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Bucket Shops and Regulatory Change: An Accounting Perspective

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Abstract

In the late 19th and early 20th centuries, 'bucket shops' relieved everyday workers of large sums of money. They were places where individuals could place bets (gamble) on the future price movement of stocks and commodities while they held no equity position in these items. In 1922, Congress passed the Grain Futures Act (GFA), making bucket shops illegal. Elimination of such outposts of gaming was accomplished only after decades of long legislative activity, first at the state level and then at the federal level. This paper reviews the developments related to early episodes of bucket shops and explores how the reversal of the GFA's legislative prohibition amplified the 2008 financial crisis. Furthermore, the paper provides background for improving contemporary understanding of the concept of liabilities, especially with regard to financial instruments.

Keywords*:* Financial Instruments; History of Accounting Thought; Regulation

"In peering into the future, let us also look backward." - John Hill, *Gold Bricks of Speculation* 1903

Introduction

In 2008, the International Insurance Group (AIG) was brought to the brink of ruin because of the sale of credit derivatives. The *Wall Street Journal* reported in December 2008 that AIG owed $10 billion to Wall Street firms as a result of previously undisclosed trades made with those firms (Ng, Mollenkamp, & Siconolfi, 2008). Three of the largest failures in recent years were bucket shops. Madoff, Lehman, and AIG are all examples of fine citizens of financial society who sold one-sided and unhedged contracts that they would not be able to honor, making them insolvent. However, derivatives and credit default swaps are nothing new on Wall Street: They facilitated the panic of 1907. Back then, the 'banksters' created bucket shops, which bet on the stock market. After J.P. Morgan personally contained the panic of 1907, state authorities in New York outlawed and regulated such bucket shops. Unbelievably, this 'bucket shop' system was legalized on the last day of the 106th Congress[1] with the passage of the Commodity Futures Modernization Act of 2000 (CFMA). Led by Greenspan, Bernanke, Geithner, and Clinton Treasury Secretary Larry Summers, this bill specifically forbade state authorities from regulating bucket shops. Many compare today's financial crisis to the stock market crash of 1929, but it is closer to the events of the credit freeze and bank panic of 1907.

Prior to the 2000 CFMA legislative change, all futures trading was required to be made on a regulated exchange, in view of the public. The CFMA also exempted Wall Street firms from state gambling laws. The regulation requiring that all futures contracts be made on a regulated exchange had been in place since 1922, when the Grain Futures Act was passed in order to eliminate bucket shops in the United States. Two and a half years after the CFMA was passed, trade volume in futures had increased by 50% (Keaveny, 2005).

Bucket shops were considered gambling establishments where common wage earners could bet on the future prices of stocks and commodities. This paper discusses the rise of bucket shops in the United States, the war waged by the Chicago Board of Trade and the New York

[1] The bill was signed on December 21, 2000.

Stock Exchange to eliminate bucket shops, and the legislative actions taken first by state and then by the federal government to finally dispose of the bucket shops. The paper discusses the ways in which the CFMA amplified the financial crisis of 2008 by repealing the 1922 Grain Futures Act. Stigler (1971) argues that organizations with money can either create legislation to benefit themselves or co-opt the legislative process to reduce the effect of legislation directed at them. The current legislative process has seen examples of both. Enron supported deregulatory legislation to eliminate the rules preventing bucket shops, thus opening avenues for its operations. In contrast, many people felt that Wall Street firms co-opted the 2010 process of reregulation resulting in stripping out those portions of the Dodd-Frank bill constructed to address the CFMA's problematic deregulatory legacy.

