

DO THE NOTES NEED TO BE REGISTERED?

Most promissory notes must be registered with the Securities and Exchange Commission (SEC) and the states in which they are 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 do not 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 the 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 investment 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 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 is 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.