The New York Times

A Con Man Who Lives Between Truth and Fiction

By Andrew Ross Sorkin June 25, 2012 9:17 pm

BUTNER, N.C. — “I’m a proven liar. Don’t believe anything I say.”

That was what Samuel Israel III told me last week. He is the hedge fund manager convicted of running a $450 million Ponzi scheme who faked his own suicide in the summer of 2008 to avoid his prison sentence before turning himself in after a worldwide manhunt.

He was sitting across from me in the visiting center of the Butner prison complex, about 45 minutes north of Raleigh in eastern North Carolina. (Bernard L. Madoff is in the same complex.)

DealBook Column
View all posts

Mr. Israel, 52, who is serving a 22-year sentence, was wearing a tan prison uniform with his hair grown out, a mass of silver and brown curls sprouting from the sides of his bald head. (“I’m never going to cut it until I get out,” he exclaimed.)

I was there to talk to him because his story is a cautionary tale of the highly sophisticated, often endemic, fraud that still lurks on Wall Street. People I spoke with who dealt with him are still mystified about the breach of trust and how no one had a clue about his deception until it was too late.

“Everyone cheats,” he said as a matter of fact.

"I'm not a liar," he insisted, affably. "I became a liar."

I flew down to visit Mr. Israel after reading an advance copy of a book about him that is coming out in two weeks, "Octopus: Sam Israel, the Secret Market, and Wall Street's Wildest Con" by Guy Lawson (Crown). I was riveted by Mr. Lawson's telling of Mr. Israel's bizarre conduct — sometimes genius and often sickening.

Here's a quick recap of his sordid story: A native of New Orleans who is the grandson of a well-known commodities trader on Wall Street, he started Bayou Hedge Fund Group in 1996 and quickly became a rising star, amassing money from some of the most-respected investors on Wall Street based on the firm's trading track record. Bayou traded through, among other firms, a unit of Goldman Sachs. There was only one problem: the firm's profits were fictitious. Completely made up. In truth, Bayou consistently lost money. The firm's accounting firm, which blessed Mr. Israel's numbers in letters to investors, was also fictitious. Mr. Israel and his partners created the accounting shop out of thin air, including its stationery and logo.

After the fraud unraveled in 2005 as his losses mounted and investors demanded their money, Mr. Israel pleaded guilty. But after he was sentenced to 20 years in prison (the sentence was extended after his efforts to avoid prison), he faked his suicide on Bear Mountain just north of Manhattan, leaving his GMC Envoy on a bridge after writing "Suicide is Painless" in dust on the hood. He was on the run for two months during which, he now says, he tried to commit suicide for real, but failed. He told me he turned himself in after he saw himself on TV and was struck by how many people he had truly hurt. "I was watching America's Most Wanted and I see me!" he said. "I said, 'Oh my god!' "

His girlfriend, Debra Ryan, had been arrested on charges of helping him with his escape plan. "I have so many regrets but my biggest is ruining this poor girl's life. The only reason they screwed her was to get to me — and it worked. I knew they were coming for my mother next." (Ms. Ryan plead guilty and was sentenced to house arrest.)

So how did Mr. Israel's fraud begin?

He said building a fraud was never the plan. (It never is.) Early on, he said the firm had made a series of losing trades. He was willing to lie to his investors — which he claimed was his partners' idea — because he thought that by the next quarter he would be able to make back a profit.

"I thought, 'I can make this back.' I wasn't worried in the least," he said. "I was a good trader. I was a workaholic." He added: "Was it hard to lie in the beginning? No. Did it get harder? Yes. I lived with this beast every day. I lived with 'the hole.' It was awful. It was the worst feeling in the world."

Yet he continued to lose — and lie, compounding lies upon more elaborate lies.

At one of his lowest moments, he said, he chased what he believed was a "secret market" supposedly run by the Federal Reserve in order to make back the lost money for investors. Along the way, he fell in with a con man, and of course, never was able to return any money to investors.

The story is mind-boggling. But it raises the question of why no one saw the red flags.

The Securities and Exchange Commission, Mr. Israel said, "could not bother to go through everything with a fine-tooth comb because they did not have the manpower to do so." He said that only six months before the firm's collapse the S.E.C. had looked at its trading and "they did not see anything wrong."

In an arbitration case, Goldman Sachs's execution and clearing unit, formerly known as Spear Leeds & Kellogg, which cleared trades for Bayou, was ordered to pay $20.6 million to creditors of the failed hedge fund. The firm is appealing the decision.

"Are there similar frauds going on today?" Mr. Israel asked. "I am most sure there are."

What, I asked him, can an investor do to avoid being conned by the next Samuel Israel?

"Seek as much transparency as possible," he said. "If they do not understand exactly how a manager is making money, do not invest. If there is a secret process that cannot be explained, run. Go see the organization yourself, talk to the employees. The manager cannot see everyone or he could not be making money; if he has all the time in the world for you, that is a flag."

Mr. Israel is a good salesman, even in prison. It is clear why he was able to get away with his fraud for as long as he did. He is likable; he likes to tell you about his mistakes and acts as if he has known you forever. When I first sat down to talk with him, he offered me an orange Life Saver. When he mentioned Mr. Madoff, he leaned in to confide — as if we were best friends — that the Butner grapevine had it Mr. Madoff was "a terrible guy. Not a nice dude."

About halfway through, the interview turned bizarre when Mr. Israel, on the verge of crying, announced: "I took a man's life. I shot him twice."

I asked for more details. The story is recounted in "Octopus," but the author, Mr. Lawson, doesn't appear to believe it. In the supposed slaying, Mr. Israel describes himself defending a known con man, Robert Booth Nichols, who claimed to have once worked for the Central Intelligence Agency and has since died. Mr. Nichols was undertaking a secret trade at a German bank and was ambushed outside by a cockeyed "Middle Eastern guy." Mr. Israel says he shot the ambusher in the hip and then in the head.

He looked at me, shaking, and said, "I've seen someone with their head blown off maybe two feet back — as close as I am to you."

Mr. Israel recognized my skepticism. When I asked him what happened to the body, he said, "Bob made a couple of calls."

Again, I looked at him quizzically.

"These people can do anything. They can get rid of a body," he said. "Come on," he added, looking at me as if I didn't understand. "They can kill presidents."

I wasn't sure what he was talking about. "The J.F.K. thing," he said. He went on to tell me that he had videotapes of Kennedy's assassination and that one was stolen by the F.B.I. “I know it makes me look like a crackpot,” he said. “But I know it’s real. Look into my eyes — I don’t care if people think I’m crazy.”

When I asked Mr. Lawson what to make of Mr. Israel’s more adventurous stories, he told me: “I don’t think he’s lying. But that doesn’t mean he’s telling the truth.”

Mr. Lawson holds out the possibility that a murder was staged in Hamburg. But, he said, Mr. Israel “believes J.F.K. was assassinated by the C.I.A. I don’t.” The author added: “That’s the nature of confidence games — it becomes impossible to tell where the truth ends and deception begins.”

My conversation with Mr. Israel left me with a sense that at some level Wall Street, too, is a confidence game. Investors are sometimes too busy looking for profits to notice where the truth ends and the deception begins.

Correction: June 27, 2012
The Deal Book column on Tuesday, about Samuel Israel III, founder of the Bayou Hedge Fund Group, who is in prison for running a Ponzi scheme, misstated the action taken by the Financial Industry Regulatory Authority against a Goldman Sachs unit that cleared trades for Bayou. Finra ordered Goldman to pay $20.6 million to the creditors of the collapsed hedge fund; it did not fine Goldman that amount.