



AUGUST 2009. The search for the cause of the current worldwide financial melt-down has led one to the complex field of Financial Risk Management and the Gaussian copula function, an ingenious formula published in an academic journal in 2000 by **Dr David X Li**, a Canadian-educated Wall Street quant. The elegant formula turns the otherwise intractable task of risk assessment into child's play.



Without bothering to fully understand how it worked, what assumptions were used and what the limitations were, Wall Street took the formula as a godsend and ran. Esoteric financial instruments which no one really understood were concocted along the way. Big money was made... until the sub-prime mortgage market in the US imploded and every major economy in the world started to collapse like a house of cards.

A comment at the RedTory.WordPress blogsite perhaps sums up the public's sentiment:

The truth is that a very select few fully understand how derivatives work. Yet, it was supposedly all those oh-so-much-smarter-than-us hedge fund managers (who also didn't understand how they worked) that got people invest in them. And how they got Washington to agree that only smart people invested their money in them so there was no need to regulate them.

I laughed a hearty laugh back when oh-so-clever Orange County California (a place I used to live in) went broke on them in 1994. Not only that, but derivatives played a prominent role in the S&L crisis that happened back in the late 80's/early 90's. Basically a lot of rich people gambled depositor's money on derivatives, lost and then wanted their money back.

Greed, ego, the herd mentality and the constant fear of being left behind the bandwagon have long been some of the reasons for many corporate failures. Now, this recent Wall Street episode highlights another factor for the spectacular failure of even the most venerable institutions: the Emperor's new clothes. Will we ever learn?!

Read how the now-infamous Gaussian copula function took down Wall Street in "[Recipe for Disaster: The Formula That Killed Wall Street](#)".

..... **News Alert:** Ontario to Protect CA Monopoly
Ontario CAs do not want CGAs' hands in their pockets:

- [Jeff Buckstein of The Bottom Line](#)
- [Terence Corcoran of the National Post](#)

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CanMAPP is a self-help group of accounting practitioners from coast to coast. Everyone is invited to participate in its events and in its organization.