



# Navigating States' Financial Assurance Requirements When Launching or Growing a Franchise System

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Congratulations on your decision to launch a franchise system. The majority of brands form a new company to act as the franchisor operating entity. Early in the process, clients often ask us to outline the cash needed to capitalize the franchise company. Additionally, emerging franchise systems that are beginning to expand outside “non-registration” states and file initial state franchise registrations also ask about state-specific capitalization requirements.

This e-book is intended to: (1) provide critical information to assist you in determining how to capitalize your franchise company and (2) help you navigate the state franchise registration process and potential demands for additional financial assurance requirements from state examiners.

## **Recent Legal Developments and Regulatory Trends**

### ***Federal Framework: The FTC Franchise Rule***

The FTC Franchise Rule (16 C.F.R. Parts 436–437) establishes the minimum federal floor for franchise disclosure but does not prescribe specific capitalization thresholds. Instead, financial assurance requirements remain a creature of state franchise registration law. Practitioners should be aware that while the FTC periodically reviews the Franchise Rule, any future amendments would require a formal rulemaking process, and no such rulemaking is currently pending that would affect financial assurance obligations.

### ***State Registration Framework: NASAA Guidelines***

The North American Securities Administrators Association (NASAA) updated its Franchise Registration and Disclosure Guidelines in 2008, and those guidelines remain the operative framework for the state registration process. NASAA's Uniform Franchise Registration Application (Form B, Franchisor's Cost and Source of Funds) continues to be the primary tool used by state examiners to assess financial adequacy. While NASAA periodically convenes its Franchise Project Group to review and propose updates to the guidelines, the core financial assurance framework — including the methodology for calculating capital adequacy described later in this e-book — has remained fundamentally stable.

### ***Emerging Trends in State Examiner Scrutiny***

Despite the stability of the legal framework, franchise practitioners have observed several important trends in how state examiners apply financial assurance requirements in practice. First, examiners increasingly review a franchisor's digital footprint — including website content, social media posts, and press releases — to assess whether stated expansion plans are consistent with projections in the FDD. Second, examiners in states such as California and Illinois have shown heightened skepticism of startup franchisors relying on intangible assets (such as goodwill or intellectual property) to satisfy capitalization thresholds. Third, there has been a growing emphasis on the quality and liquidity of assets rather than simply nominal net worth, with examiners discounting receivables, related-party notes, and assets subject to rapid dissipation.

Additionally, in the years since the COVID-19 pandemic, state regulators have been attentive to the long-term financial sustainability of franchise systems. Examiners may scrutinize whether a franchisor's business

model can withstand economic disruption and whether contingency reserves are adequate. Franchisors should be prepared to address questions about revenue concentration, reliance on initial franchise fees versus recurring royalty income, and the sufficiency of working capital under stress scenarios. The sections that follow provide detailed guidance on how capitalization standards are applied and what options are available if a state examiner imposes a financial assurance condition.

### ***Practical Implications for Emerging Franchise Systems***

For emerging franchise systems preparing to enter registration states, these trends underscore the importance of proactive financial planning. Franchisors should: (a) ensure that financial projections in the FDD and on Form B are conservative and supportable; (b) structure capitalization with liquid, unencumbered assets that will withstand examiner scrutiny; (c) avoid publicly overstating expansion timelines or financial performance; and (d) engage experienced franchise counsel and a franchise-knowledgeable CPA well before filing initial registration applications.

With this regulatory landscape in mind, the following sections address the specific requirements and options that franchise systems encounter during the registration process.

### **Initial Capitalization of a Franchise System and Preparation of Financial Statements**

When launching a new franchise system or preparing an updated franchise disclosure document (FDD), the franchisor needs sufficient capital to support its franchise development plans. The FTC Franchise Rule does not require a startup franchisor to possess a specific level of capital before franchising. However, if a state examiner determines that a franchise system applicant may not have the financial wherewithal to satisfy its obligations to franchisees, then it may reject a registration application and impose "additional financial assurance requirements" that must be met before a franchisor may sell franchises in its state. Best practice is to engage a franchise-experienced CPA early in the process to help model working-capital needs, prepare GAAP-compliant financial statements, and identify potential state examiner concerns before initial filings.

