situation is in a position to determine if this investment is appropriate for you.

Your investment checklist:

Fully research the opportunity.
Check with your state securities regulator or the SEC's EDGAR database (www.sec.gov) to determine if a promissory note is properly registered – or whether it's exempt from registration. To find your state regulator, check with the North American Securities Administrators Association (www.nasaa.org). If you suspect that your investment is a fraud, be sure to alert your state regulators or the SEC.

Steer clear of nine-month promissory notes.
These short-term notes, which are sometimes exempt from securities registration, have been the source of most – but not all – of the fraudulent activity unearthed by securities regulators in the promissory note area. Since these notes are sometimes exempt from registration, you might not be entitled to some of the redress that the securities laws or regulators provide.

Buy only from licensed or registered securities brokers.
Insurance agents, financial planners, and investment advisers cannot sell securities – including promissory notes – without a securities license or registration. You should make sure the broker selling the note is registered or licensed by contacting your state securities regulator or the Public Disclosure Program of FINRA. Call 800-289-9999 or log on to www.finra.org and click on "FINRA Broker Check" to verify a broker's license or registration and obtain a background report on the broker detailing any existing legal or regulatory problems.

Ask yourself: Does this investment make sense for me? Before making any investment, determine what you are looking for and whether it fits into your portfolio. Investigate before you invest. And don't forget to consider the risk-reward ratio the investment is offering – a higher yield generally means higher risk. Then comparison-shop. Look for similar or nearly as high returns with less risk whenever possible.

To learn more about promissory notes, check with the following regulators and organizations:

NASAA
Organized in 1919, the North American Securities Administrators Association is the oldest international organization devoted to investor protection. The membership of the voluntary association consists of 67state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, The U.S. Virgin Islands, Canada, and Mexico.

NASAA
750 First Street, N.E., Suite 1140
Washington, D.C. 20002
(202) 737-0900
www.nasaa.org

FINRA
The Financial Industry Regulatory Authority is the largest non-governmental regulator for securities firms doing business in the United States. FINRA oversees nearly 5,100 brokerage firms, about 174,000 branch offices and more than 627,000 registered securities representatives.

FINRA
1735 K St., NW
Washington, D.C. 20006
(301) 590-6500
www.finra.org

SEC
The U.S. Securities and Exchange Commission protects investors and maintains the integrity of the securities markets. The SEC's Office of Investor Education and Assistance provides a variety of services to address the problems and questions investors face.

SEC
Office of Investor Education and Advocacy
100 F Street, NE
Washington, DC 20549
(800) SEC-0330
e-mail: help@sec.gov
www.sec.gov

SIFMA
Securities Industry and Financial Markets Association brings together the shared interests of more than 680 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance.

SIFMA
1099 New York Avenue, NW, 6th Floor
Washington, D.C. 20001
(202) 962-7300
www.sifma.org

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Before You Invest, Investigate™

Promissory Notes: Promises, Problems

William Francis Galvin
Secretary of the Commonwealth
Securities Division

Many investors seek out safe, fixed-rate investments, especially ones that can boost the interest they earn. You, too, may be looking for sound investments that pay better than average interest to generate income or meet the needs of your overall investing plan. But as you consider new investment products or services, always remember the correlation between risk and reward: every investment involves some degree of risk, and the greatest-yielding investments usually carry the highest levels of risk.

One interest-paying investment is the promissory note. These are an important means by which companies raise capital. Legitimate promissory notes are marketed almost exclusively to sophisticated or corporate investors that have the resources to research thoroughly the companies issuing the notes and to determine whether the issuers have the capacity to pay the promised interest and principal.

For sophisticated or corporate investors, promissory notes can be a good investment. These instruments provide a reasonable reward for those who are willing to accept the risk. However, promissory notes that are marketed broadly to the general public often turn out to be scams. And even legitimate notes carry some risk that the issuers may not be able to meet their obligations.

Unfortunately, there have been many instances of unscrupulous individuals pushing bogus promissory notes. They're being sold as instruments that guarantee above-market, fixed interest rates, while safeguarding their principal. While fraudulent promissory notes appear to give investors the two things they desire most — higher returns and safety — they may not be worth the paper they're printed on. Remember, if something sounds too good to be true, it probably is.

