

# **Exploring the Perils of the Precious Metals Market**



## **United States Senate Special Committee on Aging**

*Summary of Committee Staff Investigation*

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## SUMMARY

Precious metals are a class of metals deemed rare or highly valued, such as gold, silver, palladium, and platinum. Since the advent of exchange-traded funds for these metals in the early 2000s, demand for precious metals jumped significantly. Then, when the 2008 financial crisis hit, the allure of precious metals as a relatively safe investment grew even more.

As more and more Americans sought the safety of precious metals, thieves, con-men, and swindlers entered the retail market looking for an easy buck. They lured seniors and other populations with tall tales of quick riches, endless profitability, and privileged information. Consumers were told that precious metals were immune from market volatility, even though commodity prices are subject to the general fits and starts of supply and demand. In 2013 alone, the price of gold fell nearly 30 percent.

Some of the telemarketing firms that sold retail precious metals worked with seedy suppliers to defraud consumers by either taking customer money without any intention to deliver the metals, or applying the transaction on paper only—through derivative contracts, such as gold futures. Although customers were led to believe they owned the metals outright, many of them in fact only owned a stake in a derivatives contract held by the company, and they suffered the first loss if the metal declined in value.

Many of these firms convinced would-be consumers that an impending jump in the price of a metal was right around the corner, getting them to act fast on supposed privileged information, which in some cases was found to be contrived out of thin air. Customers were also pressed to store the metals they purchased in an account not under their control, rather than take physical delivery of the metal. The firm could then charge storage fees on top of commission and account fees, and any price markup charged by the supplier. Remarkably, in some cases, Committee staff found storage fees were applied even though no metal was actually stored on behalf of the customer.

Disreputable retail precious metal companies use various tactics to extract as much money from their customers as possible, including pressuring them to use in-house credit to buy more of the metals. Through this financial arrangement, the company can charge interest expenses on the total metal value even though the customer never takes physical possession of it. In some of these cases, customers are not told—either before or after the sale—about the risks involved in such financial arrangements, and the possibility they may end up with negative equity if the price of the metal declines and they are subject to a margin call that puts them on the hook for the remaining balance of the loan. In fact, these financed transactions make it nearly impossible for customers to get a return on their investment.

Recently the Federal Trade Commission (FTC) and the Commodity Futures Trading Commission (CFTC) have stepped up efforts to combat the worst practices in the industry. Generally, the FTC has gone after nefarious retail precious metal dealers that use high-pressure sales tactics to deceive consumers into believing they'll earn substantial profits in a short period of time. Some of them may also hide or understate the risk involved with the purchase, or fail to disclose all the fees and commissions charged.

Meanwhile, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) gave the CFTC the ability to regulate retail commodity transactions, including the sale of precious metals. In recent years, the CFTC has exercised its authority by going after precious metal companies that take customer funds without physically delivering the metals to the customer, or to a storage account under his or her control.

Even though the federal government has stepped up enforcement actions, many unscrupulous precious metal dealers are still able to cheat customers due to a lack of transparency within the industry and relatively little monitoring of their business practices. However, local officials in Florida, Minnesota, Texas, North Carolina, and California have made progress at combating the worst practices in the industry.

During a year-long investigation into the industry by Committee staff, several precious metal firms were contacted to learn more about their practices. Although some of the firms were cooperative, a number of them employed various tactics to shield their activities from public scrutiny. Committee staff found the retail precious metals world to be incredibly limited, with a handful of salespeople and managers going from one firm to the next. In at least one case, employees who worked at one firm that was shut down by a federal regulator moved to another company to sell precious metals to customers unaware of their tainted history.

While many firms claim to not deal with seniors in any notable capacity, direct observation of their sales calls suggest they look for customers with attributes that tend to apply to seniors. During a sales call, several questions are asked to gauge the profit potential of the customer, including the age of the customer and the amount of money he or she has in a retirement account. According to state prosecutors, many firms pressure customers to use their retirement savings to buy the metals. Retirement savings are sought after because federal law allows the funds to be used on a pre-tax basis for the purchase of the metals.

Even though the law imposes strict standards for the quality of metals eligible for purchase through a retirement account, there are no restrictions on the type of financial arrangement used to purchase the metal. In other words, pre-tax retirement funds can be used to purchase precious metals financed in part with in-house credit, which has been found to be highly risky.

Committee staff conservatively estimates that more than 10,000 Americans have been victimized through these schemes, with losses around \$300 million. Unfortunately, while federal and state regulators continue to be aggressive against the worst actors in the industry, many other bad actors are able to continue their shady dealings with impunity. The purpose of this staff investigation is to shed light on these schemes and help protect consumers from the perils of the precious metals market.

## WHAT ARE PRECIOUS METALS?

Precious metals are a class of metals deemed rare or highly valued, such as gold, silver, palladium, and platinum.<sup>1</sup> Such metals can be bought and sold in the form of bullion bars, ingots, or coins.<sup>2</sup> Due to the size and weight of the goods, investment firms typically transfer the title of the metal instead of the metal itself, which often remains in storage under the care of the firm or its affiliates.<sup>3</sup>

Like all commodities, the price of precious metals fluctuates.<sup>4</sup> Still, the metals are perceived to be the safest form of investment, as they can be less volatile than the stock market.<sup>5</sup> An April 2011 Gallup poll found that 34 percent of Americans thought gold in particular was the best long-term investment, more than any other investment category, including real estate and mutual funds.<sup>6</sup> Precious metal sellers often use this perception to their advantage when soliciting customers. However, the public's comfort with gold may be waning, as a 2013 Gallup poll found the percent of Americans that viewed gold as the safest investment slipped from 34 to 24 percent.<sup>7</sup>

Unlike stocks and bonds, the value of precious metals is not based on the revenue stream or the earnings potential of an underlying asset. It is based purely on the supply and demand of the metal, whether the demand is driven by industrial uses or investment appeal. Over the last decade, the price spikes of gold and other precious metals largely coincided with the advent of commodity exchange-traded funds (ETFs), which allow small investors to jump in and out of the market quickly and cheaply.<sup>8</sup>

Many analysts believe it is easier to place a value on stocks and bonds—because they can be linked to dividends and interest—than it is to value gold, because its value is based on an investor's perception of its worth.<sup>9</sup> Although precious metals can be safe investments during periods of financial distress, their value becomes less attractive during periods of economic stability.<sup>10</sup>

The following graphs compare market volatility for precious metals and the stock market, as represented by the Standard & Poor's 500 (S&P 500) Index. As these graphs show, both precious metals and stocks can experience periods of volatility, and neither are immune from wild swings in the market.

