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The Small Business and Enterprise Reform Bill proposes reforms to the regime for disqualifying company directors in England and Wales, aimed at restoring market trust in the financial services market and in business generally, by increasing the accountability of company directors. This paper examines whether disqualification is an appropriate tool to achieve these goals. It considers the different forms of trust and trustworthiness that regulation can promote, and how. It argues that disqualification is a poor means of promoting intrinsic commitments to trustworthiness which would provide the greatest protection to market participants, and may have limited impact in encouraging trustworthiness for extrinsic reasons. Importantly it is a poor tool for addressing the loss of trust in the financial services market and the present focus on disqualification deflects attention from more pressing questions, namely how best to promote accountability of directors both in financial institutions and in dispersed share-ownership companies generally.

A. INTRODUCTION

In July 2013 the Government launched a Discussion Paper, Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business (‘the Discussion Paper’) proposing reforms to the UK disqualification regime for company directors contained in the Company Directors Disqualification Act 1986 (‘the CDDA’). Just one month previously the Parliamentary Commission on
Banking Standards (‘PCBS’) had published its Final Report in which it had criticised the fact that:

‘Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility. Top bankers dodged accountability for failings on their watch by claiming ignorance or hiding behind collective decision-making.’¹

As the PCBS recorded, this had led to public anger and to demands for greater accountability from those ‘at the highest levels of the banks’.²

At the launch of the Discussion Paper, the then Business Secretary, in a speech entitled ‘Trust: Why It Matters’ acknowledged the PCBS’s criticisms and set out the Government’s proposals ‘to create, or restore, trust in market transactions’.³ Referring to ‘people apparently responsible for major corporate failures seemingly going unpunished, particularly at the banks’⁴ he stated that this lack of accountability had caused the public to question the adequacy of the disqualification regime.⁵

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¹Professor of Law, Centre for Business Law and Practice, School of Law, University of Leeds. I would like to thank Professor Andrew Keay for his comments on an earlier draft of this article.


⁵Supra n 3. See also, ibid, pp 61 and 64.
However the reforms were not only a response to pressure to increase accountability of senior individuals in financial services. They were also part of the Government’s overarching policy of ‘Making Companies More Accountable to Shareholders and the Public’, directed at companies generally. This had been launched, according to the Government, to address a loss of trust by shareholders and the public in the way that companies in general were run and the perception that companies and those who ran them were being rewarded for failure not success. Reform of disqualification was said to be required to deal more effectively with directors involved in ‘phoenix companies’, educate other directors and provide compensation for creditors.

The reforms therefore had two goals. Firstly, along with other industry specific initiatives, they were intended to address the loss of market trust caused by the conduct of those in the banking sector following the financial crisis, by increasing the accountability of directors in that sector. Secondly they were intended to promote trust in companies and the business environment more generally.

This paper examines the Government’s resort to disqualification to achieve these goals. It will argue that the disqualification regime is a poor means of addressing the loss of trust in the banking and financial services market. It may be more successful at promoting trust in the market generally for those dealing with owner-managers but

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6 See Gov.UK, Company Ownership: Transparency and Trust Discussion Paper

7 Supra, n 3.

8 See B. Ferguson, “The Personal Accountability of Bankers” herein.
there is little evidence that there has been a loss of trust in the general business environment. In addition even in the context of owner-managers the disqualification regime may not be the most effective regulatory tool for creating market trust.

The article is organised as follows. It first provides a brief overview of the disqualification regime under the CDDA and of the proposed reforms. It then considers the meaning of trust and trustworthiness and why they are economically important. Then, in order to identify the scale and nature of the problem that the proposed reforms seek to address, it considers whether there is evidence of a lack of market trust in financial services and the general business environment. The next section considers how regulating for accountability might address a loss of trust. The penultimate section draws together and applies the previous discussion in the context disqualification to assess how effective it could be in promoting market trust in the business environment generally and in financial services. The article concludes by considering the wider political context of the reforms.

B. THE DISQUALIFICATION REGIME AND PROPOSED REFORMS

The CDDA sets out a range of grounds upon which individuals can be disqualified, that is, prohibited from acting as directors of a company, receivers of a company’s property or being concerned or taking part in the promotion, formation or management of a company directly or indirectly. The most common basis for disqualification is found in section 6 which provides for mandatory disqualification when a court is satisfied that a director’s conduct as a director of an insolvent

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9 CDDA, s 2-s 5, s 6, s 8, s 9, s 10-s 12.
10 CDDA, s 1.
A company makes him unfit to be concerned in the management of a company. The minimum period of disqualification under section 6 is two years and the maximum fifteen years.11

Directors may also be disqualified for unfitness under section 8 of the CDDA. This differs from section 6 in that disqualification is discretionary, there is no minimum period of disqualification, and there is no requirement for the company to have become insolvent. Rather, disqualification occurs following an investigation into the company’s affairs on the application of the Secretary of State, where it appears from investigative material that it is expedient in the public interest to disqualify the director.12 Disqualifications under both sections can take place by way of court order or by way of undertaking, which avoids the need for court involvement, but otherwise the effect of an undertaking is exactly the same as a disqualification order.13

The Discussion Paper proposed several reforms to this regime including that: the nature and number of previous company failures a director has been involved in could be taken into account in determining unfitness;14 those subject to foreign restrictions on being directors, or who had been convicted overseas of a criminal offence in relation to the management of an overseas company could be disqualified;15 that the time limit for bringing disqualification proceedings should be extended;16 that disqualified directors should be subject to a period of training or

11 CDDA, s 6(4).
12 CDDA, s 8(1)-(4)
13 CDDA, s 1A. Breach of an order or undertaking is a criminal offence. Directors can also become personally liable to creditors: CDDA, s 13 and s 14.
14 Discussion Paper supra, n 4, p 68
15 Ibid, p 80.
16 Ibid, p 74
and that courts should be able to make compensation orders against disqualified directors of insolvent companies. There were also proposals more directly targeted at financial services including proposals to grant sectoral regulators such as the Financial Conduct Authority (FCA) the power to disqualify and allowing courts and the Secretary of State to take account of material breaches of sectoral regulations and the wider social impact of a director’s conduct when determining unfitness. Although not directly relevant to disqualification, the Government also consulted on amending directors’ duties in the Companies Act 2006 to make the promotion of financial stability over the interests of shareholders the primary duty of bank directors, which had been recommended by the PCBS as a way of making directors of financial institutions more accountable.

