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GRETCHEN MORGENSON

Are Options Seducing Directors, Too?

TRYING to extricate company directors from their chief executives' pockets has been at the heart of many changes in corporate governance during these dizzying scandal years. Indeed, the most commonly cited cure-all for what ails corporate America is director independence.

But all the independent directors in the world cannot seem to fix perhaps the biggest problem facing shareholders: egregiously high and ever-rising executive pay. Even though members of companies' compensation committees now must be independent, executive pay just keeps on rocketing.

A new study by academics at Baruch College, part of the City University of New York, offers a possible explanation of why this may be. You may not be shocked to learn that — once again — it's about money.

Donal Byard and Ying Li, both assistant professors of accountancy at Baruch, analyzed stock option grants given to chief executives at United States companies from 1992 to 2002. The sample was large — almost 18,000 grants — and the study confirmed other academic research showing that options are very often granted to executives just before good news about the company is disclosed or directly after bad news. No companies were identified in the study.

Some outside directors are compensated entirely in stock options.

The study also found that the practice of bestowing well-timed option grants — which the professors called "timing opportunism" — has become more prevalent in recent years. Puzzled by this, the professors said they decided to dig further. So they looked at how directors were paid and found that timing opportunism was more pronounced when directors on the compensation committee received a larger proportion of stock options in their pay package.

As a result, the professors said, a heavier reliance on stock options in the pay of independent directors more effectively aligns their interests not with the shareholders to whom they have a duty, but with top management.

"Since outside directors frequently receive options at the same time as C.E.O.s," the study noted, "these directors also benefit from any timing opportunism. We argue that when outside directors receive a lower proportion of their compensation from stock options, they are more likely to limit C.E.O.s' timing opportunism."

The trouble, at least from a shareholder's perspective, is that stock options are growing as a percentage of the compensation that outside directors receive for serving on a board. During the first half of the study's 10 years, for example, the professors found that option grants averaged 16 percent of directors' pay. During the second half of the period,

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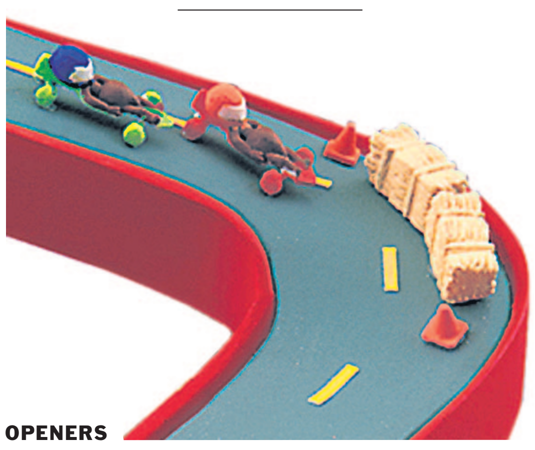

Linda Spillers for The New York Times (left) ; Santiago Llanquin/Associated Press
Illustration by The New York Times

The Pinochet Money Trail

A Dictator's Mysterious Cash At Riggs Bank

By TIMOTHY L. O'BRIEN and LARRY ROHTER

SANTIAGO, Chile

GEN. MANUEL CONTRERAS is a religious man. A bas-relief of the Last Supper hangs on his dining room wall, not far from a thick, leather-bound Bible that rests on a table. As the former head of Gen. Augusto Pinochet's secret police in Chile, General Contreras is also a controversial man. A large silver plate, given to him by Argentina's intelligence services, sits on a shelf, a few feet from the Bible.

The inscription on the plate reads June 1976, the same month and year that General Contreras and other South American intelligence chiefs, according to declassified United States intelligence documents, authorized assassinations of exiled political dissidents in a wide-ranging conspiracy known as Operation Condor. Although General Contreras denied the existence of such a plan in a recent interview in his hillside home here, the plot has been amply documented in the United States intelligence records.

General Contreras's past banking activities have been documented, too. According to a declassified 1979 State Department memo, he opened a "secret bank account" at Riggs Bank in Washington in 1966, when he was a young soldier based in the United States. The State Department report noted that General Contreras's balance at Riggs was as high as $26,000 in the mid-1970's. In the interview, he said he was sure he never kept more than $1,000 at Riggs and that it was common for members of the Chilean army who were based in the United States to have personal accounts at the bank.

But General Contreras was less certain about funds Riggs held for his former boss, General Pinochet, whose accounts are among those at the center of a sweeping money-laundering investigation of the bank. The sums involved — as much as $8 million, according to an assessment by the United States Senate — have left even General Pinochet's staunchest allies wondering about their origin.

"The problem with Pinochet is that he got quite a lot," General Contreras said. Army wages were very low, he said, even for someone as senior as General Pinochet.

Does he believe that the general accumulated his riches fairly?

"I don't know," said General Contreras, shaking his head. "I don't know."

As Chile's strongman from 1973, when he overthrew Salvador Allende, an elected civilian president, to 1990, General Pinochet presided over a purge of political opponents and the creation of a police state. But he also laid the foundations for what has become Latin America's most stable and promising

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How Consultants Can Retire on Your Pension

S.E.C. Turns a Spotlight on an Industry Rife With Conflicts

By GRETCHEN MORGENSON and MARY WILLIAMS WALSH

NINE years ago, William Keith Phillips, a top stockbroker at Paine Webber, met with the trustees of the Chattanooga Pension Fund in Tennessee to pitch his services as a consultant. He gave them an intriguing, if unusual, choice. They could pay for his investment advice directly, as pension funds often do, or they could save money by agreeing to allocate a portion of its trading commissions to cover his fees. Under a commission arrangement, Mr. Phillips told the trustees, the fund would be less likely to incur out-of-pocket expenses, leaving more money to invest for its 1,600 beneficiaries.

Seven and a half years later, Chattanooga's pension trustees discovered just how expensive that money-saving plan had been. According to an arbitration proceeding they filed against Mr. Phillips, the agreement cost the fund $20 million in losses, undisclosed commissions and fees. And since 2001, Chattanooga has had to raise nearly $3.7 million from taxpayers to keep the $180 million fund fiscally sound.

The Chattanooga trustees fired Mr. Phillips in 2003 and, last October, filed arbitration proceedings against him, **UBS Wealth Management USA**, formerly the Paine Webber Group, and his new firm, **Morgan Stanley**. The case, which is pending, accuses the consultant of, among other things, fraud and breach of fiduciary duty. The commission arrangement was central to the problem because it put Mr. Phillips's interests ahead of his client's, the fund said in its complaint.

"The very important and in many ways unique relationship that a pension fund board has with its consult-

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Christopher Berkey for The New York Times

David R. Eichenthal says a former adviser to the pension fund for Chattanooga, Tenn., breached his trust.