The history of bucket shops seems to have been forgotten in the decades since they were outlawed. This might have remained the case if not for the financial crisis of 2008. The 2008 financial crisis has provided a reminder that the past should not be forgotten. The early federal legislation (1922 Grain Futures Act) that eliminated bucket shops was written to rid the public of a nuisance which preyed on human weakness; gambling. With the invention of new financial instruments, Enron sought legislation to remove these restrictions based strictly on self-enrichment. Having forgotten the past, along with the reason for the passage of the 1922 Grain Futures Act, the public did not seem concerned about the potential consequences of removing the legislation. This paper serves as a reminder of a past that has been forgotten and shows that the Commodity Futures Modernization Act has helped magnify the financial crisis of 2008.

Bucket Shops

The term "bucket shop" is generally associated with activities of unscrupulous 'individuals' who take advantage of unsuspecting victims by pushing phony investments and trades that aren't meant to be honored. Traditionally, bucket shops took orders for the purchase and sale of securities from customers but did not execute the orders. Instead of executing orders for the purchase or sale of a stock, bond, or other contract, the operators metaphorically threw orders into a "bucket" and did not tell their customers about what they had done. Customers became unsecured creditors of the bucket shop and hoped that the bucket shop had the financial resources to honor their trades. It is apparent from articles written at the time that it was not obvious to potential customers that a facility was a bucket shop. Apparently, most bucket shops looked identical to a standard brokerage firm (Thomas 1900). One contemporary author went so far as to provide indicating factors that a prospective customer could utilize in determining a legitimate broker from a bucket shop (Anonymous 1923).

The period of 1890 to 1929 was similar in ways to the period of 1990 to 2008 in that the stock market was widely followed by the common person. In the 1920s it was felt that even elevator operators in New York kept up with how the market was doing each day. During World War I, the number of stock traders grew from 500,000 to over 17 million (Cowing, 1965). If a customer wanted to purchase stock in a company they were required to purchase a round lot of 100 shares[2]. For example, a $10 stock required a $1,000 investment. Today, $1,000 is not a large sum of money, but in the 1920s it was more than enough to buy an automobile. With the intense interest of the common people in the stock market, establishments were created to fill this need. Pratt (1921) stated that the bucket shops made

[2] There were dealers who would sell shares in less than 100 shares but these dealers charged a large premium for the service making the transaction cost prohibitive.

speculation affordable to the average person, depicting people as bulls eager to double their money and "inflamed" by stories of those who made immense fortunes on Wall Street.

A review of the *New York Times* articles for the term "bucket shop" revealed the first reference dated March 2, 1869. These articles were mostly police reports associated with violence surrounding low drinking establishments. Ferris (1988) provided several theories for the origin of the term bucket shop. One "romantic" theory was that beer scavengers in London slums drained beer remnants from various kegs into buckets and then returned to establishments to consume their gains.

Ferris (1988) provided another theory for the origin of the term in reference to commodities gambling. The Chicago Board of Trade required grain trades to be made in minimum lots of 5,000 bushels. Outside the Board of Trade, various brokers traded in smaller quantities. Some Board of Trade brokers would on occasion send a bucket down to the alley to get several small orders which were then put together to meet the minimum size trade on the board. The first known article in the *New York Times* referring to stock gambling was dated February 28, 1878. Regardless of the true origin of the name, by the 1880s stock and commodity gambling firms were known as bucket shops.

Bucket shops were gambling establishments where the common person could speculate on the future price of stocks or commodities. In these shops a person would place bets as small as a dollar on a particular stock. If the stock price rose the person would win, if the price fell the person would lose. Meeker (1922) described the bucket shop as a fictitious stock brokerage office that pretends to either execute a customer order or sell the stock a customer is holding for a long term.

One bucket shop proprietor was quoted as saying, "Bucket shopping is no worse than making a book at the race track, or any other form of gambling" (Teague, 1906). The difference between gambling on a horse race and gambling in a bucket shop is the control exerted by the house. In both cases the house is betting against the individual. In a horse race the house has no control over the outcome of the race; the horse that wins is the horse that wins. A bucket shop is different. The house is still taking the opposite side of the bet, but in a bucket shop the house can affect the outcome of the wager. It is generally thought that most individuals are bulls and bet on the up side of the market. The house can affect the outcome of the wager by selling stocks to lower prices.