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<sup>1</sup> <http://www.investopedia.com/terms/p/preciousmetal.asp>

<sup>2</sup> <https://www.fidelity.com/trading/investment-choices/gold-silver-platinum>

<sup>3</sup> Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

<sup>4</sup> [Baiocchio, Paul. The Gold ETF/Physical Gold Disconnect. \(blog\). April 23, 2013.](#)

<sup>5</sup> [Americans Choose Gold as the Best Long-Term Investment](#), Gallup (August 25, 2011)

<sup>6</sup> [Jacobe, Dennis. "Americans Choose Gold as the Best Long-Term Investment." Gallup. August 25, 2011.](#)

<sup>7</sup> [Jacobe, Dennis. "Gold Loses Luster in U.S. as Investment; Real Estate Gains." Gallup. April 16, 2013.](#)

<sup>8</sup> [Light, Joe. "What's Next for Gold." \*The Wall Street Journal\*. November 1, 2013.](#)

<sup>9</sup> [Ellin, Abby. "The Truth About Buying Gold." \*ABCNews.com\*. June 12, 2012.](#)

<sup>10</sup> [Kristof, Kathy. "Should You Invest in Gold?" \*Kiplinger\*. September 7, 2011.](#)

## Both Precious Metals and Stocks Experience Volatility



\*Source: Kitco Metals Inc. (kitco.com) and Yahoo Finance

Although many legitimate market analysts believe precious metals are a good way to diversify an investment portfolio,<sup>11</sup> they warn that investments in precious metals only make sense if an investor has money he or she does not need right away.<sup>12</sup> Unfortunately, unscrupulous precious metal dealers who are the subject of this investigation have often manipulated those with very limited resources, especially senior citizens, into moving all of their assets into unfavorable precious metal transactions, riddled with high fees, commissions, and other hidden costs.<sup>13</sup>

## THE PILLARS OF FRAUD & DECEPTION

Retail precious metal scams often involve several firms acting in unison to extract as much money from a customer as possible.<sup>14</sup> One firm acts as a telemarketer, known as the introducing firm, often soliciting retail investors through high-pressure sales tactics.<sup>15</sup> Once the customer decides to invest in the precious metal, his or her information is passed on to a separate, but affiliated entity, known as a wholesale dealer.<sup>16</sup> Wholesale dealers are supposed to buy the metal from a distributor and ship it directly to the customer, or store the metal on the customer's behalf.<sup>17</sup> In exchange, the introducing firm shares a percentage of its fees with the wholesale dealer.<sup>18</sup> The wholesale dealer also typically charges a spread of 3 to 5 percent of the current market price of the metal.<sup>19</sup>

The introducing firm typically charges a commission for the transaction, which can amount to 15 percent of the total metal value, in addition to any fees associated with opening an account,

<sup>11</sup> [Id.](#)

<sup>12</sup> [Ellin, Abby. "The Truth About Buying Gold." ABCNews.com. June 12, 2012.](#)

<sup>13</sup> [Light, Joe. "What's Next for Gold." The Wall Street Journal. November 1, 2013.](#)

<sup>14</sup> Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

<sup>15</sup> [Id.](#)

<sup>16</sup> [Id.](#)

<sup>17</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\), pg. 10-14](#)

<sup>18</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\), pg. 11](#)

<sup>19</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#) and [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#)

storing the metal, or delivery of the metal.<sup>20</sup> In some cases, customers are charged storage fees even though no metal is stored on their behalf.<sup>21</sup> In such cases, customers are led to believe they own the metal, but in reality the wholesale dealer may only cover the purchase on paper through offsetting derivatives<sup>22</sup>—such as futures, forwards, and rolling spot contracts.<sup>23</sup> In some cases customer purchases are “covered” by giving them a direct stake in the derivatives, through which the customer receives the first loss if the derivative declines in value.<sup>24</sup>

Many of the retail precious metal companies involved in these scams also offer in-house credit to help customers buy metals through “leveraged” or “financed” transactions.<sup>25</sup> In such cases, the customer usually pays 20 to 25 percent of the full metal cost, with the remainder financed through in-house credit.<sup>26</sup> The customer is responsible for paying back the full amount of the loan, plus interest.<sup>27</sup>

Since the purchased metals act as collateral for the loan, leveraged transactions add more risk to the investment, even though many customers believe they wholly own the metals and can wait out any downturn in the market.<sup>28</sup> However, in a leveraged transaction if the value of the metal depreciates below a minimum threshold – typically 10 percent<sup>29</sup> – the investment account is subject to a margin call, requiring the customer to buy more of the metal to maintain the equity in the account.<sup>30</sup> If the customer cannot cover the margin call, the account is usually liquidated—without customer permission—to cover the remaining balance of the loan.<sup>31</sup>

While leveraged transactions increase the profitability of precious metal firms, it is nearly impossible for consumers to make a profit from such transactions.<sup>32</sup> In fact, with all the hidden charges attached, they can easily end up with a loss greater than their initial investment.

Here’s an example, as illustrated in the following graphic: A customer buys \$10,000 worth of gold through a leveraged transaction. He covers 20 percent of the cost by putting \$2,000 down. The firm finances the remaining \$8,000, charging the customer 9.5% interest, or \$760 annually.

