NASAA

Investor Awareness is the Best Defense Against Fraud

Investor Protection Tips from NASAA

Promissory Notes: Promises & Problems

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.

Promissory notes can 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 — often 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.

TELLTALE SIGNS OF PROMISSORY NOTE FRAUD

"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. Remember: only an investment professional familiar with your financial situation is in a position to determine if this investment is appropriate for you.

Remember, if it sounds too good to be true, it probably is.