these securities were quite safe as they were backed by several thousand loans and the probability that all these loans could simultaneously default was slim to none.

The ratings given to these CMOs were necessary for the financial institutions to be able to sell them to organizations like pension funds and banks which had restrictions on the securities in which they could invest. As described below, the ratings "game" now being played was quite different from the ratings that agencies previously had issued for bonds of companies like Enron.

For traditional bond issues, the focus is placed on the borrowers' ability to run their business and generate cash flows to pay the interest and principal to the debt investors. All the financial information needed to calculate the relevant ratios is retrieved from the company's audited financial statements. A publicly traded company is required to hire an independent audit firm which certifies that the financial statements follow the Generally Accepted Financial Principles (GAAP) and accurately depict what a firm owes and owns on its balance sheet. The audited income statement looks at the revenue and expense recognition standards followed by the company and produces net income after tax generated by the company over a 12 month time period. The credit rating agencies came under tremendous criticism for holding on to the best possible triple A ratings for Enron bonds just prior to Enron declaring bankruptcy. At that time, ratings agencies claimed that they should not bear any blame because companies like Enron were engaged in fraudulent bookkeeping with total cooperation from
their auditors. The “cooked” financial statements painted a significantly better financial picture of Enron compared to the reality. Enron’s management, with help from its auditors, had created thousands of Special Purpose Entities (SPEs) whose sole purpose was to take the debt off Enron’s balance sheet. The ratings agencies relied heavily on the “window dressed” financial statements certified by the company’s auditors, and they successfully defended themselves in court, arguing that they had no reason to independently investigate if Enron had taken deliberate steps to hide debt from its balance sheet.6

The ratings assigned to derivative products like the CMOs could not be figured out using the same technique. These securities were backed by thousands of mortgages spread over many geographic locations and borrowers. It was next to impossible to verify the details of each and every mortgage. The practice of continuously slicing and dicing the bundled securities to create more securities exacerbated this problem even more as one mortgage debt might now be backing more than a couple of CMO’s. The rating agencies had to get their information from the investment banks that created the pooled securities. The rating agencies also assumed, erroneously, that housing prices would continue their upward movement indefinitely, minimizing the chance of even subprime borrowers defaulting on their loans.

Another significant difference between the processes used for assigning ratings to traditional corporate bonds versus the ratings assigned to structured products lies in the differences in the customer base for these products. The ratings agencies have a lot more control over ratings for bonds as they have many clients with no single client providing a significant source of revenue. On the other hand, derivative securities were put together by only a handful of investment banks whose loss as clients would mean a huge loss of revenue to the ratings agencies. This concentration of clients put tremendous pressure on ratings agencies to assign favorable ratings to some structured products to please their clients.7

Investors who relied on these ratings are now seeking to hold the rating agencies responsible for the losses generated by these CMOs & CDOs as the real estate market all over the world went into a freefall leading to simultaneous defaults on thousands of loans. In the past, ratings agencies have successfully argued that their opinions are not actionable and are analogous to that of a stock analyst who issues buy or sell recommendations. Moreover, the worldwide economic conditions are completely unprecedented. Interestingly, legal counsel representing Fitch in its testimony to Congress, called ratings the “World’s Shortest Editorial” and claimed that first amendment protection is appropriate.8

Nonetheless, plaintiffs are aggressively pursuing fraud and liability theories that question both the traditional First Amendment protection enjoyed by the rating agencies and their government-sanctioned role in “certifying” the safety of the securities they rated. The SEC is likewise moving to curb the conflicts of interest that led to ratings shopping and inflated assessments.

ARE CREDIT RATING AGENCIES ENTITLED TO FIRST AMENDMENT PROTECTION?