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<sup>20</sup> [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#) and Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

<sup>21</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#); [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#); [CFTC v. Lions Wealth Holdings, Inc., et al., No. 2:13-cv-01787 \(D. Nev. filed Sep. 30, 2013\)](#)

<sup>22</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#)

<sup>23</sup> Rolling spot contracts are commodity contracts meant for immediate delivery but are rolled into to the next month, moving forward the delivery date. They can be rolled forward in perpetuity. In effect, this allows traders to buy and sell the contracts without the need to ever take or make immediate delivery.

<sup>24</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 13

<sup>25</sup> [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#), pg. 4-5 and [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 10

<sup>26</sup> [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#), pg. 4-5, and [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 10

<sup>27</sup> Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

<sup>28</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 10

<sup>29</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 11

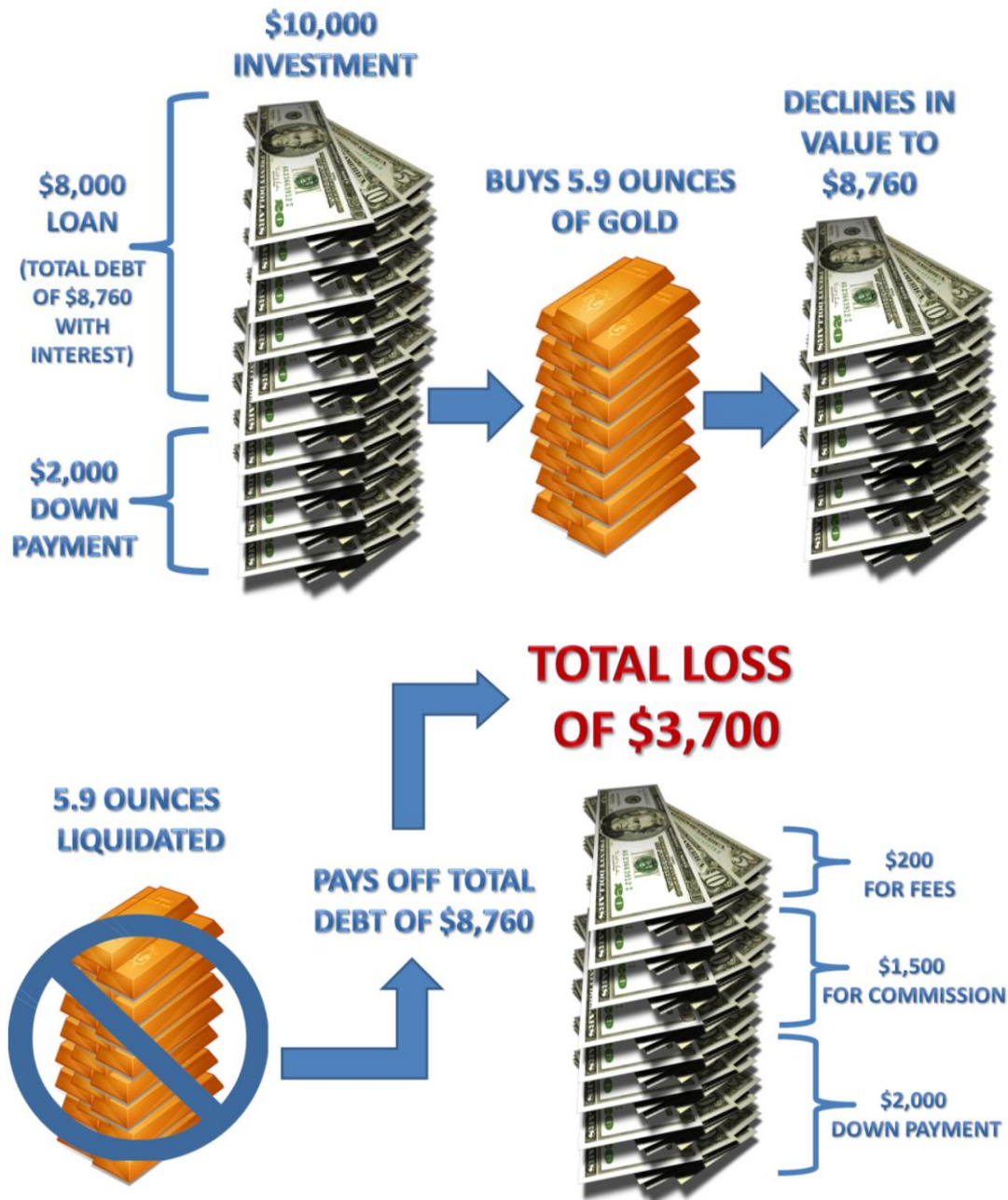
<sup>30</sup> *Id.*

<sup>31</sup> [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#), pg. 11 and

<sup>32</sup> Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

The firm also charges him a 15% commission, totaling \$1,500 in addition to \$200 in other fees. Interest payments aside, the customer is already out \$3,700 from the start. If the value of the gold drops below the value of the loan plus interest (\$8,760), the metal is automatically liquidated and the customer loses that \$3,700 with no gold to show for it.<sup>33</sup>

### How Customers Lose Out on Leveraged Transactions



<sup>33</sup> \$3,700 total cost, assuming \$1,500 paid for a 15 percent commission, \$200 paid for fees, and the loss of the original \$2,000 down payment.



In this scenario, the customer would only make money if the value of the gold increased to cover storage and service fees, commission costs, and the cost of the loan plus interest; without first experiencing any significant decline in price. Unfortunately, the market for precious metals is not immune to volatility, as changing expectations can lead to significant swings in the market. In 2013 alone, the price of gold fell nearly 30 percent.<sup>34</sup>

While many investment firms try to steer their customers toward financial safety, several precious metal companies have been found to lead nearly all of their customers to financial ruin through a gamut of fees, debt expenses, and commission charges.<sup>35</sup> For example, since it commenced operations, wholesale dealer Hunter Wise—along with its affiliates—lost more than 91 percent of its customers' funds to fees and trade-related losses.<sup>36</sup>

## ON THE INSIDE

Thanks to the cooperation of the New York County District Attorney's Office in New York State, Committee staff interviewed Karl Spicer, an insider from Boynton Beach, Florida. Mr. Spicer worked in the retail precious metals industry for nearly seven years, most recently working for a firm indicted on charges of fraud for misleading investors. According to the District Attorney's Office, Mr. Spicer's firm, PMCO Services Inc., pressured customers to use their retirement savings to buy precious metals on leverage, taking nearly \$7 million from 150 investors.<sup>37</sup>

According to Mr. Spicer, salespeople would typically give customers three reasons to buy precious metals,<sup>38</sup> emphasizing the need to act quickly to take advantage of the information. Customers were typically approached using the following setup:

Front Call: An opening conversation would be used to gauge the interest and value of the customer, including an assessment of how much money the customer could be talked into investing. Interested customers were sent promotional and "educational" materials.