While these requirements vary among the states, franchisors that are found to be undercapitalized will not be allowed to offer or sell franchises unless they comply with certain conditions, which may include posting a bond, escrowing initial fees, or deferring the collection of initial fees until the franchise unit opens for business. State examiners may also mandate the inclusion of risk factors relating to the franchisor's financial condition in the FDD. State franchise laws do not specify a minimum net worth required of a franchisor for registration, but there are certain rules of thumb adhered to by administrators. A franchisor's net worth must usually exceed a single franchisee's total required initial investment found in Item 7 of the FDD (not just the required initial franchise fee listed in Item 5 of the FDD).

In addition, certain state administrators examine underlying descriptions of the proposed franchise relationship in the FDD in determining whether a franchisor meets that state's net worth test. Examiners consider the following:

- Term of the proposed franchise agreement
- Number of principals of the franchisor
- Number of franchises proposed to be opened in the upcoming year
- Number of existing franchisees
- Geographic scale of the franchised system
- Scope of the franchisor's obligations under the franchise agreement
- Type of capitalization reflected in the franchisor's balance sheet

Upon renewal of a franchise registration, the franchisor and the franchisor's auditors must also be aware that franchise fees are not deemed "earned" under generally accepted accounting principles (GAAP) until all franchisor pre-opening obligations are satisfied. This can translate into a skewed balance sheet that initially could indicate a less than successful franchise operation. Highlighting this hidden, unearned asset

may assist the financially marginal franchisor in demonstrating its solvency. However, in our recent experience with state examiners, this explanation is not always persuasive in lifting a financial assurance demand.

Also, keep in mind that not all states follow the FTC Franchise Rule and permit the "phase in" of audited financials. Minnesota, New York, and Virginia all require initial financial statements to be audited. If a startup franchisor is launching nationwide, then it must have its financial statements audited by an independent accountant. In addition, California requires a startup to submit a balance sheet that is "reviewed" by a certified public accountant (CPA) who provides limited assurances that the financials meet GAAP requirements and are free of material misstatements. Finally, it is important to keep in mind that some states, like Illinois, still require that even unaudited statements be prepared by an independent CPA in accordance with GAAP.

### **What Constitutes Undercapitalization Generally**

Undercapitalization poses a severe threat to franchisors seeking registration. Many state regulators take the position that the offer or sale of a franchise of an undercapitalized franchisor would constitute an unreasonable risk to prospective franchisees, and registration is refused or conditioned upon fee deferral, escrow, performance bond, surety bond, or guarantee requirements. What constitutes undercapitalization varies from state to state. However, any state is unlikely to grant registration to a franchisor if one or more of the below apply:

- Franchisor is technically insolvent
- Franchisor's current liabilities exceed its current assets
- Franchisor appears unable to pay its obligations as they become due
- Franchisor's net worth is zero or negative

While a franchisor's nominal net worth may appear to be substantial, state administrators, especially those in California, Illinois, and New York, consistently look beneath the surface of balance sheets submitted and examine what they perceive to be the "true" value of the franchisor's assets. "Officers' loans" subject to immediate call are discounted entirely; similarly, any other "assets" subject to immediate withdrawal or dissipation by the franchisor (or any of its principals, corporate parents, or affiliates) will frequently be set aside in determining a franchisor's perceived "true" net worth.

Conversely, a franchisor with a perceived inadequate net worth may surmount this difficulty by converting certain assets that state administrators may deem questionable. For example, if a substantial "officer's loan" is converted to a capital contribution or a long-term subordinated loan (subordinated to the franchisor's obligations under its franchise agreements), and the loan is subject to repayment only from retained earnings (and not from working capital), an "asset" that might otherwise be dismissed by state administrators as being insubstantial may be converted into one that may withstand scrutiny.

There is wide variation in the thoroughness of state regulators in reviewing registration applications and in the financial measures, minimum liquidity, and net worth standards they apply in judging if a franchisor has adequate financial resources to provide promised pre-opening support to franchisees.

Some states, such as Washington, seem to require a financial assurance from every startup franchisor based on the franchisor's lack of prior franchising experience even though the franchisor's net worth would otherwise be sufficient to avoid a financial assurance condition if the franchisor were filing a renewal registration application.

