EXPLORING THE PERILS OF
THE PRECIOUS METALS MARKET

HEARING
BEFORE THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE
ONE HUNDRED THIRTEENTH CONGRESS
SECOND SESSION
WASHINGTON, DC
APRIL 30, 2014
Serial No. 113–21
Printed for the use of the Special Committee on Aging


U.S. GOVERNMENT PUBLISHING OFFICE
WASHINGTON : 2013
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(III)
EXPLORING THE PERILS OF THE PRECIOUS METALS MARKET

WEDNESDAY, APRIL 30, 2014

U.S. Senate,
Special Committee on Aging,
Washington, DC.

The Committee met, pursuant to notice, at 2:15 p.m., Room 562, Dirksen Senate Office Building, Hon. Bill Nelson, Chairman of the Committee, presiding.
Present: Senators Nelson, McCaskill, and Collins.

OPENING STATEMENT OF SENATOR BILL NELSON, CHAIRMAN

The Chairman. Good afternoon. Senator Collins is on her way, and she insisted that I go ahead.

I want to thank you all for being here. Today we are going to talk about precious metals and the schemes that have cheated Americans out of millions.

A year-long investigation by our Committee has uncovered that over 10,000 Americans, many of whom are senior citizens, have lost nearly $300 million from these schemes.

We have seen all the commercials on TV touting the benefits of owning precious metals—gold, silver, platinum. Indeed, many investment advisors agree that investing in precious metals can be a responsible way to diversify an investment portfolio.

We are not here to talk about the virtues of different investment strategies. We are here to spotlight the worst practices in an industry that has run amuck and largely remains in the shadows. Consumers are increasingly trapped in bad deals, and some of these bad practices include hefty fees and commissions, using bait-and-switch tactics to sell products at highly inflated prices, using high-pressure sales tactics to get consumers to buy metals on leverage, and it becomes flat-out fraud.

Now, many precious metals firms will also downplay the risks associated with precious metals in order to get the customer to spend more money, which the company can then get the excessive fees and commissions, but the most blatant type of fraud occurs when the seller outright lies to the customer, either through a Ponzi scheme or by charging fees for fictitious service. An example: The Commodity Futures Trading Commission, which will testify today, has gone after a number of companies for charging storage fees when, in fact, no metal was ever stored on the customer's behalf.

Customers can also be tricked into buying metals on credit, sometimes called “on leverage,” where they are charged an interest
expense on top of other fees and charges, and this makes it nearly impossible for them to make money or break even. In fact, investors often end up losing money from these deals with no metal to show for their troubles since the company can seize the customer's holdings during a short-term dip in the market.

Clearly, whenever there has been money to be made, you can bet that unscrupulous individuals will soon follow. Well, that is what is happening in this industry, so you get a deal like this or this looks official, it has got bulls and bears, and it says, “Precious Metals Corporation.” On the front page, it says, “We do the right thing on principle, not regulation. PMCO was founded on the name and the principle synonymous with the highest degree of ethics and professionalism in the precious metals industry. Whether you are a seasoned investor or new to the industry, we listen to your desires, dig deep to understand your needs, and offer you our extensive resources and expertise to meet your investment goals.” It ends up with a quote: “Patience is more important than market timing.”

Well, thanks to all these good folks, we have done a year-long investigation, and so we want to bring the focus now into the panel which is going to be able to go into greater detail about what is going on in this industry and how law enforcement is responding to protect consumers from these schemes.

Senior citizens that have often seen through the ups and downs of the marketplace want to get into something to provide for their future. There is always a fear in the back of the mind of a senior citizen: Are they going to have enough to take care of themselves? They are particularly susceptible to this kind of scheme, so we are going to hear from a star-studded panel. First we are going to hear from Mr. Melomo, a former IBM physicist and a victim of precious metal fraud.

Next we are going to hear from Ms. Dama Brown, Director of the Southwest Region of the Federal Trade Commission, and then we are going to hear from Ms. Rosemary Hollinger, Regional Administrator of the Commodity Futures Trading Commission, Chicago office, and Deputy Director in charge of the Commission's Division of Enforcement in Chicago, and then we are going to hear from Mr. Karl Spicer, a former industry insider who will share with us how this scam works based on his personal experience, and so when Senator Collins arrives, I will finish whosoever's testimony is there so that Senator Collins can make her statement, so—and she is here right on cue, with a flourish.

OPENING STATEMENT OF SENATOR SUSAN M. COLLINS, RANKING MEMBER

Senator Collins. Thank you. Thank you, Mr. Chairman. I apologize. I was on the floor because we have a Maine judge who I hope will be confirmed later today that I needed to speak to, so my apologies to you and to the witnesses as well.

Mr. Chairman, since you and I assumed leadership of this Committee, we have conducted five hearings on various scams, swindles, and cons used by fraudsters to separate America’s seniors from their hard-earned money. Today’s hearing is the sixth. It is indeed a sad commentary on human nature that the cruelty of the
scammers who target our Nation’s seniors seems limited only by their creativity and never by their conscience.

Today’s hearing focuses on a particularly appalling scam, the so-called sale of precious metals to seniors who are eager to avoid the dangers of the stock market, trying to find a safe haven for their life savings, seeking to protect their financial independence, and wanting to pass on some portion of their nest egg to their children and their grandchildren.

I say “so-called sale” because, as we have discovered in our investigation, a key feature of this scam is to get the customer to pay real money for a fiction—gold, silver, platinum, or palladium that the scammer never actually delivers and often does not even own. These scammers use dubious sales tactics to steer their victims into highly leveraged derivatives contracts where the victim acquires not precious metal but a piece of paper.

Too often victims are not told that they are purchasing a derivatives contract, nor are they told that leverage greatly increases the risk that they could lose their investment if the precious metal drops in value, and, of course, they are not told of the exorbitant fees built into the contracts that virtually guarantee that they will lose money.

One company brazenly operated a Ponzi scheme that bilked 945 investors out of at least $90 million over an 11-year period until it was finally shut down by Federal regulators.

Over the past several years, Federal and State prosecutors around the country have been pushing back against this type of fraud, and I am pleased to say that they have met with some success. In preparation for this hearing, we looked at 34 Federal cases involving more than 9,100 victims who lost a total of nearly $300 million. As a result of Federal action, many of these scammers have faced steep penalties, and some victims have been able to recover part of their financial losses.

Despite these successes, however, precious metals fraud remains the sixth most significant form of financial fraud in our country. According to a report by the Enforcement Section Committee of the North American Securities Administrators Association, what we have always called the “other NASAA,” the Vice Chair of that Committee, Judith Shaw, is head of the Maine Office of Securities, which I oversaw during my five years as head of the Department of Professional and Financial Regulation quite some years ago. While Ms. Shaw is unable to join us in person today, she has provided written testimony, which I would like to submit with unanimous consent for the record.

Ms. Shaw describes how con artists monitor the markets to figure out what type of scam they should run. When the stock market looks like a bad place to put your money, as it did a few years ago, the con artists know that seniors are more likely to turn to gold and silver, which they may perceive as safe investments. That makes them vulnerable to precious metals scams.

Maine has been fortunate to avoid the worst of the precious metal cases, a fact that Administrator Shaw attributes in part to the aggressive enforcement of Maine’s commodities law and transient sales law. She warns, however, that scammers may have ne-
glected Maine simply due to the fact that our elderly population is less wealthy than that in other States.

There may, of course, be many good reasons to invest in a portfolio of any well-managed, diversified portfolio in precious metals, and there are many reputable dealers who can help investors. Our focus today is not on these legitimate dealers in precious metals but on those who would use these metals as a tool to defraud the elderly.

Again, Mr. Chairman, thank you for calling this hearing, and I look forward to hearing from our witnesses.

The Chairman. Thank you, Senator Collins.

Without objection, we will enter the Committee staff's investigation report into the record.

We will proceed according to the order in which I introduced you. First, Mr. Melomo.

By the way, your written testimony is entered in the record, and we want you to just give us a verbal summary.

Mr. Melomo.

STATEMENT OF JOE MELOMO, VICTIM OF PRECIOUS METAL FRAUD

Mr. MELOMO. Chairman Nelson and Ranking Member, thank you very much for inviting me here.

My name is Joe Melomo. I have had considerable success in my business life as a former physicist with IBM. My wife and I have raised four successful children, of whom I am very proud. I was always raised to try to do the right thing and to treat other people the way I would like to be treated. I consider myself a reasonably savvy businessman and investor, and yet I sit here today before you having lost more than $170,000 investing in what I know now was a precious metal scam, so that you can understand my frame of mind at the time I invested in precious metals, I would like to share with you the events leading up to the call I received from American Precious Metals. My wife passed away at the end of 2001 after 41 years of marriage, and I was lost and found it very hard to look back. I sold my house in 2004 and moved from the outskirts of Austin back to downtown Austin to be around my kids and my grandchildren.

In Austin, after much due diligence, I became a silent partner in a restaurant but soon discovered the majority partner in the business was stealing a lot of money. While I succeeded in proving this in court—this man was convicted of fraud—he was unable to pay me the quarter of a million dollars the court ordered him to pay, so at that time, at age 71, I took over the business, dealing with all the stress that comes with having to support a team of employees and their families and cover the enormous bills that came due, due to his terrible management of the business.

While all this was going on, I received a call at the restaurant from American Precious Metals, even though my number was on the “Do Not Call Registry.” The person who called talked to me about investing in precious metals, primarily gold and silver. The conversation got my attention because I could see a way to possibly cover some of my losses from the restaurant, so I asked him to send me some information, which he did, and all of the materials,
like you just pointed out, looked very professional and legitimate. Between his encouragement and what seemed to be genuine interest in helping me profit from this investment and my desire to make back some money, I started to invest in gold and silver.

To me, it was a perfect storm. The economy was bad. I was wrapped up in a restaurant. I was not focused on precious metals. It looked good. I was consumed by a restaurant. I could have done better. Apparently I did not do it.

I never really understood the leveraged process and was not clear on the kind of fees I would be charged. Storage, commission, and interest fees were never discussed. I trusted him to watch out for my interests since I explained to him the kind of turmoil I was going through at the restaurant. That was probably not a good thing to do because now he knew I was really vulnerable. He told me there is some risk associated with precious metal investments, but assured me that he would be watching out for me. I guess that feeling of assurance allowed me to let my guard down, so with that I focused my attention on trying to correct all the issues with the restaurant. When the monthly statements came, I looked at them, but I did not really understand them. All I did make of them was my investment was looking good. Occasionally, I would call asking if I should be concerned and was told no, that everything looked good.

During this period, several different sales representatives worked my account. The sales reps working with me changed for various reasons, but each salesperson that was assigned made me feel like I was a friend. We talked about our children and where they went to school, et cetera. A nice “bond,” I guess I would call it.

For almost an entire year, they kept calling me and urging me to invest more money because everything looked good.

Around August of 2008 the precious metals prices dropped significantly, and most of my precious metals were liquidated. As you pointed out before, they took your assets and paid up what was needed, so American Precious Metals contacted me and told me to send more money to protect my investment. I told them I did not have any more money to send and that I wanted them to return my money. They said they did not have it. I called numerous times demanding that they return my money, and then ultimately they said it was entirely gone.

I was devastated to realize that I had been deceived by this company. I paid them just under $170,000, and they charged me approximately $165,000 in administrative fees, another $37,000 in interest charges. With the help of an attorney from Florida, I was able to get back $25,000. The overall loss from this investment, along with the cost of the restaurant, completely—I would not say “completely,” but a majority of my retirement was gone.

When I told my children what had happened, they were not too pleased with me and obviously not with American Precious Metals. My daughter Nancy, who is here with me, took it upon herself to research the company and the people who worked there, and she found that they were banned once before, in 2005, for doing the exact same thing, yet they restarted again in 2007 under a different name, so they were banned from doing it, and they came back and did it again. She contacted the Federal Trade Commis-
sion, specifically Ms. Dama Brown, and between my daughter’s tenacious drive and the excellent work by Ms. Brown and the FTC staff, they were able to get the people from American Precious Metals convicted in December 2012.

I commend Ms. Brown and her staff at the FTC for following through and getting this conviction. Unfortunately, to this day I still have not fully recovered the money that I lost to American Precious Metals.

I come here today to have my story serve as a warning to others who may fall victim to this trap and encourage our elected leaders to help protect us little guys from the predatory schemes of these companies.

I thank you for the opportunity to share my story and stand ready to answer any questions you might have.

The CHAIRMAN. That is a riveting story, and that is the reason that we are having this hearing, to try to elevate it.

Ms. Brown, you cannot get much of a better introduction than what you have already had. You are recognized.

STATEMENT OF DAMA BROWN, DIRECTOR, SOUTHWEST REGION, FEDERAL TRADE COMMISSION

Ms. BROWN. Thank you, Chairman Nelson and Ranking Member Collins, for inviting me to speak about this important issue today. My name is Dama Brown, and I am the Regional Director of the Southwest Region of the Federal Trade Commission.

As you know, the Federal Trade Commission is the Nation’s leading consumer protection agency, and our mission is to protect consumers from unfair or deceptive acts or practices. I am honored to be sitting today next to Mr. Melomo, who has just testified about his experience with American Precious Metals. I had the pleasure of working with Mr. Melomo and his daughter on numerous occasions while we were prosecuting our case against American Precious Metals. His assistance and his willingness to come forward and speak about his experience was invaluable to the FTC, and it helped us to unravel this scheme and helped prosecute the perpetrators of the scam.

As the testimony makes clear, stopping precious metals is and should be a top law enforcement priority. In recent years, the FTC has observed an increase in complaints involving the deceptive telemarketing of leveraged precious metals investments. Unfortunately, the experience that Mr. Melomo has just described to the Committee is typical of the scams that the FTC has investigated. Telemarketers cold-call consumers nationwide. They claim to be professional precious metals brokers. Citing headlines about the economy or recent precious metals performances, the telemarketers claim to be offering safe and lucrative investment opportunities in precious metals.

Using phrases like, “This is an investor’s safe haven” or comparing the leveraged transactions to an insurance policy that is similar to keeping metal under your mattress, these telemarketers deceive consumers about the safety of the investments, and they urge them to invest heavily in the scam.
Consumers are pressured to liquidate their IRAs, to withdraw equity from their homes, or even to borrow money from credit cards or life insurance policies to invest in these very high risk scams.

