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Featured Article:
The aftermath of Lehmans Minibonds Crisis and the way forward for Hong Kong

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Foreword - The fall of Lehmans Brothers Holdings Inc.

Lehman Brothers Holdings Inc. declared its bankruptcy in September 2008. The company was one of the giants in the banking industry and had enjoyed reputation in the investment banking and the trading industry. While its offices resided globally and controlled a huge network of the financial market, the fall of it brought a significant crisis to the world economy.

Starting from 2002, a type of product named the Minibond was introduced to the market. It is a structured product that was classified as debentures under the Companies Ordinance and contained complex derivative arrangements (Wong 2011, p. 44). The Domino Effect did not come to live until the severe deterioration of the world global credit crisis. The collateral contained by the Minibond perished in a sudden. This incident has discovered the deep-rooted sales force of Lehman Brothers' financial derivatives among Hong Kong banks and brokers. The criticisms toward the HKSAR Government and monitory bodies have led to social unrest concerning the protective measures to safeguard general public from the high-risk products. The community started to call for a stricter regulation on the financial products.

Until today, the world economy is still under the shadow of the Euro Debt Crisis. However the once-shaking financial market does not seem to be aware of the changing structure and financial risk in the future. This article aims to review the transformation of the financial industry in the midst of the Lehman Brothers bankruptcy crisis, capture the changing rationality of the financial market in Hong Kong and to suggest feasible policy recommendations in the latest financial development of the world.

The Changing International Financial Industry

The Evolving Monitory System

In the 20th Century, free market system was generally agreed to be the best model in the financial sector. The greed of the investment bankers and trader was the dynamic drive of the system. However the Financial Crisis in 2008 has proven that there are problems with the regulation-free financial market.

The freedom in the financial market had allowed the creation of millions of products claiming to secure high profit return. Nevertheless, the high risk under the lucrative profit was always ignored. For instance, the overgrowth of the credit amount has led to the current Euro Debt Crisis. The overlook on the risk has, in long term, weakened the ability for the world economy to withstand crisis. Even if there are monitory structures in most countries, the monitory bodies of different countries do not cooperate to a large extent to meet the rapidly globalizing market (Mathieson, 2000, p. 35). This lack of collaboration allowed the crisis spread across the world market exponentially. With the highly globalized financial market today, a single derivative product would be introduced in several markets instead of one. The Lehman Brothers Minibond Crisis all over the world is an obvious example. Without thorough cooperation and understanding, the monitory bodies of a single country could not safeguard and check the financial products in the globalized world market, not to mention to effectively manage the risk they involved.

Since 2008 more and more financial journalists used the term "Bretton Woods II" to call for a new system: for key international financial institutions like the IMF and World Bank to be revamped to meet the demands of the current age. (The Bretton Woods system was the first example of a fully negotiated monetary order intended to govern monetary relations among independent nation-states) By late 2009, more emphases were put on structural reform on the international monetary system and attention being paid to issues such as re-balancing the world economy by the stronger international institutes. The international monetary institutes including the IMF, World Bank and World Trade Organization are entrusted with higher expectation to monitor and maintain stability in the global market.

The Shifting Focus of the Financial Market

What the financial crisis brought us was also the change of the focal point of the financial power. In 2008 over 10 well known financial institutes shut down in the

West. As the Europe and America institutes suffered the most during the financial tsunami, developing world seems less worse-off relatively. By market value up to 20 January 2012 (http://www.relbanks.com/worlds-top-banks/market-cap), the top two banks of the world are from China. The Industrial & Commercial Bank of China (ICBC) and China Construction Bank (CCB) have been strong evidence to shows the increasing influence of developing countries, including China, Brazil, India and other Asia countries in the financial market. We could predict that the status quo the Western countries used to enjoy would shrink in the coming decades. Financial institutes from China, Brazil and the other growing nations would play a more crucial in the future development of the market system.

Apart from the financial power, the weakened US economy after 2008 also affected the superior position of US dollars as a global strong currency. The effect of Renminbi appreciation on US-China trade imbalances has continuously signified a shift of the economical power. As a political issue, political conflicts initiated by the financial issue (e.g. the urge from US to push RMB appreciation and free trade) would pose a threat to the stability of the world market.

The Growing Importance of the IMF

Adding to the first point concerning the free market, the IMF have played an active role since 2008 to provide monetary resources to financially incapable nations in the crisis. This had projected a new picture that nations are empowering the IMF to take action in stabilizing world economy. The G20 Summit in Pittsburgh, America in 2009 have clearly given IMF higher legitimacy. The IMF have started to monitor the economic growth and spending of the countries that received the subsidy. The increasing importance of the IMF's role implies that more crisis and disputes of the world market would be discussed and solved in the international society.