In April 2014 the Government published a revised set of proposals, subsequently incorporated into the Small Business, Enterprise and Employment Bill (the Bill). These watered down the reforms targeted at financial services and banking. Thus the proposals to amend the duties of bank directors and to grant sectoral regulators

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17 Ibid, p 77.
18 Ibid, p 70.
19 Ibid, p 62.
21 Ibid, p 61.
22 PCBS, supra n 1, para 124.
25 Government Response, supra n 23, para 258.
powers to disqualify were dropped. However the Bill removed restrictions on the material that the Secretary of State may rely on to determine whether a director is unfit under section 8 of the CDDA, which should enable sectoral regulators and the Insolvency Service to exchange information more easily, and provides that material breaches of legislative or other obligation such as sectoral regulations can be taken into account when assessing unfitness, along with the nature and extent of any harm caused by a director’s conduct. The majority of the more generally targeted reforms were retained, including compensation orders. Proposals to permit the disqualification of persons who instruct directors to act in unfit ways, and to allow liquidators and administrators to assign causes of action against directors to third parties were added. Plans for the compulsory education of disqualified directors were dropped.

At the time of writing the Bill has not yet received Royal Assent.

C. TRUST AND TRUSTWORTHINESS

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26 Ibid, para 257.

27 cl 109.

28 Government Response, supra n 23, para 253.

29 cl 106, amending Schedule 1 of the CDDA.

30 This is not a comprehensive overview of the reforms. For that, see J Tribe, Disqualification Newsletter Issue 57 (LexisNexis, August 2014).

31 cl 110

32 cl 105.

33 cl 118.

34 Government Response, supra n 23, para 194.
Although creating market trust was the objective of these reforms, the Government did not explain what exactly was meant by market trust. As it is, there is no settled consensus on how to define and measure trust, or its counterpart, trustworthiness. In relation to trust, one approach considers how people act: they trust if they place their resources at the disposal of another, or make themselves vulnerable to that other.\(^{35}\) A second definition refers to the trustor’s belief that a “counterpart in a transaction will not take advantage of him”\(^ {36} \) whilst a third refers to the inclination to believe that others will act for one’s benefit and will not take advantage of one if an opportunity to do so arises.\(^ {37} \) The first definition is not concerned with why a trustor acts as they do, whilst the second, which can be termed calculative trust, counts as trust the belief that one will not be exploited because it would be too costly for the trustee to act in an untrustworthy way.\(^ {38} \) Some, though, take the view that calculative trust is not real trust and is better described as reliance.\(^ {39} \) The last definition therefore excludes


calculative trust and emphasises that trust involves relying on the trustee’s goodwill to motivate them to act in the trustor’s interests. Another area of disagreement concerns the type of conduct that harms trust: some consider that only opportunistic and disloyal behaviour harms trust,\(^{40}\) whilst others assume that trust encompasses an expectation that another will act competently and without negligence.\(^{41}\)

Trustworthiness meanwhile has been defined as an unwillingness to exploit another person’s vulnerability\(^{42}\) but the reasons for this unwillingness can differ in important respects. A person may be trustworthy for calculative reasons, that is because the benefits of doing so outweigh the costs,\(^{43}\) (calculative trustworthiness) or they may be trustworthy even when external incentives favour betrayal, for intrinsic reasons such as altruism, or adherence to professional values (intrinsic trustworthiness).\(^{44}\) Research suggests that people’s motivations to act trustworthy may result from a combination of intrinsic commitment and extrinsic calculative considerations, with the latter shoring up the former, particularly when the costs of acting trustworthy are high.\(^{45}\)

\(^{40}\) Guiso, supra n 36, 6-7.

\(^{41}\) Baier, supra n 39, 238; Jones, supra n 37, 6-7; C Mayer, “Trust in Financial Markets” (2008) 14 European Financial Management 617, 627; Ben-Ner and Halldorsson, supra n 37, 65.

\(^{42}\) Blair and Stout, supra n 37, 1746.

\(^{43}\) Ibid, 1747-1750.

\(^{44}\) Gold supra n 39, 133-134.

It might be thought that policy-makers need only be concerned with behavioural definitions of trust, since their primary concern is to raise levels of trusting conduct so as to encourage greater market participation, rather than exploring why people act this way. To an extent this is true, but beliefs about how a trustee will act are likely to influence whether a person will act in a trusting way, and these beliefs can be influenced in turn by the conduct of the trustee. So if a trustee acts in an untrustworthy fashion, this will negatively affect a trustor’s belief in their trustworthiness and the extent to which the trustor will act in a trusting way. As Kay said in the context of financial services, “the erosion (of trust) is not a result of misplaced public perception, which can be addressed by a public relations campaign; it is based on observation of what has happened”. So to restore trust policy-makers must be concerned not only with measures that promote behavioural trust, but also measures to promote trustworthiness. This will also ensure that trust is not misplaced which is itself costly both for individuals and the economy. Misplaced trust, not lack of trust, was the primary problem in the financial services market prior to the crisis. Furthermore policy-makers may be concerned about the type of trustworthiness

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47 Fehr, ibid, 261-262.


50 Brescia, supra n 45, 1376-1377.
encouraged by regulation: when the potential for exploitation is high due to information asymmetry between the trusted and the trustee, such as between sellers of financial products and purchasers, and between directors and creditors in owner-managed companies; when detecting misconduct is difficult; and when other external incentives for calculative trust are weak, regulators should seek to encourage intrinsic trustworthiness to ensure that trusting behaviour is not exploited.

D. TRUST AND THE MARKET

The economic importance of trust has long been acknowledged and the literature on the subject is vast. As Arrow’s well known claim put it, ‘Virtually every commercial transaction has within itself an element of trust….much of the economic backwardness in the world can be explained by a lack of confidence’. Economists have shown a positive correlation between economic performance and per capita income and levels of trust in a country and that increases in levels of trust in a population are linked to increases in GDP growth, though it is not clear whether trust causes these effects, or is caused by them. Trust matters in all markets, reducing transaction costs because, for example, parties have less need to negotiate detailed contracts to protect themselves, and it encourages greater economic

51 K Arrow. “Gifts and Exchanges” (1972) 1 Philosophy and Public Affairs 343, 357.
activity. Trust is seen as particularly important in financial markets due to special features of that market such as information asymmetry that makes it difficult to rely on monitoring to control the trusted person’s conduct. It may be important for the growth of equity markets when investor protection is low, though it also has a role where legal protections are good, but enforcement expensive. A lack of trust in financial markets can reduce investors’ willingness to invest in equity, and direct investment to more secure assets, thus reducing investor diversification and raising the cost of equity capital for companies, rendering it unavailable for smaller businesses.

Low levels of trust in the UK business environment would therefore be problematic and justify a policy response, which has come in the form of reforms to disqualification. As disqualification targets owner-managers of insolvent companies,

55 Knack and Keefer, supra n 52, 1252-1255. For recent data that supports these findings see Edelman Trust Barometer 2007 [http://www.slideshare.net/fullscreen/edelman.milan/edelman-trust-barometer-2007/12](http://www.slideshare.net/fullscreen/edelman.milan/edelman-trust-barometer-2007/12) at p 34 (accessed 24 January 2015) detailing actions that people report having taken against companies that they do not trust including refusing to buy their products and refusing to invest in them.