Telemarketers may call a consumer for weeks before convincing them to invest in the precious metals scheme. During each conversation, the telemarketer repeats claims regarding the profitability and safety of precious metals. Telemarketers often fail to disclose that the investments are leveraged, and they hide a whole host of substantial fees and interest charges. Consumers who purchase these leveraged investments are highly unlikely to realize any gains at all. Many consumers have seen their entire life savings wiped out through these schemes.

We continue to work vigorously to prosecute these scams. Most recently we brought three successful law enforcement actions against companies that defrauded more than 1,000 consumers and resulted in judgments totaling more than $33 million.

The FTC seeks to return money to consumers who were ripped off. Unfortunately, in the majority of situations, the defendants have spent all the money. Nevertheless, critically the final orders that we obtain do include bans that prevent these defendants from ever selling precious metal investments again.

Thank you for the opportunity to speak today, and I look forward to answering any questions you may have.

The CHAIRMAN. Thank you, Ms. Brown.

Ms. Hollinger.

STATEMENT OF ROSEMARY HOLLINGER, REGIONAL ADMINISTRATOR AND DEPUTY DIRECTOR, DIVISION OF ENFORCEMENT FOR THE CENTRAL REGION, COMMODITY FUTURES TRADING COMMISSION

Ms. HOLLINGER. Chairman Nelson, Ranking Member Collins, thank you for the opportunity to address you today. My name is Rosemary Hollinger. I am a Deputy Director in the Division of Enforcement of the Commodity Futures Trading Commission. I am here today to speak about the issue of precious metals fraud—to be precise, off-exchange transactions in precious metals with retail investors.

The Commission has been fighting precious metals fraud for most of its existence, and the Division of Enforcement has used whatever tools we have had available at the time.

In 2010, Congress passed the Wall Street Reform Act, which clarified our jurisdiction to combat precious metals fraud in the area of leveraged or financed commodity transactions with retail customers. Going forward, these instruments would be treated as if they were futures in our fraud cases. This enabled us to bring cases against metals dealers offering financed metals while avoiding protracted battles over our jurisdiction.

Using this authority, the Commission has filed 21 cases since the passage of Dodd-Frank. Nineteen of those cases have been filed in the area of financed precious metals and two involved non-financed investments in precious metals.

Many of the CFTC actions have now been resolved, and the Commission has obtained a large range of sanctions, including restitution, civil monetary penalties, and trading and registration bans.
Typically, these firms operate at multiple levels with a so-called metals wholesaler or clearing firm at the top, which claims to buy and sell precious metals with a retail dealer, who then in turn buys and sells precious metals to the retail customer. In reality, it is really the wholesaler just outsourcing its sales function to a host of telemarketing firms.

Senior citizens, as you noted, are often victims of precious metal telemarketers who attempt to build trust and rapport and then reassure their victims by saying things like, “We are bound by the law to give you the best advice at all times.” Or they will talk about how things have changed for the worse like, “Our economy is in a recession. How long will it last? How deep will it get?” Or they will say things like, “The U.S. dollar is poised for new all-time lows with almost $3 trillion new U.S. dollars being printed. It is dramatically devaluing the existing dollars in circulation.”

Then the telemarketer will offer an alternative investment: precious metals. They present it as an opportunity to “invest in the actual commodity, not just a piece of paper.” In fact, there often is no metal and not even a piece of paper.

They claim that this investment will “protect your buying power, protect your assets and provide . . . the safety of gold,” because, as they say, gold will “always have a value.”

They talk about the benefits of compounding profits through the use of leverage without disclosing that leverage also compounds the risk, so, in fact, the investor could lose their entire investment.

What is advertised as safe, secure, and reliable is anything but. The telemarketers promise to “deliver your gold to your depository within 72 hours after the purchase is made.” Often, as I mentioned, there is no gold.

In the typical financed transactions, customers pay commissions, service fees, and markups immediately. About 38 percent of the customer’s initial investment will go to fees. Thereafter, interest and storage fees are charged every day, eroding the value of the customer’s account until the equity falls below 10 percent, and then a margin call and forced liquidation.

When the fees are taken into consideration, the price of the metal has to increase at least 25 percent to break even, so even if the market moves in favor of the investor, the investor can still lose their money.

In the rare instance when the customer makes a profit, the telemarketer will push another trade until eventually the customers lose their money, but one thing is certain: The transactions will always result in fees for the metals dealer.

The Commission continues to bring cases to stop fraud in this area and to seek restitution for the defrauded investors. Typically, we seek asset freezes to preserve the funds for the investors, but, frankly, recovering investor funds in this area is difficult. The retail dealers are thinly capitalized, spending every dollar as soon as they get it.

In addition to our enforcement efforts, we also strive to educate the public about metals frauds and other related frauds through public advisories and consumer outreach efforts through our Consumer Protection Office. We will also work closely with the Depart-
ment of Justice and other Federal and State criminal and civil authorities to stop illegal and fraudulent conduct.

Thank you again for the opportunity to address this important issue. I will be happy to answer any questions you may have.

The Chairman. Ms. Hollinger, why wouldn’t the legitimate precious metals sellers be just completely up in arms and be your greatest advocate?

Ms. Hollinger. Well, that is a really good question. I am not sure I could answer that question. You would think it would be in their best interest because it does harm their industry, but they sure have not been.

The Chairman. None of the existing legitimate precious metals folks have been rushing to support the FTC or the CFTC?

Ms. Hollinger. No, they have not supported us in our cases.

The Chairman. Well, Mr. Spicer, we want to hear from you how all of this is done. Share with us, please.

STATEMENT OF KARL SPICER,
FORMER PRECIOUS METALS TELEMARKETER

Mr. Spicer. Thank you. Thank you, Chairman Nelson, Ranking Member Collins, and distinguished members of the Special Committee on Aging for this opportunity to testify at this important hearing on the protection of the elderly.

My name is Karl Spicer, and as a result of my participation in a South Florida-based commodities fraud scheme, I am a convicted felon. Consequently, I have firsthand knowledge of the deceptive methods employed by scam artists to entice unsuspecting and vulnerable victims to part with their hard-earned savings.

As this Special Committee is uniquely aware, because of their accumulated assets, the elderly are particularly attractive targets for a wide array of fraudsters, regardless of the specific nature of the investment vehicle being offered to the public. From my vantage point, it is clear that the elderly need to be well educated and equipped with the necessary skills to protect themselves from financial exploitation.

My purpose in testifying today is to provide the Special Committee with some measure of insight into the specific methods used by trained salesmen to deceive the investing public. I wish to impress upon the Special Committee that my willingness to speak candidly about the so-called tools of the trade is based upon a clear recognition of the magnitude of the monetary and emotional harm that my conduct has caused to the victims in my specific case. It is my hope that, by testifying about the pitfalls in succumbing to high-pressure sales tactics, I can help prevent elderly victims from being ensnared in ongoing or new investment scams.

In approximately 2000, after working a number of years in the construction industry, I became a licensed commodities broker in South Florida. After cycling through a number of questionable firms, some of which came under the scrutiny of the Commodity Futures Trading Commission, I became steeped in the methods used to sell investment opportunities. Throughout the period of time that I was a commodities broker in South Florida, I earned commissions in the approximate amount of $1.5 million.
Eventually, in about March 2012, I became affiliated with a South Florida commodities firm known as PMCO Services, Inc.—the brochure that you have there before you today. From that period of time through February 2013, myself and a number of business associates engaged in a systematic scheme to defraud the investing public through the sale of silver bullion and other precious metals. The PMCO scheme involved 150 harmed investors and resulted in approximately $7 million in losses. As a result of my efforts, I earned approximately $227,000 in commissions during the PMCO scheme.

Specifically, after purchasing a lead list from other telemarketing firms, or “boiler rooms,” potential clients were subjected to a carefully choreographed plan which was designed to emphasize the supposed safety of the highly risky investment along with the need to immediately take advantage of a unique investment opportunity. In my experience, the elderly are particularly susceptible to succumbing to high-pressure sales tactics that emphasize a “time is of the essence” investment decision. In order to get the scheme off the ground, a “fronter,” or a less experienced salesman, would utilize a sell script in order to gauge investor interest in a leveraged program designed to entice clients by offering the ability to finance a significant portion of the investment.

After forwarding glossy promotional materials, the client would then be contacted by a “closer,” who would misrepresent the safety of the opportunity in order to secure an initial modest investment in the program.

Shortly thereafter, the client would be contacted by a “loader,” who would claim that he had just acquired highly relevant information that would have a significant impact on the market and that time was of the essence for the investor to increase their position. In order to construct a superficial layer of plausible deniability, the new client was then directed to the Compliance Department, in reality an untrained secretary or other administrative person. The closer would then “school” the investor to give the appropriate responses during the recorded compliance call, including a confirmation that the client was specifically aware of the risks associated with the highly speculative nature of the leveraged program.

Finally, through the use of a simple mail drop, we intentionally deceived potential investors into believing that PMCO was a well-established firm located in the financial district in New York City, when, in fact, it was located in South Florida.

Immediately upon learning that I was the subject of a criminal indictment filed by the New York County District Attorney’s Office, I fully accepted responsibility for my conduct, and I also agreed to cooperate against other culpable individuals, including my partner. I am scheduled to be sentenced for my role in this scheme in June 2014.

There can be no doubt that I knew that my conduct in connection with the PMCO venture was not only illegal but morally wrong. As a result, I accept full responsibility for my conduct, and I know that I alone must face the consequences of my actions.

Thank you again, Senator Nelson, for the opportunity to testify today. I am here and prepared to answer any questions put forth by the Special Committee.
The CHAIRMAN. Mr. Spicer, before I turn it over to Senator Collins, how about giving the Committee your sales pitch? You are making a call. It is a cold call. Give us the pitch.

Mr. Spicer. It is actually a four-act approach, and the whole thing is a very long, drawn-out, choreographed plot. I mean, for each part of that act—or each act would take about 20 minutes per act. What I would like to do, if it is okay with you, is really explain each act, the purpose of each act, and then really give you the full pitch on what I believe is most important, which is really the setup for Act 3, which is designed to really extract where the money is—extract the most amount of money from clients where it is set up for the loader. Would that be okay?

The CHAIRMAN. Of course.

Mr. Spicer. Okay. The way it works is, like I described, there are four acts. Act 1 is done by the fronter, which is, again, a less experienced salesperson. Okay? That part of it and the purpose of that fronter is really designed to get three things: to pique investor interest by, you know, scamming or hyping up the projections of the market and what the percentage returns will be; also to gather information from the client or the prospect, things like their income, their net worth, their age, how much money they can invest; and, most importantly, to find out who the decisionmaker is in the process.

The fronter then sends out prepared glossy material, a folder, a package, if you will, and then turns it over to Act 2, which would be the closer.

The closer’s job is to really introduce some new information, new market information, whatever is going on that day, just something that the prospect has not heard before, and to really build on the fronter’s hype that was set forth in the original call.

They really are designed primarily just to get the investment commitment, just to get them in the door. No matter how small the investment may be, their job is to solely get that client to fill out the account forms and send in an initial investment, generally around $5,000 or $10,000 it can range, but that is the general.

Then it gets turned over to Act 3, which is really—it is done by the closer. Once the account comes in, the documents, the money, et cetera, as I described in my opening statement, they are put into Compliance. Once the compliance call is done, we place their trade for that initial $5,000 or $10,000 for XYZ amount of ounces.

What I will do is I will certainly role-play and give you the pitch on what happens at that point. It is a very choreographed plan, but what I was taught to say was:

“Mrs. Jones, I have got great news for you. I just got your fill back. We have got a great fill. Here is what happened.” “Fill price” meaning what price they paid for the ounces they bought. We say, “Here is how it happened. As soon as we got you through Compliance, I took your trade ticket. I ran down to our trade desk to try to get you the best possible fill as quickly as possible. As I went to the elevator, it was packed. Everybody was trying to get down there to get their clients in as quickly as possible. I actually took the stairs.”

“When I came down through the stairs, I actually ran into our chief bullion dealer, our head trader”—whoever that person may
be, and in my case it was a gentleman that was using an alias by
the name of Mr. Goldman.

“When I ran into him, I actually knocked all his trade tickets out
of his hand, et cetera, and he asked me where I was going in such
a big hurry. I explained to him that I was just trying to get a new
client in the market and that I was eager to do so.”

This was all, obviously, a lie.

I then said, “Mrs. Jones, he then told me to go back to my office,
get back on the phone, and he would take care of it before I
knocked anybody else over on the trading floor.” I said, “Mrs.
Jones, when I came back, I was on the phone. I went to get some
coffee. I came back. Your trade was on my desk, and I have got
great news. We actually got a phenomenal fill, probably the best
price of anybody out of the entire day. My chief bullion dealer
saved you about 30 or 40 cents per ounce. You got the best fill of
the day, so we owe him a huge thank you.”

I said, “More importantly, we have a huge mandatory meeting
that I just found out about that is being called tomorrow at around
10:00 or 11:00 a.m. Now, this has got to be something major, sim-
ply because we make our living on the phones, and for the firm to
call all the brokers off of the phone in the middle of the day, some-
thing major has to be going on, so I want to know where you are
going to be at, you know, and how can I reach you tomorrow at
10:00 or 11:00 a.m.?" We find out, we let them go, give them their fill price, “Have a
great day.” Call them back the next day in the morning around
10:00 or 11:00 a.m. We tell them, “Listen, I have got great news.
The meeting went phenomenal. There is a lot of stuff happening in
the market. We believe it is going to have a tremendous impact on
the market. You are not going to believe this. In fact, the gen-
tleman conducting the meeting was our chief bullion dealer, the
guy that gave you the great fill price.”

“I went up to him after the meeting to thank him for helping us
out, giving us that great price, and he took an interest in your ac-
count and would like to speak to you. Do you have a few minutes
to speak to him?” They of course say yes.

At that point I say, “Listen, I want you to do a couple of things:
one, take a pad and pen, jot down some notes. He is our chief bul-
lion dealer, our head trader. He certainly knows more about what
is going on in these markets than I do, and, you know, he hopefully
can shed some insight on your account.”

“The other thing that we want you to do is thank him for his
time and thank him for helping you out yesterday and giving you
a better fill price.”

Then we pass them off to the loader, and that would be Act 4,
which is generally done by the most experienced salesperson in the
room, and it is usually done behind closed doors—at least in my
case it was.

The CHAIRMAN. What does the loader say?

