


April 9, 2008

PAGE ONE

DOW JONES REPRINTS

 This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit:

www.djreprints.com.

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now.](#)

Subprime Lender's Failure Sparks Lawsuit Against Wall Street Banks

People Who Bought Its Notes Lost All; FBI Comes Calling

By **STEVE STECKLOW**

April 9, 2008; Page A1

PHILADELPHIA -- Until a few weeks ago, Sonia Deravedisian had never heard of the subprime-mortgage market. Nevertheless, she lost her life savings because of it.

The \$55,000 she saved over 35 years as a self-employed tailor is gone. Ms. Deravedisian, now 74 and disabled, is one of the earliest victims of the mortgage crisis, in a case that has drawn the attention of federal investigators over the role some of the biggest names on Wall Street may have played.

TARGETING BANKS

- **Collapse:** A subprime lender called ABFS sold notes to 22,000 people, who lost all when firm collapsed in 2005.
- **Suing the Banks:** Bankruptcy Trustee sued banks that securitized ABFS's mortgages, accusing them of enabling it to overstate the value of its assets.
- **Upshot:** Early subprime wreck shows a new way some individuals lost out and a potential new exposure for investment banks.

She and 22,000 other people, many elderly, lost about \$750 million when a Philadelphia lender called American Business Financial Services Inc. went bankrupt three years ago. ABFS had funded its operation partly by selling notes directly to the public, pitching them in newspaper ads and mass mailings that promised high interest rates. When it went under, these notes, which carried no collateral and weren't insured, became worthless.

Now a bankruptcy trustee is trying to recover money from the investment banks that turned the lender's loans into securities. His claim: They helped keep the lender alive -- and paying them fees -- by enabling it to overstate the value of assets on its books.

Defendants in a suit the trustee has filed include **Bear Stearns Cos.**, **J.P. Morgan Chase & Co.**, **Morgan Stanley** and **Credit Suisse Group**. In court filings, all deny any wrongdoing or knowledge of what the trustee alleges. All declined to comment for this article, through a spokesman or lawyer.

1

12.18%
ANNUAL YIELD*

30 MONTH TERM

These high interest rates available through September 30, 2000

TERM	RATE	YIELD*	BONUS RATE	YIELD*
12 - 17 mos.	10.20%	10.74%	10.45%	11.01%
30 - 35 mos.			11.50%	12.18%
120 mos.	11.50%	12.18%	11.75%	12.46%

- Rate and terms 3 mos. to 10 yrs.
- Fixed rate --- fixed terms --- non-callable
- Interest compounded daily --- paid monthly, quarterly, semi-annually, annually or at maturity
- \$1,000 minimum investment
- No fees or commissions
- Ask about our rates for larger investments

For a prospectus and a free information kit call anytime 1-800-776-4001
www.ABFSonline.com

AMERICAN BUSINESS FINANCIAL SERVICES INC.

111 Presidential Blvd. • Bala Cynwyd, PA 19004

American Business Financial Services, Inc. is a publicly traded Company (NYSE: ABFS).
Interest is calculated and based on a 360 day year. *The Annual Percentage Yield (APY) is calculated by compounding the interest rate on a quarterly basis. The actual yield may vary slightly from the advertised yield. The actual yield is based on the actual number of days in the year. The actual yield is based on the actual number of days in the year. The actual yield is based on the actual number of days in the year.

See a larger image

On March 19, representatives of the Federal Bureau of Investigation and the Securities and Exchange Commission met for several hours in Philadelphia with an attorney and accountants working with the bankruptcy trustee, according to people familiar with the session. The FBI, along with the SEC, recently launched a broad investigation of the mortgage crisis, focusing on, among other things, the Wall Street process of turning loans into securities for sale to investors. The ABFS case suggests one avenue under examination: the way investment banks worked with lenders to value those securitizations.

The case provides one of the first inside looks at the cratering of a subprime lender; more than 100 have collapsed since.

Bruce Boyle, a former spokesman for ABFS, says of the company: "They were sort of precursors to everything that has happened to the subprime industry. They were securitizing pools of subprime loans. The first time they were unable to do this on a quarterly basis, all hell broke loose."

The ABFS story also shows another way individuals were hurt by the subprime mess -- not by foreclosure but by entrusting their money to a lender that then went out of business.

ABFS, which began in 1988 and went public nine years later, specialized in lending to borrowers with poor credit. It made more than \$6 billion in subprime loans, mostly residential, in the five fiscal years through June 2004, then failed in early 2005.

Like other lenders, it pooled its home loans into trusts and, via Wall Street firms, sold securities based on them to investors. The company funded its operations partly by borrowing from some of the same Wall Street investment banks that handled its loan securitizations.