The bucket shops called their operation "buying on margin." However, in a brokerage firm, to purchase on margin meant an individual entered into an agreement with a brokerage firm – to purchase 100 shares of XYZ stock, for example. The two parties agreed on a margin amount; say 20%. The purchaser deposits 20% cash with the broker. The broker then purchases the stock on the market. The broker either borrows from the bank or uses internal funds to finance the additional 80% of the purchase price. The broker charges a commission on the purchase and interest on the borrowed funds. If the stock value drops, the broker will call the purchaser for additional funds; a margin call. When the stock is sold the borrowed money is repaid. The broker receives the commission and interest and the purchaser receives any residual funds from the sale.

Purchasing stock in a bucket shop operated on a different premise. The bucket shop would allow purchasers to buy stock on a margin as low as 1%. When an agreement was made to purchase stock, the bucket shop broker took the purchaser's money, charged a commission, charged interest on a non-existing loan, and recorded the purchase. However, the bucket shop broker never actually purchased the stock. If the stock price increased, then the purchaser had a gain and could collect the winnings. If the stock price fell, the bucket shop kept the entire amount of money.

Allowing investors to trade on such low margins actually assisted the bucket shop in separating the customer from his funds. A stock price does not have to decrease very much before a 1% margin is depleted and the house takes the money. However, sudden increases or a long bull market tends to work against the bucket shop. In April 1885, the impending war between England and Russia caused a large surge in grain prices. A Buffalo bucket shop chain consisting of 73 locations was forced to close ("Bad for the Bucket Shops," 1885a).

In outward appearance, the bucket shop looked like a legitimate brokerage firm. The office had a chalk board used to display price changes of stocks and commodities. A ticker provided a continuous stream of prices from the exchanges. For many individuals, it was difficult to recognize a legitimate broker from a bucket shop. Teague (1906) provided a list of questions an individual should ask a prospective broker before investing any funds in order to assist in differentiating a bucket shop from a brokerage firm.

While both the horse track bookie and the bucket shop operator have incentive to influence the outcome of the bet, it is much more difficult to change the outcome of a horse race. As the bucket shops evolved and gained sophistication, their operators obtained more tools to influence the outcome of bets.

Teague (1906) wrote from the prospective of an investigator, having been one during the Haight and Freese bucket shop case. Haight and Freese operated a chain of bucket shops throughout the East and Midwest. Teague accused the bucket shops of using a vast assortment of tactics to influence the outcome of the wagers. These tactics included spreading rumors by contacting individuals on the market to talk down a stock. Another tactic was the wash sale: Teague accused the bucket shop operators of paying stock exchange members to put wash sales through on the market in order to decrease stock prices. The act began by paying two brokers to agree to act as agents buying and selling a security at a set price that was lower than the market. This price then went over the wire and made its way to the bucket shop, where the customer account was then closed for being over the margin on the stock. To back up this allegation, Teague presented affirming testimony from George Turner of the Haight and Freese Company.

In an anonymous article published in *The Literary Digest*, an author who had worked in a bucket shop told of another method to keep a customer from winning. The author worked a phone bank, calling prospective customers to solicit investments. When the author got a customer to invest in a particular stock, the trade closed at a particular number, say 114 ¾. Reading the paper the next day, the salesman would find that the high for the day had actually been 114 (Anonymous, 1922).