The financial review is designed to prevent a franchisor from selling more franchises than it is capable of servicing. The goal is to prevent an undercapitalized franchisor from being overly dependent on a franchisee's initial fee payments in providing the franchisee with promised pre-opening support.

## **NASAA Form B Sources and Uses of Funds Disclosure Impact on Financial Assurance Requirements**

To assess the adequacy of a franchisor's capital, state regulators often begin by multiplying the franchisor's estimated per-franchise unit cost of providing promised pre-opening and opening services and support as disclosed on Form B of the NASAA Uniform Franchise Registration Application (Franchisor's Cost and Source of Funds) by the number of franchises the franchisor estimates it will sell in the next year as disclosed in Table 5 of Item 20 of the FDD. The total of per-unit cost and total projected sales is then compared to the financial resources indicated by the franchisor's financial statements. The franchisor's liquid assets on hand must at least be equal to the total. However, some state regulators require an additional amount of available cash in excess of the total needed to fund estimated promised pre-opening and opening services and support. Best practice is to prepare these projections conservatively and ensure they are supportable, because optimistic estimates can increase the capital regulators expect the franchisor to have available.

### **Item 20 Projections Impact on Financial Assurance Requirements**

In some states, the lack of a franchising track record may result in a financial assurance condition regardless of the startup franchisor's initial capital shown on audited financial statements. The capital requirements on initial registration appear to be scrutinized more closely than on renewal. A track record of franchise sales, openings, and documented growth is often helpful to convince a state regulator to accept a lower current-assets-to-current-liabilities ratio on renewal. Existing franchise units generate continuing royalty fees that franchise regulators will consider in assessing the renewing franchisor's financial condition. However, a financial assurance condition is unavoidable on renewal when the current-assets-to-current-liabilities ratio is less than 1.

Item 20 projections are another important part of this review. A franchisor will compound its own problems by puffing up its franchise expansion plans for the next year in Item 20 or in public statements on its website. Franchise regulators read the franchisor's website for many different things, including representations of past or future success and undocumented financial performance representations. Item 20 estimates of franchise sales in the next fiscal year should be realistic — particularly because this is the key multiplier state regulators use in determining the franchisor's minimum capital needs.

### **Financial Assurance Requirement Options**

When a new franchisor files an initial application for registration in a state or if a franchisor's financial condition deteriorates, the state will require some evidence of "financial assurance" that the franchisor can perform all of its pre-opening obligations for franchisees. The principal options for providing that assurance are described below. Depending on the state and the franchisor's financial situation, the franchisor may be required to post a bond, find a guarantor, provide additional capital, set up an escrow, or defer payment certain initial fees from franchisees.

#### ***Surety Bonds***

With the exception of Virginia, all other franchise registration states imposing additional assurances permit a franchisor to satisfy a financial assurance condition by posting a surety bond. The bonding company must be a registered surety in the registration state. If multiple registration states each impose a financial assurance condition, the franchisor will need a separate surety bond for each state.

A surety bond works like an insurance policy. The company underwriting the bond will assess the risk and creditworthiness of the franchisor and decide the amount to be paid for the bond, like an annual insurance premium. The franchisor's existing insurance provider is a good place to start. Begin the application process early because underwriting can take several weeks and the bond must be in place before the registration condition can be satisfied. The companies below are also known to write surety bonds for franchise systems:

|                     |                                                                                                                                         |
|---------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| <b>Gallagher</b>    | <a href="http://suretysolutions.com/bonds-by-state/washington-bonds/">suretysolutions.com/bonds-by-state/washington-bonds/</a>          |
| <b>Surety Group</b> | <a href="http://www.suretygroup.com">www.suretygroup.com</a>                                                                            |
| <b>Surety One</b>   | <a href="http://www.suretyone.com">www.suretyone.com</a><br><i>Surety One is an independent broker and works with several sureties.</i> |
| <b>Marsh Agency</b> | <a href="http://marshmma.com/">marshmma.com/</a>                                                                                        |

The amount of the bond typically is the product of the initial fees multiplied by the number of franchises the franchisor intends to sell in the state during the coming year. However, some states require a minimum of three times the initial fees regardless of the projected sales in Item 20 of the FDD if a development offering is part of the FDD.

