

Lehman Brothers collapse: If we saw it coming, why didn't we stop it?

April 11, 2012

Following the 2008 collapse of Lehman Brothers, growing ranks of financial experts have claimed that the bankruptcy was all but inevitable. But sifting through the data that was publicly available at the time tells a different story.

The September 2008 bankruptcy of Lehman Brothers, one of the largest investment banks on the planet, sent shock waves around the world.

Yet, somehow, it was completely unanticipated on the global markets.

Indeed, only one out of a total of 106 reports issued by analysts between January and September of that year recommended selling Lehman stock.

During Lehman's final days, major financial institutions such as Deutsche Bank and Morgan Stanley clamored to buy shares in the firm, and Lehman was able to hang onto its "A" rating right up to the day of its bankruptcy.

[Examining the predictability of the Lehman](#) crash, [IESE Prof. Pablo Fernández](#) questions the many financial analysts and pundits who now claim that Lehman Brothers' collapse was all but inevitable.

"Anyone who claims it was foreseeable, and yet is not a millionaire as a result, has no credibility," he says.

The calm before the storm

According to Fernández, in the months leading up to the collapse of Lehman Brothers, virtually no one was aware of the financial tsunami looming on the horizon. The firm's stock price was similar to that of other investment firms like Merrill Lynch and UBS.

There were no dramatic movements in the firm's credit default swaps (CDS), a form of insurance that guarantees payment to buyers if an underlying financial instrument fails to meet its payment obligations on time, or if the issuing institution goes belly up.

CDS prices tend to rise when there is a greater risk of default by the respective institution or country.

Yet the price of CDS on Lehman stock was not particularly high at the time of its bankruptcy.

On the contrary, their price had stabilized after peaking in March 2008, settling at levels similar to those of other banks such as Merrill Lynch or Goldman Sachs.

From strength to strength

Looking back at the recommendations made about Lehman by pundits, reporters and financial analysts in the middle months of 2008, the picture that emerges is of a company in robust health that would bounce back once it had overcome the short-term, albeit serious, difficulties it faced.

Indeed, only one company — Punk, Ziegel & Company — actually prescribed the selling of Lehman shares, and not out of fear of its potential collapse, but because it believed that Lehman stock was overvalued by a mere \$5 per share.

Fernández notes that 65 percent of investment reports — including those of inside experts like Morgan Stanley and Deutsche Bank — recommended buying. The rest advocated holding onto the stock.

According to the firm's auditors, the net income reported by Lehman Brothers in the year preceding its bankruptcy was nearly double what it had earned just three years earlier, reinforcing the impression of a company in sound health.

Very few in the financial community appeared to know what was really going on behind the scenes.

Even the three major credit rating agencies — Standard & Poor's, Moody's and Fitch's — were seemingly caught unawares.

In a document it was forced to issue after the collapse to justify its high rating, S&P stated that "fundamental credit analysis could not have anticipated" Lehman's downfall.

Hindsight soothsayers

Nevertheless, after the bank's sudden failure, the idea began to take root that the downfall of Lehman had been foreseeable all along.

In a matter of months, these "*a posteriori* prophets," as Fernández calls them, had executed a perfect about-turn. Those who had lauded Lehman's management during the good times were now claiming that the firm's bankruptcy had been obvious.

But, as Fernández argues, such arguments hold little weight, especially considering the paucity of public information at that time on the true state of Lehman's balance sheet.

Indeed, the only explanation for such accurate predictions after the fact is that the financial community has been hit by a case of collective amnesia — a worrying development in these harsh economic times, as the world looks for clear guidance to exit the crisis as soon as possible, hopefully with lessons well and truly learned.

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