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Federal Regulators Ban A-Mark's Leveraged Precious Metals Investment Platform

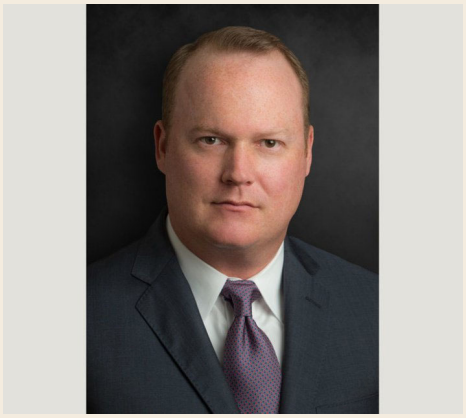
By Aaron Cohn

Historically, South Florida has been a hotbed of precious metal investment frauds including unregistered retail investment firms pushing off-exchange, leveraged precious metal investments. These schemes often make money by charging undisclosed spreads, commissions, fees and interest on loans to purchase precious metals on margin without disclosing the risks. Under these schemes, the unlawful dealer always wins, and the customer usually loses because the costs to maintain the account rise faster than the price of precious metals—requiring liquidation of the accounts.

The Dodd-Frank Act, passed in 2010, prohibits these types of off-exchange leveraged retail commodity transactions where delivery of the metals is not made to the retail customer within 28 days. Since then, the Commodity Futures Trading Commission (CFTC) has brought dozens of lawsuits and enforcement actions in South Florida to shut down unlawful and fraudulent leveraged precious metals trading schemes. However, in a never-ending game of whack-a-mole, each time the CFTC or other government agencies shut down a bogus operation, a new one seems to pop up. With each new iteration, the scheme is tweaked and perfected to avoid future detection.

A primary defense raised by these precious metal advisory firms is that they are more akin to pawn shops than investment advisers, not subject to compliance with the federal securities or commodities laws and are not subject to regulation by claiming they make delivery of the metals. Recent enforcement actions defeat these arguments.

Indeed, on Sept. 22, the CFTC entered a significant administrative order against one of the largest precious metals dealers in the country, A-Mark Precious Metals, Inc. (A-Mark), and its subsidiary, Goldline Inc., as part of a settlement. It finds that A-Mark and its subsidiary are liable for fraudulent conduct in connection with off-exchange precious metals transactions and for engaging in off-exchange, leveraged retail commodity transactions that violate the 28-day delivery rule, among other things. A-Mark and its subsidiary are required to pay in excess of $1 million in disgorgement and monetary penalties.



Courtesy Photo

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

The enforcement order is exceptional in that A-Mark is a publicly traded company that was held directly liable for the fraudulent conduct of its subsidiary because it controlled and directed management, which A-Mark replaced when it acquired the company in 2017.

According to the CFTC's order, customers were defrauded from April 2018 through June 2021 by false breakeven and buyback disclosures. Generally, a financial advisor fails to disclose breakeven rates to avoid disclosing that the profits being earned by the firm far exceed industry standards or will require a substantial gain in the precious metals market just for the investor to break even.

The order also found that A-Mark's subsidiary engaged in unlawful, off-exchange, leveraged retail transactions that violated the 28-day delivery requirement from April 2018 through July 2019. Specifically, A-Mark's subsidiary offered a "Collateral Finance Program" under which customers could use their newly purchased metals to secure loans of up to 75% of the asking price of those metals, which could then be used to purchase additional metals from Goldline. The metals were held in storage by an A-Mark subsidiary chosen by Goldline until the loans were satisfied. Customers paid additional fees for storage of their metals. Until the loans were satisfied, the metals could not be withdrawn. Thus, there was no delivery to the retail customer under this program because none of the customers could or did satisfy the loan and take possession of the metals within 28 days of their transactions. Accordingly, the off-exchange transactions violated the Commodity Exchange Act.

Given the order requires A-Mark to cease and desist from further violations of the Commodity Exchange Act (CEA) and CFTC regulations, as charged, and that A-Mark's lending subsidiary may have been involved in making the loans to support Goldline's leveraged transaction scheme, this order has the potential to ripple through the fairly tight-knit precious metals brokerage community that can rely on A-Mark and its subsidiaries to finance leveraged retail transactions. Indeed, A-Mark and its subsidiaries should have a heightened responsibility to ensure that the loans it purchases or originates do not violate the Commodity Exchange Act when those loans involve retail investors.

Scott Silver, managing partner of Silver Law Group, a top securities and investment fraud law firm thatregularly represents victims of precious metal fraud, commented that "this enforcement action demonstrates the need to require precious metal advisory firms to register with either the SEC or CFTC rather than allowing these firms to market themselves as professional financial advisers and then litigating as if they are a pawn shop without regard for the investor's best interest."

A similar scheme to Goldline was recently shut down by a federal judge in California at the urging of the CFTC. In 2017, the CFTC initiated a lawsuit against Monex Credit Co., its affiliates and principals, for engaging in allegedly similar conduct to Goldline, but on a much larger scale. Rather than doing hundreds of thousands in leveraged transactions, Monex did hundreds of millions for more than 12,000 customers over nearly six years. According to the CFTC's complaint, approximately 90% of investors lost money in that span. Recently, Monex was enjoined from engaging in any leveraged retail transactions, an order which is now pending on appeal.

Unfortunately, way too often, the victims in these schemes are unsophisticated investors, seniors and others seeking preservation of capital, who put their trust in someone presenting themselves as a professional. John Fisher, past chairman of the National Coin and Bullion Association, who runs Fisher Precious Metals, commented: "In my 20-plus years of experience, the vast majority of individuals that are new to investing in precious metals simply wish to purchase bullion coins or bars and take physical possession of them, or store their items in their own name at a depository of their choosing. Unfortunately, many fall victim to the compelling marketing and smooth-talking sales representatives they encounter with telemarketing firms. Before they know it, they find themselves having purchased a highly leveraged fractional ownership in precious metals, all of which have excessive markups, high finance charges applied on the entire balance (not just their fractional ownership), and subsequent margin calls on even the slightest decline in price. These firms are the bane of the precious metals industry. It is no wonder many would-be investors approach precious metals dealers with such trepidation and mistrust."

High-risk investing is appropriate when there is the potential for high return. However, as highlighted by the A-Mark and Monex cases, an advisory firm that only makes money for itself based on undisclosed risks is a fraud or a boiler room. The CFTC and other government agencies have their work cut out for them to shut down these unlawful precious metals investing schemes in an industry that is chock full of fly-by-night outfits offering investment advice while only licensed as telemarketers. Like any other kind of financial adviser, precious metal investment advice should be left to regulated professionals who must act in their client's best interests.

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