Efforts to Eliminate Bucket Shops

In 1882, the Chicago Board of Trade (CBOT) undertook endeavors to eliminate bucket shops ("Spoiling the Bucket Shop," 1882c). CBOT decided that the way to shut down bucket shops was to remove their tickers. If the bucket shops did not have access to the quotes, then they could not bet on the future changes in price. CBOT maintained that quotes were the property of the exchange and therefore telegraph companies could not sell them to anyone without the permission of CBOT ("Bucket Shops in Chicago," 1882a). On November 28, 1882, CBOT announced that the bucket shops would be cut off from the quotes effective December 1 ("Spoiling the Bucket Shop," 1882c). Bucket shops around the country took the case to the courts in hopes of forcing the telegraph companies to continue furnishing quotes. Injunctions were achieved in numerous cities including Cleveland ("A Bucket Shop Defeated," 1883a), New Orleans ("Bucket Shop Men Defiant," 1883b), and Chicago ("Decision against a Bucket Shop," 1883d). In the Illinois legislature, a bill was introduced to force CBOT to furnish quotes to anyone ("'Bucket Shop' Bill Killed," 1883c).

In November 1884, CBOT signed a new contract with Western Union which included a provision that Western Union would only furnish quotes to authorized customers ("After Bucket Shops," 1884a). Western Union removed tickers from all but three bucket shops; one in Louisville and two in Chicago which still had court ordered injunctions in place restricting the removal of the equipment. On November 22, 1884 CBOT requested Western Union remove all equipment from CBOT premises by the end of the month ("The Chicago Bucket Shops," 1884b). In May 1885, CBOT moved into new premises and no telegraph companies were allowed to install wires ("The 'ticker' War Renewed," 1885d). The only wires exiting were CBOT owned wires. On May 2, 1885, the *New York Times* reported that bucket shops were functioning normally, receiving quotes from some other source ("Fighting the Bucket Shops," 1885c).

In July 1885, CBOT discontinued the provision of quotes to the Louisville Board of Trade, claiming that the Louisville Board was furnishing quotes to bucket shops. After the Louisville Board of Trade adopted a resolution to cut off the bucket shops, CBOT restored service ("Brought to its Senses," 1885b). Philadelphia bucket shops fought against being cut off, claiming that telegraph companies were common carriers ("A Demand for Legal," 1886c). The Philadelphia shops were granted an injunction pending a hearing ("The Bucket Shop War," 1886a). However, the judge decided bucket shops constituted illegal gambling and removed the injunction, allowing tickers to be removed ("Bucket Shops Illegal," 1886b).

The New York Stock Exchange (NYSE) joined the movement to eliminate bucket shops in September 1884 ("War against the Bucket Shops," 1884c). The NYSE quotes were gathered by the Gold and Stock Telegraph Company, and then furnished to Western Union for distribution around the country. Some felt that CBOT and the NYSE were not merely working for the greater good in their efforts against the bucket shops. Boyle (1920) stated that CBOT was acting in "enlightened self-interest" in their fight against the bucket shops. CBOT believed that their reputation was impugned by the bucket shops (Markham, 1987). Both CBOT and the NYSE believed that the money being lost in bucket shops would be profit in their member firms if the shops were eliminated (Ferris, 1988).

Living and Dying in Muckraker Time

At the turn of the 20th Century, muckraking journalism began to increase. Journals published articles criticizing public vices and expressed opinions against issues for which individual authors sought legislation to eliminate. One of the most widely known is *The Jungle,* written by Upton Sinclair in 1906, in which he described the conditions in the Chicago stock yards. *The Jungle* was helpful in facilitating the passage of the Pure Food and Drug Act by the US Congress. The bucket shops were a natural target for muckrakers. Publications such as *Arena*, *Outlook*, and *Munsey's* printed articles not only against bucket shops but speculation in general.

The magnitude of the bucket shop problem was indicated by a *New York Times* article in November 1887, in which it was reported that there were over 5,000 bucket shops operating in the US and Canada ("Bucket Shop Sharpness," 1887). The wealth accumulation of the gilded age brought more outspoken criticism. Much of the discussion focused around the difference between speculation and gambling (Cowing, 1957). The bucket shops argued there was no difference between the speculators on Wall Street and the commerce performed in a bucket shop. As public opinion increased against both speculation and the bucket shops, state legislatures began to pass bills aimed at removing both from the marketplace.