**Advantages.** The surety bond option gives the franchisor access to the initial fees as soon as they are paid, which may be the principal source of cash flow for a startup franchise company. The bond also covers only the franchisor's performance of pre-opening services and may be terminated once the franchisor's capitalization has improved.

**Disadvantages.** Bonds can be costly, and a franchisor will need a separate bond for each registration state that imposes a financial assurance condition. Like an insurance premium, a bond is an annual business expense of the franchise system that cannot be recouped. Finally, the franchise system must qualify for the bond.

### ***Deferral of Initial Fees***

Deferring payment of initial fees until the franchised business opening date is the simplest option for complying with a financial assurance condition. Some states may waive the financial assurance requirement if the franchisor agrees to modify its franchise agreement so that no monies are payable to the franchisor until after the franchised business opens and all of the franchisor's pre-opening obligations to the franchisee are satisfied. From the state regulator's perspective, an initial fee deferral ensures that the franchisor will have other available working capital and cannot use a franchisee's initial fees to fund the cost of discharging pre-opening duties owed to that franchisee. It decreases the risk that the franchisee will lose its initial fees if the franchisor fails to satisfy its training, assistance, and other pre-opening obligations.

There are risks with this option. The franchisee may lack sufficient funds to pay the initial fees on the opening date. To reduce this risk, it is permissible to have the franchisee sign a promissory note stipulating that the initial fees are all due and payable on the franchised business opening date. Best practice is to structure the promissory note carefully so that its payment terms, default remedies, and relationship to the franchise agreement are clear and consistent with applicable state requirements. The promissory note coupled with threatened termination for breach of the franchise agreement will make it easier for the franchisor to recover the initial fees if the franchisor must initiate a legal proceeding.

This option is typically preferable for franchise concepts with shorter periods between signing the franchise agreement and opening, such as service-based or mobile concepts, where leased real estate, build-outs, and heavy capital improvements are not required to open.

### ***Escrowing Initial Fees***

All registration states allow a franchisor to satisfy a financial assurance condition by setting up an escrow account with a third-party escrow company or bank where initial fees will be deposited and held until the franchisor and franchisee provide mutual instructions to release the funds by affirming that the franchisor has fulfilled all promised pre-opening obligations and the franchisee's business has opened. Best practice is to identify and select the escrow agent early, because the bank's state presence, willingness to open a franchise escrow, and review timeline can affect the registration schedule.

**Advantage.** The escrow option requires the franchisee to pay the initial fees when the parties sign the franchise agreement, giving the franchisee real "skin in the game" early on.

**Disadvantages.** The primary disadvantages are cost and complexity. Only a handful of banks will open a franchise escrow, and the bank used must have a physical operating presence in the state where the franchise registration is pending. This limits the franchisor's options. Setting up an escrow account and negotiating the form of escrow agreement can also add attorney time and cost, particularly when the bank's preferred form differs from the escrow language requested by the state examiner. Finally, the franchisee may refuse to sign mutual instructions for release of the funds when the time comes. Even when all parties agree, state examiners may delay approval because of backlogs and understaffing. As a result, using an escrow can become a cumbersome process.

### ***Guarantee of Performance***

An undercapitalized franchisor may offer a guarantee by an affiliate of the franchisor's performance of franchise agreement obligations if the guarantor has audited financial statements that the franchisor includes in the FDD along with a copy of the affiliate's guarantee. Consequently, a guarantee is not an option unless an affiliate has audited financial statements. Some states may require that the guarantor be a parent company. Even if the franchisor has an affiliate with an audit history, this option foregoes one of the chief benefits of forming a new, separate legal entity to act as the franchisor — the segregation of liabilities. Additionally, a significant drawback of an affiliate guarantee is that the guarantee is not limited to the franchisor's performance of pre-opening obligations. The guarantee applies to the franchisor's performance throughout the term of the franchise agreement for each agreement signed during the period that the guarantee is in effect. If a guarantee is used, its scope and duration should be carefully defined so that the parties understand which obligations are covered; a broad guarantee can extend well beyond pre-opening support and undermine the intended segregation of liabilities.

