Backdating Not Limited To Execs: Study

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About 460 public companies manipulated stock options grants not only for their executives, but also for their outside directors, according to a new study by Harvard Law School.

The study, the first of its kind to examine directors and not just executives, could explain why more boards didn't act to stop the activity.

"This paper shows that opportunistic timing problems have not been limited to executives' grants, as has been thus far assumed, but rather have also affected outside directors' grants," wrote co-authors Lucian Bebchuk of Harvard Law School, Yaniv Grinstein of Cornell University and Urs Peyer of Insead business school in France.

"Outside directors play a key role in the structure of public companies with dispersed ownership and are counted on to reduce executives' agency problems by monitoring, supervising and setting executives' compensation," the authors added.

The study, which was released Monday, analyzed "lucky grants," or grants given at the lowest price of the month, at over 6,000 public companies between 1996 and 2005.

Overall, the authors found more than 2,600 lucky grants, of which they estimated 800 had been manipulated for economic gain. They also found about 1,100 "super-lucky" grants, which were given at the lowest price of not only the month, but also of the quarter.

A total of about 1,400 outside directors received manipulated options grants, according to the report. Even though most of the alleged misdeeds took place before the passage of the Sarbanes-Oxley Act in 2002, options backdating continues to this day, the report added.

"Director grant events were more likely to be lucky when the potential gains from such luck were larger," the authors wrote.

"Lucky Directors," as the study is called, came out just a few weeks after "Lucky CEOs," another study by the same three authors.

That report concluded that companies with long-tenured chief executives and a dearth of independent directors on their boards were more likely to backdate stock options.

The study also confirmed that backdated grants were not substitutes for other forms of compensation, but instead lavished extra benefits on executives who were already making more money than their peers.

Overall, the authors found about 2,300 lucky grants given to CEOs, half of which they estimated had been manipulated for economic gain. They also found about 1,000 "super-lucky" grants, which were given at the lowest price of the quarter.

An estimated 62% of those super-lucky grants were manipulated, the report said.

"A day was most likely to be chosen if its stock price was at the lowest level, second most likely to be chosen if its price was at the second-lowest level, and third most likely to be chosen if its price was at the third-lowest level," the study said. "Similarly, dates with a stock price at the highest level of the month were most likely to be avoided as grant dates, followed in turn by dates with the second-highest price and then dates with the third-highest price.

Finally, the authors estimated that 850, or 10% of all CEOs, and 720, or 12% of all firms, backdated options over the 10-year period in question.