Early legislature attempted to remove the bucket shops by defining them as organizations with a sale of securities where there is no intent to deliver the security. These laws were extensions of gambling laws, and bucket shop proprietors were arrested for gambling. Anti-bucket shop laws were passed in Illinois, Michigan, and other states in 1887.

C. C. Christie, a bucket shop owner, published a pamphlet in 1906 arguing that the Chicago Board of Trade was the largest bucket shop in the country (Christie, 1906). Christie stated that the laws deeming a bucket shop illegal defined them as institutions that sell securities that they have no intention to deliver. Christie wrote that three quarters of trades on the CBOT were never intended to be delivered and therefore the institution was a bucket shop under Illinois law. He argued that the CBOT should be shut down, not the bucket shops. Cowing (1965) provided supporting evidence, showing that in the 1870s the grain traded on the CBOT was seven times the annual grain production of the United States. Despite the correctness of Christie's argument, the court sided against Christie.

Following the panic of 1907, additional laws were passed in many states seeking to control speculation and eliminate the bucket shops (Cowing, 1957). One such set of regulations, the Blue Sky Laws, were designed to require all sellers of securities to clearly disclose what was being sold and how much the seller was making on the transaction. The Blue Sky Laws required two major changes. The first change was the licensing of brokers. The second was that an application had to be filed and approved by the state before any security could be offered for sale. New York, with the most stock issues, did not have a Blue Sky licensing law. Instead of licensing brokers to limit fakers from public access, New York went in the other direction. They investigated abuses after the fact. The law passed in New York required the attorney general to investigate any security that appeared to be fraudulent (Editor, 1924).

Federal Regulation

The United States Congress started working on its own financial market legislation in 1890. The first pieces of legislation introduced were anti-option bills aimed at controlling speculation. Debate over a series of bills continued in congress for four years without any act being passed. When the two individuals that annually put forth a regulatory bill departed congress, the possibility of federal financial regulation died for a period of time. Following the panic of 1907, there was a renewed interest in anti-speculation bills in the United States Congress (Parker, 1911).

Untermyer (1915) argued for regulatory legislation of the New York Stock Exchange. Among his arguments for regulation was the idea that the exchange was unincorporated and therefore had no legal regulations imposed. The membership of the exchange was limited to 1100 persons; a limit which had been reached 40 years prior. The exchange was the sole judge of which securities it would list. Untermyer argued that these issues gave the exchange too much power, and therefore needed to be regulated.

Congress passed the first futures trading legislation in 1921. Called the Futures Trading Act, this legislation established a prohibitive tax on futures trading that was to be overseen by the Department of Agriculture. However, the Supreme Court declared this act an unconstitutional exercise of the taxation authority of congress. Congress responded with the Grain Futures Act of 1922, which relied upon the commerce regulatory powers of congress rather than the taxation powers. This act required that all futures trading transactions be done on a regulated exchange overseen by the Secretary of Agriculture. The Grain Futures Act also required the exchanges to prevent manipulative conduct by their members. The Secretary of Agriculture created the Grain Futures Administration to administer the act as well as hold an investigate role, while the exchanges maintained self-regulation (Keaveny, 2005).

Following the stock market crash of 1929 and the creation of the Securities and Exchange Commission in 1934, congress again focused on commodities regulation. One senator at the time referred to the CBOT as the "world's greatest gambling house." This comment echoed what C.C. Christie had said when referring to the CBOT thirty years earlier. The Commodity Exchange Act was passed in 1936, replacing the Grain Futures Act of 1922 and increasing regulation over futures transactions. The act required much work because the securities legislation was controlled by the banking committee while the futures industry was controlled by the agriculture committee (Keaveny, 2005). A Commodity Exchange Authority (CEA) was created to enforce the act. The Commodity Exchange Act included statutes against price manipulation in addition to creating position limits, establishing registration requirements for brokers, and initiating a margin requirement for customers. All the pieces of the Commodity Exchange Act were an attempt to reduce pure speculative actions on the commodity exchange (Keaveny, 2005).

