

The hidden pitfalls of the JOBS Act

Eleanor Bloxham Mar 27, 2012



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FORTUNE -- We are moving into a new, even more freewheeling, anything-goes economy. Ready to throw the dice and take your chances?

The JOBS Act [passed](#) the Senate last week and the House passed it on Tuesday, sending the bill to President Obama to sign. Ostensibly designed to make it [easier](#) for companies to raise capital, [the act](#) has some dangerous elements for both investors and taxpayers. To its credit, the SEC warned Congress of the risks in a [letter](#) from Chair Mary Schapiro. Not only will some who invest in private companies face more risk, public companies will now be riskier to invest in (and work for) too.

[Most Powerful Women](#) Jane Fonda Reveals She Was Raped and Sexually Abused as a Child

The bill is part of an overall reshaping of the capital markets, producing new minefields that investment managers must step around. These investment minefields include products from banks that still appear to be [out of control](#), companies with runaway executive compensation, and proposed IPOs with draconian features.

The JOBS Act is aptly named. The upshot of this reshaping is that jobseekers will need to do even more due diligence on economic sectors and particular companies if they're looking for a stable gig. And due to some provisions in the JOBS Act, there may be less trusted information out there.

Any jobs coming from this JOBS Act?

It's unclear what [kind of jobs](#) the JOBS Act will actually create. The bill is a hypothesis without the tests or the results. Perhaps, you'll see more ads for forensic accountants, criminologists and plaintiffs' lawyers. University of Missouri Law professor Bill Black and University of California professor Henry Pontell [wrote](#) on the Huffington Post that

“The JOBS Act is so criminogenic that it guarantees full-time jobs for criminologists” while the “bill will kill millions of jobs” because of its “fraud-friendly provisions.”

Provisions of the JOBS Act modify rules put in place following the Great Depression. For certain companies with up to \$1 billion in revenues (not a small firm by any measure), the act lessens the requirements now in place for financial statement audits, governance standards, and other controls. Provisions in the act also open the door to more conflicts in Wall Street research reports, that “would benefit Wall Street, at the expense of Main Street,” according to a [speech](#) by SEC Commissioner Luis Aguilar.

We seem doomed to repeat history. If we have learned anything from the financial crisis, it's that repealing major corporate governance, conflict of interest, and other regulatory safeguards is a bad idea for everyone. “While there needs to be a regulatory balance,” says Darren Robbins, a partner at law firm Robbins, Geller, Rudman and Dowd, “the burdens and costs of inadequate regulation have impacted us in unprecedented ways as private and public pension funds have lost trillions of dollars in the wake of the repeal of [Glass-Steagall](#) and the passage of [Gramm-Leach-Bliley](#) and the [Private Securities Litigation Reform Act](#).”

So it seems like we are on a path to kick sand in the face of hard-fought wisdom. Despite experiencing the worst crisis since the Great Depression just a few short years ago, investment banks and some commercial banks continue to operate in a way that requires constant [adult supervision](#) from the SEC. Out of control executive compensation shines a light on board laxity and fuels [economic instability](#). And the [imperial CEO](#) is making a revival, only now wearing a T-shirt. Bellowing “[my company, my board](#),” new wizards of technology and finance are [proposing IPOs](#) (like Facebook and Carlyle) that ensure no top manager accountability to others as they virtually eliminate any [shareholder rights](#) for recourse aside from taking the companies to court.

True, if you are investing your own money, you can do what you like. You can play the horses, pull the slot machines, participate in crowd funding, or buy stocks in the market, which appears more like a casino than ever. The more money you have, the greater risks you are allowed to take under the new bill and existing regulations. So knock your socks off. It's unclear, however, if taxpayers will be racing to rescue your investment choices. And I sincerely hope you do not intend to use taxpayer money clogging the courts when the stocks -- without audited financials and adequate controls -- tank.

Investing vs. gambling

But that's less than half the story because this free-for-all will create a split between responsible investors and irresponsible gamblers. And it should dry up certain kinds of capital for companies that do not voluntarily comply with basic governance and control standards.

That's because there is something called [fiduciary duty](#). People who manage other people's money are obligated to adhere to these requirements. The concept of fiduciary duty originated with the Crusades, according to Bob Monks, founder of LENS Investment Management. When knights sallied forth, they needed to entrust their property to someone who would watch over it and take care of their family if they did

not return. Those who are entrusted are called fiduciaries and they are legally obligated to be prudent. These laws are there to protect your mutual fund investments and pension funds. They are there to ensure investment managers -- who get paid a fee to choose assets on your behalf -- act in your interest.

So fiduciaries have their hands tied. As a fiduciary, it isn't prudent to invest in companies where you know important controls are missing or in companies where there is no real accountability to shareholders. It also isn't all **that prudent** to invest in products -- like CDOs or auction rate securities -- manufactured by investment banks that **regulators** and other stakeholders have **said** can no longer **be consistently trusted**. And unless you intend to turn the situation around, it's not a good idea to invest in companies, Monks says, that are "profligate with compensation." Compensation is "insightful as to the quality of management, and if an investment manager doesn't consider it, they're liable for a breach of fiduciary duty," he says.

Regrettably, some investment managers just don't want to live up to the standard. They say they must have diversified holdings. But that doesn't curb the risk in current markets -- and they know it. It really isn't sensible to rely on diversification as your only measure of prudence when you've seen the result: trillions of dollars lost.

Sure, you can buy any equity security the law says you can, but your investment manager shouldn't. And you can invest in products created by Wall Street magicians.

But no investment manager should do that with your money unless they do their own, in-depth, expert due diligence -- when that's even possible or worth the cost.

If an investment manager or pension fund "gambles with people's money and has been warned, that's high risk and there could be claims," Robbins told me.

Investment managers, pension funds, mutual fund boards and trustees: you've been warned.

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