Closer Call: A week later, the salesperson would call the customer to give him "new" information to prompt him to make an investment. Once a customer agreed to buy the metals, the salesperson would prep him to pass the compliance call. Usually customers were told to say "Yes" when asked if they understood all the risks involved in the transaction, which were often leveraged transactions. Fees were also disclosed during the Closer Call, which did not follow any registered script.

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<sup>34</sup> [Denina, Clara. "Gold lower, set for biggest yearly loss since 1981." \*Reuters\*. December 23, 2013.](#)

<sup>35</sup> [The Special Monitor and Corporate Manager's Initial Report for CFTC v. Hunter Wise Commodities, LLC, pg. 9](#)

<sup>36</sup> [The Special Monitor and Corporate Manager's Initial Report for CFTC v. Hunter Wise Commodities, LLC](#)

<sup>37</sup> [The People of New York v. Stropp et al.](#) (The New York County District Attorney's Office has revised the value initially reported in the press release from nearly \$8 million to nearly \$7 million)

<sup>38</sup> Popular examples include the declining value of the dollar or the changing political environment abroad.

Compliance Call: Once they agreed to buy the metal, customers were transferred to an operator—usually a secretary at the firm—and asked a series of questions about their understanding of the risks involved, which was recorded to comply with legal obligations. Afterward, the purchase was finalized.

Re-Up Call: Some time later the salesperson called the customer, and would indicate that he ran into the company's chief trader who had a hot tip that could benefit the customer. The customer would then be transferred to another salesperson who would pretend to be the chief trader, and who would make up a story about an impending move in the market that could lead to huge profits if acted upon quickly.

During the initial sales pitch, customers were not told of the full risk involved with the investment, or how they could end up with negative equity if they bought the metals on leverage. In fact, customers were not told of how leveraged transactions worked until after the purchase was made. According to Mr. Spicer, even though about 70 percent of the firm's customers knew what leverage was, they did not understand that they would not physically own the metal. The District Attorney's Office believes almost all of the firm's customers lost money.

## VICTIMS OF DECEPTION

Throughout this investigation, Committee staff heard stories of Americans who were talked into putting their life savings into precious metals, only to later learn that they had been duped. The following is a sample of their stories:<sup>39</sup>

### Victim 1

A Mississippi woman was convinced to spend \$33,800 to buy silver but was not told 30 percent of her funds would go toward fees instead of the actual purchase of silver. She paid around \$12,500 in administrative fees alone. The woman was also led to believe she wholly owned 5,000 ounces of silver, even though she only owned a marginal interest in the company's silver holdings, which vanished once the value of silver declined. Within three to four months she lost all of her money. Fortunately, with the help of the Mississippi Attorney General, the victim was able to recoup nearly \$13,000.

### Victim 2

Joe Melomo, a former IBM physicist who lives in Austin, Texas, received an unsolicited call from a precious metals dealer who talked him into buying gold and silver. The salesperson told him that he would realize significant profits in a very short time, claiming the price of gold would jump 50 percent in just a few weeks, and 150 percent in a few months. When the value of gold declined, he was asked by the dealer to invest more money to make up his equity loss. Unbeknownst to him, the company made all of his transactions on leverage, leading to only \$3,426 of the nearly \$170,000 he spent at the firm going toward the purchase of the metals. Approximately 97 percent of his funds went to fees, with an additional \$37,000 charged for interest from the leveraged transactions. Neither the fees nor the interest charges were fully

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<sup>39</sup> Due to confidentiality requirements, some of the names have been withheld.

explained to him before the transactions were made. When Mr. Melomo finally asked the company to liquidate his holdings and give his money back, company representatives told him they couldn't because they never actually purchased any metals in his name. Instead, they pooled his money with the money of other clients in order to buy metals in the name of the company. Through a settlement agreement, he was able to recoup \$25,000.

### Victim 3

An 82-year-old retiree lost \$52,000 when she invested in silver on leverage. She sold her personal effects and used \$41,000 from her IRA annuity to buy 600 ounces of silver. Within two months, she was told she had to send in an additional \$10,000 to cover the decline in value of silver. After she told the precious metals firm she didn't have the money to invest any more in silver, her account was liquidated. The firm led her to believe she could wait out any downswing in the market. Unbeknownst to her, she only owned the metal on paper, which evaporated when the value of silver suddenly declined. Eventually, the victim was able to recover about \$13,000 through a settlement agreement with the company.

## **FEDERAL REGULATORY ACTION**

### Federal Trade Commission

In May 2011, the FTC issued a consumer alert about the dangers of gold fraud and published consumer education brochures.<sup>40</sup> Since then, the agency has gone after retail precious metal firms suspected of violating the FTC Act and the Telemarketing Sales Rule (TSR), which prohibit fraudulent or deceptive sales tactics.<sup>41</sup>

Under section 5(a) of the FTC Act (15 U.S.C. § 45(a)), individuals and companies are prohibited from using “unfair or deceptive acts or practices in or affecting commerce.”<sup>42</sup> The TSR also prohibits deceptive or abusive telemarketing practices, pursuant to the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. 6102).<sup>43</sup> The FTC considers violations of the TSR or the “misrepresentations or deceptive omissions of material fact” a violation of Section 5(a) of the FTC Act. TSR violators are subject to civil penalties of up to \$16,000 per violation and can be required to pay restitution to injured consumers.<sup>44</sup> The court also has the