### ***Capital Infusion***

In certain states, additional capital contributions may be made to the franchisor entity to satisfy a state examiner's concern. Short-term loans repayable on demand or within 12 months will equally increase both current assets and current liabilities and, therefore, will not improve the franchisor's ratio or net working capital. However, long-term loans (i.e., loans that are not repayable for at least 12 months) of a sufficient amount may correct an undercapitalized franchisor, even if the loan is from an officer or stakeholder.

In some cases, state regulators might require an undertaking that loans will be paid from retained earnings, not from current income, and that repayment will be expressly subordinated to the franchisor's obligations under all franchise agreements. This includes existing franchise agreements, not just new franchise agreements signed during the next registration year. Some states, like Maryland, will not accept a capital infusion as an option once a financial assurance requirement is imposed by comment letter.

### ***Informal Undertaking***

In cases where a state regulator finds the franchisor's financial statements to be marginally adequate, the state may condition registration on a corporate officer agreeing to maintain a minimum cash balance in the franchisor's operating account throughout the registration period based on some multiple of the initial fees (e.g., two times) to be used as a fund to guarantee performance of pre-opening obligations related to franchises sold during the registration year. Usually, there is no prescribed form of undertaking and a letter on the franchisor's letterhead may be sufficient. The registration is issued in reliance on the franchisor's promise to maintain a minimum fund, so a breach of this promise would expose the franchisor to an independent statutory claim for fraud or for filing a false statement. Additionally, the state may require the marginally capitalized franchisor to also file quarterly unaudited financial statements so the state can stay abreast of changes in the franchisor's financial condition during the registration year.

Best practice is to plan capitalization and financial assurance needs proactively, before filing for state registrations or signing franchise agreements. Coordinating projections, financial statements, and any bond, escrow, deferral, guarantee, or capital-infusion documents early can reduce delays and help avoid last-minute conditions.

## **State-by-State Discussion**

The following state-by-state discussion applies these principles. State regulators appear to focus on three criteria: (i) positive net worth; (ii) a current assets-to-current-liabilities ratio of at least 1; and (iii) an operating profit during the prior fiscal year. Each franchise registration statute contains authorizing language permitting state examiners to require financial assurances under certain conditions. Some states set forth a specific test of the financial condition of the franchisor, while others contain general guidelines that the examiner must consider. Some state statutes and regulations do not contain any additional guidance beyond the general authorizing statute.

Keep in mind that whatever option is chosen, the additional financial assurance must be disclosed in the FDD. States will allow it to appear in a state-specific addendum to the FDD and amendment to the franchise agreement. However, for franchise systems using one uniform FDD, it can draw extra attention to the financial condition of the franchisor to prospective franchisees located in nonregistration states.

### **California**

California does not have a bright-line test for determining whether a franchisor will be required to satisfy a financial assurance as a condition to registration. Although this allows flexibility, California applies assurances inconsistently as different examiners take different approaches. Some of the factors that the examiners review include: capitalization; operating history; working capital in relation to the amount the franchisor will spend for each franchise before opening; and liquidity, the ratio of current assets to current liabilities of the franchisor.

### **Hawaii**

Hawaii is much like California and Rhode Island in that it does not have a specific test. Hawaii will review various factors, including the current assets and current liabilities of the franchisor.

### **Illinois**

The Illinois Franchise Disclosure Act allows an examiner to require a financial assurance where the examiner determines that (1) adequate financial resources are not available to the franchisor, or (2) the franchisor will be relying primarily on initial franchise fees for the capital to perform its pre-opening obligations. The Illinois regulations indicate that several factors should be considered, including: current ratio; quick ratio; debt-to-equity ratio; amount of working capital; proportion of tangible assets to intangible assets; amount and multitude of debts; amount of equity; earnings history; proportion of receivables compared to other assets; and quality of receivables (including financial statements that indicate bad debt, debt discharged in bankruptcy, or failure to allow for aged receivables).

