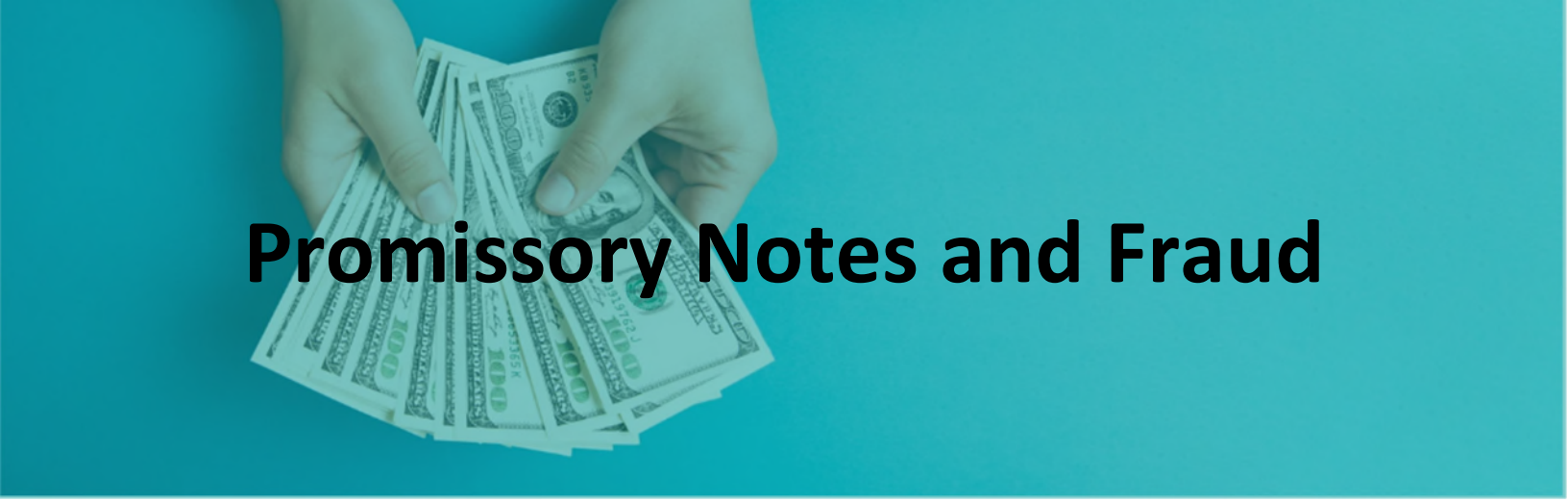

Promissory Notes and Fraud

About Promissory Notes

A promissory note is a form of debt issued by a company to raise capital. In return for the loan of money, the company agrees to pay the investor interest over a specific time period. The interest may be paid during the time period of the note or at the end.

There are two major types of promissory notes, *secured* and *unsecured*.

- **Secured promissory notes** have collateral behind them to secure the loan.
- **Unsecured notes** might have a personal guarantee but no valuable collateral, which carries a higher degree of risk of financial loss.

Promissory notes are only as sound as the companies or projects there are financing. Even promising companies can fail because of competition, bad management decisions or unfavorable market conditions. Promissory note may be subject to regulation and individuals who are selling the notes may need to be registered or licensed.

Red Flags of Fraud

Insured or guaranteed returns. With promissory notes, the higher rate of return, the higher risk of financial loss.

Above-market interest rate. A return on investment that is different from other similar investments should raise questions.

A start-up with "prime quality" notes. In the securities industry, prime quality means a company has an established history of operations and earnings.

Limited time period to act. Legitimate salespeople want you to take your time, ask questions and do some research.

Name-dropping of other investors. This is merely a persuasion tactic to convince you to invest.

"Out of the blue" contact. Strangers emailing or calling you about investing in promissory notes is suspicious. Feel Free to hang up or hit delete.

Lack of audited financials. Be cautious about investing in a company that cannot produce an audit by certified public account.

Risk-free notes. The risk with promissory notes is that the issuer will not be able to make principal and/or interest payments. Risk and reward are intrinsically related when investing. There is no reward without some level of risk.

Ask and Check
before you invest!

Education and Prevention

1. **Be on guard** when someone uses testimonials from group members to promote an investment opportunity.
2. Be wary of promises of **high returns** with **little to no risk.**
3. **Avoid** feeling pressured to make a decision about the investment.
4. Receive a **copy** of all agreements and risk disclosures.
5. **Understand** the terms and conditions of the contract.
6. **Ask** a neutral, third party to evaluate the investment.
7. Focus on **how you can get out** of the investment and not just the potential financial gains.
8. **Verify** registration and disciplinary history of the investment promoter, to find out if the investment is permitted to be sold or to file a complaint.
9. Ask the seller what they are getting paid in commissions. Steer clear of **hidden or exorbitant commissions.**

Online Resources

It is important to conduct an online search for objective information about the investment and the company. Review more than one source to obtain all the information you can before making a final decision. Most importantly, check the public records by using the following links:

BrokerCheck by FINRA

BrokerCheck.finra.org

Investment Adviser Public Disclosure (IAPD)

AdviserInfo.sec.gov

File a Complaint on MiCLEAR

For general information on wise investing and fraud prevention, visit *Investor Education Resources* at michigan.gov/securities

Ask and Check
before you invest!

The information provided on this website is not comprehensive, is not offered as legal or investment advice, and is not a substitute for competent legal or financial counsel. The Corporation, Securities and Commercial Licensing, Securities and Audit Division provides this information to give you an overview of the topics discussed. You should not rely on the accuracy of this information but should carefully review all applicable statutes and regulations with the assistance of legal counsel.

LARA
LICENSING AND REGULATORY AFFAIRS