A. Are Credit Rating Agencies Journalists?

The process of newsgathering is a protected right under the First Amendment, albeit a qualified one. This qualified right, which results in the journalist’s privilege, emanates from the strong public policy supporting the unfettered communication of information by journalists to the public. Ratings put forth by
a credit rating agency may qualify as newsgathering under certain circumstances. This is true if the information provided by the credit agency is a matter of public concern and is opinion, not factual.9

Statements of fact may be proven, and if false, are subject to defamation or fraud claims, whereas statements of opinion are not provable... "a statement of opinion relating to matters of public concern which does not contain a provably false factual connotation will receive full constitutional protection."10 As stated in the Enron case, "In other words, if a statement "cannot reasonably [be] interpreted as stating actual facts," it is shielded by the First Amendment."11 As factors to consider in the determination of whether a statement can reasonably be interpreted as one of fact, the court may examine the language employed, e.g., whether it is "loose, figurative, or hyperbolic language which would negate the impression" that it was a statement of fact, as well as the context of the statement and the "general tenor of the article."12

B. Matter of Public or Private Concern?

The information provided by the credit rating agency must be of public concern in order to receive protection. For example in the Enron case, the court pointed out that "The sheer size of the...litigation, not to mention the numerous related criminal actions, attests to the public import of Enron and its sudden collapse in 2001."13 The court went on to say "that while there is no automatic, blanket, absolute First Amendment protection for reports from the credit rating agencies based on their status as credit rating agencies, the courts generally have shielded them from liability for allegedly negligent ratings for various reasons."14

On the other hand, if the matter is one of private rather than public concern, then the court will not protect the credit rating agency. In Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.,15 D&B prepared a credit report concerning Greenmoss Builders that contained the erroneous information that Greenmoss had filed for bankruptcy, when in fact it had not. Upon learning of the error, D&B sent a correction to the five creditors who had received the report, but Greenmoss was not satisfied and sued for libel. In one of the few decisions to so hold, the U.S. Supreme Court emphasized that "[w]hether ... speech addresses a matter of public concern must be determined by [the expression's] context, form, and context ... as revealed by the whole record."16 Here, the Supreme Court found that the credit report of a private construction contractor was not entitled to First Amendment protection because it concerned "no public issue, ... [but] was speech solely in the interest of the speaker and its specific business audience," since it concerned solely a private plaintiff and was sent to only five subscribers who were under agreement to keep the information confidential.17 Therefore the report did not involve any "strong interest in the free flow of commercial information" that would "ensure that "debate on public issues [will] be uninhibited, robust, and wide-open.""18

Similarly, in the case In re Nat’l Century Fin. Enters., Inc. Inv. Litig.,19 the plaintiffs sued Moody’s and Fitch for giving National Century notes their highest credit ratings, which the plaintiffs claimed they relied on to purchase the notes. National Century subsequently went bankrupt. The Court found that the notes in question were issued by a privately-held company and "targeted to a select class of institutional investors with the resources to invest tens of millions of dollars in the notes. And the only place that the ratings are alleged to have appeared were in the offering materials given to the select class of investors."20 Since the ratings were not published to the
investing public at large, Moody's and Fitch were denied First Amendment protection.

If the information gathered by the credit agency is not disseminated to the public, but is published for example, on a website, it may not be “public” information. This was the case in American Savings Bank, FSB v. UBS PaineWebber\(^2\) holding that no journalistic privilege applied. Here, PaineWebber made investment recommendations to American Savings Bank, based on information that PaineWebber received from Fitch. The matter before the court involved discovery of information provided by Fitch, for which Fitch claimed a journalistic privilege. The court found two factors significant. First, Fitch’s primary means of disseminating information to both its subscribers and the public was on its website; and secondly, Fitch performed its ratings based on a private, contractual agreement for a fee. Finding that Fitch rarely performed its services without a fee, the court held that “research conducted for a fee cannot be journalism.”\(^2\) In an ancillary case the Second Circuit also held that Fitch was not entitled to a journalistic privilege because, unlike a business newspaper or magazine, which would cover any transactions deemed newsworthy, Fitch only “covers” its own clients. “We believe this practice weighs against treating Fitch as a journalist. This practice, of course, contrasts noticeably with Standard & Poor’s practice (as described in Pan Am) of rating nearly all public debt issuances regardless of whether it was hired to do so or not.”\(^2\)

C. Can Rating Agencies Claim First Amendment Protection When They Helped to Create the Product They Rated?

David Grace, a noted securities lawyer, made an illustrative comparison between rating agencies and a restaurant critic.\(^2\) If a critic merely goes to a restaurant, eats a meal and then writes a review, he is clearly expressing his opinion. However, if the critic was actually involved in the preparation of the meal in the kitchen then he is not just writing his opinion.\(^2\) In the case of ratings assigned to derivative products, the rating agencies were actually present in the board rooms of investment banks engaged in bundling these securities. Given that vested interest, plaintiffs argue that the rating agencies should lose the protection associated with free speech.

