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Expert: Bayou had 'screaming red flags'

By Julie Fishman-Lapin
Staff Writer

NEW HAVEN — When it comes to the scandal that brought down Bayou Group, the Monday morning quarterbacking has begun.

There were "screaming red flags" that with proper due diligence investors could have picked up on, said Guy Simonian, founder of Cotal Systems, a company that conducts background screening for financial services firms.

Simonian was one of several panelists to discuss the failed Stamford hedge fund at a Yale School of Management conference yesterday.

The panel discussion entitled, "Lessons From the Swamp — What We Can Learn from the Bayou Debacle," attracted about 140 investors, regulators, academia and portfolio managers.

There's a laundry list of warning signals investors should have seen surrounding Samuel Israel III, Bayou's founder and mastermind behind the fraud, Si-

A little research could unearth fund's deception, he says

monian said. Israel never graduated from Tulane as he told investors. He was asked to resign from one firm and left another under questionable circumstances. Then there was the fact that he had past regulatory violations and was subject to a lawsuit in Louisiana.

"Anyone doing two or three hours of due diligence would have probably red-flagged the fund," Simonian said.

Greg Schuler, a senior managing director at Aetna Capital Management, was one of the institutional investors who saw the red flags and decided against investing in Bayou.

Schuler said his company's contact with Bayou was as recent as this past May. But he found Israel and his staff to be inaccessible. That was suspicious, said Schuler, who also was alarmed by the fund's organizational structure.

Six of the 12 people who worked at

Bayou were on the marketing side of the business. That's unusual for a \$440 million fund, Schuler said. And Bayou reported better returns than most other funds at times that the industry was struggling.

"If things are too good to believe, they usually are," he said.

But Schuler's experience was not typical when it came to dealing with Bayou, said Jeffrey Cobb, a partner with Cobb & Eisenberg, a Westport law firm that represents hedge funds and helps them weed through the complicated compliance process.

In most cases Israel was unusually accessible to investors. "This really filled a lot of investors with an artificial sense of comfort," Cobb said.

And many smaller funds flocked to Bayou, taking comfort that big names funds invested in the hedge fund.

"It's a classic illustration of herd men-

talities in investing," Cobb said.

The lesson is not to do due diligence by proxy, he said. "Assume others can be fooled."

And it's likely investors will be fooled again, said Stuart Robinson, an FBI agent who supervises the white-collar investigative squad in Fairfield County.

"I'd like to propose to you that it is overwhelmingly likely that there are other Bayou's out there," he said. "Just because Bayou got caught, nothing has truly changed. It's an industry geared to very smart people that get in over their heads so they commit criminal acts. These are folks . . . who are geared toward reporting perfection in their professional lives."

For some managers who aren't realizing the results they want, "lying is the only way to earn a living the way they are accustomed to," Robinson said.