The Grain Futures Act of 1922 had two major limitations. First, the Grain Futures Administration had only an investigative role, and only one internal auditor to carry out that role. With a staff of one, the administration was unable to fully oversee the commodities market. The Commodity Exchange Act of 1936 (CEA) provided additional investigative staff to allow for greater oversight of the brokers and the exchange. One success of the CEA was having Cargill expelled from membership of the exchange for manipulation of grain prices. Cargill was subsequently prosecuted for price manipulation of corn and oats (Keaveny, 2005).

In 1968, congress amended the Commodity Exchange Act to increase its regulatory authority. This amendment created more minimum financial requirements for brokers, expanded the reach of the act to include livestock and orange juice futures, and increased criminal penalties for market violations. The Commodity Exchange Act was also given the power to override rules passed by exchange members (Keaveny, 2005).

Keaveny (2005) provided evidence that although the Commodity Exchange Act was effective in some cases, such as Cargill, overall it was not very effective in regulating the commodity market. To illustrate this conclusion, one investigation noted that 10% of the trading volume on the exchanges came from wash sales. To eliminate wash sales and institute other controls, congress responded with the Commodity Futures Trading Commission Act of 1974. The Commodity Futures Trading Commission (CFTC) was created as a regulatory body similar to the Securities and Exchange Commission. CFTC was an independent board consisting of five members who held jurisdiction over all futures and options trading, not just specific commodities listed under the prior acts. Similar to the SEC oversight of the securities exchanges, the CFTC would oversee the broader markets and leave the exchanges to self-regulation.

The original federal laws and their subsequent modification meant that all contracts for future delivery had to be traded on a regulated exchange and were subject to federal oversight. In the 1980s and 1990s the federal government started removing regulations of various industries. Following the collapse of Long Term Capital Management in 1998, then treasury secretary Robert Rubin declared that additional futures regulation would be forthcoming. Long Term Capital Management made huge bets on financial derivatives based on a financial model of how the market worked. Unfortunately, the firm failed when the market did not react as the model had projected.

Commodities Futures Modernization Act

In 2000, Enron was trading electricity and moving into other markets. Enron did not want to have to send all transactions through an exchange; they wanted to be the exchange. However, under the standing commodities legislation Enron was not able to do so without becoming a regulated exchange. In order to not be subject to federal oversight, Enron requested that the law be changed. Everyone concerned with the legislative change was in favor of deregulation (Keaveny, 2005). The Commodity Futures Trading Commission, the federal body charged with overseeing commodities trading prior to 2000 stated that it was willing to grant broad regulatory relief. The Chicago Board of Trade wanted the change, as it felt that replacing rules with principles would remove barriers that hamper markets.

On the last day of the last session of the "lame duck" congress of 2000, the Commodity Futures Modernization Act was passed and signed into law by President Clinton without any debate in congress (Keaveny, 2005). Syndicated columnist Molly Wins (2000) commented that congress had passed a "little horror that was a lump of coal in our stockings."

The Commodity Futures Modernization Act removed oversight and control over the derivatives market. In his discussion of the act, Hazen (2005) stated that regulation of legalized gambling is designed to protect gamblers from fraud and manipulation. The former commodities regulation was not only to prevent fraud and manipulation but also to permit only those derivatives contracts that met economic and public policy requirements. Enron had provisions included in the bill that blocked federal oversight of many of their own trading businesses (Schroeder & Ip, 2001).

The Commodity Futures Modernization Act removed all restrictions on the kinds of futures contracts that could be traded as well as all restrictions on who could be a participant in these contracts (Hazen, 2005). Two and a half years after the passage of the Commodity Futures Modernization Act the volume of futures traded had increased by 50% (Keaveny, 2005). As stated above, Stigler (1971) argues that organizations with money can either create legislation to benefit themselves or co-opt the legislative process to reduce the effect of legislation directed at them. Enron eliminated the rules preventing bucket shops by creating legislation benefitting itself.