58 The Kay Review supra n 48, p 26; L Guiso, P Sapienza and L Zingales, “Trusting the Stock Market” NBER Working Paper 11648 (September 2005) 2-4, 23, 27; Guiso, supra n 36, 11-14; Armstrong, supra n 54, R4-R5;

59 An empirical survey conducted in 1997 found that 75% of those disqualified were owner-managers: A Hicks, Disqualification of Directors: No Hiding Place for the Unfit? (ACCA, Research Report 59,
this in turn suggests that their activities have undermined market confidence. Certainly, when announcing the reforms the Government highlighted the harm that ‘rogue directors’ were causing.60 The Discussion Paper, meanwhile, argued that there was a need to pursue such directors in order to provide ‘reassurance that we operate a level playing field, (which) creates an environment in which honest entrepreneurs are willing to invest in activities promoting growth and employment.’61

The rhetoric echoes the debate that led to the introduction of the present disqualification regime following the Report of the Review Committee on Insolvency Law and Practice (‘The Cork Report’).62 This recorded a widespread perception, bred by corporate collapses, and the press that ‘cowboy’ directors were ‘getting away with it’. Consumer affairs programmes and the media campaigned for action to be taken against ‘rogue directors’.63 Reforms to disqualification at that time could therefore be viewed as a response to public anxiety over the issue of owner-manager ‘rogue directors’ which in turn may have been impacting on levels of trust in the market.


61 Discussion Paper, supra n 4, para 6.2


However an analysis of the Nexis database of UK newspapers does not suggest that the Bill was responding to similar concerns. Following the introduction of disqualification undertakings in 2003, few reports raised concerns over rogue directors. Between 2004 and 2006 and in 2008 and 2010, there were no stories, or only one story per annum relating to rogue directors. In 2009, 2011 and 2012 a total of six reports raised concerns about rogue directors abusing pre-pack administrations, and one in 2009 detailed the disqualification of a rogue director who had breached trade sanctions. But in 2013 the picture changed. Thirteen stories mentioned rogue directors: two concerned worries over budget cuts to the Insolvency Service; two, the lack of accountability of rogue directors in dispersed share-ownership companies; one, the abuse of pre-pack administrations; and one reported a disqualification. The remaining eight however concerned the Government’s reforms to the disqualification regime and its announcement that these would ‘crack down’ on rogue directors. Again in 2014 there were twenty-eight reports, but none raised concerns about the activities of rogue directors. Sixteen related to the Government’s proposed ‘clampdown on rogue directors’ and three reported on increases in the numbers of directors disqualified. A further nine reported that reforms to the recovery of costs in insolvency litigation were likely to lead to a reduction in litigation against rogue directors. In short, the increased focus on rogue directors appears to have been instigated by the Government’s reforms, rather than being a response to market concerns over the activities of such individuals.

It might be objected that this does not take account of public concern, recorded in the media, over fraudulent investment schemes such as land-banking.

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64 See for example, J Dean, “Reforms ‘Will Help Rogue Directors Keep the Cash’”, The Times 21 April 2014.
wine investment and carbon credit schemes. The Government cited such frauds when justifying its disqualification reforms.\textsuperscript{65} However enforcement activity by the Financial Services Authority (FSA), the FCA and the Insolvency Service had already led to a substantial reduction in this activity, raising questions over the need for further action.\textsuperscript{66}

It might also be justifiably argued that media reports are not reliable reflections of levels of public concern. However there is little evidence from elsewhere that there has been a collapse of trust in business generally.\textsuperscript{67} According to the Edelman Trust Barometer,\textsuperscript{68} in 2007 44\% of the British public surveyed trusted business to do what was right, \textsuperscript{69}a result that predated the financial crisis.\textsuperscript{70}

\begin{itemize}
\item \textsuperscript{65} supra, n 60.
\item \textsuperscript{66} S Read, “Eight are Charged by FCA Over £5m Landbanking Fraud”, The Independent 18 April 2013 recording that only six cases of landbanking fraud had been reported to the FCA in 2012.
\item \textsuperscript{67} It has been said that constituents often raise phoenix trading with their MPs but it is unclear whether these concerns relate to pre-pack administrations or defects in the disqualification regime: L Conway, Phoenix Trading, House of Commons Library, 9 September 2014, 1.
\item \textsuperscript{68} The Edelman Trust Barometer is an annual survey across countries conducted by Edelman for the last 14 years. While World Values Survey is the most commonly used data source for country trust levels it last surveyed the UK in the 2005-2009 wave. It is acknowledged that survey data must be treated with some caution: see, for example, on the World Values Survey, Guiso, Sapienza and Zingales, supra n 57, 6. Edelman usually surveys only college educated individuals aged 34-65 whose income is in the top quartile for their country, though in the last three years have also surveyed the general public.
\item \textsuperscript{69} Edelman Trust Barometer 2012, \texttt{http://www.slideshare.net/edelman.milan/edelman-trust-barometer-2007} (accessed 24 January 2014) p 12: the public were asked to rate on a scale of 1-9 where 9 meant “Trust them a great deal” and 1 meant “Do not trust them at all”. The overall percentage is based on the total of those who gave scores of 6-9.
\item \textsuperscript{70} Ibid, p 2. The survey was carried out in October-November 2006.
\end{itemize}
levels dropped during the crisis but by 2013 and 2014 had increased and stabilised at 56%.\textsuperscript{71}

This may seem surprising, given the financial crisis and subsequent scandals led to a significant drop in trust in the financial markets.\textsuperscript{72} However the Edelman data suggests that levels of trust and distrust are not spread evenly throughout the market. On the contrary, trust in banks and financial institutions is substantially lower than in business generally. In 2007, pre-crisis, trust in banks was at 41% but by 2010 this had dropped to 21%,\textsuperscript{73} and by 2011, 16%.\textsuperscript{74} There was a slow recovery so that by 2014 trust in banks stood at 32%. Edelman separately canvassed trust levels for financial services, which were higher, jumping from a 34% trust level in 2013 to 44% in 2014. Nevertheless financial services remained the fourth least trusted industry ahead of the media, energy and the banks, and trust levels in financial services were some 12% lower than trust in business generally.\textsuperscript{75} Since the crisis trust in business has generally outstripped that in banks and financial services, whereas prior to the crisis trust-levels were similar. Furthermore levels of trust in business are presently higher

\begin{footnotesize}

\textsuperscript{72} F Roth, Who Can be Trusted After the Financial Crisis? CEPS Working Document No 322 (November 2009) 23-32; Guiso, supra n 36, 3-6.

\textsuperscript{73} Edelman Trust Barometer 2010 supra n 76, slide 15.

\textsuperscript{74} Edelman Trust Barometer 2011 supra n 76, slide 16.