Illinois considers it a red flag where financial statements show a debt-to-equity ratio of 6 or above, or less than \$100,000 in equity. The test imposed will vary based on the amount of the initial franchise fees, and the type and value of assets of the franchisor. For example, if a large component of the assets of the franchisor is allocated to intangible assets (such as intellectual property or goodwill), the examiner may require the franchisor to have a lower debt-to-equity ratio.

Illinois is the only registration state that requires a franchisor that relies on an affiliate guarantee to also file with the registration application a copy of the affiliate's corporate resolutions and secretary's certificate ratifying the affiliate's agreement to guarantee the franchisor's obligations. The franchisor does not include these documents in the FDD except for the affiliate guarantee itself.

**Indiana**

Indiana does not formally review the FDD of a franchisor; therefore, this state does not commonly review the financial statements of the franchisor.

**Maryland**

Maryland examiners evaluate the assets, liabilities, shareholders equity, and working capital of the franchisor at the initial registration of a franchisor and each renewal filing. If the examiner determines that the franchisor possesses insufficient assets and capital to fulfill its franchisee obligations, the FDD registration will be conditioned on franchisor's agreement and satisfaction of a financial assurance requirement.

**Michigan**

Michigan does not formally review the FDD of a franchisor; therefore, this state does not commonly review the financial statements of the franchisor.

**Minnesota**

Minnesota examiners analyze the current assets of a franchisor compared to current liabilities. Neither the Minnesota Franchise Act nor its regulations provide for a specific test to be used by the state in determining if a financial assurance is required.

**New York**

New York has the authority to require financial assurances, but rarely does so. If a New York examiner determines that your franchise system does not possess sufficient capital, then it will require that you add a specific risk factor to your FDD state cover page but will not impose a financial assurance or initial fee deferral requirement.

**North Dakota**

North Dakota has no definitive set standard for review, but typically considers whether the franchisor has a negative liability-to-asset ratio and whether the franchisor has negative stockholders' equity when making additional financial assurance requirement determinations.

**Rhode Island**

Rhode Island examiners do not have a specific test that they use in determining if a financial assurance should be imposed on a franchisor. Rhode Island analyzes the balance sheet of the franchisor including cash flow and takes into account the number of states in which a franchisor is registering, the amount of the franchise fee, and the source of funds information disclosed by the franchisor.

**South Dakota**

South Dakota does not formally review the FDD of a franchisor; therefore, this state does not commonly review the financial statements of the franchisor.

**Utah**

Utah does not formally review the FDD of a franchisor; therefore, this state does not commonly review the financial statements of the franchisor.

**Virginia**

The Virginia Retail Franchising Act provides a specific test for determining whether a financial assurance will be required, providing that if a franchisor's liabilities exceed assets, the examiner may require an escrow condition. Virginia has a blanket prohibition on registering franchisors whose financial statements contain a going concern opinion. Although many states will still allow a franchisor with a going concern opinion to register after satisfying a financial assurance requirement, Virginia does not. Under the Virginia statute, a franchisor that "cannot meet its obligations as they mature" (the basis for a going concern opinion) will be prohibited from registering in Virginia.

### Washington

Washington has historically taken the position that a franchisor or its parent (if a parent's financial statements are being used) must have a "net worth" of at least \$100,000 in order to avoid the imposition of a financial assurance requirement. Washington may impose financial assurance requirements on all startup franchisors regardless of their financial situation. Washington indicates that financial assurances may be required when the financial statements show less than \$100,000 in equity. As a condition of approval of the registration, Washington may require the escrow or impound of initial fees if the state finds it necessary to protect prospective franchisees. In certain circumstances, the state may allow other methods of financial assurance such as a guarantee of performance by a parent or affiliate, posting of a surety bond, or fee deferral.

### Wisconsin

Wisconsin does not formally review the FDD of a franchisor; therefore, this state does not commonly review the financial statements of the franchisor.

### Other States

The remaining registration states' laws and regulations do not include any specific guidance as to what factors are considered in determining whether financial assurances will be required. Instead, they generally look at each situation on a case-by-case basis and focus on the Franchisor's Costs and Source of Funds document that a franchisor must submit as part of its filing, together with the projected openings for the next fiscal year listed on Table 5 in Item 20 of the franchisor's FDD. States also may look at the estimated initial investment required for each franchise, as disclosed in FDD Item 7.