Contemporary Issues

The changes made by the Commodity Futures Modernization Act (CFMA) did not bring about a return of the bucket shops, per se. However, it is felt that this regulatory change did have an effect on the financial crisis of 2008. The 2008 crisis began with the housing bubble and the related derivative securities which spread to the financial institutions involved.

AIG and others were underwriting credit default swaps on huge quantities of the collateralized mortgages being issued by financial institutions. *These credit default swaps were viewed as 'de factor' insurance, guaranteeing that if the borrower failed to pay the underlying mortgage, AIG would pay.* Financial analysts and rating agencies either overlooked the underlying securities or tacitly approved them as creditworthy. The housing industry had been stable and growing for years. It appears that AIG believed the premiums collected would be free money because they would never have to pay off these guarantees. People defaulted on mortgages because it was assumed that the value of the property would never decrease sufficiently enough to threaten the securities' worth. AIG had written billions of dollars worth of credit default swaps on the outstanding debt of other institutions. To avoid bankruptcy, AIG received $120 billion in financial aid from the United States Government.

Prior to the passage of the Commodity Futures Modernization Act, all of AIG's futures transactions were required to be traded on a regulated exchange and therefore in the public eye. The CFMA removed that requirement. On September 30, 2008, AIG had exposure to $71.6 billion due to collateralized debt obligations (Ng et al., 2008).

With decades of deregulation leading up to the current financial crisis, new federal regulation is a certainty. Following the stock market crash of 1929 and the resulting depression, the United States Congress passed a myriad of regulatory laws overseeing the financial landscape of the country. Treasury Secretary Timothy Geithner announced plans to regulate derivatives trading (Lynch & Ng, 2009). However, large companies are pouring money into Washington lobby firms to fight any regulation of derivatives (Scannell, 2009).

The Dodd-Frank Bill

Financial regulation in the United States generally follows a pattern. When there is a crisis, the public is outraged at the results and congress decides that something must be done. Following the financial panic of 2008, there was little doubt that congress would be inclined to produce some regulatory legislation. The second half of the Stigler argument was that the legislative process can be co-opted by those in the crosshairs of the legislation. The Dodd-Frank Bill is an example of this co-opt. The original proposal is nothing close to the legislation that emerged after major portions of the bill were stripped out during the committee process (Paletta & Scannell 2009; Paletta, 2010). While the Dodd-Frank Bill did increase government regulation of financial markets, additional controls over derivatives trading failed to reappear in the legislation. The freedom still exists for anyone to trade derivatives.

Future research is needed to understand the lack of transparency brought about by the CFMA deregulation in 2000. With the ability to trade any derivatives anywhere and at any time, the public is left in the dark as to the real amount of liabilities outstanding on company financial statements. For the accounting profession, auditors must try to determine if a company has disclosed the proper amount of outstanding liability. Here auditors are left at the mercy of company management, relying on them to be completely honest and disclose an amount that is sufficient based on the conservative principles of accounting. In the AIG situation, this was obviously not the case. The true liabilities of a company regarding derivatives can only be truly determined after the fact. This leaves the accounting profession liable and exposed to potential audit failures. It is possible that further research could develop a financial model able to assist in the prediction of liability arising from economic factors.

Additional research could focus on the mispricing of derivatives resulting from the absence of transparency. When the CFMA removed derivatives trading from regulated markets a purchaser could no longer determine pricing from prior trades. The financial firms now have the ability to extract the highest price attainable from each customer.

Conclusion

Margavio (1993) explored the regulation, deregulation, and re-regulation of the savings and loan (S&L) industry. This cycle showed the collapse of the S&L industry and the subsequent take over by the federal government. The S&L crisis cost the United States taxpayers over $500 billion (Mayer, 1990). Margavio further illustrates the role of the accounting profession in the S&L crisis. As gatekeepers, the accounting profession failed to help identify industry problems before the collapse. This lack of proactive effort left the accounting profession trying to explain why it had failed to act.