Fraud Costs Some Investors Their Life Savings

Here are two examples of how investors lost their money:

Business Risk.
At least 100 investors nationwide invested more than $4 million in promissory notes that promised to pay an interest rate of 13 percent over nine months. The funds were for a company selling premium coffee at drive-through kiosks. Savvy, slick marketing materials hyped the company and its products. The promissory notes were sold by individuals who were neither registered or licensed to sell securities. The company collapsed, defaulting on its notes. Investors lost all of their principal, including $200,000 in life savings of an Oregon resident.

Fraud.
Investors in Georgia lost more than $2.5 million after purchasing promissory notes that, according to the salespersons promoting the product to earn high commissions, would pay for new ambulances for a start-up company. The investors were told that their investments were "risk free." After the ambulances were purchased, they would be leased to pay back the money the company borrowed. The ambulances would also be used as collateral for each investor's promissory note. But the company never purchased the ambulances with the money it received. Instead, it pledged the same fictitious ambulance as collateral.

In both cases, the notes were sold by unregistered salespersons. The law requires that anyone selling securities must be registered or licensed. (Some states require licensing while others require registration.) That's why you should verify the registration or license of the person who wants you to invest with them.

How Promissory Notes Work

Legitimate promissory notes are a form of debt that is similar to a loan or even an IOU. Companies issue these notes to finance any aspect of their business, from launching new products to repaying more expensive debt. In return for the loan, companies agree to pay investors a fixed return over a set period of time.

Even legitimate promissory notes are not risk-free.
These notes are only as sound as the companies or projects they're financing. Promising, smart public companies can stumble because of competition, bad management decisions, or unfavorable market conditions. If a company's financial health weakens suddenly, it may not be able to pay interest and principal to investors.

Do the Notes Need to Be Registered?

Most promissory notes must be registered as securities with the SEC and the states in which they're being sold. But remember that some promissory notes, such as those that have nine-month or shorter terms, may be "exempt." That means that they don't have to be registered. Since these notes fly under the radar screen of securities regulatory review, they have been the major source of investor complaints and fraudulent activity.

Registration is important because the process generally involves what is known as "due diligence." In short, that means that financial professionals, including lawyers and accountants, have looked into the notes and companies behind the notes. While due diligence does not guarantee that you will be repaid, it means that you are much more likely to be given accurate information that will help you make an informed decision.

Who Can Sell Promissory Notes?

The salespeople who market promissory notes typically include securities brokers, insurance agents, financial planners, and investment advisers. Since promissory notes are usually securities, they must be sold by salespeople who have the appropriate securities license or registration.

How A Scam Works

Promissory notes have become a vehicle for fraud primarily because there is a growing investor appetite for above-market interest rates with little risk. The sellers of bogus notes promise high, fixed-rate returns — ranging as high as 15 percent to 20 percent — coupled with "guaranteed safety." They market these notes to individual investors, hoping to lure buyers who won't ask how such a high-yield investment could carry such low risk.

In a far-reaching regulatory crackdown on the fraudulent sales of promissory notes in mid-2000, securities regulators nationwide brought 370 actions against firms that defrauded more than 4,500 investors out of $170 million. It's important to remember that in many of these cases, investors won't get their money back because the fraudsters have already spent it.

In one case, promoters of fraudulent promissory notes said the funds were earmarked for projects that ranged from the digging of sandpits to developing resorts in the Caribbean, but the investors' dollars were used instead to finance the high-flying lifestyles of the individuals behind the issuers and to pay high commissions.

Telltale Signs of Promissory Note Fraud

What are the red flags you should look for when being offered a promissory note investment? Here's a list:

"Insured" or "guaranteed" returns.
To create a false sense of safety, the sellers of these notes may say they "insure" the payment of interest and principal, using either nonexistent insurers or those that reside offshore and may not be legitimate or registered to offer insurance within the United States.

The promise of above-market returns.
Returns that are higher than those of similar investments should raise questions.

"Risk-free" notes.
Your risk with promissory notes is that the issuing company will not be able to make principal and interest payments. Since risk and reward are intrinsically related, it pays to remember that there is no such thing as a low-risk, high-reward investment.

A start-up's notes that are labeled "prime quality.
" In the securities industry, prime quality investments require that a company have an established history of operations and earnings. So if the company issuing the so-called "prime" notes is a start-up or new company, steer clear.

Short-term notes.
Notes with a nine-month term may be exempt from securities registration.

Notes from a stranger.
A call or visit from a stranger hawking promissory notes is usually a good sign that the investment is fraudulent. But, remember, too, that only an investment professional familiar with your financial