Many angry investors also claim that the ratings are actually products and when these products were consumed (relied upon) by investors they were hurt. As such, rating agencies could be sued on the grounds of selling a defective product much like a manufacture of a toaster that bursts into flames. Indeed, the analysts themselves were unsure about the rating process and the models they were using to come up with ratings for the structured products.\(^2\) It was revealed in Congressional hearings that the debt analysts may have failed to recognize the higher level of risk associated with these derivative products and were engaged in giving out ratings to any issuer who paid for them.\(^2\) As the real estate bubble grew, Moody’s, Fitch and S&P doubled their revenues from $3 billion in 2002 to $6 billion in 2007.\(^2\) One recent complaint filed against the big three alleges that they “failed to conduct due diligence and willingly assigned the highest ratings to ...impaired instruments since they received substantial fees from the issuers,” and that this “cozy relationship” resulted in inflated ratings based on an outdated rating methodology.\(^2\)

D. Applying the First Amendment Shield

Still reeling from the subprime implosion, government and private investors are testing the extent of the First Amendment protection. In the pending case of Abu Dhabi Commercial Bank v. Morgan Stanley & Co.,\(^2\) institutional investors King
County, Washington and Abu Dhabi Commercial Bank brought a class action to recover losses stemming from a liquidation of notes issued by a structured investment vehicle. The eight defendants include S&P and Moody’s. The rating agencies claimed in their motion for summary judgment that they are entitled to immunity under the First Amendment, but the court disagreed. Noting that under “typical” circumstances the First Amendment normally protects rating agencies subject to an “actual malice” exception, the court relied on the Greenmoss and National Century cases (supra), stating that “where a rating agency has disseminated their ratings to a select group of investors rather than to the public at large, the rating agency is not afforded the same protection.” The court also rejected the defendants’ argument that their ratings were opinions. The judge found that the plaintiffs had sufficiently alleged that the rating agencies did not genuinely or reasonably believe the ratings they assigned to the rated notes to be accurate or to have a basis in fact. “As a result, the Rating Agencies’ ratings were not mere opinions but rather actionable misrepresentations.” For the same reasons, the defendants’ disclaimers that “(a) credit rating represents a Rating Agency’s opinion regarding credit quality and is not a guarantee of performance or a recommendation to buy, sell or hold any securities,” were deemed unavailing to protect the defendants from liability for promulgating misleading ratings.

CONGRESSIONAL AND SEC RESPONSES

In addition to First Amendment protection, ratings agencies also have been shielded from liability for everything except fraud under federal securities law. In 2006, Congress passed the Credit Rating Reform Act (CRARA), pursuant to which the SEC liberalized the ground rules whereby a credit rating agency can become an NRSRO. Although that act achieved its goal of expanding the number of NRSROs, it did nothing to prevent the inflated ratings so intertwined with the financial meltdown. Nor did it significantly increase competition, as Moody’s, Fitch and S&P still maintain an 85% market share. Relatively weak new rules were enacted, but they still did not tackle the “critic-for-hire” problem.

The SEC’s new rules were released in the Federal Register on November 23, 2009, and went into effect in June, 2010. When an issuer, underwriter or other offering participant uses a credit rating to market its securities, more credit ratings history and disclosure are required in the prospectus and registration statements. Disclosure must include general information regarding the scope of the credit rating, potential conflicts of interest (such as other services and fees paid to the credit rating agency), and all preliminary or final credit ratings obtained from other credit rating agencies for the same class of securities. The last requirement is designed to help investors identify potential instances of ratings shopping. The SEC has deferred, however, consideration of a rule that would have required NRSROs to report the ratings methodologies and particular credit risk characteristics for structured finance products.