\textsuperscript{75} Edelman Trust Barometer 2014 UK Results http://www.slideshare.net/Edelman_UK/edelman-trust-barometer-2014-uk-data slide 25
\end{footnotesize}
than before the crisis whereas trust in banks and financial services continues to be lower.

In sum, while encouraging higher levels of trust in business generally may well be desirable because it can boost economic growth, there is no evidence of a crisis in market confidence as a result of activities of rogue directors of owner-managed companies. There are however continuing low levels of trust in the banking and financial service market.

E. TRUST, REGULATION AND ACCOUNTABILITY

The Government asserted that regulation that promoted accountability would increase market trust, but the precise way in which this would occur was not explored further. Yet the link between accountability and trust is obscure, and that between trust and regulation contentious. Like trust, there are many definitions of accountability but the Government appears to have equated it with legal and regulatory mechanisms that sanction those who breach the law. Thus the Discussion Paper stated that it was necessary to strengthen the disqualification system in order to pursue ‘the small minority of company directors that don’t follow the rules’ to ensure that the UK was a ‘trusted place to do business and invest’.

Stronger regulation may be necessary to address a loss of trust in the regulatory system and the law caused by a failure to hold individuals accountable for

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76 Zak and Knack, supra n 53, 307-308


79 Discussion Paper, supra n 4, p 5 and also p 53.
conduct that causes harm, such as occurred after the financial crisis. This, though, does not resolve how promoting accountability through sanctions can promote market trust. There are a number of possibilities.

Thus regulation may promote calculative trust by reassuring market participants that untrustworthy individuals will be removed from circulation, or that the law will reliably enforce promises, or to make it more likely that market participants will be compensated for losses they suffer from untrustworthy conduct. Regulation may also require individuals to provide an account of their conduct that allows market participants to judge whether those individuals can be trusted. These regulatory outcomes increase the probability that market participants will benefit from entering the market, or at least not suffer a detriment, and so encourage trust behaviour, but they do not necessarily increase levels of trustworthy conduct. In order to do this, regulation needs to alter trustees’ behaviour. Since the reform proposals seek to promote accountability by increasing directors’ exposure to legal sanctions, it appears that the Government is seeking to achieve behavioural change through deterrence. This can promote calculatively trustworthy behaviour by counteracting the weakness of other external incentives to behave well, such as the need to maintain a good reputation or to avoid social sanctions. The prospect of accountability through regulatory sanctions may therefore cause an otherwise untrustworthy person to calculate that it is better for them to behave well.

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80 O’Neill, supra n 46, 180-181.
81 Williamson, supra n 38, 463.
82 I Ayres and J Braithwaite, Responsive Regulation: Transcending the Deregulation Debate, (Oxford University Press, 1992), 19; Jones and Welsh, supra n 45, 369.
Furthermore insofar as other market participants believe regulation has this effect, calculative trust may be encouraged.

However promoting trust and trustworthiness in these ways is subject to well-recognised limitations, namely that the regulated must be subject to a realistic possibility of sufficiently serious consequences. If either regulatory penalties are too low to deter, or if the chances of detection are low, then untrustworthy behaviour will continue and untrustworthy individuals will remain in the market. It is also important that that those whose trust is being sought perceive regulation to be effective, otherwise trust will not materialise, and that this perception is accurate, otherwise trust may be misplaced.

It would be preferable therefore for regulation to encourage intrinsic trustworthiness. Experiments on trust suggest that carefully designed regulatory strategies might be able to do this. Thus Fehr and List found that people were more trustworthy when trustors could threaten to sanction them for being untrustworthy, but did not do so. Trustworthiness decreased when sanctions were threatened. One explanation may be that the non-use of available sanctions indicated to the participants that they were trusted and they reciprocated by behaving in a more trustworthy manner. However trustworthiness was also lower when sanctions were not available at all: it was important therefore that the possibility of sanctioning existed. This suggests that regulatory mechanisms that are most likely alter internal commitments to trustworthy conduct will resemble Ayres and Braithwaite’s

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84 Ibid; Ayres and Braithwaite, supra n 82, 19 and 39.
responsive models of regulation. These adopt an ‘enforcement pyramid’ whereby regulators first use negotiation to persuade the regulated to comply, escalating their response in the face of non-compliance and resistance, with sanctions being used only as last resort for the most recalcitrant.

Citing research on social dilemmas Stout and Blair have also argued that regulation can promote intrinsic trustworthiness more generally, because individuals’ conduct is influenced by what they perceive to be others’ expectations about appropriate conduct, and others’ actual behavior. By articulating norms of trustworthiness in judgments or regulatory rulings and guidance, courts and regulators can provide the regulated population with information of what is expected in particular contexts. In turn, this ‘social framing’ by authority figures can lead to the regulated internalizing trustworthiness as a social norm.

However empirical evidence on the link between regulation and trust is ambiguous. While it has been found that in countries with lower levels of trust there is more demand for, and higher levels of, regulation, the causal relationship between

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85 Ayres and Braithwaite also recognise the role of trust in their regulatory strategy: ibid, 48.
87 Blair and Stout, supra n 37, 1772-1773, 1796-1797.
88 Roth supra n 72, 28; Guiso, supra n 36, 14-15; P Aghion, Y Algan, P Cahuc and A Shleifer, “Regulation and Distrust” (2010) Quarterly Journal of Economics 1015; See also P Pinotti “Trust and Regulation: Addressing a Cultural Bias” (Bank of Italy, October 2009) at http://econpapers.repec.org/paper/bdiwptemi/td_5f721_5f09.htm (accessed 24 January 2015). Trust in much of this research is measured by responses to the World Values Survey that asks “Generally speaking would you say that most people can be trusted or that you need to be very careful in dealing with people”.

these factors is unclear. Some argue that regulation may promote trust,\(^89\) others that it counter-productively erodes it.\(^90\) Again, while lack of trust may lead to more regulation,\(^91\) regulation may not produce trust, but rather replace it. Thus where regulation is weak, such that parties cannot rely on the law to satisfactorily redress breaches of trust, trust levels must be higher before market transactions will take place.\(^92\) Meanwhile where trust levels are low, regulation is required to encourage market transactions.\(^93\)

Yet recent data suggests regulation may have some effect in increasing trust. The 2014 Edelman Trust Barometer found that of those who reported increased levels of trust in financial services, 62% attributed this to better government regulation and 61% to better enforcement of regulation.\(^94\) The same survey found that a decrease in trust in the media was associated with the view that the industry was under-regulated.\(^95\) Again, while 43% thought that business as a whole was not sufficiently


\(^90\) Carlin, Dorobantu, and Viswanathan, ibid, 323 where social capital is high; Aghion, Algan, Cahuc and Shleifer, supra n 88, 1046.


\(^92\) Guiso, Sapienza and Zingales, supra n 57, 3; N Vanston, Trust and Reputation in Financial Services (Foresight, Government Office For Science Driver Review DR30) 3.