In the current study we illustrate a similar pattern. The early regulation of derivatives was presented along with one of the root causes of the regulation; bucket shops. Regulation was traced from its beginnings to the point of deregulation. We are now experiencing a financial crisis on a magnitude not seen since the Great Depression. We find that the deregulation of derivatives assisted in the magnification of our current crisis. Unfortunately, there has yet to be re-regulation of any significance. While the accounting industry has not been generally indicted over the current crisis, it is not sheltered from the storm. Once again, the accounting profession has been left trying to explain why it sat on the sidelines and watched events unfold without standing up and alerting the world to the problem.

Much of the current crisis is the result of an asset bubble. Bubbles come and go; they cannot be controlled. The accounting profession has no liability in causing the bubble. Where the accounting industry has failed is in the disclosure of liabilities. The financial statements of AIG failed to indicate the level of exposure the company had regarding the trade of derivatives. The accounting profession allowed Lehman Brothers to offload debt each quarter to appear more financially sound.

This paper presented a sequence of events, starting with the advent of the bucket shops, continuing with Enron's facilitating the passage of the Commodity Futures Modernization Act, and ending with the creation of the Dodd-Frank bill. Early 20th century progressive journalists fought the bucket shops as part of their moral crusade. The CBOT and NYSE assisted in the crusade for their own gains, expecting to gain transactional income by funneling the trades into their domain. However, the general view was that bucket shops were a type of gambling den and that the world was a better place for their having been removed.

The investing public continues to say *caveat emptor* in regards to investments. However, the public looks to the federal government to be paternalistic and provide protection from the hazards of investment losses. There is little complaining when most everyone is winning. It is only when the majority start to lose that the public wants protection. Cowing [1965] writes that P.T. Barnum was correct when he said that that the gullible public never changes. He further speculates that a gradual education of the public would cause bad practices to disappear. It is not likely that the general public ever will be sufficiently educated about financial markets. After shocks to the system, governmental regulations appear in an attempt to save us from ourselves. The state "Blue Sky" laws followed the market crash of 1907. These laws were intended to remove fraudulent stock and bond issues from the marketplace. The stock market crash of 1929 resulted in the creation of the Securities and Exchange

Commission among other regulatory changes. Unfortunately, the current crisis only resulted in the Dodd-Frank bill. Its promise appears limited.

The bank panic of 1907 is remembered for J.P. Morgan forcing all the bankers to stay in a room until they had agreed to contribute to fixing the crisis. What has been forgotten is one major cause of the crisis – unregulated speculation on the prices of securities by people who did not own them. The major causes of the financial crisis were not how lax our regulation, or how hard we enforced, but what we chose not to regulate. What we decided was old fashioned and in need of modernization was, in fact, an effective check on an activity that had been illegal for a century, and for good reason. What was forgotten was that the biggest competitive advantage of the United States financial system has always been safety, security, and transparency; with that perception destroyed the social and economic cost to our society is incalculable.

The muckrakers work against the bucket shops was indeed a moral crusade. CBOT and the NYSE fought the bucket shops for personal benefit. Both exchanges believed that all the trade being serviced by the bucket shops should be commissions to their brokers. In this effort, the governmental legislation may have been founded on moral fiber but definitely aided and benefitted CBOT and NYSE. Enron intended to benefit from the deregulation of the Commodity Futures Modernization Act, but did not survive long enough to do so.

The Enron legacy continues to haunt us today. Enron lobbied hard for the passage of the Commodity Futures Modernization Act. Their lobbying effort was for their own benefit, but even after the Dodd-Frank Bill, Enron left us with a leaking bucket; unregulated derivatives trading. In writing about his efforts in the crusade against the bucket shops, John Hill ends his book with the following quote: “In peering into the future, let us also look backward” (Hill, 1903).

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