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Regulators Are Failing to Protect Elderly From Precious Metals Fraud Using 401K Accounts

By Aaron Cohn

Some of my clients have been completely devastated by frauds committed by precious metals brokers. Others have just lost a lot of money.

They are victims of a bad subset of an industry dedicated to promoting precious metals as an alternative investment to more common investments like stocks and bonds. Precious metals are marketed as particularly safe when the markets turn south, as they have in the last six months. Look up any precious metals dealer that promotes a 401k conversion, and, almost certainly, there will be statements and online articles hawking the value and benefits of investing in precious metals in volatile markets.

These marketing materials are particularly attractive to retirees, who tend to be more risk adverse and understand that, with limited resources and no future income, wealth preservation can be more important than wealth creation. Among those looking for safe investments, it is often the doomsayers that are the most receptive because they already believe that the world might come apart at any time or that the value of fiat currency is on the verge of being decimated.

Many companies operating in this industry are legitimate businesses that provide honest services to customers looking to buy precious metals. However, because precious metals brokers exist in the grey area between pawn shops and registered investment advisers, and because many precious metals dealers believe they are not providing investment advice even if they are promoting an investment in precious metals based on their opinions about the future conditions of the market, the industry is attractive for those operating on the fringes of acceptable behavior. Indeed, many precious metals brokers have a disciplinary history from their previous roles in an investment advisory firm or a broker dealer. They find precious metals brokering attractive because they believe they are not required to register with a regulatory authority or be subject to any duties to their clients, like a basic fiduciary duty.

The mechanics of fraudulent precious metals sales are similar to boiler room tactics for securities. These companies are typically set up to convey legitimacy on the unknowing client and convince them that the investment is safe and will preserve or create wealth. They often employ fronters and closers/brokers, use fake names that are more relatable to the clients, and use sophisticated talking points to drum up fear in the clients considering an investment in precious metals.


Courtesy Photo
Aaron M. Cohn, partner with Weinberg Wheeler Hudgins Gunn & Dial.

Once a firm has contact information for an interested client, they can “qualify” the client through a phone call with a “fronter” and then transfer the call to a “closer” or “broker.” It is that broker’s job to close the transaction through whatever means necessary. Clients are told that central banks are buying precious metals at an extraordinary rate, or that the value of the dollar will collapse from an overextended federal reserve, or that the banking system is on the verge of collapse and can take money held in checking or savings accounts to make up the shortfall, among other things. This list of stories told to prospective clients is surprisingly consistent across bad operators in this industry. The stories are designed to make the prospective client believe that the price of metals will skyrocket or at least outperform other investment options.

Many elderly people are convinced by these fictions to transfer their retirement savings to a self-directed IRA custodian so they can invest in precious metals. Equity Trust is one example of a self-directed IRA custodian. In connection with a transfer, which is often facilitated by the broker, the client identifies the broker as the representative on the account with authority to conduct transactions.

With that authority in hand, the clients are sold a bag of goods. They authorize the purchase of precious metals at grossly inflated prices over market without ever checking the market value. They believe the hype sold to them by the broker, including the typical false representations that they are buying metals at a fair market price. Even worse, some buy these grossly inflated metals on leverage, compounding immediate losses.

The Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission, and various state attorney general's Offices have been attempting to bring down the worst operators for decades. These efforts have not stopped the flood of new fraudsters, however. As an example, earlier this year, the CFTC and 27 states joined together in a lawsuit seeking to shut down a fraudulent precious metals dealer out of Los Angeles, California, called Safeguard Metals, which was charging grossly inflated markups on precious metals coins of more than 50%, mostly to elderly people, according to the lawsuit. The company, meanwhile, marketed itself as specializing in wealth preservation. Safeguard Metals is believed to be an offshoot of another company that was shut down several years earlier in Texas, and a successful Safeguard Metals broker opened his own shop recently to continue selling marked up precious metals coins to "qualified" investors through his own company.

The reality is, unfortunately, that the federal and state regulatory organizations do not have the resources or bandwidth to keep up with the breadth of fraudulent precious metals activity in this country. It is like whack-a-mole. One fraudulent shop is taken down and three more pop up. And regulators take a long time to act. It often takes years to investigate potential fraud that is obvious on first blush. Once a matter is investigated, it takes significant time to authorize any action.

The American public, and particularly the elderly, need better protection. This industry is ripe for regulation that would dampen the extent of the fraud being committed every day against our most vulnerable population group. For starters, Congress needs to amend its tax laws that effectively insulate self-directed IRA custodians from any liability for fraud committed using their 401k accounts. Those custodians need to have some accountability, and once that is in place, fraudsters will have a much harder time taking advantage of elderly people who keep their retirement in a 401k account.

Second, any broker or dealer of precious metals that is selling precious metals as an investment should be subject to the same regulation as an investment adviser, or at least be held to a basic fiduciary duty to their clients.

Last, we need to consider how "additional insured" certificates can be used to promote fraud by indicating to unknowing customers that precious metals purchased in their accounts are covered if stolen, even if they are not covered for fraud. Insurance laws governing "additional insureds" need to address clear disclosures on the declaration page or place limits on the exclusions under precious metals coin policies.

Legislatures and regulators can take action to correct these problems, but it will take a concerted effort. No one wants to wake up one day and hear from their elderly parents or relatives that they lost everything in a scam.

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