\(^93\) Knack and Keefer, supra n 52, 1284.

\(^94\) Supra n 71, slide 26. The general public were surveyed for this response.

\(^95\) Ibid, slide 12
regulated, and 17% thought it was over-regulated, the figures for financial services were 64% and 4% respectively.96

How should this differing evidence on the effect of regulation be interpreted? It may be that the surveys measure different types of trust.97 But the findings are consistent with the idea that regulation might promote calculative trust, for example because those dealing in the market believe that regulation will provide sufficient incentives to deter untrustworthy conduct. The findings are not consistent with the idea that regulation promotes intrinsic trustworthiness, since the research suggests that trust levels remain low even when there is strong regulation. However this may be in part because the law and regulatory rules economists have considered are not aimed at, or successful at, altering the attitudes (and not just the incentives) of those regulated, so as to promote intrinsic trustworthiness. Law is not always primarily directed at altering behaviour.98 Even when this is a goal, it may seek to achieve this by altering extrinsic incentives only, that is, it may only be designed to promote calculative trust through deterrence.

Furthermore badly designed regulation may be counter-productive. Experiments on accountability have found that when those being held to account are required to justify a decision or action that they have already taken, accountability entrenches their commitment to that decision even if it is demonstrably incorrect.99

96 Ibid, slide 15
97 For the the World Values Survey question see supra n 88. For Edelman see supra n 69
98 J Stapledon “Regulating Tort”, in C Parker, C Scott, N Lacey and J Braithwaite (eds), Regulating Law, (OUP, 2004), 134.
Imposing sanctions can erode intrinsic trustworthiness in those being sanctioned.\(^{100}\) Thus regulation that promotes accountability through sanctioning is unlikely to alter internal commitments to trustworthiness in those being held to account. It might also erode intrinsic commitments to trustworthiness more generally, by signaling that people are not behaving trustworthily, thus altering the regulated population’s expectations regarding how others act.\(^{101}\)

However as Blair and Stout point out, caution is needed.\(^{102}\) Much social dilemma research explores expectations about how others within the participant’s group will act, and these groups are seldom large.\(^{103}\) There are difficulties in assuming that these outcomes can be generalised at a population level. On a smaller scale, norms of reciprocity and commitment can influence behavior. Thus experiments on trustworthy behaviour suggest if the subject expects that the person(s) he or she is dealing with will act in a trustworthy fashion towards him or her, they will reciprocate by also acting trustworthily.\(^{104}\) Again sanctions may be counter-productive because the person being sanctioned may reciprocate by ‘punishing’ the sanctioner’s hostile behavior through untrustworthy conduct.\(^{105}\) In contrast, in the regulatory context

\(^{100}\) Fehr and List, supra n 83.

\(^{101}\) Blair and Stout, supra n 37, 1772-1773, 1797-1798.

\(^{102}\) Ibid, 1777-1778


reciprocity is absent: those who are betrayed are not those who impose sanctions, and untrustworthy conduct does not punish the courts or regulators. Again, although some research demonstrates that people can be influenced by information about the attitudes and conduct of those with whom they have no dealings, it does not consider how sanctioning those others may influence a person’s intrinsic commitments.106 Finally, failing to sanction behaviour may undermine norms of behaviour by signaling that non-compliance does not matter.107 In sum it is probably unsafe to draw policy conclusions about the effect of sanctions on the intrinsic trustworthiness of the regulated.

Nevertheless the research suggests that regulatory mechanisms aimed at promoting intrinsic trustworthiness must be carefully designed if they are not to be counter-productive, and sanctioning should only be used as a last resort. Meanwhile the challenge for regulatory mechanisms that rely on sanctions and deterrence to alter extrinsic incentives for good conduct is to ensure that there is sufficient awareness of those mechanisms to support the development of calculative trustworthiness and trust.

F. ASSESSING DISQUALIFICATION


107 Jones and Welsh, supra n 45, 366-370.
In the light of the preceding discussion this section considers to what extent the disqualification regime is an appropriate remedy to promote market trust, taking account of the reforms in the Bill. It first considers the extent to which disqualification presently appears to promote market trust and the possible impact of compensation orders on calculative trust, before exploring how disqualification may promote or undermine intrinsic and calculative trustworthiness in the business environment generally and the financial services market specifically. As previously argued the impact of regulation on trustworthiness is important for two reasons: firstly regulation that encourages trustworthy conduct may in turn create greater trust, whereas if regulation undermines trustworthiness the reverse will be true; secondly, even if regulation encourages enough trust to support satisfactory levels of market participation, this will be problematic if it is unable to create sufficient levels of trustworthiness to safeguard those who have been encouraged into the market. Given that the Government has opted to use disqualification to promote trust it is therefore necessary to understand its strengths and shortcomings in promoting trustworthiness. Particular issues arise in relation the financial services market which will be separately considered.

1. Market Trust

In order for disqualification to promote calculative trust, market participants must be aware of it and consider it effective in deterring misconduct or at publicising which directors are untrustworthy (so that they can be avoided) or at removing them from circulation qua directors. There does appear to be high levels of awareness of the sanction: a survey of Insolvency Service stakeholders that canvassed the views of a number of groups including 100 institutional creditors and 100 non-institutional
creditors, found that 80% overall were aware of disqualification orders and undertakings.\(^{108}\) Evidence regarding views of the efficacy the regime are, however, more ambiguous. While confidence in the Insolvency Service’s enforcement regime stood at 69% in 2013-2014,\(^{109}\) the survey found that only 49% of stakeholders were confident that the Insolvency Service correctly targeted and took action against the culpable. Of those, only 6% gave disqualification as a reason for their confidence,\(^{110}\) though 12% of those who lacked confidence stated this was due to a lack of disqualifications.\(^{111}\) However confidence levels amongst creditors in the efficacy of disqualification stood at 51% for non-institutional shareholders and 59% for institutional shareholders.\(^{112}\) When asked how effective disqualification orders and undertakings were in deterring and stopping misconduct, of those who knew about the sanction, 55% thought it was quite or very effective.\(^{113}\) On the other hand, only 37% of stakeholders thought that the Insolvency Service was effective in addressing or stopping commercial wrongdoing by live companies, which may in part reflect the low use of disqualification in live companies.\(^{114}\) Given this, it is not clear what overall impact disqualification might have on market trust.

\(^{108}\) SPA Future Thinking, The Insolvency Service Stakeholder Confidence Survey 2012 8\(^{th}\) January 2013, 27.


\(^{110}\) SPA Future Thinking, supra n 108, 16-18. There are no 2013-2014 statistics available for these or subsequent statistics in the main text.

\(^{111}\) Ibid, 20.

\(^{112}\) Ibid, 30.

\(^{113}\) Ibid, 29.