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<sup>40</sup> [“Investing in Gold.” Federal Trade Commission: Consumer Information.](#)

<sup>41</sup> [FTC Stops Bogus Precious Metals Dealers; FTC Charges Bogus Precious Metals Investment Scheme; FTC Takes Action Against Bogus Precious Metals Investment Scheme](#)

<sup>42</sup> [U.S. Government Printing Office, Section 5\(a\) of the Federal Trade Commission Act of 1914 \(Public Law 63-203, 38 Stat. 717\), \[15 U.S.C. § 45\(a\)\], Incorporating U.S. SAFE WEB Act amendments of 2006 \(Public Law 109-455, 120 Stat. 3372\).](#)

<sup>43</sup> Through the Telemarketing and Consumer Fraud and Abuse Prevention Act (15 U.S.C. § 6102), Congress directed the FTC to establish rules to prohibit deceptive or abusive telemarketing practices, causing the FTC to promulgate the TSR.

<sup>44</sup> [“Complying with the Telemarketing Sales Rule.” Federal Trade Commission: Bureau of Consumer Protection \(Pg. 15 of 60\)](#)

authority to order a nationwide ban on the telemarketing activities of transgressors to prevent further violations of the law.<sup>45</sup>

For retail precious metal companies that make sales over the phone, the FTC considers their salespeople to be “telemarketers” engaged in telemarketing activity, pursuant to the TSR.<sup>46</sup> The TSR applies equally in cases where telemarketers make outbound telephone calls to “...induce the purchase of goods or services,”<sup>47</sup> or where the call is initiated by the consumer “. . . in response to an advertisement relating to investment opportunities.”<sup>48</sup>

According to the FTC, it is a violation of the TSR for a telemarketer to misrepresent, “...*directly or by implication, in the sale of goods or services ... any material aspect of an investment opportunity including, but not limited to risk, liquidity, earnings potential, or profitability.*”<sup>49</sup>

In addition to prohibiting misrepresentations, telemarketers are required to clearly and conspicuously disclose—before a customer agrees to pay for goods or services—“*the total costs to purchase, receive, or use, and the quantity of, any goods or services that are the subject of the sales offer;*” and “[a]ll material restrictions, limitations, or conditions to purchase, receive, or use the goods or services that are the subject of the sales offer.”<sup>50</sup> A failure to do so is considered a “deceptive telemarketing act or practice” and a violation of the TSR.<sup>51</sup>

To date, the FTC has formally charged three precious metal firms, all based in Florida, with breaking the law.<sup>52</sup> Within the FTC’s complaints against the three companies, the agency alleges the companies violated the law by:<sup>53</sup>

- Using high-pressure telephone sales tactics;
- Informing individuals that they would earn substantial profits in a short period of time;
- Falsely claiming there was only a minimal risk of loss with precious metal investments;
- Failing to clearly disclose all fees and commissions charged; and
- Failing to disclose that the precious metal investments were highly-leveraged and therefore risky.

The three complaints filed by the FTC allege a total of approximately \$56 million in consumer losses.<sup>54</sup> To date, two of these cases have settled and the defendants were required to pay a combined total of \$32.6 million.<sup>55</sup>

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<sup>45</sup> [U.S. Government Printing Office, Section 13\(a\) of the Federal Trade Commission Act of 1914 \(Public Law 63-203, 38 Stat. 717\), \[15 U.S.C. § 53\], Incorporating U.S. SAFE WEB Act amendments of 2006 \(Public Law 109-455, 120 Stat. 3372\).](#)

<sup>46</sup> [U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 §310.2\(aa\), \(cc\), and \(dd\).](#)

<sup>47</sup> [U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 § 310.2\(v\) and \(aa\).](#)

<sup>48</sup> [U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 §310.6\(b\)\(5\).](#)

<sup>49</sup> [U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 CFR §310.3 \(i\) and \(ii\)](#)

<sup>50</sup> *Id.*

<sup>51</sup> [U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 CFR §310.3](#)

<sup>52</sup> [FTC Stops Bogus Precious Metals Dealers; FTC Charges Bogus Precious Metals Investment Scheme; FTC Takes Action Against Bogus Precious Metals Investment Scheme](#)

<sup>53</sup> *Id.*

## Commodity Futures Trading Commission

While the FTC’s jurisdiction generally extends to the telemarketing practices of precious metal companies, the CFTC generally has authority over retail commodity transactions in which the commodity is not delivered within a specific period of time.<sup>56</sup>

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 expanded the CFTC’s authority over retail commodity transactions.<sup>57</sup> Generally, for transactions in which the full price of a metal contract is not paid up front (i.e., sold on credit, margin, or leverage), retail precious metal dealers must deliver metals to their customers within 28 days of purchase or else the transaction is considered an illegal off-exchange commodity transaction.<sup>58</sup>

The CFTC has filed at least 22 complaints against individuals and companies that lost over \$193 million of their customers’ hard earned cash.<sup>59</sup> Of these cases, seven currently remain active.<sup>60</sup>

The following are examples of cases the CFTC has pursued:

### *CFTC v. Atlantic Bullion & Coin, Inc.*<sup>61</sup>

In 2013, the CFTC filed and settled charges against Atlantic Bullion & Coin—a South Carolina company—and its owner for operating a Ponzi scheme involving silver over an 11-year period. At least 237 investors nationwide were led to believe they purchased silver bullion, but in reality Atlantic Bullion and its owner pocketed the money without ever purchasing silver on behalf of customers. Customers were sent false account statements to hide the scheme. The defendants settled to pay \$11.53 million in restitution and \$23 million in civil monetary penalties. The owner was also sentenced to nearly 20 years in prison due to the fraud.<sup>62</sup>

### *In re Pan American Metals of Miami, et al.*<sup>63</sup>

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<sup>54</sup> [“FTC Stops Bogus Precious Metals Dealers.” \*Federal Trade Commission\*](#); [“FTC Charges Bogus Precious Metals Investment Scheme.” \*Federal Trade Commission\*](#); [“FTC Takes Action Against Bogus Precious Metals Investment Scheme.” \*Federal Trade Commission\*](#).