Under CRARA, the substance of credit ratings and the procedure and methodologies by which NRSROs determined those ratings were protected from SEC and state regulation, though there was a narrow exception for state actions brought on tort grounds. The federal preemption defense may come into play as state attorneys general seek redress in the foreclosure crisis. For example, in 2008, Connecticut attorney general Richard Blumenthal filed suit against the credit rating agencies on a fraud theory, alleging violation of Connecticut’s Unfair Trade Practices Act.
Pressure to enact stiffer regulations intensified in the months leading up to the passage of the sweeping Wall Street Reform and Consumer Protection Act, signed into law July of 2010 (Financial Reform Act). In December of 2009, the SEC had announced that it was considering rescinding Rule 436(g) which insulated NRSROs from potential liability under Section 11 of the Securities Act for material misstatements or omissions in a registration statement. The Financial Reform Act eliminated the exemption. NRSROs and other credit rating agencies will now be on an equal footing. Companies that include a credit rating in their registration statement will need to obtain the consent of the rating agency for the use of its name in the prospectus, in the same manner as consent is required from auditors. The rationale is clear: when ratings are used to sell securities, investors rely on NRSROs as experts, and they should be subject to the same liability as are other experts, such as auditors. Recission of Rule 436(g) should cause rating agencies to improve the quality of their ratings and analysis in order to reduce their risk of liability.

The Financial Reform Act embraces many of the provisions that were included in related House and Senate Bills introduced in 2009. The Rating Accountability and Transparency Enhancement Act (the RATE Act), incorporated under Title V, Subtitle B, of the Financial Reform Act, requires the SEC to review credit ratings and methodologies employed by NRSROs. It also directs the SEC to create and enforce rules to prohibit, or manage and disclose conflicts of interest, as well as to establish a compliance office. A critical component of the RATE Act is to modify the scienter requirement in a private action for monetary damages against an NRSRO. It will be sufficient for plaintiffs to state with particularity acts giving rise to a strong inference that the NRSRO knowingly or recklessly failed either to conduct a reasonable investigation of the rated security or to obtain reasonable, independent verification of the factual elements relied on to evaluate credit risk.

Congress also directed the SEC to study and report within a year on (1) a system that assigns NRSROs on a rotating basis to issuers seeking a credit rating; (2) the effect of new requirements on NRSRO registration; (3) credit ratings of different classes of bonds; (4) meaningful multidigit ratings system; and (5) ratings standardization. The Comptroller General must likewise study and report to Congress on the implementation of the RATE Act, including (1) the appropriateness of relying on ratings for use in federal, state, and local securities and banking regulations, as well as for determining capital requirements; (2) the effect of liability in private actions due to rescission of Rule 436(g); (3) alternative means for compensating credit rating agencies that would create incentives for accurate credit ratings; and (4) alternative methodologies to assess credit risk, including market-based measures.

ARE THE PROBLEMS BETTER LEFT IN THE INVISIBLE HANDS OF THE FREE MARKET?

One of the solutions proposed to address this crisis was to do nothing and leave it to market forces to assign a value to the work done by the raters. Not surprisingly, one of the strongest supporters of this solution has been Deven Sharma, President of S & P. He argued that the NRSRO ratings were interpreted by some investors as a “government seal of approval” instead of using them as one piece of additional information they could use to assess risk. If investor rating requirements are removed, newer ratings agencies can enter the market facilitating appropriate flow of capital through the debt ratings.
There is no broad support for such an argument. If history has taught us anything it is that:

- Ratings agencies will continue to have conflicts of interest and analysts will get "routinely bullied" by the companies paying for such ratings.69
- Only a handful of rating agencies have been dominating the industry for several decades and without proper reforms there is no room for any new small agency to enter the industry.
- Some experts believe that imposing explicit disclosure requirements may force the agencies to take their debt ratings more seriously. If the disclosure rules pertain to historical facts such as the relationship between the ratings and the actual defaults, this type of information could be fairly easy to file with no major resistance from the agencies. However, if the rules require the agencies to disclose immediately information such as the data & the proprietary methodology used, the raters may be reluctant to comply with the rules as they may not be able to make any money for the ratings. Any disclosure rules imposed on the ratings agencies would necessarily require a reasonable time frame during which the agencies need to complete the necessary paperwork.50 Such a lag in time would defeat the purpose of extra disclosure as the investors would have already made their decision based on the assigned ratings.
- Requiring additional labels (e.g. S for structured products) may not be helpful, especially if in the future any products are introduced by the investment banks under new non-derivative sounding names.51 Usually rules and regulations lag significantly behind the new changes taking place in the marketplace and do not win at the catch-up game.