But unlike most subprime lenders, ABFS also drew operating cash from another source: individual investors, who purchased notes the company sold directly to the public. "Found: a 24 month investment opportunity yielding 9.14% annually," said a mass mailing from ABFS dated Nov. 14, 2001. At the time, two-year Treasury notes paid about 3%. ABFS's ads touted interest rates of more than 12%.

Small Investors

Virgil Magnon of Oceanside, Calif., says that in 1997 he saw the ads and began buying ABFS's notes -- in effect, lending it cash. He received regular interest payments for about seven years. But when ABFS went under, Mr. Magnon, who is 81, says he was out \$761,000, or 80% of his liquid assets.

"Small investors like me are not very savvy," says the retired aerospace contract administrator. "My primary interest in investing was to raise enough money for catastrophic medical problems down the line. You could call that greed, but I don't think it's greed. It's trying to get more for your money."



Sonia Deravedisian

Mr. Magnon, who has a heart condition, says the loss of their nest egg has caused anxiety to his wife, Carolyn, who's also in poor health. "There's not enough in our savings to amount to very much," she says.

In papers filed in the Court of Common Pleas of Philadelphia, federal bankruptcy trustee George L. Miller contends the investment banks are partly responsible for these investors' straits because of how the banks handled the process that turned mortgages into salable securities.

This process brought ABFS, among other things, something called "interest-only strips" or "residuals," which represent the right to receive future cash flows from securitized loans. ABFS assigned these too high a value, making itself look more financially sound than it really was, says the trustee's suit, because of actions by the investment banks.

Early Payoffs

Steven M. Coren, a lawyer for the trustee, says the banks underestimated how many borrowers would pay off their mortgages early, usually through refinancing, and the company relied on the

banks' estimates. Early payoffs resulted in less cash flow for ABFS from interest payments. The company ended up booking more than \$500 million in "fictitious assets," the suit alleges -- while the investment banks that supplied the faulty data for the overvaluations were reaping millions in fees from ABFS.

Credit Suisse participated in six ABFS loan securitizations, according to the trustee's suit. The trustee has obtained internal emails in which a Credit Suisse risk-management analyst, Victor Hong, questioned the loan "prepayment assumption." He noted that the bank assumed 23% of the loans would be paid off early, while other subprime loans experienced actual early-repayment rates of 30% to 45%. "Could it eventually prepay much faster, hurting the value of the residual?" he asked in one email in December 2002.

The bank continued using a 23% prepayment assumption in structuring ABFS mortgage securitizations, other internal Credit Suisse documents show. Mr. Hong, no longer at Credit Suisse, wouldn't comment on his emails.



Sonia Deravedisian, who lost \$55,000 she invested in ABFS notes, looking at an ad from the firm.

ABFS was responsible for valuing these strips, or residuals, on its books. Its filings show it used a slightly lower prepayment assumption in valuing many of them, 22%.

But with interest rates low and lenders ever more accommodating, refinancings boomed. The 22% and 23% estimates proved way off the mark. Actual loan prepayments ranged from 41% to 53%, ABFS said in an amended annual report for the fiscal year ended June 30, 2004. The company was forced to take large write-downs in the value of its strips.

Mr. Boyle, the former spokesman for ABFS, says the higher-than-expected rate of early loan payoffs contributed to the lender's collapse. Wall Street firms stopped securitizing ABFS's residential loans in late 2003. One of the reasons, the company said in an SEC filing, was "an anonymous letter regarding us received by our investment bankers" -- warning that many borrowers were likely to refinance ABFS loans and questioning the value of its interest-only strips.

The letter, dated May 15, 2003, and addressed to the SEC and the FBI, also accused ABFS of selling notes to "unsophisticated investors...in a pyramid scheme" likely to collapse. "Who is protecting these investors?" the letter asked.

In describing why Wall Street firms stopped securitizing its loans, ABFS also cited a federal investigation of whether it was pressuring delinquent mortgage holders to deed their homes over

to the company rather than go through foreclosure, which gives them more time to try to save the house. ABFS settled the probe by agreeing not to do that.

Despite losing the ability to turn its loans into cash through securitization, ABFS was able to keep funding its lending operation, partly through the notes it pitched to individuals in mailings and newspaper ads.

Risks were spelled out in lengthy prospectuses. The last one, for a \$295 million offering dated Nov. 7, 2003, was 230 pages long, with 18 pages of "risk factors." The front page contained a bold-face warning: "You should only invest in these securities if you can afford to lose your entire investment."