**State Chart of Financial Assurance Options**

| State      | Bright Line Tests                                                                                | Factors Used by State Examiners                                                                                                                                                                                                                                                             | Options for Financial Assurances                                                              |
|------------|--------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| California | Not Applicable                                                                                   | Capitalization, operating history, working capital in relation to the amount the franchisor will spend for each franchise before opening, and liquidity.                                                                                                                                    | Fee Deferral<br>Escrow Initial Fees<br>Surety Bond                                            |
| Hawaii     | Not Applicable                                                                                   | Will review various factors, including the current assets and current liabilities of the franchisor.                                                                                                                                                                                        | Escrow,<br>Initial Fees, Deferral of<br>Surety Bond                                           |
| Illinois   | Financial statements show a debt-to-equity ratio of 6 or above, or less than \$100,000 in equity | The current ratio, quick ratio, the debt-to-equity ratio, amount of working capital, proportion of tangible assets to intangible assets, amount and multitude of debts, amount of equity, earnings history, proportion of receivables compared to other assets, and quality of receivables. | Fee Deferral<br>Escrow Initial Fees<br>Surety Bond                                            |
| Indiana    | Not Applicable                                                                                   | Does not formally review the FDD.                                                                                                                                                                                                                                                           | Not Applicable                                                                                |
| Maryland   | Not Applicable                                                                                   | Will review various factors, including the current assets and current liabilities of the franchisor.                                                                                                                                                                                        | Does not accept<br>infusion of capital.<br>Fee Deferral<br>Escrow Initial Fees<br>Surety Bond |
| Michigan   | Not Applicable                                                                                   | Does not formally review the FDD.                                                                                                                                                                                                                                                           | Not Applicable                                                                                |

|                     |                                                                                            |                                                                                                                                                                                                                                                      |                                                                                                                                                                                                                                  |
|---------------------|--------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Minnesota</b>    | Not Applicable                                                                             | Analyzes the current assets of a franchisor as compared to the franchisor's current liabilities.                                                                                                                                                     | Fee Deferral<br>Escrow Initial Fees<br>Surety Bond                                                                                                                                                                               |
| <b>New York</b>     | Not Applicable                                                                             | Not Applicable                                                                                                                                                                                                                                       | Does not impose financial assurance or franchise fee deferral requirements.                                                                                                                                                      |
| <b>North Dakota</b> | Not Applicable                                                                             | Will review whether the franchisor has a negative liability to asset ratio, and whether the franchisor has negative stockholders' equity.                                                                                                            | Escrow Initial Fees<br>Surety Bond                                                                                                                                                                                               |
| <b>Rhode Island</b> | Not Applicable                                                                             | Analyzes the balance sheet of the franchisor including cash flow, and takes into account the number of states in which a franchisor is registering, the amount of the initial fees, and the source of funds information disclosed by the franchisor. | Escrow Initial Fees                                                                                                                                                                                                              |
| <b>South Dakota</b> | Not Applicable                                                                             | Does not formally review the FDD.                                                                                                                                                                                                                    | Not Applicable                                                                                                                                                                                                                   |
| <b>Utah</b>         | Not Applicable                                                                             | Does not formally review the FDD.                                                                                                                                                                                                                    | Not Applicable                                                                                                                                                                                                                   |
| <b>Virginia</b>     | If a franchisor's liabilities exceed assets, the examiner may require an escrow condition. | Will review various factors, including the current assets and current liabilities of the franchisor.                                                                                                                                                 | Does not accept surety bond; only deferral of initial fees, guarantee of performance by parent or affiliate, or escrow of funds. If escrow is elected, need to use VA form.                                                      |
| <b>Washington</b>   | Financial statements show less than \$100,000 in equity.                                   | Will review various factors, including the current assets and current liabilities of the franchisor.                                                                                                                                                 | Escrow or impound of initial fees and in certain circumstances, the state may allow other methods of financial assurance such as a guarantee of performance by a parent or affiliate, posting of a surety bond, or fee deferral. |
| <b>Wisconsin</b>    | Not Applicable                                                                             | Does not formally review the FDD.                                                                                                                                                                                                                    | Not Applicable                                                                                                                                                                                                                   |

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