<sup>55</sup> [“FTC Action Results in \\$24 Million Settlement with Precious Metals Dealers.” \*Federal Trade Commission\*](#); [“Precious Metal Marketers Agree to Settle FTC Charges.” \*Federal Trade Commission\*](#); [“FTC Settlement Bans Precious Metal Marketers from Selling Investment Opportunities.” \*Federal Trade Commission\*](#).

<sup>56</sup> [CFTC Issues Interpretation Concerning Retail Commodity Transactions](#)

<sup>57</sup> Miller, Rena. “The Commodity Futures Trading Commission: Background and Current Issues.” Congressional Research Service. June 24, 2013 (R43117)

<sup>58</sup> [U.S. Government Printing Office, \*Section 742\(a\) of the Dodd-Frank Wall Street Reform and Consumer Protection Act \(Public Law 111-203, 124 Stat. 1376\), \[7 U.S.C. § 2\(c\)\(2\)\(D\)\]\*](#).

<sup>59</sup> Based on data provided by the CFTC.

<sup>60</sup> [CFTC v. Lions Wealth Holdings, Inc., et al., No. 2:13-cv-01787 \(D. Nev. filed Sep. 30, 2013\)](#); [CFTC v. The Yorkshire Group Inc., et al., No. 13-5323 \(E.D.N.Y. filed Sep. 25, 2013\)](#); [CFTC v. AmeriFirst Management LLC, et al., No. 13-cv-61637 \(S.D. Fla. filed July 29, 2013\)](#); [CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 \(S.D. Fla. filed Dec. 5, 2012\)](#); [CFTC v. American Bullion Exchange ABEX, Corp., et al, No. 8:10-cv-01876-DOC-RNB \(C.D. Cal. filed Dec. 8, 2010\)](#)

<sup>61</sup> [CFTC v. Atlantic Bullion & Coin, Inc., et al., No. 8:12-cv-01503-JMC \(D.S.C. filed Feb. 27, 2013\)](#)

<sup>62</sup> [U.S. v. Ronnie Gene Wilson, No. 8:12-cr-00320-JMC \(D.S.C. filed April 4, 2012\)](#)

<sup>63</sup> [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#)

In 2013, the CFTC ordered Pan American Metals of Miami and Pan American Metals of Miami Beach to pay \$3.2 million in restitution and \$1.5 million in civil monetary penalties for engaging in precious metals fraud. According to the CFTC, the companies sold precious metals on leverage, but failed to actually transfer ownership of the metals, disburse loan funds, or store the metals on behalf of customers. The companies also misrepresented and failed to disclose the risks associated with leveraged transactions. Over 95 percent of their customers lost money. Unfortunately, many seniors fell victim to the scheme; at least 27 percent of the combined customer base was over the age of 65.

*In re Newbridge Metals, LLC*<sup>64</sup>

In 2013, the CFTC filed and settled fraud charges against Newbridge Metals, LLC, a Florida company. Newbridge sold precious metals through leveraged transactions. Customers were told they could purchase the metals with only a 25 percent deposit, with the remainder financed through in-house credit.

However, after customers paid the deposit, they were surprised with additional costs, including a finance charge for the loan, a service charge, and a commission of 15 percent. According to the CFTC, even though Newbridge made millions of dollars from customers, they never actually bought, sold, loaned, stored, or delivered any of the metals customers paid for. The company settled, and was required to pay more than \$1.5 million in restitution.

Both Newbridge and the Pan American Companies used Hunter Wise Commodities as their wholesale dealer. The CFTC filed charges against Hunter Wise in 2012, alleging it deceptively coerced customers into buying precious metals on leverage in a fraud scheme that involved 188 different precious metal companies from across the country, including Florida, California, New York, Nevada, South Carolina, and Texas. In February 2013, a district court judge issued a preliminary injunction against Hunter Wise, finding that the company provided misleading reports to customers that created the “illusion that actual commodities [were] transferred into or out of their accounts, when in reality, no real metals [were] transferred as a result of the transaction.”<sup>65</sup>

## STATE REGULATORY ACTION

Even though the federal government has stepped up enforcement actions on unscrupulous retail precious metal dealers, many are able to escape oversight due to the lack of federal licensing and reporting requirements. Although many of these firms operate across state lines, state agencies are responsible for regulating the market.<sup>66</sup>

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<sup>64</sup> [In re Newbridge Metals, LLC, CFTC Docket No. 13-37 \(CFTC filed Sep. 24, 2013\)](#)

<sup>65</sup> [“Federal Court in Florida Enters Preliminary Injunction Order against Hunter Wise Commodities, LLC, Lloyds Commodities, LLC, and 18 Other Defendants in Connection with Operating a Multi-Million Dollar Fraudulent Precious Metals Scheme.” U.S. Commodity Futures Trading Commission.](#)

<sup>66</sup> [Browning, Dan. “Minnesota May be 1st State to Regulate Retail Coin Dealers.” McClatchy News. July 29, 2013.](#) Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013), pg. 1-3; [“Attorney General Brings Action Against AGT American Silver and Gold.” Better Business Bureau – Dallas & North Texas \(March 8, 2012\);](#) [Ignasiak, Darrick. Alleged Internet Gold, Land Scam Results in Arrest. The Dispatch. October 23, 2013](#)

Since many of the precious metal firms are based in Florida, the Florida Office of Financial Regulation (OFR) has led the way in protecting consumers from the worst practices in the industry. Between 2009 and 2011, the clients and creditors of seven Florida-based precious metals businesses claimed losses of more than \$54 million.<sup>67</sup> Working with Federal regulators, OFR helped recoup more than \$10.3 million for cheated customers.<sup>68</sup>