Mr. Spicer. Well, in retrospect, after kind of finding out later
down the road, he essentially lies about everything. In my case, I
mean, he was saying stuff that, like he was managing the New
York Mets’ money. I mean, it got extravagant after that. Really, to
be honest with you, we were not privy to that information at the
time. I found out afterwards, so just hearing that one piece of it, I can really in my imagination run wild with it, and I can only imagine.

The Chairman. With the purpose of getting——

Mr. Spicer. Extracting several hundred thousand dollars.

The Chairman. Right. As is my practice here, I am going to give my colleagues the chance to question first. I want to thank all of you, and, by the way, Mr. Melomo, tell me: What happened to the restaurant?

Mr. Melomo. Well, that is a good question. I turned it around, spent an awful lot of money and time, and made it a successful restaurant, but as I found out, if you try to do things the right way, you do not make any money. Usually in restaurants, you have a credit business and a cash business. What I found out, I always accounted for all the cash and all the other. Not everybody does that, and some cash does not get accounted for, and that is how money is made, and I did not do it that way, and as a result, I did not make any money, so I was getting older and tired, and I said, “This is not for an old guy.” I found a buyer and got out of it. I said I just cannot deal with it anymore, and I had accumulated a lot of debt to fix it up, so I did not even—that was part of my loss, so, you know, there were two errors: that one, and then the precious metals.

I was glad to get out of it. I was unhappy with my performance—not in that one but in the gold one. I should have known better. I should have done better, but as Mr. Spicer pointed out, we did not have a chance.

The Chairman. Well, let me tell you, you do not look like an old guy.

Thank you for being here and sharing that extraordinary story.

Okay. Senator Collins.

Senator Collins. Thank you very much, Mr. Chairman.

Mr. Melomo, when I heard Mr. Spicer go through the sales pitch that he would give, I can certainly understand why you were deceived, particularly given all else that was going on in your life, and when I think of the ads that I have seen in reputable magazines and newspapers for precious metals, I would not know which ones of those are legit and which ones are not.

In addition to far more aggressive prosecution, I think we need to do a better job of educating consumers, so I have had my staff pass out—and I want to give one to the Chairman, and I apologize that I do not have one for everyone here, but this is a document that has been put out by the Maine Securities Office, and it is what every investor needs to know before investing in gold, and in large print, it says, “It is a myth to say that gold is a safe investment,” which is what you read in those ads. It is what you read in the precious metal publication that was sent to you, and it sounds like it is what Mr. Spicer was telling people, or people within your organization, you know, “This is safe, the stock market is not, it is very volatile, but gold? Gold is safe?” I can see why so many people are deceived.

One of the things I like about this publication is it goes through two actual scenarios that are very commonly used. The one about
keeping the gold in a secure vault and promising to sell it as soon as it gains in value, it sounds very similar to what you were told.

I have a feeling if this had made—this publication had made it to you, that you would not have sent your hard-earned money to these con artists.

I know that the FTC and the Commodity Futures Trading Commission also have put out consumer alerts in publications, but I do not think these are getting to our seniors.

Mr. Melomo, had you ever seen any kind of warning about being careful in dealing with——

Mr. Melomo. Not at all. Not at all.

Senator Collins. You know, I am going to direct it to the two regulators that we have here. If you invest in a mutual fund, you get all sorts of disclosures that are mandated by the SEC. Are there disclosures that are mandated for precious metal dealers to have to, such as the kinds of disclosures that are included here? Why aren’t we requiring—by “we” I am putting on my old regulator hat here. Why aren’t you requiring disclosures to be included in these print ads and any kind of publication to warn investors that it is not a sure thing? Ms. Hollinger, we will start with you and then Ms. Brown.

Ms. Hollinger. Well, that is a good point that you are making, and I think that consumer education is the first line of defense in these cases.

The Commission’s public outreach program is going to be starting a campaign, a much more aggressive campaign, in terms of consumer education in the precious metals area this year. It is being unfolded as we speak, so I think that we will be doing a better job of getting the message out with brochures like what you have shown us, so I think that the consumer advisories certainly did not reach people like Mr. Melomo, and, you know, it is unfortunate, but we are going to try to do a better job in the future.

Senator Collins. Do you have the authority to require these dealers, who are, after all, registered—in the State of Maine they are. I do not know whether they are—maybe that is something we need to do, but in the State of Maine, the Office of Securities Licenses, firms and brokers who sell gold-related securities and investment advisors who recommend the purchase of gold-related securities or selling securities to purchase gold as an investment.

Tell me what the regulatory scheme is here. Is anyone regulating these firms?

Ms. Hollinger. Well, I am really only qualified to talk about what the CFTC registers, but we do not.

Senator Collins. But you do commodities.

Ms. Hollinger. We do commodity futures.

Senator Collins. Right.

Ms. Hollinger. Options and swaps and a host of other things, but under Dodd-Frank Act, if the metals dealer or the entity offering the retail commodity to an investor delivers within 28 days, they do not have to be registered.

Senator Collins. Ms. Brown, does the FTC have any ability—I would like to not only increase our prosecution efforts; I think we need to up front put some disclosure requirements on these dealers, the good and the bad. For one thing, it would be a lot easier
for you to go after them if they violated the disclosure, if they have not made the disclosures or they violated them.

Ms. Brown. I understand your concern, Senator Collins. The Federal Trade Commission enforces the telemarketing sales rule. To the extent that these companies are offering products through telemarketing, there are mandatory disclosures that are required. A telemarketer must disclose clearly, conspicuously—and before a consumer agrees to pay—certain information, including cost and quantity. The telemarketing sales rule also prohibits companies from misrepresenting profitability or risk, and then our Section 5 authority is somewhat broad and flexible, and it prohibits a business from relying upon deception in their business practices, and deception does include deceptive omissions, so the failure to provide information upon which a consumer would need to make a prudent decision.

Senator Collins. I know my time has expired. Let me just say that I would welcome—and I think the Chairman would, too, and Senator McCaskill—if there are gaps here in the laws, we would like to know what they are, and I also am really concerned when I hear from Mr. Melomo that he basically got nothing back, $25,000 out of his $170,000. Obviously this money is spent very quickly, but there needs to be more of an emphasis on restitution as well.

Thank you, Mr. Chairman.

The Chairman. Ms. Brown, Mr. Spicer and his firm were prosecuted under the authorities of the Federal Trade Commission?

Ms. Brown. I believe that he was prosecuted by State law enforcement. It was not a Federal Trade Commission case, Mr. Spicer’s case.

The Chairman. Would the example of the facts as related by Mr. Spicer, would that have been a violation of Federal law under the authorities of the Federal Trade Commission?

Ms. Brown. Absolutely. The scam that Mr. Spicer laid out is very similar to what we observed and prosecuted in our cases.

The Chairman. In the case of Mr. Melomo, that was—you utilized your authorities in existing law?

Ms. Brown. That is right.

The Chairman. Ms. Hollinger, I was struck that you seemed to think that you do not have any jurisdiction for scams such as Mr. Spicer’s.

Ms. Hollinger. We prosecuted that firm, so we do have jurisdiction over what Pan American of Miami did. What I was saying is that we do not have registration authority over those firms. There is a difference. Under Dodd-Frank, we have jurisdiction for anti-fraud and requiring that transactions be executed on an exchange.

The Chairman. I think that I need to know more about the extent to which your agency is going after these kinds of scams and why you said you did not know about the legitimate dealers in precious metals, why they were not jumping to the fore trying to expose these scam artists. You have a gentleman that has been nominated as the head of the CFTC but not yet confirmed. Would you please pass on to him, before I will allow consideration of his nomination in front of the Senate, I would like to have a conversation with him?

The CHAIRMAN. Okay, Senator McCaskill?

Senator McCASKILL. I want to figure out how you got prosecuted, Mr. Spicer, and I assume you are here because you want to do the right thing, especially since you have got sentencing in a month, right?

Mr. Spicer. Sure. I mean, there is no way that I could possibly pay back to these people any monetary things, so, yeah, I am certainly trying to do everything I can.

Senator McCASKILL. Who knocked on your door the first time you knew you were in trouble? What agency was it?

Mr. Spicer. The Manhattan District Attorney called me on the phone.

Senator McCASKILL. Okay, and are you saying, Ms. Hollinger, that you referred that case to the Manhattan District Attorney?

Ms. Hollinger. No.

Senator McCASKILL. Okay, so how did the Manhattan District Attorney get your case? You have got lawyers behind you. They can probably tell me.

Mr. Spicer. Yeah, we had set our corporation up through the State of New York with a virtual office and had a physical location in South Florida.

Senator McCASKILL. A victim came forward in New York and brought this to the attention of the financial sector of the Manhattan DA and the Manhattan DA took action?

Mr. Spicer. I do not know if there was a victim that let them know. I am not really sure about that.

Senator McCASKILL. I am sure that it probably was, so how many cases have been criminally prosecuted through the FTC or the CFTC for this, for these metals scams? How many cases have gone to a criminal prosecution with people going to prison?

Ms. Hollinger. I can only speak to how many indictments that I am aware of. In addition to the Pan American case, I am aware——

Senator McCASKILL. Are you referring to his case?

Ms. Hollinger. Yes.

Senator McCASKILL. You did not do that case. The Manhattan DA did that case. That was not a Federal case. That was a State case. You just told me you did not refer that case.

Ms. Hollinger. I must have misunderstood your question. I thought that you asked me how many precious metals criminal cases——

Senator McCASKILL. I want to know how many your agency began and brought to completion through Federal authorities, because I do not think you generated that case, correct?

Ms. Hollinger. I think we were working on it simultaneously.

Senator McCASKILL. Okay, so you were working on it. Did you notify the Manhattan DA office, or were you working through Federal law enforcement?

Ms. Hollinger. We were in constant communication.

Senator McCASKILL. Okay, so here is the deal: We have got local prosecutors, and you have got an office like the Manhattan DA that is very sophisticated.

Ms. Hollinger. Yes.
Senator McCaskill. They know a crook when they see one—pardon me, sorry—and they go after him, and then we have got the Federal folks who have a tendency to dither and take months and not bring very many cases, so I am trying to compare and contrast how aggressive the Manhattan DA was in this case with perhaps how aggressive the CFTC and the FTC has been, and, frankly, I do not mean to yell at you guys because a lot of it is about resources.

Ms. Hollinger. The CFTC has brought 21 cases.

Senator McCaskill. Okay, 21 cases totally in the country?

Ms. Hollinger. To date.

Senator McCaskill. Okay, and have those all been prosecuted federally, or were they prosecuted at the local level?

Ms. Hollinger. Well, the CFTC can only prosecute on the Federal level.

Senator McCaskill. Okay. Well, just a minute ago, you tried to take credit for the State prosecution, so I want to make sure you were not putting State prosecutions in with Federal prosecutions.

Ms. Hollinger. No, I was not trying to take credit for the State prosecution. I was just pointing out that we also brought a case against that firm.

Senator McCaskill. Okay, so you did one in addition to the Federal—to the State, so the Federal did a case and the State did a case in Mr. Spicer’s case.

Ms. Hollinger. The State criminal authorities and the Federal civil authorities both brought a case against the same firm.

Senator McCaskill. His lawyers are saying, no, that is not true. Would you mind, Mr. Chairman, if they clarified it? I think this is important.

The Chairman. Certainly. State your name and your position for the record.

Mr. Bruno. Yes, Senator, my name is Christopher Bruno. I represent Mr. Spicer.

Senator, there was not a Federal civil action. I think that the confusion is this is PMCO. I am not sure what the civil case was. There was not a parallel civil action here. I think there is a confusion in terms of the identity of the two ventures. This is PMCO. I think she referred to Pan American.

Ms. Hollinger. Pan American of Miami. I thought that was the same firm.

Mr. Bruno. That is not PMCO.

Senator McCaskill. No, that is not even the same company.


Senator McCaskill. Okay, so you have got 21 total cases in the country, and——

Ms. Hollinger. Filed.

Senator McCaskill. Filed, and how many of them have been convicted and gone to prison?

Ms. Hollinger. I think none.

Senator McCaskill. Okay, and how about you, Ms. Brown? How many have been convicted and gone to prison?

Ms. Brown. Senator McCaskill, we do have a Criminal Liaison Unit that advocates and attempts to refer our cases over for criminal prosecution. Whether or not a criminal prosecutor accepts our
case and is investigating it would be non-public information that I am not able to disclose. However, I will say as of yet there have not been any indictments in the cases we have brought.

Senator McCaskill. Okay. You cannot tell me about—they cannot talk about whether or not investigations are ongoing, but that is obviously in the context of a specific case. You can certainly say, if you know, how many cases are currently ongoing. Do you know how many cases are currently ongoing in terms of investigations?

Ms. Brown. I do not know as we sit here today.

Senator McCaskill. Okay. Well, that is kind of important, and I would ask for the Committee that you provide that information, because here is the deal: I respectfully disagree with you, Ms. Hollinger. The first line of defense is not consumer education. The first line of defense is putting the crooks in prison, because when crooks go to prison, other crooks notice. This is an underbelly of scam artists that are working this scam all over the country, and the most effective way to ferret this out and protect people like Mr. Melomo is to go after them with criminal prosecutors.

Let me ask you this: Do either one of your offices have a liaison with the National District Attorneys Association and the local prosecutors that have the authority like the DA in Manhattan to bring criminal prosecutions?

Ms. Hollinger. I would have to check with our office and find out.

Ms. Brown. We do have a Criminal Liaison Unit that works with those groups.

Senator McCaskill. Okay, so what I would like to know from that criminal liaison group if they would communicate back how many local prosecutors they have met with, how many local prosecutors they have brought cases to for prosecution, because what happens is in the Federal Government, this gets all tied up, and you all do not have prosecutors. All you can do is call Justice, and if Justice is busy, then Justice is not interested, and we have got to be much more aggressive about this.

Now, I have jurisdiction over the FTC, as you know, in my Subcommittee on Commerce. You do have the authority to clear up fraudulent advertising. Have you taken any actions against the fraudulent advertising that is going on where precious metals say this is a safe investment, there is no risk? That is fraudulent.

Ms. Brown. I am not aware of any cases that we brought against national advertisers. The cases that we testified to in our written testimony were marketers that were presenting this as a safe and profitable investment.