What Should the World Do?

After reviewing the foreseeable changes in the short and long run, the authorities from the governments should accordingly formulate policies to adapt to the transition. This would be especially true to city-state like Hong Kong as simply a financial center would not have the bargaining power to influence the world market. Below are a few of my policy recommendations to, but not limited to, the HKSAR Government.

A Forward-looking Financial Warning System

The financial tsunami in 2008 is somewhat like an infectious decease. After getting started in the US, it rapidly spread to European and Asian countries. When comparing to the 1997 financial crisis initiated from Southeast Asian countries, we can easily derive the conclusion that crisis initiated by the great power would be more hazardous.

The HKSAR government should consider establishing a mechanism to prevent a hard landing on future financial crisis. The system should divide world countries into 4 categories. First, the "Great Powers" (US, China and the European Union) that any change of policies, currency and crisis would lead to immediate effect to local market; Second, the "Major Stakeholders" (Japan, Brazil, India, etc.) that have been a strong participants in the world market; Third, the "Regional Countries" (Malaysia, Thailand, Mexico, etc.) that would trigger crisis within a continent or region; Fourth, the "City-states" (Hong Kong, Singapore, etc.) that hold substantial financial power but do not pose a huge threat to the world economy.

The four classes identified would better utilize the authority's resources in monitoring incidents happened in the countries. When there are clues that a crisis would pop out, the government could immediately manage the risk by providing early warning to the local financial sector or seeking assistance from other parties. To be specific, the mechanism can track the changes on the stock market, credit rating and housing property price of the world countries. A successful system could enhance the collaboration between countries, and to a certain extent decrease the uncertainty.

To Reengineer the Credit Rating System

One of the biggest dilemma currently would be the low credibility of the credit rating agencies. From the grave experience gained in 2008, the credit rating agencies may not necessary be objective and impartial to reflect the true quality of companies and products. The HKSAR Government may invest to build a public credit rating system that is non-profit making. It would motivate the local investors to reference the more accurate and transparent information of the market.

This means would better protect the investors by increasing the transparency and credibility of the credit-rating information. This would not interrupt the market too much while ensuring that the investment transaction are carried out with honest sales information, given investors may acquire relevant information of a certain market or product easily from the government.

Review the Legal Regulation on the Financial Sector

Currently the common law legal system of Hong Kong does not favor investors when the latter would like to raise a lawsuit towards inappropriate behavior. Although it would be hard to amend the legal structure, the HKSAR Government should at least modify it to suit the global market.

In the first place, the authority should legislate on the information gap between investors and financial institutes. The moral hazard that happened frequently before 2008 is that the sales force from financial institutes could easily deceive individual investors. Increasing the transparency by law would regain investors' confidence to the market. It could also improve the efficiency of banking industry to manage dishonest behavior.

Secondly, the overuse of leverage should also be monitored by the legal system. Although for those who opposed would claim that Lehman Brothers Failure is an independent case, and the use of leverage is the key of the financial system, it would be vital to note that the stability of the financial system as a whole should be put in a high priority. To detail the design of the system, the government shall not intervene the internal auditing of the financial institutes. Therefore the government should make the law a soft indicator of "safe" ration of the leverage use in different markets and sectors. It would promote and educate the investor to be cautious on the risk associated with the leverage practice of the institutes.

Conclusion - From Corporate Responsibility to Social Responsibility

There have been claims from the local investors reiterating that the HKSAR Government, Securities and Futures Commission and the Hong Kong Monetary Authority had been incompetent to realize the crisis before the bankruptcy of Lehman Brothers Holding Inc., nonetheless we must recognize that the free market approach had been the most prevailing and successful milestone in 20^{th} century. In addition to the above analysis, I would like to highlight in the conclusion that the obligation to safeguard the investor as well as to maintain market stability have transformed from a corporate responsibility to social responsibility. That means as far as it concern the stake of a large population, the authority should not let the financial institutes alone to make sure things work ethically and appropriately in the market.

The Lehman Brothers Minibond was a late reminder for the world economy. The aftermath has been disastrous and long lasting. However it did leave questions for us to discuss: are we still embracing the free financial market principle? If so, how are we going to maintain the market stability and protect the stakes of the general public? If not, how do we ensure the market would flourish and function normally? The policy recommendations would hope to attract further discussion and thoughtful solutions to the above questions.

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