OFR found that many of the firms targeted older Americans who were given misleading or conflicting information by salespeople.<sup>69</sup> For example, customers were led to believe they were buying physical metals when they were buying metals on leverage.<sup>70</sup> In reality, they were only buying an indirect ownership interest in a derivative contract that rolled-over every month and never resulted in actual delivery of the metal.<sup>71</sup> According to OFR, customers were also told by salespeople that the investments were low-risk, while the written documents the firm provided disclosed the high-risk nature of the investments.<sup>72</sup>

In addition to Florida, states like Minnesota, Texas, and North Carolina have also gotten stricter on unruly retail precious metal companies.<sup>73</sup> Minnesota, in particular, enacted a law to stop ex-convicts from becoming precious metal dealers.<sup>74</sup> A 2011 newspaper investigation found that ex-convicts and con artists—who routinely misled or defrauded customers—staffed many of the precious metal companies in the area.<sup>75</sup> Salesmen who had been convicted of fraud, forgery, and even bank robbery were allowed to handle the hard-earned savings of customers, totaling millions of dollars.<sup>76</sup>

Texas authorities have also gone after precious metal companies, many of which convince their customers—often seniors—to use their life’s savings to buy coins priced at least three times their fair market value, claiming the coins would triple in value over a short period of time.<sup>77</sup> Meanwhile, local officials in Santa Monica, California, have pursued several coin dealers for deceiving or bullying their customers, including Goldline International, Superior Gold Group,

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<sup>67</sup> [Burstein, Jon. “Little Regulation, Lots of Risk Can Leave Gold Investors on Shaky Ground.” \*Sun Sentinel\*. March 19, 2011.](#)

<sup>68</sup> [U.S. v. Richard Eugene Engel, No. 2:10-cr-14079 \(S.D. Fla. filed Oct. 7, 2010\); U.S. v. Christopher Kertatos No. 2:10-cr-14079 \(S.D. Fla. filed Oct. 7, 2010\); U.S. v. Zito, No. 1:12-cr-20030 \(S.D. Fla. filed Jan 12, 2012\).](#)

<sup>69</sup> Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> [Browning, Dan. Minnesota May be 1st State to Regulate Retail Coin Dealers. McClatchy News \(July 29, 2013\), “Attorney General Brings Action Against AGT American Silver and Gold.” Better Business Bureau – Dallas & North Texas \(March 8, 2012\), Ignasiak, Darrick. Alleged Internet Gold, Land Scam Results in Arrest. The Dispatch \(October 23, 2013\)](#)

<sup>74</sup> [Browning, Dan. Minnesota May be 1st State to Regulate Retail Coin Dealers. McClatchy News \(July 29, 2013\)](#)

<sup>75</sup> *Id.*

<sup>76</sup> [Browning, Dan. Ex-cons Make a Killing in Coins. StarTribune \(May 9, 2011\)](#)

<sup>77</sup> [“Attorney General Brings Action Against AGT American Silver and Gold.” Better Business Bureau – Dallas & North Texas. March 8, 2012. and Abbott, Greg. “All That Glitters: Investing in Gold and Rare Coins.” \*Weekly AG Newspaper Columns\*. July 2007.](#)

and Merit Financial.<sup>78</sup> The companies were either forced to shut down or change their business practices.

In North Carolina, local officials went after a scam artist who used Craigslist to steal thousands of dollars from people interested in buying gold.<sup>79</sup> While the fraudster told customers they could double their money through the investments, he allegedly used the money on dinners, massages, and other personal expenses instead of gold purchases. Meanwhile, investors had no idea the man they trusted with their savings had been served with a cease and desist order from the state.<sup>80</sup>

## COMMITTEE STAFF INTERACTION WITH FIRMS

Committee staff contacted several retail precious metal firms to learn more about common practices within the industry. The companies were selected based on a combination of factors, such as previous administrative action taken against the company or its owners, information provided to staff by state regulators, and customer complaints. Committee staff sought to find out what percentage of retail precious metal sales were made on leverage, how the firms chose salespeople, where and how the metals were acquired, the full cost of the transactions, and how the firms handled customer complaints. The companies were also asked to share their telemarketing scripts and the contracts they required customers to sign upon sale.

Very few of the firms cooperated with the Committee's investigation in good faith. After numerous calls, emails, and letters to their management and attorneys, a number of the firms used stalling tactics and offered only partial responses to the Committee staff's inquiries. On several occasions Committee staff was bounced around between company management and their attorneys, only to receive incomplete responses from some of the companies. The high degree of recalcitrance from these firms and their attorneys casts a dark shadow on their business practices and demonstrates the need to ensure that consumers are protected from misleading investment schemes.

The firms that did respond in full explained that they relied on state regulators to evaluate the qualifications of their employees. If a person obtained a telemarketing license from a state regulator, they were generally considered qualified to make sales calls—even if they had been disciplined in the past for unfair business practices by state and federal regulators. Due to this oversight, the industry has become a constant revolving door for seedy individuals looking to make a quick buck. In fact, the Committee found several instances where people who had been disciplined or scolded by the National Futures Association or state and federal regulators for questionable business practices were still operating in the industry, but under a new guise.

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<sup>78</sup> [Warmerdam, Elizabeth. "Santa Monica Goes After Gold & Coin Dealers." Courthouse News Service. February 18, 2014.](#) and ["Santa Monica-Based Goldline International Placed Under Injunction, Ordered To Change Sales Practices." Santa Monica Mirror. February 22, 2012.](#)

<sup>79</sup> [Ignasiak, Darrick. Alleged Internet Gold, Land Scam Results in Arrest. The Dispatch \(October 23, 2013\)](#)

<sup>80</sup> *Id.*



All of the firms alleged to have either received very few complaints or none at all the entire time they have been in business. Those that admitted to receiving customer complaints claimed they resolved the complaints through direct negotiation with the consumer. However, consumers had limited options for recourse due to mandatory arbitration clauses in their contracts. Prior to purchasing any metals, customers are required to sign a contract that typically contained a mandatory arbitration clause, under which they forfeited their right to pursue the claim in court. These mandatory arbitration clauses also put the burden on the customer to travel to the company's local jurisdiction in order to settle the dispute, making it more difficult for non-local customers to pursue their rights.