Senator McCaskill. Okay. Well, that I think would be the second line of defense, is going after the fraudulent advertising. You know, you can turn on satellite radio right now and hear it as you drive home tonight. Get on one of the XM stations, and you will hear the fraudulent advertising—it will not be hard to find them, because it is everywhere—where they are not having to follow the same rules as—a lot of these investment firms do not advertise on radio because they cannot get in the disclosures. They are too long for the radio ads, but these guys do not have those disclosure requirements, so I would ask that your agency take a much harder look at the fraudulent advertising that is going on.
Thank you, Mr. Chairman.

The Chairman. I can tell you, we are not going to let this go. We are going to have some visitation with the FTC and the CFTC, with the Department of Justice.

In 1983, the Associated Press ran a story that is very similar to the one that has been recounted to us here today, so why are we still struggling with this problem today?

Ms. Hollinger. Do you want me to address that?

The Chairman. Anybody.

Ms. Hollinger. Okay. I think that this is cyclical based on my experience at the Commission for 28 years. When I first joined the Commission in the mid-1980s, we were dealing with precious metals fraud. It looks like these people are opportunists and they will go wherever the opportunity is, so we saw them move to options and then to forex and then finally back to precious metals, so I think that the reason it is precious metals fraud right now—in essence, the flavor of the day—is because precious metals’ prices are volatile right now and they can prey on the fear, the insecurity of investing in the stock market.

I think that the reason you see the same people over and over again is that this is their career, telemarketing, and so you are going to see them go from one scam to another until they are finally stopped. I think that is the best answer I can give you.

The Chairman. Does your agency as the commodities futures trading, are there futures in precious metals?

Ms. Hollinger. Yes.

The Chairman. Okay, so there are legitimate businesses on precious metals.

Ms. Hollinger. Yes.

The Chairman. I just simply do not understand why the legitimate businesses are not raising Cain about the fraudsters, because when we get through with this hearing and when the members of this Committee get through telling about these scams, it is not going to give a degree of confidence in a potential investor that wants to invest in gold or other precious metals. Mr. Spicer?

Mr. Spicer. Yes, if I may. It has been my experience, although I am sure that I do not have all the answers as to how to kind of stop this, if you will, I do know that where I am from in South Florida, there are one of these on every corner, and when you take one down, three pop up, and I truly believe there are a couple of things that can be done.

One, I believe with Mrs. McCaskill, I think that with all due respect to the civil authorities, the people that I have encountered in my experience do not really respect the civil authority bans and the things that can be done there. To be honest, they still—they take bans that—the gentleman that I was with has a CFTC ban. He cooperated, he had a ban, and he still went about doing business the very next day. I think she is right that the first thing is—I think that the criminal aspect exposure, like what happened in my case, is what is going to open eyes, as she stated.

The other thing is I believe that obviously investor awareness is key, but I think the other key ingredient to this is the transactional lawyers that help these guys put these things together and avoid detection and avoid, you know, regulation. I think something
needs to be done there, because there are a group of them, lawyers
that help these guys put these things together.

The CHAIRMAN. They have escaped prosecution.

Mr. Spicer. Well, I mean, the guy that I was with had an attor-
ney, he was banned, and he was telling him what to do, and he
was using an alias, and he was using a nominee for the business,
putting it under somebody else’s name, just things like that.

The CHAIRMAN. How about the telemarketers? Are they pros-
ecuted?

Mr. Spicer. In most cases, the individual guys are not. It is
mainly—even in the civil cases, it is the higher-ups. The individual
telemarketers, frontiers, brokers are generally left out.

The CHAIRMAN. As a legitimate stockbroker—you said you were
a registered broker.

Mr. Spicer. Yes, sir.

The CHAIRMAN. You made a million and a half bucks.

Mr. Spicer. That was my entire commodity career, both with
precious metals and with being a registered commodity broker.

The CHAIRMAN. How did you get seduced into this

Mr. Spicer. That is a great question. It was a combination of
several things, I am sure. I actually had my own commodity firm
for a while, for about three years, that I was trying to run by my-
self with nobody else, just me, myself, and I, and it just really got
to be too much between trying to do all of the regulatory aspect
and trying to find investors. Just really all by yourself, it was too
much.

I actually got a call from a guy that used to be a commodity
broker when I first started who owned a precious metals firm, and
he offered me a position and I took it, and I think a lot of the guys
that were in the commodity industry down there in South Florida
went to metals. I think when the CFTC lowered the commission
rate that they could charge—or whatever, the commission that we
were able to charge on an option, because that is what those firms
down there do, do option contracts, they were charging back when
I first started $200 per option on a $1,000 option, and it went down
to a certain percentage. It may not be a dollar amount, but at any
rate, a lot of those guys went to precious metals because there is
no regulation. Originally, there was no regulation. This was before
the Dodd-Frank Act, and that is just kind of how it—what hap-
pened.

The CHAIRMAN. Ms. Brown and Ms. Hollinger, do you think there
is a role for an agency like the Consumer Financial Protection Bu-
reau to be more proactive in protecting seniors and other investors?

Ms. Brown. Of course. I think whenever you introduce more law
enforcement agencies, it is a good thing. Having the ability to bring
law enforcement actions, engage more in consumer education ef-
forts would certainly prove helpful.

I would also note that already there is a lot of collaboration be-
tween different Federal agencies and State agencies. The CFTC
and the FTC both participate in a task force that was organized
by the U.S. Attorney’s Office in Miami, Florida, and we speak regu-
larly about law enforcement options. That task force includes the
SEC, FINRA, the FBI, the IRS, several State and local agencies as
well, including Attorneys General, the Office of Financial Regula-
tion, Florida’s Department of Agriculture and Consumer Services, and all of the agencies work very hard to leverage our resources, share information, and find the best means of, you know, going after these scams.

The Chairman. I want our staff to follow up with the U.S. Attorney down there.

Senator McCaskill. Let me just point out, you did not mention any local prosecutors. The prosecutor who put him in prison was a local prosecutor. It was a State prosecutor. They prosecute 99 percent of the crime in this country. Invariably, Federal agencies hang out with U.S. Attorneys, no disrespect to U.S. Attorneys, but they are not going to go after these guys. They are not going to do it. If they were, they would have done it since 1963. They are not going to do it. You are going to have to bring in local prosecutors and get their expertise up, get their interest up. If you have a task force and there is not a local prosecutor in it, it is not going to be successful.

Ms. Brown. We rely heavily on local law enforcement as well. In fact, when we bring a new case, we involve the local authorities, and they assist us in our immediate access of cases, and we do solicit their——

Senator McCaskill. I am anxious to find out one case that the CFTC has been brought against one of these guys that they have referred through their work to a local prosecutor. One case. I am anxious to hear about it.

The Chairman. I would like somebody in the Federal Government to start providing consumer information like this provided by Senator Collins’ State of Maine, their Office of Securities, because if an investor like Mr. Melomo had seen this and read it word for word—yes, sir?

Mr. Melomo. I think this is excellent, first of all. However, I have never seen anything like this, but I thought about how could I have done things differently, how could I have protected myself, and I thought originally, why don’t we put in place a law like we have for sexual predators, a national list of all those folks who prey on the children, one that preys on the elderly?

Then I thought, that is a lot of work and it is complicated, so I thought a little differently, and I said, well, here is what a consumer ought to do: A consumer, first order of business, in my case what I did not do is I did not engage my family when I was called by these people. Had I engaged my family, I mean, they would have definitely played devil’s advocate with me, and I would have re-thought what I was doing.

The second thing is I think we need to put in place a 72-hour rule like we do in automobile buying where the consumer, after they purchase something, has the ability to go back and say, “I think I made a mistake. I want out of this deal.” If we had something like that and you talked to your family, I bet a lot of consumers would say, “Wait a minute. This is not a legit thing.”

Then the third part of that is we have an Internet out there that my daughter used very successfully to find lots of dots to connect.

We ought to be using those three things. I say “we”—the consumer, the person. Had I done that, I definitely would not have lost
that money, but I did not do that. That was my fault, but I think something like that has value. At least I think it has value.

The CHAIRMAN. Senator Collins?

Senator COLLINS. Thank you.

Those are excellent suggestions, and I really appreciate your sharing them with us. One of the concerns that I have is although the CFTC and the FTC have some excellent documents that are online, they are just not likely to get to people like Mr. Melomo, and what I started doing with a senior newsletter that I am doing as a result of our work is putting them in senior centers and working with AARP to distribute them and putting them in area agencies on aging or places where seniors go to apply for low-income heating assistance programs.

I think that the Federal Government produces excellent materials, but really fails when it comes to getting them into the hands of seniors, or try to get public service ads that would alert people to help counter all those radio ads that are heard, and that is what I think we should do a lot more of.

I want to get back to a point that Senator McCaskill raised, Ms. Brown, and that is, she talked about the jurisdiction you have over fraudulent or misleading advertising, but what I want to know is, can you mandate certain disclosures? For example, some of the disclosures that are included in the Maine Bureau of Securities brochure, do you have the authority to put the kinds of disclosures that, as Senator McCaskill memorably said, would be too long for the radio ad—which is why we do not hear mutual funds generally advertising in 30-second ads because they are required to make all these disclosures?

Can you mandate disclosures? I do not know who has the responsibility to make sure these people behave.

Ms. BROWN. Thank you, Senator Collins, and I come here today as a litigator who has brought these cases. I am not a policy analyst, and I do not engage in rulemaking at the Federal Trade Commission. We have a fabulous team of people who do those things, and I am happy to forward your inquiry on that point to them and have them respond. I feel ill-equipped to address potential rule changes or legislation that the agency might take on. It has not been my role in the agency.

Senator COLLINS. I would ask that the agency get back to us.

Ms. Hollinger, what about the CFTC? Can you—and I realize you are dealing with futures contracts, but we know there are futures involved in the sale of gold and other precious metals. Can you mandate disclosure requirements to appear in advertisements?

Ms. HOLLINGER. I think in regulated futures and options we do have requirements and mandated disclosures. This is unregulated, so I have to say I am in the same position Ms. Brown is in. I am a litigator also, but I would be happy to take your question back to the agency, supplement the record, and give you a more precise, focused answer.

Senator COLLINS. I mean, can you imagine if seniors had a disclosure that said, “It is a myth to say that gold is a safe investment”? I mean, I do not know, Mr. Spicer. You are talented at talking people into things. There is no doubt about that, but if you had an educated consumer who started pushing back at you and saying,
gee, I just read a warning to beware of buying told through a telemarketer cold call and pointed out to me that it is a myth that gold is a safe investment and that mutual funds by law have to have 90 percent of their income from securities, gold is not a security, and, you know, went through some of the—if they started pushing back with the kind of information—I realize you have not seen this brochure. Would that cause you to go on to your next victim? Or would you try to still talk them into it? Or would you be worried that maybe they would be on to you?

Mr. Spicer. To be honest, they would still try to go——

Senator Collins. You would still try to push it.

Mr. Spicer. Yes. I mean, there are—I mean, there are certain people out there that pay attention and that, you know, obviously are aware of the disclaimers that the Commodity Futures Trading Commission—the pamphlets that they put out and so on. They would continue to go forward until the person hung up.

Senator Collins. It sounds like we get back to Senator McCaskill’s point that the best deterrent—though I still think consumer education and warnings on those ads would be very helpful, but the best deterrent is going to be aggressive prosecution, although I will tell you what will happen. They will just move on to the next scam.

Senator McCaskill. Not if they go to prison.

Senator Collins. True, but, I mean, it is amazing. The scam hearings that we have had, the creativity of the con artists is just unbelievable.

Thank you.

The Chairman. Senator McCaskill.

Senator McCaskill. Yes, first, I have a lot of passion for this, so I do not want you to mistake my passion for being so abrupt and rude to you that I do not appreciate your service and that you are working hard, but I was struck by both of you saying that you are litigators, and so I want to probe that a little bit.

Ms. Brown, what do you actually do as a litigator?

Ms. Brown. I was the litigating attorney on the three cases that the Federal Trade Commission brought in this area. My role there was to help investigate the operations, work with a Federal trade investigator, determine what was going on. I had the opportunity to speak to many consumers who were victimized by these scams, including Mr. Melomo. I interviewed them, determined what representations were made to them. I investigated the underlying facts. I looked at the companies’ Web sites, at publicly filed documents.

Senator McCaskill. Then you did what?

Ms. Brown. Then I recommended to the Commission that we file an enforcement action against these companies to close them, to shut them down.

Senator McCaskill. Okay, and you successfully shut them down.

Ms. Brown. We did.

Senator McCaskill. Okay. Now, at what point in that investigation under your protocols would you have been instructed to involve criminal authorities?

Ms. Brown. I was involved with criminal authorities in these matters very early on, as was the CFTC. The first case that I
brought was American Precious Metals. I worked on that matter alongside with the CFTC. Carlin Metzger of Rosemary's office and I coordinated, shared information, brought our respective actions, and we met with prosecuting officials.

Senator McCaskill. Okay, and who did you meet with?

Ms. Brown. We met with U.S. Attorneys.

Senator McCaskill. Okay, and these were U.S. Attorneys all over or they were specifically in one jurisdiction?

Ms. Brown. We met with both Main Justice and from South Florida.

Senator McCaskill. Okay, and when you met with the U.S. Attorney from South Florida, was that U.S. Attorney interested in criminally prosecuting these cases?

Ms. Brown. They were noncommittal. They took a lot of information, and we shared all of our resources with them.

Senator McCaskill. Then you went away and did your civil stuff, and did anybody follow up with him about why criminal cases were not filed?

Ms. Brown. Our Criminal Liaison Unit has pursued inquiries with the U.S. Attorney's Office as well as some other Federal regulators and reminded them of our interest in seeing this matter prosecuted.

Senator McCaskill. Are you aware of what the Florida State statutes are as it relates to these crimes?

Ms. Brown. I am sorry. I do not understand your question.

Senator McCaskill. The difference between State statutes and Federal statutes. You know, we have two sets of laws—ones that are State laws, ones that are Federal. Are you familiar with the State criminal laws around this activity?

Ms. Brown. I am not familiar with the laws in the State of Florida. However, I did speak to a county sheriff also about these cases and outlined, you know, a thumbnail sketch of the case and asked if they would be interested in criminally prosecuting.

Senator McCaskill. I am guessing that—have either one of you ever been trained or told that at the point in time that you are investigating these cases and you have criminal fraud—because I assume both of you know very well what the elements of criminal fraud are broadly——

Ms. Brown. We routinely refer things to——

Senator McCaskill. You are both lawyers, so you learned—you had to take those exams, like I did, and you learned what the elements of criminal fraud were, so when you find elements of criminal fraud, are you trained to call the State prosecutor that has jurisdiction over the crime to talk to them about the crime that has occurred?

