How the Prospect of Fault Influences Managers’ Compliance

*M Sooy*

*University of Kentucky, 2016*

**Abstract:**

The SEC relies heavily on ‘no-fault’ settlements in its enforcement, where targets avoid costly litigation by accepting sanctions without admitting or denying fault. This policy is argued to enable the agency to pursue greater numbers of violators. However, opponents argue that no-fault sanctions may be less effective, reducing fines to a ‘cost of business’. In an experiment, I examine the effects of fault assignment on managers’ cost perceptions, ethical framing and compliance. I manipulate the presence of fault assignment in prospective sanctions, and additionally manipulate sanction strength and sanction target - attributes that commonly vary in sanctions and which may interact with fault assignment. I find that all manipulated sanction attributes increase managers’ cost perceptions, and that managers’ cost perceptions are associated with greater compliance frequency and compliance quality. I also find that managers facing fault assignment in manager-targeted sanction conditions perceive their compliance differently – as an ethical, rather than economic choice. Consequently, these managers comply more frequently with costly regulations and select higher quality compliance than do managers in manager-targeted no-fault conditions. Targeting firms with sanctions also increases managers’ ethical perceptions, but adding fault to firm-targeted sanctions does not further increase ethical perceptions or compliance. My findings are consistent with sanctions facilitating greater ethical awareness and compliance when fault targets managers or when sanctions target firms, and with ethical awareness facilitating greater compliance. Supplementary analysis suggests that results are stronger among individuals high in ‘dark triad’ personality traits (narcissism, machiavellianism, and psychopathy), suggesting that findings generalize to subpopulations thought to be high in dark triad traits such as firm managers (O’Reilly et al. 2014).