Even though the firms purportedly operated independently from each other and employed different business practices, several of them used the same sales contracts—with identical text, which suggests they at least affiliated with the same wholesale dealer. At the same time, at least one operated out of the same address and used some of the same staff as another firm that had closed after being sanctioned by a regulator.

However, the companies that were contacted differed in the amount of fees and commissions they charged. On average, the firms applied an initial charge of 7.4 percent of the metal value, in addition to a 0.5 to 1 percent monthly storage fee if the metal was allegedly stored on behalf of the customer. The storage fee may also include an initial charge of up to \$200 for opening the account. For metals purchased on leverage, an annual percentage rate (APR) was charged ranging from 7.75 to 9.5 percent. Since leveraged transactions allow retail precious metal companies to make more money from customers, several companies have relied on the product to make up a substantial part of their business. At least one firm the Committee corresponded with admitted making 70 percent of its sales through leveraged transactions.

## MARKETING TO SENIORS

While some retail precious metal companies claim not to deal with seniors in any notable capacity, the CFTC has found that an overwhelming number of victims of precious metal fraud are seniors.<sup>81</sup> Direct observation of the companies' sales calls also suggests they employ a sophisticated method of evaluation to identify individuals with large savings. During a sales call, customers are asked about their sources of income, their age, and their assets, including how much they have in their savings and retirement accounts. If a customer falls on the low-end of the equity spectrum in terms of the amount of funds they have in their savings or retirement accounts, they are either turned away or half-heartedly pursued. While the criteria used to evaluate potential customers may not always explicitly use age as a benchmark, it does skew toward older Americans who are more likely to have a greater amount of equity built up in their retirement and savings accounts than younger Americans. This also benefits the firms by allowing them to extract a more sizeable commission.

Additionally, federal law makes it easy for precious metals to be added to individual retirement accounts (IRAs).<sup>82</sup> In 1981, Congress prohibited precious metals as investments in IRAs.<sup>83</sup> Over

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<sup>81</sup> [In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 \(CFTC filed July 29, 2013\)](#)

<sup>82</sup> U.S. Government Printing Office, *Code of Federal Regulations, Title 26 § 408(m)*. 2014

time, the prohibition eroded to allow IRAs to invest in coins minted by the U.S. Treasury, as well as bullion.<sup>84</sup> Under current law, individuals are able to purchase precious metals through an IRA on a pre-tax basis, and without having to pay an early withdrawal penalty.<sup>85</sup> Although the law requires any metal purchased through an IRA to be of investment grade, and not just a collectable, there are no restraints on the type of financial arrangement used to purchase the metal, such as leveraged transactions.

## CONCLUSION

For too long, too many bad apples in the retail precious metals industry have been able to flout the law and cheat consumers out of millions of dollars. When precious metals became a credible alternative to the instability in the stock market in the wake of the 2008 financial crisis, questionable individuals flooded the marketplace, offering deals too good to be true.<sup>86</sup> What should have been an opportunity for the industry to provide financial security for the millions of Americans seeking refuge from the calamity on Wall Street, became an opportunity for dishonest individuals to run loose with high-pressure sales tactics, hidden fees, and unfair financial deals—such as leveraged transactions. Committee staff conservatively estimates that more than 10,000 Americans have been victimized through these schemes, with losses around \$300 million.<sup>87</sup>

These precious metal dealers thrived on the haze that clouds the industry in secrecy. This can be seen in the actions of the retail precious metal companies that tried to conceal their practices from the Committee staff's investigation. While some past attempts to increase transparency have proven unsuccessful,<sup>88</sup> some reforms—such as those contained in the Dodd-Frank Act—have led to greater oversight and insight into this ever-evolving industry.<sup>89</sup> Still, more may need to be done to reduce gaps in oversight and improve consumer protection.

As Americans look for new ways to achieve long-term financial security, they should be mindful of the dangers of deceitful precious metal deals. Consumer protection requires not only strong oversight by law enforcement but also an informed and educated citizenry. Fortunately, the FTC and CFTC<sup>90</sup> have made it a priority to educate consumers on the dangers of spurious retail precious metal dealers. Above all, consumers should be wary of any offer requiring them to “act

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<sup>83</sup> U.S. Government Printing Office, *The Economic Recovery Act of 1981 (PL 97-34)*. 1981

<sup>84</sup> U.S. Government Printing Office, *The Taxpayer Relief Act of 1997 (PL 105-34)*. 1997

<sup>85</sup> To discourage the use of retirement funds for purposes other than normal retirement, the law generally imposes a 10 percent tax penalty on distributions from retirement accounts before the age of 59 and 6 months.

<sup>86</sup> [Greisman, Lois. Prepared Statement of the Federal Trade Commission on the Precious Coins and Bullion Disclosure Act Before the House Energy and Commerce Committee's Subcommittee on Commerce, Trade, and Consumer Protection \(September 23, 2010\)](#)

<sup>87</sup> Estimate based on data provided by the Commodity Futures Trading Commission (\$194 million), Federal Trade Commission (\$32.7 million), U.S. Department of Justice (\$63.3 million), and New York County District Attorney's Office (\$7 million). This does not include other state actions, including those referenced elsewhere in this document.

<sup>88</sup> U.S. Government Printing Office, *Coin and Precious Metal Disclosure Act (H. R. 6149)*. 2010

<sup>89</sup> [U.S. Government Printing Office, Section 742\(a\) of the Dodd-Frank Wall Street Reform and Consumer Protection Act \(Public Law 111-203, 124 Stat. 1376\), \[7 U.S.C. § 2\(c\)\(2\)\(D\)\]](#).

<sup>90</sup> [“CFTC Fraud Advisories - Precious Metals Fraud.” U.S. Commodity Futures Trading Commission.](#)

fast.”<sup>91</sup> As a golden rule, an investor should always take the time to closely evaluate the costs, risks, and suitability of any investment.

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<sup>91</sup> [“Investing in Bullion and Bullion Coins.” \*Federal Trade Commission: Consumer Information.\*](#)