In other words, the only viable change that may effectively protect investors is to give them the power to sue the raters under expanded theories of liability.

CONCLUSION

Unlike Enron, where the ratings agencies had no reason to know that the company's managers and auditors were engaged in systematic fraud and manipulation of the company's balance sheet, in the instant cases, the rating agencies were actively involved in structuring the very products they rated. States, institutional and private investors alike were caught in the subprime implosion. The rating agencies should not be allowed to hide behind either the First Amendment or their government-sanctioned status as NRSROs. Courts should hold these agencies responsible for their misrepresentations, and Congress has appropriately responded with strong new regulation and expanded liability for private actions under the Securities Exchange Act of 1934. Rating agencies should be treated as experts and held to the same standard as auditors. The SEC's and Comptroller General's reports to Congress next year on implementation of the RATE Act will be critical in assessing what further steps should be taken to regulate the credit rating system as part of the larger agenda of achieving true financial reform.

4 FRANK J. FABOZZI, FIXED INCOME ANALYSIS, 421-461 (John Wiley & Sons, Inc. 2d ed. 2007).
8 Id.
9 In re Fitch, 330 F. 3d 104 (2d Cir. 2003); American Savings Bank, FSB v. UBS Painewebber, Inc. WL 31833223, 31 Media L.Rep 1444 (S.D.N.Y. 2002).
11 Id.
12 Id. at 21.
14 Id. at 817.
17 Dun & Bradstreet, 472 U.S. at 759-60.
18 Id.
20 Id. at 640.
22 Id. at *3.
23 In re Fitch, Inc., 330 F.3d 104 (2d Cir. 2003). Pan Am Corp. v. Delta Air lines (In re Pan Am Corp.), 161 B.R. 577 (S.D.N.Y. 1993). The court found that Standard and Poor’s had the “requisite newsgathering intent” and therefore the journalist’s privilege applied.
24 Grade Inflation, supra note 7.
25 Id.
26 WILLIAM D. COHAN, HOUSE OF CARDS: A TALE OF RUBRIS & WRETCHED EXCESSES ON WALL STREET 331-32 (Doubleday 2009).
27 Id.
28 Larry P. Ellsworth and Keith V. Porapaiboon, Credit Rating Agencies in the Spotlight, 18 BUSINESS LAW TODAY 1, No. 4 (2009).
32 Id. at 175.
33 Id.
34 Nagy, supra note 30 at 148, citing 17 C.F.R. section 230.436(g)(1)(2007) which mandated an express exemption for NRSROs from liability under section 11 of the Securities Act of 1933.
36 David Segal, Rating Agencies’ Overhaul Seems to be Losing Steam; Some See Loss of Political Will in Congress, HOUSTON CHRONICLE, Dec. 8, 2009, at 10.
40 Ellsworth and Porapaiboon, supra note 28 at 3.
43 H.R. Con. Res. 4173, supra note 41, Title V, Subtitle B: Accountability and Transparency in Rating Agencies Act (Sec. 6012).
44 Shearman & Sterling, supra note 42.
46 H.R. Con. Res. 4173, supra note 43 (Sec. 6003).
47 Id. (Sec. 6013).
IRS PRESSES FOR TRANSPARENCY ON TAX ACCRUALS

By

Martin H. Zern *

The art of taxation consists in so plucking the goose as to procure the greatest quantity of feathers with the least possible amount of hissing.

—JEAN-BAPTISTE COLBERT

I. INTRODUCTION

Recently, the Internal Revenue Service (IRS) announced that corporations and businesses generally will be required to reflect on their tax returns any tax position that is considered inconsistent with Financial Accounting Standard Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or similar financial reporting standards. To this end, the IRS has developed a new form (Form 1120 Schedule UTP) that will have to be filed annually by some corporations.

Clearly, the IRS is seeking more transparency from corporations and businesses in general regarding their tax planning ventures, which some may categorize as tax evasion schemes or even scams. No doubt the government’s stance is attributable to its need for more revenue and the overall tone of hostility by much of the general public to large corporations in light of the recent — and perhaps continuing — financial crisis. Many believe that corporations are unfairly reducing their tax liability by utilization of aggressive corporate tax shelters that often have no purpose other than tax reduction.

50 Scannell and Lucchetti, supra note 1.