\(^{114}\) Ibid, 23.
The reforms in the Bill, and in particular the introduction of compensation orders, could increase calculative trust by reassuring those entering the market that if their trust is betrayed they would be compensated for any loss. However it is not presently clear how compensation orders will work in practice and how effective they will be. They could be a weak safety net, as many disqualified owner-managers will have suffered financial loss themselves as a result of their business failing, and will be unable to pay any awards. It also seems likely that the costs of obtaining a compensation order, and possibly of the disqualification process itself, will be deducted from any award insofar as they are not recovered from the directors. This could substantially reduce levels of compensation, and in turn weaken calculative trust.

2. **Intrinsic Trustworthiness**

Using disqualification to promote intrinsic trustworthiness is problematic for several reasons. While disqualification can be viewed as mechanism to promote accountability, it is a sanctions based regime which provides little flexibility. Under section 6 of the CDDA, disqualification is mandatory when a director has been found to have acted in an unfit manner, even if the director is no longer a threat to the

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115 Discussion Paper, supra n 4, p 17.

116 Hicks, supra n 59, 95.

117 Discussion Paper, supra n 4, pp 72-73; P Walton, The Likely Effects of the Jackson Reforms on Insolvency Litigation (R3, April 2014) 44.

The courts have a discretion regarding the length of time a person must be disqualified for, but it must be for a minimum period of two years. The courts also have the discretion to grant a disqualified director leave to act as a director in relation to a particular company or companies, which they are most likely to use when the director presents no further, or only a minimal degree of, risk to the public. However this discretion is rarely utilised. Again, while section 8 of the CDDA provides that disqualification for unfitness is discretionary, the courts have tended to approach section 8 disqualifications much like section 6 applications and rarely exercise their discretion in the director’s favour. In any event, once the disqualification process is underway, any element of discretion may come too late to have a positive effect on attitude. This is because the process itself is likely to be

120 Re Sevenoaks Stationers (Retail) Ltd [1991] Ch. 164, 167 and 171.
121 CDDA s 6(4).
122 CDDA s 17.
125 CDDA s 8(1) and (2).
126 A Walters and M Davis-White, Directors’ Disqualification and Insolvency Restrictions (London, Sweet & Maxwell, 3rd edn, 2010), 163-166. See also Secretary of State for Business, Enterprise and Regulatory Reform v Sullman [2008] EWHC 3179 (Ch); [2010] BCC 500 para [120]; Secretary of State for Business, Innovation and Skills v Bloch [2013] CSOH 57 at [48].
perceived by directors as hostile, and research on trust and regulation suggests that when the person trusting is seen as hostile, because they threaten sanctions, trustworthiness is eroded.\textsuperscript{127} Disqualification does not form part of the tiered enforcement response that Ayres and Braithwaite advocated which could promote intrinsic trustworthiness.\textsuperscript{128}

In addition the form of accountability that disqualification promotes may be unhelpful for creating positive internal commitments to trustworthy conduct. Disqualification operates retrospectively, requiring directors to justify their conduct after the event in an adversarial context. This is likely to result in them seeking justifications for their conduct and to minimise its wrongfulness, making them less to accept the legitimacy and fairness of the disqualification.\textsuperscript{129} Hicks’s empirical research bears this out: many disqualified directors felt that they had been denied access to justice and some thought the process was vindictive.\textsuperscript{130} In such circumstances the process will not lead to directors accepting that their conduct was wrong and changing their behaviour as a result.

Disqualification may not, therefore, be a good tool for promoting intrinsic trustworthiness in those being held to account. However one of the established goals of disqualification has been to raise standards of conduct amongst directors

\textsuperscript{127} Supra, text to n 105.

\textsuperscript{128} Supra, text to n 82.


\textsuperscript{130} Hicks, supra n 59, 9.
generally. In the light of Blair and Stout’s arguments, disqualification might signal what constitutes trustworthy and untrustworthy conduct and provide social cues that could encourage intrinsic trustworthiness. Yet it has long been recognised that relying on disqualification to raise standards is problematic, not least because levels of awareness of the sanction are low. Thus a survey in November/December 2012 found that of 100 directors, only 43% were aware of disqualification. While the Insolvency Service has sought to raise its profile and has successfully increased the media coverage it receives, there is a risk that media coverage of disqualification proceeding will focus on ‘newsworthy’ cases involving clearly fraudulent and untrustworthy conduct, in relation to which there is less need to rely on signalling to support social norms against the conduct concerned. Furthermore, if Blair and Stout are correct, the greater the awareness of the Insolvency Service’s activities, the greater the risk that this signals to directors that others are not behaving in a trustworthy manner, which in turn could counter-productively erode intrinsic trustworthiness. As argued previously however, this argument should be treated with caution.

3. Calculative Trustworthiness


132 Hicks, supra n 59, 10, finding that while 71% were aware of disqualification, few understood what it meant or the consequences of breach; Williams, supra n 59, 233-235.


The reforms to disqualification were aimed at creating a ‘level playing field’ between those engaging in untrustworthy conduct and ‘honest entrepreneurs’.\textsuperscript{135} Sanctioning would achieve this by off-setting the benefits of such conduct, which in turn would promote calculative trustworthiness through deterrence.

Most disqualifications are brought against owner-managers who have weaker incentives to be trustworthy than other groups of directors: they are, for example, less likely to have strong reputations to protect compared with directors of dispersed share-ownership companies. However while this suggests that there is a case for regulation to bolster weak social incentives, there are well-recognised problems with utilising disqualification to deter misconduct. Firstly the low levels of awareness of the regime amongst directors undermine its deterrent effect. Secondly disqualification does not prevent disqualified persons from setting up business in their own name. Hicks found that disqualified directors had little trouble obtaining employment after disqualification.\textsuperscript{136} If this is still the case- and attitudes may have hardened since Hicks’s study, given the crisis and other high profile corporate collapses\textsuperscript{137} - disqualification would provide weak economic incentives for owner-managers to behave well. Again, insofar as disqualification depends on reputational consequences to deter, these are not likely to be material considerations for many owner-managers. For those who do care about reputation, disqualification adds little to the loss of reputation they suffer by virtue of their business becoming insolvent.\textsuperscript{138}

\textsuperscript{135} Discussion Paper, supra n 4, p 9.

\textsuperscript{136} Hicks, supra n 59, 11.

\textsuperscript{137} Such as Farepak Plc, though its directors were not disqualified: J Croft, “Farepak Case Dropped”, Financial Times, 20 June 2012.

\textsuperscript{138} Hicks, supra n 59, 11, 13.
Those who are aware of disqualification seem undeterred by it. Thus Hicks found that disqualified directors who stated that they knew that directors could be disqualified for unfitness, also said that this had had no influence on the manner in which they had run their businesses and discharged their obligations. More recently, in 2012, only 37% of 100 directors surveyed considered that disqualification was effective in deterring misconduct.