Ms. Brown. We generally refer matters through our Criminal Liaison Unit, and that is their role. They contact, you know, a variety of different criminal enforcement authorities.

Senator McCaskill. Well, I would like to follow up with that, because I think what is happening here, you know, there is this tendency to assume that local prosecutors are not worthy or maybe not capable of handling these kinds of cases, and they are really pretty straightforward. You know, you have got two or three elements you have got to prove, and, frankly, local prosecutors do cases—I am
sure the lawyers that are with Mr. Spicer can tell you, they do much more complex cases than these cases. These are not hard. Once you get the elements of a fraud, it is like taking candy from a baby, and I can assure you, putting these cases in front of juries, you are going to get convictions, because nothing infuriates a jury more than someone who has done to people like what was done to Mr. Melomo, and I know Mr. Spicer is aware of that. That is why he pled guilty, because he knew that a jury would have no patience with this.

I hate to be harping on this, but I really think it is time that Federal agencies look beyond what they have been doing here and try to get into a meaningful partnership with local prosecutors who are going to be much more responsive to victims, who do not have the luxury of cherrypicking what cases they take. You know, I like to tease my friends that have been U.S. Attorneys. If only you had to answer a 911 call, you would understand what law enforcement is really like, because Federal prosecutors get to pick what they take. Local prosecutors do not, and if there is a crime committed in a jurisdiction, a local State prosecutor does not really have the ability to say, “I am not interested.” I think we are missing an opportunity to get meaningful enforcement here, because there does not appear to be a real effort to coordinate with local prosecutors.

You have heard it from Mr. Spicer—and I cannot imagine a more potent or powerful witness—that doing civil actions is not going to stop these people. Shutting down their businesses, they are just going to go somewhere else, but once they have a felony record and once they have spent time in prison, then you have got a horse of a different color.

I am going to venture to say, Mr. Spicer, I have a feeling that when you finish doing whatever you need to do in connection with your criminal prosecution, you are probably going to avoid commodity trading.

Mr. Spicer. Yes, ma’am. Of course, altogether, financials altogether.

Senator McCaskill. Financials altogether, and I would be surprised if he returned to that. On the other hand, he can probably name you dozens of people he knows that have been the victim of your excellent work in terms of litigation, but that has not had a deterrent effect.

I would look forward to hearing from your Criminal Liaison Department, and we will have—through this Committee and through my Subcommittee, we will follow up with the FTC and the Criminal Liaison to see how much local prosecutors are actually getting pulled into the loop.

Ms. Brown. Thank you.

Senator McCaskill. Thank you both very much.

The Chairman. Mr. Spicer, what kind of information was contained on those lists that you called from?

Mr. Spicer. They are pretty basic. They have a name, a phone number, usually one or two numbers, maybe an e-mail address. Some of them are more extravagant. Some of them have incomes, occupation, and such. Most of the ones I dealt with just had a name and a number.

The Chairman. Are they purchased?
Mr. Spicer. Yes and no. Yes, they do get purchased, but I have also seen where firms will swap lists. You know, once their people have gone through them, even the front sheets, the people that are interested, they get packages, it has been known in the industry for firms to sell those interested prospects, the ones they did not close, to other firms.

The Chairman. Other firms that are doing the scam?

Mr. Spicer. Doing the same—selling precious metals or even commodities or anything like—a like service.

The Chairman. Ms. Hollinger and Ms. Brown, if you wanted to legitimately buy gold, how would you go about it so that you could avoid the scams?

Ms. Brown. We advise consumers that they really need to be skeptical of cold calls. There are very few legitimate companies that engage in cold calling and even fewer that would be offering an investment through this method, and if your number is registered on the National Do Not Call List, as Mr. Melomo mentioned, we encourage consumers to hang up when they get that cold call. That company has already violated the law, and we know that they cannot be trusted.

We also encourage consumers to be very wary of sales claims. No salesperson can guarantee profits, nor can they prevent a consumer’s losses. Anyone who says otherwise would be lying.

A legitimate salesperson will thoroughly explain the costs and risks associated with an offer, in writing if requested, and would not pressure any consumer into a quick decision, so we encourage consumers to watch for those red flags.

The Chairman. Just do not take the cold calls. If you want to buy it, go to your registered broker that you are accustomed to dealing with.

Tell me, Mr. Melomo—and it is terrible, the experience that you have gone through, and the sad human and financial cost to you. Before you made the decision to buy these precious metals, did the salespeople at American Precious Metals ever explain to you how much of your money would go to administrative fees?

Mr. Melomo. There was no discussion about any fees whatsoever. None.

The Chairman. Why Florida, my State? As a matter of fact, our Committee investigation, the one that I referred to, they found that a large portion of these scam companies operate out of Florida. Why?

Ms. Hollinger. Well, I can only tell you what answer I got when I asked someone who was running one of these boiler rooms that very same question, and his answer to me—and this really was 20 years ago, and I will never forget it—was: “There is a lot of talent here.” The fact is that this is a group of people who go from scam to scam, and they are just located in southern Florida; they migrated there years ago; they stay there, and they are set up to go there, particularly in the same geographic area, and they just go from storefront to storefront.

The Chairman. Well, it is true that there are a bunch of other fraud scams going on in South Florida. Medicare fraud, by the way, the number one place in the country on Medicare fraud is South Florida. Of course, the fact of a high concentration of senior citi-
zens, some degree of wealth among senior citizens who have moved and retired, so is the advice, is the takeaway from this Committee hearing today to consumers, and especially to gullible seniors, is the advice, the takeaway that you would give do not pay any attention to these cold calls?

Ms. Hollinger. I think that would be good advice because it is gold today and it could be heating oil tomorrow or diamonds or something else, so cold calling is probably the predominant problem.

The Chairman. Senator Collins.

Senator Collins. I do not have any further questions, Mr. Chairman. Thank you for an excellent hearing, and thanks to our witnesses today.

The Chairman. Well, I want to thank the panelists. It is going to continue to be one of the core missions of this Committee to highlight and combat all types of fraud that are confronting senior citizens. We have taken a look at Jamaican phone scams, identity theft, Social Security fraud, payday lending, and today we have focused on precious metal scams, and we are going to continue to look into other scams. Every day we hear from seniors about scams on our Committee's fraud hotline, and we will keep using this as a way to stand up on behalf of our senior population. The Committee's hotline number is 1–855–303–9470. That is 855–303–9470.

Thank you all for bringing some light onto this rather sordid subject today, and the Committee is adjourned.

[Whereupon, at 3:51 p.m., the Committee was adjourned.]
Prepared Witness Statements
Prepared Statement of Joe Melomo, Victim of Precious Metal Fraud

My name is Joe Melomo. I have had considerable success in my business life as a former physicist for IBM. My wife and I have raised 4 successful children, of whom I am very proud. I was raised to always try to do the right thing and to treat other people the way I would like to be treated. I consider myself a savvy businessman and investor, and yet I sit here today having lost more than $170,000 investing in what I know now was a precious metal scam.

So that you can understand my frame of mind at the time I invested in precious metals, I would like to share with you events leading up to the call I received from American Precious Metals. My wife passed away at the end of 2001 after 41 years of marriage and I was lost, and found it very hard to look back. I sold my house in 2004 and moved from the outskirts of Austin to downtown Austin to be closer to my children and grandchildren.

In Austin, after much due diligence, I became a silent partner in a restaurant but soon discovered the majority partner in the business was stealing money. While I succeeded in proving this in court – the man was convicted of fraud – he was unable to pay me the $250,000 the court ordered him to pay me. So, at age 71, I took over the business, dealing with all the stress that comes with having to support a team of employees and their families, and cover the enormous bills that came due.

While this was all going on I received a call from American Precious Metals, even though my number was on the “Do not call registry.” The person who called talked to me about investing in precious metals, primarily gold and silver. The conversation got my attention because I could see a way to possibly cover some of my losses from the restaurant. So I asked him to send me some information, which he did. All of the materials looked very professional and legitimate. Between his encouragement and what seemed to be genuine interest in helping me profit from this kind of investment, and my desire to make back some money, I started to invest in gold and silver.

I never truly understood the leveraged process, and was not clear on the kind of fees I would be charged. Storage, commission and interest fees were never discussed. I trusted him to watch out for my interests since I explained to him the kind of turmoil I was going through at the restaurant. He told me there is some risk associated with precious metal investments, but assured me that he would be watching out for me. I guess that feeling of assurance allowed me to let my guard down. So with that I focused my attention on trying to correct all the issues with the restaurant. When the monthly statements came I looked at them, but I didn’t really understand them. All I did make of them was my investment was looking good. Occasionally, I would call asking if I should be concerned about my investment and was told no and that it still looked good.

During this period, several different sales representatives worked my account. The sales representative working with me changed for various reasons. But each salesperson that was assigned to me made me feel like I was a friend. We talked about our children, and where we went to school.

For almost an entire year they kept calling me and urging me to invest more money because everything looked good.
Around August 2008 the precious metals prices dropped significantly and most of my precious metals were liquidated. American Precious Metals contacted me and told me to send more money to protect my investment. I told them I didn’t have any more and that I wanted them to return my money. They said they didn’t have it. I called numerous times demanding that they return my money and then ultimately they said it was entirely gone. I was devastated to realize that I had been deceived by this company. I paid American Precious Metals just under $170,000 and they charged me approximately $165,000 in administrative fees and $37,000 in interest charges. With the help of an attorney, I was able to only get back $25,000. The overall loss from this investment, along with the cost of the restaurant, completely depleted my retirement savings.

When I told my children what had happened, they were extremely upset with me and with American Precious Metals.

My daughter Nancy took it upon herself to research the company and the people who worked there. She found that they were banned once before for doing the exact same thing, but they restarted under a different name. She contacted the Federal Trade Commission and specifically Ms. Dana Brown. Between my daughter’s tenacious drive and the excellent work by Ms. Brown and the FTC staff, they were able to get the people from American Precious Metals convicted in December 2012.

I commend Ms. Dana Brown and her staff at the FTC for following through and getting this conviction. Unfortunately, to this day I still have not fully recovered the money that I lost to American Precious Metals.

I come here today to have my story serve as a warning to others who may fall victim to this trap, and encourage our elected leaders to help protect us little guys from the predatory schemes of these companies. I thank you for the opportunity to share my story, and stand ready to answer any questions.

Thank you,

Joe Melomo
PREPARED STATEMENT OF DAMA BROWN
OF THE FEDERAL TRADE COMMISSION

on

EXPLORING THE PERILS OF THE PRECIOUS METALS MARKET

Before the

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

Washington, D.C.
April 30, 2014
I. Introduction

Chairman Nelson, Ranking Member Collins, and Members of the Committee, I am Dama Brown, Director of the Southwest Region of the Federal Trade Commission (“FTC” or “Commission”). I appreciate the opportunity to testify today about scams arising from the sale of precious metals investments.\(^1\) Although precious metals can be legitimate and valuable investments, some fraudsters have used them to swindle money from consumers. These scams often prey on older Americans concerned about the security of their retirement savings, particularly during periods of economic uncertainty.

Following the economic downturn in 2008, the Commission observed a proliferation of schemes targeting financially-distressed consumers.\(^2\) These schemes have included deceptive telemarketing operators posing as “brokers” and offering precious metals as purported high-profit, low-risk investments. By failing to disclose key information about the investments’ terms and high costs, these brokers deceive consumers into believing that the investments provide a safe and secure vehicle for savings. Sadly, many Americans have lost their life savings to these unscrupulous operations.

Today’s testimony will describe precious metals scams, the Commission’s enforcement actions to stop them, and the agency’s efforts to educate consumers on how to avoid them.

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1. This written statement represents the views of the Commission. My oral presentation and responses to questions are my own, and do not necessarily represent the views of the Commission or any individual Commissioner.

2. Since 2008, the Commission has brought more than 100 enforcement actions against defendants seeking to take advantage of economically vulnerable consumers. The FTC has worked closely with other federal and state agencies in coordinated sweeps, which have resulted in over 400 additional actions. See, e.g., Press Release, FTC Cracks Down on Scammers Trying to Take Advantage of the Economic Downturn (July 1, 2009), available at http://ftc.gov/opa/2009/07/shorthcange.shtm; Press Release, FTC Cracks Down on Con Artists Who Target Jobless Americans (Feb. 17, 2010), available at http://www.ftc.gov/opa/2010/02/bottomdollars.htm.
II. Precious Metals

Precious metals are naturally-occurring metals that carry a high economic value, often due to scarcity or global demand. These metals, including gold, silver, platinum, and palladium, can be sold as physical assets, in the form of bars, bullion, or coins, or as futures contracts or other speculative investments. Although precious metals prices are volatile, they have increased markedly over the last decade. These gains occurred during a time of turbulence for more traditional investment products, including stocks, bonds, and real estate. Throughout this period, financial reports and media headlines frequently touted the significant gains in value that precious metals were experiencing contrasted against poor yields in other investments.

Fraudsters have used this backdrop to lure consumers into purchasing bogus precious metals investments. Beginning in 2010, the Commission observed an increase in investment-related frauds, including precious metals scams. This increase was similar to one the Commission observed in the 1980-90s, another time when American consumers lost confidence in traditional investments and turned to alternative investment products like precious metals.

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3 For example, between 2003 and 2012, gold trading prices increased from approximately $340 per ounce to more than $1,650 per ounce, peaking at around $1,900 per ounce in September 2011. In 2013, gold prices declined sharply, closing the year around $1,200 per ounce. See Kitco Historical Charts – Gold 2000, available at http://www.kitco.com/scripts/hist_charts/yearly_graphs.plx.

4 While precious metals frauds have never been one of the top complaints received by the Commission, we documented an increase in investment-related complaints and complaints involving precious metals between 2009 and 2012. See 2013 Consumer Sentinel Network Report, available at http://www.consumer.gov/enforcement/consumer-sentinel-network/reports.

