May 13, 2011

How Bernard Madoff Did It

By LIAQUAT AHAMED

THE WIZARD OF LIES

Bernie Madoff and the Death of Trust

By Diana B. Henriques

419 pp. Times Books/Henry Holt & Company. $30.

Ever since the Madoff scandal broke in December 2008, the public has been morbidly fascinated by the affair. How had so ordinary a man pulled off the largest swindle in history? How had he gotten away with it for so long? Then there were the casualties. In contrast to so many other financial scandals of the last 20 years, those who lost money this time were not just impersonal institutions — they were real people. And what a spectrum of the world: Jewish philanthropists from the Upper East Side; almost half the membership of the Palm Beach Country Club; rich South Americans; retired accountants living in Florida; the demimonde of Monaco; even, it was whispered, figures from the Russian mafia and the Colombian drug cartels. Some of us could imagine ourselves among the victims; others found a certain voyeuristic pleasure in the financial travails of the rich and famous.

Finally the man himself and his family. Within days it became known that it was Madoff's own sons who had turned him in to the F.B.I. From the start, therefore, it was evident that we were witnessing an almost Sophoclean family tragedy. As for Bernie Madoff, what sort of man lay behind that sphinxlike smile, and how had he coped for so many years with the psychological pressure of living with such a gigantic falsehood? "The Wizard of Lies," by Diana B. Henriques, a senior financial writer for The New York Times, makes for riveting reading because it covers all these dimensions. And although there is much that we can never know, this book comes closer than others have to answering at least some of our questions.

Madoff's story has by now been told and retold many times, in newspapers and magazines, on television and in several books. After starting on Wall Street in the early 1960s, he built an apparently successful broker-dealer firm. As a side business he began managing money for other people, at first informally, for friends and family. His results were good but not spectacular. Most important, he never lost money (or so it seemed). How he generated these returns was always a mystery — he claimed to be offsetting the downside risks of his stock purchases by selectively using options to hedge the portfolio. But the very secrecy added to his mystique. Through word of mouth he soon began attracting outside investors, spawning a cottage industry of various types of feeder funds that channeled assets his way.

At some point (no one is quite certain when; Madoff claims it was not until the early ’90s, while Henriques believes it to have been earlier), after losing money, rather than come clean to his clients, he fudged the numbers, hoping to recoup the losses later and get back on track. Instead he ended up digging himself into an ever deeper hole. After a while, the chasm between what he claimed to investors and what was actually in their accounts became so deep that he stopped even bothering to invest the cash, relying on money from new clients to pay out fictitious returns to older clients — the classic Ponzi scheme.

Henriques has been reporting on Madoff since he was initially exposed and was the first reporter to be granted on-the-record interviews with him after his arrest and incarceration. She probably knows more than anyone outside the F.B.I. and the Securities and Exchange Commission about the mechanics of the fraud. As a consequence, in “The Wizard of Lies” she is able to add significant detail to the story.

To fool his investors and any regulators who happened to come sniffing around, Madoff built a Potemkin-like investment operation complete with traders at fake terminals pretending to buy and sell stocks and a bogus paper trail of transactions and accounting reports.

Ponzi schemes can survive only by growing — in fact by growing exponentially. Even a leveling off or a slight slowdown in the pace of money coming in can threaten the viability of the entire scam. Henriques reveals how the operation came close to falling apart on several occasions, first after the stock market collapse of 1987, then again during the recession of the early 1990s, and yet again after the tech bubble burst in 2000. Each time, just as Madoff’s fraudulent enterprise seemed to be on the verge of breaking down, a new source of money was found.

Not everyone was duped. There were plenty of danger signals for those who cared to dig. The accounting firm Madoff employed to audit his books was a one-man operation run from an office park in the New York suburbs; the volume of option trading entailed by the amount of money he was supposedly managing would have far exceeded the capacity of the derivatives market; and the returns he claimed to be generating were far too steady and reliable to be plausible. The S.E.C. was alerted several times that something fishy was going on. But inadequately staffed as it was, it was never quite able to connect the dots. Henriques reveals how tantalizingly close the agency came time and again to uncovering the fraud. Many of Madoff's investors themselves suspected that he might be sailing close to the wind. But believing that if he was breaking the law it was at someone else's expense, and fearing what they might bring to light, they chose not to delve too deeply.

In the end the story holds us not because of the engrossing details of the scam, but because of its human dimension. "The Wizard of Lies" begins by reconstructing the events of that grim week in December 2008 during which Madoff broke down and confessed to his wife, Ruth, and two sons that the shadowy investment advisory business he had been running on the side had for decades been a giant Ponzi scheme. It is a harrowing scene. His son Mark, who will later kill himself on the second anniversary of his father's arrest, is "blind with fury." The other son, Andrew, "prostrate," "slumps to the floor in tears"; at another point he wraps his arms around Madoff and tells him that what he has wrought upon them is "a father-son betrayal of biblical proportions." Henriques clearly does not believe that Ruth, Mark and Andrew were complicit in the extraordinary fraud. The family, like Madoff's clients, obviously chose not to ask too many questions about where all the money was coming from. But in Henriques's telling, they were not among the criminals, and she concludes with an impassioned challenge to the way they have been subsequently demonized.

A Ponzi scheme is the opposite of a perfect crime; detection is inevitable because eventually the numbers become unsustainable. Henriques paints a vivid picture of Madoff as this truth closes in on him in the last year of his operation. With client withdrawals accelerating and new investments drying up, as he scrambles to raise the impossibly huge amounts of money he needs to plug the hole, he finally realizes that the jig is up, and that it is only a matter of time before he will be destroyed. Madoff emerges here not as some master criminal, but as a sad, hapless man who, lacking the character to tell the truth at the critical moment, stumbled foolishly and blindly into one of the crimes of the century. He is less a personification of the crass greed that lay behind the recent bubble decade and more the embodiment of our infinite capacity for self-delusion.

Liaquat Ahamed is the author of "Lords of Finance: The Bankers Who Broke the World," which won the 2010 Pulitzer Prize for history.