While the Bill extends the scope of the disqualification regime by expanding the number of people who can be captured by it, and the range of activity for which directors can be held accountable this is unlikely to increase its deterrent effect if directors continue to be unaware of it or discount it. The introduction of compensation orders may mitigate these problems by adding substantially to the costs of disqualification and so increase its deterrent effect. It is also possible that both the introduction and the subsequent imposition of compensation orders could attract more media attention than disqualifications do at present, which would raise awareness of the regime and increase its potential to influence and deter.

There is however a risk that compensation orders could reduce external incentives for trustworthy conduct, by reducing the overall level of accountability of owner-managers. It has been suggested that administrators and liquidators will not bring claims to recover monies on behalf of creditors when they believe that Insolvency Service may take action to obtain a compensation order. This could reduce

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139 Ibid, 10. See also Williams, supra n 59, 232-236.

140 SPA supra n 108, 30. This is in line with earlier surveys: Insolvency Service Executive Agency, Company Director Disqualification- A Follow Up Report (HC 424, 1998-1999) 49, Fig 27

141 See supra, text to ns 23-33.

142 cl 110.
or, at least, not increase, levels of insolvency litigation.\textsuperscript{143} Although proposals in the Bill to allow administrators and liquidators to sell or assign causes of action may offset this effect, causes of action for misfeasance under section 212 of the Insolvency Act, which are likely to constitute a substantial proportion of actions brought against owner-managers,\textsuperscript{144} are excluded.\textsuperscript{145} Furthermore, reforms to the rules on the recovery of legal fees (the Jackson reforms) are also likely to suppress insolvency litigation generally.\textsuperscript{146} As such, when put in context, compensation orders may not result in increased extrinsic incentives for trustworthy conduct.

4. Disqualification and the Financial Services Market

While there are problems in relying on disqualification to promote trust and trustworthiness in the business environment generally, it is a particularly weak tool in the financial services market, because it fails to hold accountable those whose conduct destroyed trust in that market. It has been stated extra-judicially that the regime targets owner-managers who abuse limited liability, and is not concerned with failures in corporate governance in dispersed share-ownership companies.\textsuperscript{147} Yet part of the

\textsuperscript{143} Walton, supra n 117.

\textsuperscript{144} R Williams, “What Can We Expect to Gain From Reforming the Insolvent Trading Remedy?” (2015) 78 Modern Law Review 55, 60-61.

\textsuperscript{145} cl 118.

\textsuperscript{146} Legal Aid, Sentencing and Punishment of Offenders Act 2012 ss 44 and 46; Walton, supra n 117. See also Discussion Paper, supra n 4, p 70; J van der Luit-Drummond, “Government Acknowledges £160m cost of Jackson reforms”, Legal News 18 December 2014.

reason for the destruction of trust in the financial services market was the conduct, and subsequent lack of accountability of, the boards of the largest financial institutions.148 The Government itself recognised the importance of improving corporate governance as part of the reforms, by increasing individual accountability of senior individuals.149 If the disqualification regime is not concerned with failures in corporate governance in dispersed share-ownership companies, then its capacity to restore trust and promote trustworthiness in the financial services market is seriously undermined.150

Furthermore, most disqualification cases involve dishonesty or a lack of commercial probity: ‘mere’ commercial misjudgment and incompetence is not considered to fall within the scope of the remedy.151 However dishonesty and lack of commercial probity is rarely detected at board level in large institutions, possibly because their more sophisticated risk and governance systems prevent it occurring. Fault in these institutions, at board level in any event, is more likely to comprise incompetence, and this was borne out by the financial crisis.152 Again, while directors can be disqualified for gross negligence, this usually involves a complete abdication

149 Government Response, supra n 23, para 237.
151 Hoffman, supra n 147, 197; Re Lo-Line Electric Motors Ltd [[1988] Ch 477 at 486.
of responsibility or an irrational disregard of clear warnings.\textsuperscript{153} The conduct displayed by bank boards did not take this form but rather was evidenced through poor decisions, in respect of which courts, generally, will not disqualify directors.\textsuperscript{154} Yet as the financial crisis demonstrated, trust can be destroyed by such behaviour and the failure of disqualification to address it is again a significant weakness. Penalising incompetent conduct could encourage calculative trust by removing incompetent directors from circulation. It could also deter trust-destroying conduct and signal what counts as such conduct in order to encourage intrinsic commitments to avoid it. This signalling may have greater effect than when commercial immorality is targeted by the regime because there may be less clarity about what counts as undesirable conduct in this context and weaker social norms against it.\textsuperscript{155}

Unfortunately a key reform that could have strengthened the role of disqualification in the financial services market was dropped from the Bill, namely the proposal to grant sectoral regulators such as the FCA the power to disqualify directors. The Government cited concerns over the competence of sectoral regulators to determine whether a breach of sectoral regulation rendered a person unfit to be concerned in the management of companies generally, and concerns over due diligence.


\textsuperscript{154} Loughrey ibid.

\textsuperscript{155} Von Borgstede, Dahlstrand, and Biel, supra n 106, 1
Both issues could have been addressed by requiring sectoral regulators to seek court-ordered disqualification. However respondents to the Discussion Paper, such as the Insolvency Lawyers Association, thought that there was little to be gained by granting sectoral regulators such powers when the Insolvency Service already possessed them and moreover could obtain disqualifications out of court by means of disqualification undertakings.\(^{157}\)

The Insolvency Lawyers’ view makes sense insofar as disqualification is envisaged as primarily concerned with insolvent companies. Certainly this is the present focus of the regime, which is scarcely surprising, given that it was developed in response to the Cork Committee’s report on the reform of insolvency law,\(^{158}\) but it is problematic. Most disqualifications take place under section 6 which requires that the director’s company must have entered one of the insolvency regimes;\(^{159}\) it is not sufficient that it was cash flow\(^{160}\) or balance sheet\(^{161}\) insolvent. Yet the State did not permit banks to enter insolvency procedures during the crisis and it remains unclear whether regulators have successfully addressed the problem of financial institutions being ‘too big to fail’.\(^{162}\) If not, it is likely that the State will continue to step in to rescue banks from insolvency and their directors will continue to fall outside section 6, the core provision of the CDDA.

\(^{156}\) Government Response, supra n 23 paras 245-246, 257.

\(^{157}\) Ibid, para 247.

\(^{158}\) Supra n 62.

\(^{159}\) CDDA s 6(2).

\(^{160}\) Insolvency Act s 123(1)(e).

\(^{161}\) Insolvency Act 1986 s 123(2).