III. The Commission’s Law Enforcement Actions

The Commission has recently filed three law enforcement actions involving precious metals investment schemes.\(^6\) In addition to stopping the alleged scams, the Commission expects to return approximately $5 million to consumer victims. As alleged in the Commission’s complaints in these matters, the defendants’ conduct followed a similar pattern. Therefore, this testimony first describes some common features of these schemes, and then provides details from each of our individual actions.\(^7\)

A. Common Features of Precious Metals Schemes

In its enforcement actions, the Commission alleged that the scams were initiated by unsolicited telemarketing calls to consumers from a purported precious metals broker. The telemarketers often claimed to have insider information or falsely implied that the consumers were receiving a special opportunity to invest in a program ordinarily only available to investors with multi-million dollar investment portfolios. Citing recent media reports concerning the economy or precious metals performance, the telemarketers worked to convince consumers that they were offering a safe and lucrative investment opportunity in precious metals.

According to the Commission’s complaints, the sales pitches used by these telemarketers contained numerous claims that the offered precious metals—which were purportedly in the form of bars, bullion, or coins—were certain to rise in price. They distinguished the telemarketers’ precious metals investments from futures, options, or other “risky transactions,”


\(^7\) The evidence gathered to support the Commission’s complaint allegations in each matter included declarations from injured consumers, the defendants’ telemarketing scripts, and post-sale audio recordings made by the defendants.
and explained that because the investment was backed by physical metal, the investment was safe and consumers would not lose money. 8 Telemarketers used the actual market performance of precious metals in their sale presentations: When prices rose, they urged consumers to invest quickly before prices rose further. When prices were low, they asserted that “now is the time to buy”—before prices increased. They also used aggressive sales techniques, often calling consumers for weeks, to pressure them into investing.

As alleged by the Commission, in reality, the telemarketers offered a highly leveraged, high-risk investment. With these leveraged investments, consumers paid only a portion of the purchase price and financed the remainder. The telemarketers failed to disclose this crucial information, simply claiming instead that consumers needed to pay only a percentage of the purchase price—generally 20-25 percent. They assured consumers that the balance of the purchase price would be paid from increases in equity that they claimed would be realized as precious metals prices soared. However, the Commission alleged that the telemarketers failed to disclose that their firms would charge interest, ranging from 7 to 14 percent per annum, on the 75-80 percent of the purchase price that was financed. Likewise, the telemarketers failed to clearly disclose their commission and fees, which included a 15 percent commission on the full purchase price (including the amount that was leveraged), a $200 account opening fee, monthly storage or maintenance fees, and mark ups. In addition, they failed to explain that the transaction was subject to equity calls or forced liquidation upon a price decrease.

The Commission also alleged that, once consumers agreed to invest in precious metals, the telemarketers sent them a contract to execute and directed them to return it with a check.

8 For example, in the American Precious Metals case, supra Note 6, consumers reported that the defendants assured them that metals prices were “poised to skyrocket” and would cause consumers’ investments to quickly double or triple in value. Telemarketers also described the investment as a “safe haven.” The consumers’ testimony was corroborated by the defendants’ own telemarketing scripts.
money order, or wire transfer authorization to fund the investment. The contracts contained fine print disclosures concerning the costs of the investment, along with statements attempting to disclaim any representations about its profitability or risk. The telemarketers pressured consumers to sign and return the contracts quickly with their payments, claiming that by doing so consumers could begin realizing significant profits. After consumers returned the contract and funded the investment, the telemarketers directed them to a “compliance officer” who reviewed the order in an audio-taped telephone call. These audio recordings, which were obtained by the Commission during litigation, often revealed that many consumers were confused by what they purchased.

The Commission alleged that the vast majority of consumers who invested in these sorts of offers were unlikely to realize any gains for at least three reasons. First, the investments carried significant hidden costs, including interest, commissions, and other fees. Second, after the initial sale, telemarketers aggressively pressured consumers to continue investing in precious metals. Many consumers reported that they received daily calls from their “broker” advising them to sell one metal and invest in another or to expand their holdings of a particular metal. Each of these transactions generated additional fees for the telemarketer, while eroding the consumer’s equity and making it more difficult for the consumer to earn a profit. Third, because of the leveraging, consumers faced the possibility of losing their investments as a result of even a modest drop in prices. Specifically, if a consumer’s equity in the investment fell below a certain threshold, usually 10 or 12 percent, the firm purportedly “liquidated” the consumer’s investment. This meant that the consumer’s metals were sold at a low price and the proceeds were applied to the leverage balance. The remainder, if any, was sent to the consumer. Consumers were left shocked and confused when their accounts were liquidated and their life savings evaporated.
Many consumers, who were never fully advised about the leveraging of their accounts, were unable to understand how their investments were lost.

B. The Commission’s Enforcement Actions

The Commission’s complaints against precious metals scams have alleged that the defendants violated the FTC Act and the Telemarketing Sales Rule by falsely promising high profits with no or minimal risk and by failing to disclose hefty costs and other terms, such as forced liquidation, which rendered the investments highly risky and largely unprofitable. In light of the ongoing, irreparable injury inflicted upon consumers, the Commission sought temporary restraining orders to immediately stop the law violations, to freeze the defendants’ assets, and to appoint a receiver over the corporations.

In *American Precious Metals, LLC*, the FTC presented evidence that the defendants caused more than $24 million in consumer injury. The court-appointed receiver in the case promptly closed existing investment accounts and oversaw the return of approximately $1.8 million to 380 customers. After being confronted with the Commission’s evidence, the company and its owners stipulated to entry of a permanent injunction with a $24 million judgment, representing the full amount of consumer injury. The order requires the defendants to surrender all of their financial accounts, specific personal property, and investment properties to satisfy the judgment. The final order also permanently bans the two primary principals—both of whom were previously sued by the U.S. Commodity Futures Trading Commission for making

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9 15 U.S.C. § 45(a) and 16 C.F.R. Part 310.3 et seq., respectively.

10 Press releases and key pleadings concerning this action are available at http://www.ftc.gov/enforcement/cases-proceedings/102-3212/american-precious-metals-llc-et-al.
similar misrepresentations about the profitability and risk of futures—from selling any investment opportunity.

In Premier Precious Metals, Inc., the Commission obtained temporary relief to stop the harm, and the court-appointed receiver quickly closed existing investment accounts and returned $286,990 to 44 customers. The defendants recently settled the case, agreeing to a permanent ban prohibiting them from selling investment opportunities in the future. The final order also includes a monetary judgment of $3.6 million, representing the full amount of injury sustained by the companies’ 113 customers. As part of the judgment, these defendants surrendered an estimated $3 million in assets.

Likewise, in Sterling Precious Metals, LLC, the Commission obtained a stipulated permanent injunction with conduct prohibitions and monetary relief. The final order bans the defendants from selling precious metals, enjoins them from misrepresenting material facts about any product or service offered for sale, and requires them to record all of their telemarketing activities for seven years. The final order also includes a monetary judgment of more than $4.7 million (partially-suspended due to inability to pay) requiring the defendants to surrender personal property, including a 2013 Bentley Continental and 2012 Land Rover.

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11 The individual defendant and owner of the Premier Precious Metals companies had previously worked at American Precious Metals, LLC.

12 Press releases and key pleadings concerning this action are available at http://www.ftc.gov/enforcement/cases-proceedings/122-3099/premier-precious-metals-inc-et-al.

13 The press releases and key pleadings concerning this action are available at http://www.ftc.gov/enforcement/cases-proceedings/1223027/sterling-precious-metals-llc-et-al.
IV. Consumer Education

The Commission has produced several educational brochures to help consumers avoid scams and understand the key information they need to know before investing in precious metals, coins, or other investments. For example, the *Investing in Gold* brochure advises consumers to purchase gold investments only from licensed commodity brokers and reminds them that gold prices can fluctuate.

The Commission’s *Investing in Bullion and Bullion Coins* and *Investing in Collectible Coins* materials explain the differences between bullion, bullion coins, and historic coins. While the value of bullion and bullion coins is determined by their precious metals content, the value of historic coins depends upon their historical or aesthetic value to collectors, as well as their rarity or condition. Accordingly, the precious metals value of a historic coin may be greater or less than its value as a collectible.

The FTC provides further practical investment advice in *Investing Online*, *Investment Risks*, and *Investment and Biz Opp Seminars* publications. Among the useful tips, these publications caution consumers to be skeptical about “success stories” and to carefully research both the offered investment and the firm offering the investment.

14 The Commission’s investment-related materials can be found at http://www.consumer.ftc.gov/topics/investments-grants.
15 Available at http://www.consumer.ftc.gov/articles/0134-investing-gold.
17 Available at http://www.consumer.ftc.gov/articles/0136-investing-collectible-coins.
18 Available at http://www.consumer.ftc.gov/articles/0021-investing-online.
19 Available at http://www.consumer.ftc.gov/articles/0238-investment-risks.
20 Available at http://www.consumer.ftc.gov/articles/0239-investment-biz-opp-seminars.
V. Conclusion

Thank you for providing the Commission this opportunity to appear before the Committee to discuss the important consumer protection issues arising from precious metals investment scams. The Commission remains committed to protecting consumers from deceptive or unfair practices and appreciates the Committee’s interest in this subject.
Statement of Rosemary Hollinger
Deputy Director of the Division of Enforcement
Commodity Futures Trading Commission

Before the United States Senate Special Committee on Aging
April 30, 2014

Good afternoon Chairman Nelson, Ranking Member Collins and members of the Committee. Thank you for the opportunity to address you today. My name is Rosemary Hollinger. I am a Deputy Director in the Division of Enforcement at the Commodity Futures Trading Commission ("CFTC" or "Commission") and I am pleased to talk about the Commission's work in regard to precious metals fraud - to be precise, off-exchange transactions in precious metals with retail customers. The Commission has been engaged in combating fraud in the precious metals area throughout my 28-year career at the Commission. And, at each point along the way, the Commission has used whatever tools it had available to combat this type of fraud. The Commission’s ability to fight fraud in this area was aided in 2010, when Congress, in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), clarified the CFTC’s authority to address precious metals fraud.

Most significantly, Section 2(c)(2)(D) of the Commodity Exchange Act ("CEA" or “Act”), made sure that retail commodity transactions done on a leveraged or financed basis were executed on a regulated exchange and were fully subject to the CFTC’s jurisdiction. Specifically, the CFTC has jurisdiction over any agreement, contract, or transaction in any commodity that: (1) is entered into with a retail
customer; (2) is entered into, or offered, on a leveraged, margined, or financed basis; 
(3) does not result in actual delivery within 28 days; or (4) creates an enforceable 
obligation to deliver between a seller and buyer in connection with the line of 
business of the seller and buyer. Under CEA Section 2(c)(2)(D), leveraged or 
financed commodity transactions with retail customers would be treated “as if” they 
were futures. In fraud cases, this has streamlined the Commission’s efforts to bring 
cases against metals dealers offering financed metals while avoiding protracted 
battles over jurisdiction that the Commission had previously faced. In addition, 
Dodd-Frank also amended CEA Section 6(c)(1) making it “unlawful for any person, 
directly or indirectly to use or employ... in connection with... a contract of sale of any 
commodity in interstate commerce... any manipulative or deceptive device or 
deceptive device or contrivance...” With this new provision, the Commission is able 
to address fraud involving precious metals that are not leveraged or financed.

Subsequent to the enactment of Dodd-Frank, the Commission has filed 21 
cases utilizing these new provisions.1 Nineteen of these cases have been filed in the 
area of financed precious metals pursuant to Section 2(c)(2)(D) of the CEA, and two 
cases were filed under Section 6(c)(1) of the CEA.

In the 19 cases filed under Section 2(c)(2)(D), the Commission charged the 
firms with illegally offering off-exchange leveraged or financed precious metals to 
retail customers, and at times with fraud. Typically, these firms operate at multiple 
levels. So-called metals wholesalers operate at the top of these schemes claiming to

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1 The Commission most often learns of these matters through direct customer complaints to the 
CFTC and through referrals from federal and state agencies.
act as intermediaries between metal suppliers and retail dealers in buying and selling physical metal. The retail dealer, in turn, claims to buy and sell metals on behalf of the retail customer. In reality, the “retail dealer” is just a telemarketing firm to whom the wholesaler has outsourced its sales operations.²

While the Commission does not categorize its cases or keep statistics concerning the age of the victims, it has observed that senior citizens are often the victims of precious metals telemarketers and perpetrators of other types of solicitation fraud. For example, in the Commission’s July 2013 action against Pan American Metals of Miami, the Commission found that the precious metals telemarketer solicited at least 46 individuals over 65 years of age, including four who are over 90 years old, one of whom was solicited while he was in hospice care.

Telemarketers fraudulently selling precious metals call their victims repeatedly to build trust and rapport and to wear down their resistance with well-rehearsed sales scripts designed to reassure their victims and close the deal. They say things such as “[w]e are bound by the law to give the best advice at all times.”³

Once they have established trust, they often capitalize on current events or trends and say things like: “...our economy is in a recession...How long will it last? And how deep will it get?” or “The U.S. dollar is poised for new all-time lows! With

² The two cases filed under Section 6(c)(1) alleged fraudulent sales where there was no underlying metal.

³ The examples of solicitation practices are from evidence presented by the Division of Enforcement at a preliminary injunction hearing in the Commission’s pending litigation against Hunter Wise Commodities, LLC, et al., No. 12-CV-81311 (S.D. Fla. filed Dec. 5, 2012) (“Hunter Wise”). The Division successfully obtained the preliminary injunction, the issuance of which was affirmed on appeal by the United States Court of Appeals for the Eleventh Circuit, No. 13-10993 (11th Cir. Apr. 15, 2014) (the court of appeals also found the Commission had enforcement authority over leveraged or financed precious metals retail commodity transactions pursuant to Section 2(c)(2)(D)).
almost 3 trillion new U.S. dollars being printed, it is dramatically devaluing the existing dollars in circulation."

The telemarketer then offers precious metals as an alternative. They present it as an opportunity to “...invest in the actual commodity, not just a piece of paper.” They claim that this is an investment that will “protect your buying power, protect your assets and provide...the safety of gold.” Gold, they point out will “always have a value.” However, what is presented as “safe,” “secure,” and “reliable” is fraught with risk. One of those risks is that there may not be any metal, even though the telemarketer promises to “...deliver gold to your depository within 72 hours after the purchase is made.” Another risk is inherent in the structure of the transactions themselves.

In the schemes the Division of Enforcement typically sees, the investment the telemarketers offer is leveraged. While they tout the benefits of compounding profits through the use of financing and leverage by pointing out that the customer can “control” more metal by using leverage, they fail to disclose that leverage also compounds risk. In fact, many of these transactions are structured in such a way so that the retail customers rarely profit and, when they do, they are encouraged to make another trade until eventually they lose their money. The transactions result in substantial fees for the metals dealers. In the typical financed transaction, significant fees are immediately paid out of the customer’s initial investment.