Some investors admit they never read the prospectuses, or didn't understand them. "There was a lot of mumbo jumbo there," says Mr. Magnon, the retired aerospace manager.

ABFS finally ran out of cash after the SEC declined to approve another such note sale in 2004, and investment banks stopped lending to the company. ABFS filed for bankruptcy reorganization in January 2005, then four months later for liquidation.

The bankruptcy trustee's suit against the investment banks, filed in July 2006, also named some former ABFS officers and directors. They "do not believe they did anything wrong," says a lawyer for one of them. An attorney for three outside directors who are also defendants says, "As far as they're aware, the financial statements of the company fairly disclosed the financial condition."

Besides the trustee's suit, note holders have a class-action suit against some former ABFS officers and directors, filed in federal court in Philadelphia. It, like the trustee's suit, is pending. ABFS's founder and chief executive, Anthony J. Santilli Jr., died earlier this year.

Many who purchased ABFS notes after seeing its ads and direct-mail pitches say their losses have been devastating. "We are absolutely penniless now because all of our savings are gone," says R.L. Siddiqui, a retired accountant in London. He says he lost \$101,000 and his family is living on his \$300-a-week state pension. "We're just barely existing," he says.

Selling Possessions

In Palatine, Ill., Dayna Prochaska says her father, Eugene Haug, who died at 83 last year, lost \$175,000 -- "everything [he] earned" from an insurance agency he ran for 50 years. He had suffered a stroke in 2001 and the family was hoping to use the money to pay his medical bills, she says. Instead, Ms. Prochaska says, when ABFS went under, she had to sell all of his possessions, including a home and his cherished bass-fishing boat. "Everything that he had built up, everything that he had tried to save for college for his grandkids was gone," she says.

Ms. Deravedisian in suburban Philadelphia survives mostly on \$465 monthly Social Security checks, now that her savings have vanished with ABFS's bankruptcy. She has called and written to government agencies, courts, lawyers and the bankruptcy trustee. On a recent day, she spread out the correspondence, handwritten notes and other records on the kitchen table in her two-story condo in Norristown, Pa., where she lives alone.

'They Stole My Money'

Ms. Deravedisian, who emigrated from Turkey in 1950, says she had to quit working as a tailor in 1997 after a brain aneurism. She recovered, but later developed infections in her legs, which are so swollen that to go up to her bedroom she climbs the stairs on all fours. She says she went to a physical therapist for a while but stopped because she couldn't afford the \$40 copayments.

Now she rarely leaves home except to shop at a discount grocer or for an occasional breakfast at McDonald's "to see people's faces." For more than 20 years, she says, she had dreamed that when she retired she would visit a cousin in the Netherlands. "He said, 'Why don't you come and stay with us for awhile?' I said, 'I can't. They stole my money.'"

Ms. Deravedisian says she had never heard of a subprime mortgage until a few weeks ago while watching the news on television. "I wonder if ABFS was involved in this?" she thought to herself. "That's when it clicked."

Write to Steve Stecklow at steve.stecklow@wsj.com²

URL for this article: <http://online.wsj.com/article/SB120734275438190825.html>

Hyperlinks in this Article: (1)

http://s.wsj.net/public/resources/documents/ABFS_interest_ad.pdf (2)

<mailto:steve.stecklow@wsj.com>

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.

12.18 %
ANNUAL YIELD

30 MONTH TERM
30 MONTH TERM

These high interest rates available through September 30, 2008

TERM	RATE	YIELD*	BONUS	
			RATE	YIELD*
12 - 17 mos.	10.20%	10.74%	10.45%	11.01%
30 - 35 mos.			11.50%	12.18%
120 mos.	11.50%	12.18%	11.75%	12.46%

- Rate and term 3 mos. to 10 yrs.
- Fixed rate — fixed term — non-callable
- Interest compounded daily — paid monthly, quarterly, semi-annually, annually or at maturity

- \$1,000 minimum investment
- No fees or commissions
- Ask about our rates for larger investments

For a prospectus and a free information kit call anytime **1-800-776-4001**
www.ABFSONline.com



111 Presidential Blvd. • Bala Cynwyd, PA 19004

American Business Financial Services, Inc. is a publicly traded Company (NASDAQ: ABFI).

*Interest is compounded daily based on a 360 day year. The effective annual yield (money) of annual interest received for 365 days (calendar) investment term (annual) depends on the frequency and rate of compounding. The APR is not guaranteed as rates vary. The investment's value or the yield will vary as a result of market conditions and interest rate fluctuations. The offer is made in compliance with state securities laws.

© 1998, 1999, 2008

See a larger image