\(^{162}\) Statement by Former Members of the Parliamentary Commission on Banking Standards (4 November 2014) 5-9.
While it is possible to disqualify directors of live companies under section 8 CDDA, such orders are infrequent. The Bill seeks to address this by removing restrictions on the types of information the Insolvency Service can rely upon bring an section 8 application which should enable it to act on a broader range of information from sectoral regulators. It also enables the Insolvency Service and the courts to take account of breaches of sectoral regulation in determining unfitness, though arguably it was already possible to do this. However compensation orders will not be available when companies are solvent, thus weakening the capacity of disqualification to promote calculative trust and trustworthiness in this context.

Moreover the failure to grant sectoral regulators the power to disqualify is likely to undermine the impact of these reforms for several reasons. Firstly, given its remit and given that its resources have been severely strained by cut backs the

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163 See table in Discussion Paper, supra, n 4, p 58: in 2012-2013 only 4% of 1031 disqualifications involved directors of live companies, a drop from 12% the previous year.

164 S 8 of CDDA states that the Secretary of State can bring disqualification proceedings only where it appears “from investigative material” that it is expedient in the public interest to do so. cl 109 removes the reference to investigative material.

165 cl 106 (6).

166 CDDA s 9(1) and s 9(1A) both state that in determining unfitness the court “shall have regard in particular” to matter listed in Schedule 1 of the Act, indicating that other factors can be taken into account.

167 cl 110. For further analysis of compensation orders see A Keay and M Welsh, “Enforcing Directors’ Duties by a Public Body and Antipodean Experiences” forthcoming Journal of Corporate Law Studies (on file with author)

Insolvency Service is likely to continue to direct enforcement efforts to insolvent companies. In contrast, sectoral regulators such as the FCA may have been more likely to utilise disqualification in the context of live companies, though admittedly the FSA and FCA failed to use their existing powers to hold directors of financial institutions accountable following the crisis.  

Secondly sectoral regulators are better placed to monitor institutions in their sector, and so detect problems prior to insolvency than the Insolvency Service, which carries a heavy regulatory load in respect of disqualification of directors of insolvent companies and winding up companies on public interest grounds. Thirdly granting sectoral regulators the power to disqualify would have had a significant reframing effect for the disqualification process, signalling to the market that disqualification could operate as an accountability mechanism outside the insolvency context and that it had a specific role to play in the markets of the sectoral regulators. While it might be objected that this would have added little to the FCA’s existing powers to ban authorised persons, it could have increased the deterrence effect of the FCA’s sanctioning. Furthermore if directors who are banned by the FCA from working in financial services then assume directorships elsewhere, this could defeat the Government’s objective of improving trust in the capacity of the legal system to hold wrongdoers to account, which had been undermined by the failure to sanction senior individuals in the financial services sector following the financial crisis.

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169 Only one director of a large bank was sanctioned for lack of care: FSA, Final Notice Peter Cummings (12 September 2012). See Keay and Welsh, supra n 169, blaming a weak approach to enforcement.

170 Under Insolvency Act 1986 s 124A.

171 Under the Financial Services and Markets Act 2000 s 56?

172 Discussion Paper, supra n 4, pp 53-54.
In sum allowing the FCA to seek disqualification would have strengthened its powers, and signalled the importance of disqualification in promoting accountability, market trust and trustworthy behaviour in the financial services market, where the need to restore trust is most acute.

G. CONCLUSION

This is not the first time that reforms to the disqualification regime have been proposed in an attempt to restore market trust by increasing the accountability of market actors\(^{173}\) and to deflect public concern over major corporate scandals.\(^{174}\) At the time of the Cork Report, public concern over rogue directors and market cleanliness threatened the Thatcher Government’s privatization programme. In order to render privatization politically acceptable, the Government had to tackle ‘the unacceptable face of capitalism’ and restore confidence in the cleanliness of the markets. Reforming insolvency law, including the disqualification regime, was a means to achieve this.\(^{175}\) Thus reform of disqualification formed part of a larger political process.

It has been suggested that the present focus on disqualification may again be a politically motivated response to public anger at the lack of accountability of those in the financial sector\(^{176}\) and the need for the Government to be seen to be doing

\(^{173}\) Halliday and Carruthers, supra n 63, 374, 388, 405-406.


\(^{175}\) Halliday and Carruthers, supra n 63, 374-375, 377-379, 388-390. See also Wheeler, supra n 118, 287-289.

\(^{176}\) Arsalidou, supra n 150, 295.
something about it. However as this article has demonstrated, this is deeply problematic. The reforms in the Bill leave the financial services market largely untouched. Instead, despite the lack of evidence that there has been a drop in public confidence in business resulting from the activities of rogue directors, disqualification will continue to focus on owner-managers of insolvent companies. Although measures to promote trust in this sector could have economic benefits, there are difficulties in using disqualification to achieve this. Levels of calculative trustworthiness amongst owner-managers are likely to be lower than amongst the population of directors more generally because social sanctions, such as loss of reputation, do not provide as strong reasons for trustworthiness amongst this group. Given this it makes little sense to use a regulatory mechanism that presently relies chiefly on reputational sanctions to provide additional extrinsic incentives for trustworthy conduct. While the introduction of compensation orders could mitigate this problem, much will depend on effective detection, enforcement and market publicity of the sanction. In any event this particular reform is likely only to increase calculative trustworthiness, and it comes at a time when the Government is proposing to undermine other incentives for good conduct through reforms of the funding regime for insolvency practitioners that are likely to result in less litigation and less accountability for these directors. It is precisely when incentives for calculative trust are weak that strong trustworthiness, and regulatory mechanisms aimed at encouraging this, become most important. Yet the form of accountability utilised by disqualification is not likely to promote intrinsic trustworthiness, and may even undermine it.

In fact, compensation orders aside, the disqualification regime is likely to continue to operate much as it always has done. Its goals always included deterrence,
protecting the public by prohibiting unfit directors from trading with the benefit of limited liability, and raising standards of conduct amongst directors more generally.\textsuperscript{177} Only the rhetoric has changed to emphasise trust and accountability. In the light of the preceding discussion it is difficult to avoid the conclusion that the proposed reforms distract attention from more critical issues. These include a more fundamental appraisal of whether the present regime for disqualifying owner-managers is the best way to protect the public against abuses of limited liability. Apart from compensation orders, the reforms do not address long-standing criticisms of the regime’s overall goals and effectiveness.\textsuperscript{178} Perhaps even more significantly they deflect attention from the issue of how best to increase accountability and trustworthy conduct not only of directors in the financial services market, who have been subject to separate regulatory attention,\textsuperscript{179} but of directors of dispersed share-ownership companies more generally. It is the conduct of these individuals that imposes the greatest societal costs, and whose incompetence can have a far greater impact on market trust than the activities of rogue directors, yet who are the least legally accountable. Given this, there is a risk that should the reforms nevertheless succeed in increasing market trust, it may be misplaced, just as it was prior to the financial crisis.


\textsuperscript{178} For which see Hicks, supra n 59, 68-71; Williams, supra n 59, 225-236.

\textsuperscript{179} See supra n 8.