For example, at the preliminary injunction hearing in the *Hunter Wise* litigation noted earlier, the Division presented evidence that the customers immediately incurred fees of about 36% of their initial investment. Thereafter
interest and storage fees are charged every day eroding the cash value of the customer's account and increasing the likelihood of a margin call and a forced liquidation. In a typical case, when fees are taken into consideration, the price of the metal has to increase at least 25% in one year for the customer to break even. So, even if the market moves favorably, the customer can still lose money. While I cannot comment upon pending litigation, two months ago, at the hearing against Hunter Wise, the Division presented evidence that 98% of the customers closed their accounts at a loss.

The Commission continues to bring enforcement cases to stop fraud in this area. Typically, the Commission seeks to immediately freeze assets so that they will be preserved for the customers. Where assets are apparent, the Commission will ask the court to appoint a receiver to marshal the assets and make restitution to customers. In addition, the Commission will seek the imposition of civil monetary penalties and disgorgement of ill-gotten fees so that the individuals and entities do not profit from their unlawful activity.

While many CFTC metals litigations remain ongoing, since February 2013, wrongdoers in these cases have been ordered to pay more than $32 million in civil monetary penalties and more than $26 million in restitution and disgorgement. Recovery of funds in this area has been very difficult. In order to increase the deterrence effect of our cases, the Commission also works cooperatively with the Department of Justice and other federal and state criminal authorities. With the involvement of the criminal authorities, wrongdoers face the real prospect that fraudulent misconduct leads to jail time. The Commission also cooperates with
federal and state regulators like the Federal Trade Commission and several state securities regulators and consumer protection boards.

Though the CFTC continues to pursue cases, as with law enforcement generally, the CFTC only has the resources to pursue a small percentage of those of which the CFTC becomes aware. Consequently, enforcement efforts must be accompanied with education of consumers about the warning signs of fraud.

For example, the CFTC publishes consumer advisories warning the public about specific unlawful activity and educates the public through its consumer outreach efforts. In January 2012, the CFTC issued a Precious Metals Consumer Fraud Advisory to alert customers to precious metals fraud. The CFTC’s Advisory specifically warns that companies often fail to purchase any physical metals for their customers, instead simply keeping the customers’ funds. It further cautions customers that leveraged commodity transactions are unlawful unless executed on a regulated exchange. The Advisory alerts the customers of several red flags to beware of, including solicitations that: claim high profits with little risk; do not identify the bank or financial institution loaning the customer money, or fail to identify where the physical metal is located or claims that it is overseas. In addition to the Advisory, the Commission’s Office of Consumer Outreach has published and promotes a Precious Metals Fraud Brochure and participates in numerous expos, makes public appearances and speeches and highlights fraud cases to the media to

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get the word out to the retail public. The Commission relies on the public as an important source of information in carrying out its regulatory and enforcement responsibilities. Customers can report violations or other suspicious activities to our Division of Enforcement by calling 866-366-2382 or through the Commission’s website, at www.cftc.gov/customerprotection/FileaTiporComplaint.

Again, thank you for the opportunity to appear before the Subcommittee. I will be pleased to respond to any questions you may have.

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Precious Metals Enforcement Actions Involving Financed Transactions

1. CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012) (financed; fraud; offering and entering illegal, off-exchange transactions; failure to register); see Press Release 6447-12.


Other Precious Metals Enforcement Actions


2. CFTC v. Smithers, No. 9:12-cv-81165-KAM, Default Judgment (S.D. Fla. entered July 31, 2013) (not financed; fraud; violation of prior Commission order); see Press Releases 6397-12 (filing on Oct. 22, 2012), and 6659-13 (default judgment).
TESTIMONY OF KARL SPICER
FORMER PRECIOUS METALS TELEMARKETER

Thank you Chairman Nelson, Ranking Member Collins, and distinguished members of the Special Committee on Aging for this opportunity to testify at this important hearing on the protection of the elderly.

My name is Karl Spicer and, as a result of my participation in a South Florida-based commodities fraud scheme, I am a convicted felon. Consequently, I have first-hand knowledge of the deceptive methods employed by scam artists to entice unsuspecting and vulnerable victims to part with their hard earned savings in fraudulent “investment opportunities.”

As this Special Committee is uniquely aware, because of their accumulated assets, the elderly are particularly attractive targets for a wide array of fraudsters, regardless of the specific nature of the investment vehicle being offered to the public. From my vantage point, it is clear that the elderly need to be well-educated and equipped with the necessary skills to protect themselves from financial exploitation.

My purpose in testifying today is to provide the Special Committee with some measure of insight into the specific methods used by trained salesmen to deceive the investing public. I wish to impress upon the Special Committee that my willingness to speak candidly about the so called “tools of the trade” is based upon a clear recognition of the magnitude of the monetary and emotional harm that my conduct has caused to the victims in my specific case. The recognition of the harm that I caused is further compounded by the reality that, in all likelihood, I will never be able to provide the
victims with any appreciable measure of relief. It is my hope that, by testifying about the
pitfalls in succumbing to “high pressure” sales tactics, I can help prevent elderly victims
from being ensnared in ongoing or new investment scams. I wish to invite the Special
Committee to probe my knowledge of the tactics employed in such scams and to
specifically delve into the nature and degree of my conduct in the specific scheme for
which I stand convicted.1

Briefly, by way of background, I am thirty-seven years old and I was born in
Beckley, West Virginia. My younger sister and I were raised by our mother, a single
mom who was employed in the health care industry. In 1994, when I was eighteen, our
family moved to South Florida so that my mother could take advantage of a new
employment opportunity. Because of the long hours required by my mother’s new
position, I raised my younger sister during the years she attended middle school. My
sister eventually attained her law degree at a prestigious university and is now a
practicing attorney.

In approximately 2000, after working a number of years in the construction
industry, I became a licensed commodities broker in South Florida. After cycling
through a number of questionable firms, some of which came under the scrutiny of the
Commodities Futures Trading Commission, I became steeped in the methods used to sell

1 The Special Committee should be aware that at no time during this hearing will I be
invoking my Fifth Amendment protection against self-incrimination. In fact, I wish to
inform the Special Committee that, based upon the advice of my counsel, Christopher
Bruno, Esq. and James Saltah, Esq., both of whom are here with me today, I am
knowingly and voluntarily waiving my Fifth Amendment Rights under the U.S.
Constitution. Consequently, it is my goal to not merely respond in a cursory fashion to
isolated questions; rather, I will look to the content of the specific line of inquiry – the
spirit of the question – in order to provide the Special Committee with as much relevant
information as possible. It is respectfully submitted that my statements made during this
hearing today will be truthful, decisive and made without hesitancy.
investment opportunities, as well as the techniques employed to offset investor efforts to delay or avoid investment commitments. Throughout the period of time that I was a commodities broker in South Florida I earned commissions in the approximate amount of $1,500,000.

Eventually, in about March 2012, I became affiliated with a South Florida commodities firm known as PMCO Services, Inc. From that period of time through February 2013, myself and a number of business associates engaged in a systematic scheme to defraud the investing public through the sale of silver bullion and other precious metals through PMCO. The PMCO scheme involved 150 harmed investors and resulted in approximately $7,000,000 in losses. As a result of my effort, I earned approximately $227,000 in commissions from the PMCO scheme. Throughout this time-period, my conduct and that of my business associates was intended to defraud investors who purchased precious metals through the company.

In essence, PMCO salesmen were pitching clients on an opportunity to invest in a “Leveraged Program” for the purported purchase of precious metals. The allure of a leveraged program is specifically designed to entice clients by offering the ability to finance a significant portion of the investment. Consequently, in addition to paying an up-front portion of the investment in the program, investors were also charged finance fees. These fees were not adequately explained to potential clients. Moreover, due to fluctuations in the commodities market, investors could be subject to margin calls which could result in the sale of their existing position or in the payment of additional funds to off-set a deficiency in their account.
As an “introducing broker” in the sale of commodities, PMCO purchased leads from a number of sources, including vendors who regularly secured identifying information from other telemarketing firms or “boiler rooms.” As an introducing firm, PMCO secured an affiliation with an entity known as AmeriFirst Inc., a “clearing firm,” which was required to effectuate the trades and to also ensure the storage of the specific metals that were purportedly purchased by the investor.

In general, after identifying viable candidates from the lead list, a “fronter,” a less experienced salesman, would utilize a devised sales “script” and contact a potential investor in order to gauge potential interest, including an initial assessment of the amount of money the customer could be enticed to committing to the metals program. The fronter would immediately forward to an interested customer a glossy promotional package. Shortly thereafter, a salesman, known as a “closer,” would follow up with the potential investor and impart “new” information which was designed to insure an investment in the metals program. In order to construct a superficial layer of plausible deniability, the new client was directed to the “Compliance Department,” in reality an untrained secretary or other administrative person. The closer would “school” the investor to give appropriate responses during the recorded compliance call, including a confirmation that the client was specifically aware of the risks associated with the highly speculative nature of the leveraged program.

As with any investment scam and in order to effectuate the goals and objectives of the scheme, my associates and I deliberately deceived investors by making a number of affirmative misrepresentations and by also failing to disclose material facts concerning the investment opportunity.
More specifically, we intentionally deceived potential investors into believing that PMCO was a well-established firm located in the financial district in New York City, when in fact the company was located in South Florida. In addition, administrative personal were also directed to inform inquiring, pre-existing investors that the company was located in New York in order to alleviate any concerns about the legitimacy of the company.

In addition, at the time of the PMCO scheme, my business partner was the subject of an ongoing inquiry conducted by the CFTC concerning his role in another commodities venture. In order to disguise his involvement in PMCO, my business partner used a nominee to conceal his ownership interest in the entity and he also used an alias when interacting with existing clients to further mask his true identity. Although all of the salesmen at PMCO, including myself, knew that my partner was engaging in such conduct, we deliberately failed to disclose such vital information to our clients.

Moreover, in my capacity as an initial salesman, I engaged in a pattern of deliberate and fraudulent conduct in order to entice investors into substantially increasing their positions in the precious metals program. In this regard, I falsely led investors to believe that my partner, the so-called highly skilled, head commodities trader at the firm, had just acquired highly relevant information that would have a significant impact on the market. The purpose of this fraudulent misrepresentation was to deceive investors into believing that time was of the essence for them to take advantage of a unique investment opportunity. In my experience, the elderly are particularly susceptible to succumbing to “high pressure” sales tactics that emphasize a time-of-the essence investment decision. Due to the highly effective nature of this sales tactic, the head trader would continue this
pattern of fraudulent conduct by convincing investors to purchase more precious metals. The head trader would continue using similar techniques to reload certain investors throughout the life of the scheme.

Finally, during the first eight months of my affiliation with PMCO, I fully believed that the clearing firm was in fact purchasing the metals on behalf of our clients. However, at the end of 2012, I became aware of a number of unambiguous red flags which established that the clearing firm may have also engaged in fraudulent conduct. Needless to say, I never disclosed to new investors or to pre-existing PMCO investors my suspicions concerning the clearing firm’s failure to purchase the metals. Because of my concerns, I left PMCO in early 2013. Although I am not certain, in retrospect, it certainly appears that AmeriFirst was nothing more than a paper entity which essentially never purchased the promised metals.

Immediately upon learning that I was the subject of a criminal indictment filed by the New York County District Attorney’s Office, I fully accepted responsibility for my conduct and I also agreed to cooperate against other culpable individuals, including my business partner. Ultimately, I entered a plea of guilty to one count of Grand Larceny in the Second Degree and to one count of participating in a Scheme to Defraud. I am scheduled to be sentenced for my role in the scheme in June 2013.

There can be no doubt that I knew that my conduct in connection with the PMCO venture was not only illegal, but also morally wrong. As a result, I accept full responsibility for my conduct and I know that I alone must face the consequences of my actions. Thank you again, Senator Nelson for the opportunity to testify today. As I stated earlier, I am certainly willing to answer any questions put forth by the Special Committee.
Statements for the Record
Exploring the Perils of the Precious Metals Market

Written Testimony of Judith M. Shaw
Administrator, Maine Office of Securities

Before the
Special Committee on Aging
United States Senate

April 30, 2014

Chairman Nelson, Ranking Member Collins and Members of the Committee, thank you for the opportunity to submit this testimony for inclusion in the record of the hearing by the Senate Special Committee on Aging on April 30, 2014 entitled “Exploring the Perils of the Precious Metals Market.”

Like many investment opportunities available today, precious metals represent a legitimate prospect for the right investor who understands the associated costs and risks and is in a position to withstand the loss of their investment. Unfortunately, scam artists take advantage of legitimate investment opportunities and, through the use of creative marketing and sales pitches, lure senior investors into their traps.

The creativity and guile of fraudsters is limitless. Always on the watch for the next opening, scam artists monitor the markets to watch for trends that can create a chance to target investors particularly seniors. The crash of the markets and devastating economic downturn presented just such an opportunity for con artists interested in capitalizing on investor’s fears and uncertainty.

Quick to recognize that the value of precious metals, including gold and silver, bear an inverse relationship to the stock and bond markets, precious metal scams emerged. The rapid increase in the value of precious metals generated amazing amounts of media attention and celebrity endorsements fueling promises of continued increases in value. This attention leads unwarranted credibility to the story of the fraudster.
Despite significant declines in the precious metal market, precious metal scams continue to be a problem. Indeed, the 2013 North American Securities Administrators Association Enforcement Report revealed that precious metals were the sixth most common scheme reported by state securities regulators. It is worth noting that all enforcement actions initiated during the reporting period, approximately 1 in 6 involved seniors.

Precious metal scams can take any number of forms. Often the scam begins with some form of unsolicited contact whether by email or telephone. Or the scam may be spread over the internet through websites or social media. The promoter of the scam may offer to sell an "interest" in precious metals asserting that they represent an "exploration" company. The promoter may convince the investor to give money to help mine the gold or silver promising huge returns. And to add to the credibility of their claim, they may provide what appear to be official geological surveys or fake financial statements showing alleged progress and profit from the venture.

Another common scam involves a seller offering actual gold bars or bullion. For a fee, the seller will hold the gold in a "secure" location so the investor need not be bothered with the hassle of obtaining a safe deposit box. The pitch continues with a promise to sell the gold as soon as it peaks in value and send the proceeds to the investor. Far too often, the gold does not exist.

And the scam is not limited to gold. Silver, platinum, and even palladium have been touted as fantastic investment opportunities even as we watch the market decline. Gold, for instance, reached its high point of approximately $1900 per ounce in July of 2011 and now trades at less than $1300 per ounce.

With all of the volatility and complexity involved with the precious metals market, one might ask how it is that investors, particularly senior investors, can be convinced to place their funds with a questionable promoter. The answer: con artists are experts at what they do. They educate themselves on the ways of the markets and the ways of their victims.

When the stock and bond markets crashed, con artists knew they could promote precious metals as a "safer" investment because the value of precious metals inevitably increases when the stock and bond markets decline. Con artists know that investors lost faith in the stock market. Consequently, they are able to market precious metals as a safer investment convincing their victims that precious metals are real, tangible commodities that cannot be taken away. The line might sound something like "no matter what, you will always have the gold to hold onto."

The tricks are many. Pitches like "this offer is limited," "we don’t have much silver left in our inventory so you better act now," or "everyone sells gold but we discovered that palladium is going to skyrocket next" touch on their victim’s desire not to miss out. Promoters may promise
that the value of precious metals will continue to climb pointing to charts whether real or fake without ever disclosing any of the risks.

All of these cases serve one purpose – to perpetuate a fraud often against our most vulnerable and precious investors – seniors. State securities regulators like me consider it a critical part of our mission to protect senior investors from all forms of fraud and precious metals scams are no exception. Whether through enforcement of Maine’s Uniform Securities Act when a senior investor has been convinced to invest in a nonexistent gold mining enterprise, enforcement of Maine’s Commodity Code when a senior investor has been convinced to send hundreds of dollars for a scam artist to secure gold bullion, relying on the requirements of the transient sellers law to negotiate rescission of noncompliant sales, or education and outreach to seniors throughout Maine, protecting our greatest treasures – our senior citizens – is key.

It is my belief that the most effective weapon against any scam artist is an informed investor. Thank you for raising awareness about this issue and helping to arm our seniors.

1 The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc. (NASAA) was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands.

Don’t catch “Gold Fever!”

Gold often attracts a crowd of promoters who would like to take investors’ money. Beware of so-called “exploration” companies. Some may offer official-looking geological surveys or financial statements, when in reality there is little or no current production, just an appetite for new investor money.

Beware of these other gold scams:

Scenario #1: A seller offers to sell actual gold bullion and then retain the investor’s gold in a “secure” vault, and later promises to sell the gold for the investor as it gains in value. In many instances, the gold does not exist.

Scenario #2: A company encourages investors to cash out of their poor-performing investments to purchase gold. The investor ultimately ends up with a large bag of gold-colored coins with no monetary value. Remember, if you are advised to cash out investments and roll funds into a different type of investment, make sure the person advising this is licensed by the Office of Securities.

Gold promoters often try to create a sense of urgency to get you to suspend your judgment and part with your money before you have had a chance to thoroughly check out their claims. Don’t catch gold fever—call us for help.

Who Can Help?

The Maine Office of Securities licenses the firms and brokers who sell gold-related securities and investment advisers who recommend the purchase of gold-related securities or selling securities to purchase gold as an investment.

Always check before you invest.

(877) 624-8551

www.investors.maine.gov

The Office of Securities is part of the Maine Department of Professional and Financial Regulation, which encourages sound ethical business practices through the regulation of insurers, financial institutions, creditors, investment providers, and numerous professions and occupations.

Is gold a good investment in uncertain times?

Before you invest, read on!

A Publication of the Maine Office of Securities

Updated October 2013
Gold-related investments are on the rise. Historically speaking, the value of gold-related investments fluctuates even more than the stock market. Gold often moves in reverse of stocks and bonds, so when stocks are down, gold seems like a very tempting investment. Before jumping onto the gold bandwagon, consider these facts:

- **It is a myth to say that gold is a safe investment**: An investment in gold is not foolproof. An investor needs to know his or her investment objectives. Gold may not provide long-term investment returns. Gold is a commodity, and, like other commodities, its price can fluctuate dramatically.

- **There are multiple ways to invest in gold**: If you are interested in investing in gold, you have several options: investors can put money into actual gold, gold-related market investments (i.e., mutual funds and exchange-traded funds), futures, and gold mining companies.

- **Mutual funds containing gold**: Although several mutual funds have gold in their names, you will not find any with more than 10 percent of assets invested in the metal itself. That is because mutual funds by law must earn 90 percent of their income from securities, and gold, like other metals, is not a security.

- **Stock in gold mining companies**: Purchasing stock in a gold mining company is more volatile than purchasing physical gold because of the risks associated in discovering and mining the metal. Mining companies' profits are related to the price of gold, meaning that if the price of gold rises by a certain amount, earnings should jump by a greater percentage. If, however, the price of gold goes down, investors would expect to see mining companies' profits decline in similar fashion. Also be aware of “shell” mining companies, in which a company claims that it is in the gold mining industry when actually it exists solely to raise investor funds for fraudulent purposes.

- **Buying gold online**: As with any online transaction, be sure to go through a reputable dealer. When researching bullion dealers, thoroughly check out the dealer because, unlike what dealer names sometimes imply, there are no dealers who are authorized or affiliated with the U.S. Mint.

- **Gold as an exchange-traded product**: An investor purchases a share in a trust, and the shares represent ownership in physical bars of gold. Each share claims ownership of a small portion of actual gold. These trusts may have hidden costs that dilute the holder’s interest in gold. Investors having an investment in a gold Exchange Traded Fund (ETF) may be subject to higher rates of taxation than other types of mutual funds. They should therefore review the prospectus and consult with a tax accountant on this issue.

- **Gold CDs**: These CDs can be as illusory as “fool’s gold.” Gold CDs differ from traditional CDs because they are tied to the price of gold. Many banks seduce investors with promises of a share in the rising value of gold. If, however, the commodity decreases in value, the investor gets only the principal back, and the interest rate may vary significantly from that of a regular fixed-rate CD. Be aware that each CD has its own formula to calculate interest rates and its own set of rules for when the investor can sell the CD prior to the maturity date.

The Bottom Line: Interest in gold-related investments tends to rise in uncertain economic times. As with any investment (ad, increased interest also produces an increase in potential scams. Take time to check out an investment in gold thoroughly and always follow safe investing practices.
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.¹ Such metals can be bought and sold in the form of bullion bars, ingots, or coins.² 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.³

Like all commodities, the price of precious metals fluctuates.⁴ Still, the metals are perceived to be the safest form of investment, as they can be less volatile than the stock market.⁵ 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.⁶ 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.⁷

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.⁸

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.⁹ Although precious metals can be safe investments during periods of financial distress, their value becomes less attractive during periods of economic stability.¹⁰

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.

¹ http://www.investopedia.com/terms/p/preciousmetal.asp
³ Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013).
⁵ Americans Choose Gold as the Best Long-Term Investment, Gallup (August 25, 2011)
⁶ Jacob, Dennis. “Americans Choose Gold as the Best Long-Term Investment.” Gallup, August 25, 2011.
Both Precious Metals and Stocks Experience Volatility

Although many legitimate market analysts believe precious metals are a good way to diversify an investment portfolio, they warn that investments in precious metals only make sense if an investor has money he or she does not need right away. 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.

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. One firm acts as a telemarketer, known as the introducing firm, often soliciting retail investors through high-pressure sales tactics. 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. 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. In exchange, the introducing firm shares a percentage of its fees with the wholesale dealer. The wholesale dealer also typically charges a spread of 3 to 5 percent of the current market price of the metal.

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.

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11 Id.
14 Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)
15 Id.
16 Id.
storing the metal, or delivery of the metal. In some cases, customers are charged storage fees even though no metal is stored on their behalf. 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—such as futures, forwards, and rolling spot contracts. 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.

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. In such cases, the customer usually pays 20 to 25 percent of the full metal cost, with the remainder financed through in-house credit. The customer is responsible for paying back the full amount of the loan, plus interest.

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. However, in a leveraged transaction if the value of the metal depreciates below a minimum threshold—typically 10 percent—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. If the customer cannot cover the margin call, the account is usually liquidated—without customer permission—to cover the remaining balance of the loan.

While leveraged transactions increase the profitability of precious metal firms, it is nearly impossible for consumers to make a profit from such transactions. 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.

\[ \text{In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 13-27 (CFTC filed July 29, 2013) and Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)} \]
\[ \text{CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012)} \]
\[ \text{Rolling spot contracts are commodity contracts meant for immediate delivery but are rolled into to the next month, moving forward the delivery date. They can be rolled forward in perpetuity. In effect, this allows traders to buy and sell the contracts without the need to ever take or make immediate delivery.} \]
\[ \text{CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012), pg. 13} \]
\[ \text{Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)} \]
\[ \text{CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012), pg. 10} \]
\[ \text{CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012), pg. 11} \]
\[ \text{Id} \]
\[ \text{CFTC v. Hunter Wise Commodities, LLC, et al., No. 12-cv-81311 (S.D. Fla. filed Dec. 5, 2012), pg. 11} \]
\[ \text{Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013)} \]
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.33

How Customers Lose Out on Leveraged Transactions

33 $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.34

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.35 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.36

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.37

According to Mr. Spicer, salespeople would typically give customers three reasons to buy precious metals,38 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.

35 The Special Monitor and Corporate Manager’s Initial Report for CFTC v. Hunter Wise Commodities, LLC, pg. 9
36 The Special Monitor and Corporate Manager’s Initial Report for CFTC v. Hunter Wise Commodities, LLC.
37 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).
38 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:

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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39 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
A 62-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. 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.

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.” 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). 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. The court also has the

84 FTC Stops Bogus Precious Metals Dealers; FTC Charges Bogus Precious Metals Investment Scheme; FTC Takes Action Against Bogus Precious Metals Investment Scheme
86 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.
87 “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.\textsuperscript{45}

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.\textsuperscript{46} The TSR applies equally in cases where telemarketers make outbound telephone calls to "...induce the purchase of goods or services,"\textsuperscript{47} or where the call is initiated by the consumer "...in response to an advertisement relating to investment opportunities."\textsuperscript{48}

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."\textsuperscript{49}

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."\textsuperscript{50} A failure to do so is considered a "deceptive telemarketing act or practice" and a violation of the TSR.\textsuperscript{51}

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

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

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

\textsuperscript{44} U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 (§10.20a)(c)(c) and (dd).
\textsuperscript{46} U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 (§10.6(b)(5)).
\textsuperscript{47} U.S. Government Printing Office, Electronic Code of Federal Regulations: Title 16 CFR §310.3 (i) and (ii).
\textsuperscript{48} Id.
\textsuperscript{49} Id.
\textsuperscript{50} Id.
\textsuperscript{52} FTC Launches Precious Metals Scheme; FTC Charges Bogus Precious Metals Investment Scheme; FTC Takes Action Against Bogus Precious Metals Investment Scheme.
\textsuperscript{53} 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. 54

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 expanded the CFTC’s authority over retail commodity transactions. 55 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. 56

The CFTC has filed at least 22 complaints against individuals and companies that lost over $193 million of their customers’ hard earned cash. 57 Of these cases, seven currently remain active. 58 The following are examples of cases the CFTC has pursued:

CFTC v. Atlantic Bullion & Coin, Inc. 61

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. 62

In re Pan American Metals of Miami, et al. 63


57 CFTC Issues Interpretation Concerning Retail Commodity Transactions


60 Based on data provided by the CFTC.


63 In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 11-27 (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,

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.”

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.

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64 In re Newbridge Metals, LLC, CFTC Docket No. 13-37 (CFTC filed Sep. 24, 2013)
65 Federal Court in Florida Enters Preliminary Injunction Order against Hunter Wise Commodities, LLC, Lloids Commodities, LLC, and 18 Other Defendants in Connection with Operating a Multi-Million Dollar Fraudulent Precious Metals Scheme. "U.S. Commodity Futures Trading Commission.
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.\(^{67}\) Working with Federal regulators, OFR helped recoup more than $10.3 million for cheated customers.\(^{68}\)

OFR found that many of the firms targeted older Americans who were given misleading or conflicting information by salespeople.\(^{69}\) For example, customers were led to believe they were buying physical metals when they were buying metals on leverage.\(^{70}\) 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.\(^{71}\) 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.\(^{72}\)

In addition to Florida, states like Minnesota, Texas, and North Carolina have also gotten stricter on unruly retail precious metal companies.\(^{73}\) Minnesota, in particular, enacted a law to stop ex-convicts from becoming precious metal dealers.\(^{74}\) 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.\(^{75}\) 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.\(^{76}\)

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.\(^{77}\) 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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\(^{69}\) Florida Office of Financial Regulation Letter to Committee Staff (July 12, 2013).

\(^{70}\) Id.

\(^{71}\) Id.

\(^{72}\) Id.

\(^{73}\) Browning, Dan. Minnesota May be 1st State to Regulate Retail Coin Dealers. McClatchy News (July 29, 2013).


\(^{75}\) Browning, Dan. Minnesota May be 1st State to Regulate Retail Coin Dealers. McClatchy News (July 29, 2013).

\(^{76}\) Id.

\(^{77}\) Browning, Dan. Ex-com Make a Killing in Coins. Star Tribune (May 9, 2011).
and Merit Financial. 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. 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.

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.

79 Ianiak, Darrick. Alleged Internet Gold, Land Scam Results in Arrest. The Dispatch (October 23, 2013)
80 Id.
84

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. 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). In 1981, Congress prohibited precious metals as investments in IRAs. Over

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81 In re Pan American Metals of Miami, LLC, et al., CFTC Docket No. 12-27 (CFTC filed July 29, 2013)

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time, the prohibition eroded to allow IRAs to invest in coins minted by the U.S. Treasury, as well as bullion. 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. 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. 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.

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, some reforms—such as those contained in the Dodd-Frank Act—have led to greater oversight and insight into this ever-evolving industry. 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 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 fast.” As a golden rule, an investor should always take the time to closely evaluate the costs, risks, and suitability of any investment.

85 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.
87 Estimate based on data provided by the Commodity Futures Trading Commission ($194 million), Federal Trade Commission ($52.7 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.
90 “CFTC Fraud Advisories - Precious Metals Fraud,” U.S. Commodity Futures Trading Commission.