IDAHO
DEPARTMENT OF FINANCE

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# GUIDANCE

## Regarding Financial Analysis Review of Mortgage Broker/Lender License Applicants Pursuant to the Idaho Residential Mortgage Practices Act

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## I. Background

The purpose of this Guidance is to provide clarity and direction to mortgage broker/lender license applicants under the Idaho Residential Mortgage Practices Act (Act) regarding financial analysis requirements for licensure.

The federal Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), adopted by Congress in July 2008 in response to the U.S. subprime mortgage crisis, established minimum standards for the licensing and regulation of mortgage loan originators (MLOs). While the SAFE Act required certain financial standards for MLOs, it did not establish minimum financial standards for the mortgage brokers/lenders that employ MLOs.

Idaho Code § 26-31-206 (2)(a) requires that mortgage broker/lender license applicants demonstrate financial responsibility, character, and fitness in order to warrant the belief that the business will be operated honestly and fairly when offering financial services to the citizens of Idaho. In order to verify that mortgage broker/lender licensees meet this standard, their loan and business records, including financial statements, are subject to periodic examination by the Department.

To ensure that mortgage broker/lender license applicants meet Idaho's minimum financial fitness standards, they must file unaudited financial statements through the Nationwide Multistate Licensing System (NMLS). Start-up companies will be required to file only an initial Statement of Condition or a Balance Sheet. The reporting criteria and review standards identified below meet recognized Generally Accepted Accounting Principles (GAAP) and are part of the Multi-State Mortgage Committee's (MMC) examination guidelines.

The following standards will be used to evaluate financial statements required to be submitted as part of the mortgage broker/lender license application process in Idaho:

## II. Initial Criteria

- Monetary unit must display data in U.S. Dollars.
- Accrual-basis accounting (reporting revenue in period earned not when received; reporting expenses in period incurred not when paid).
- Full disclosure principle – requires financial statements to fully disclose any and all information an investor, lender, or private individual might need to assess the current financial state of the business, including any auditor's or accountant's notes, as applicable.

- *Initial* information provided by applicants may be taken at face value. However, this does not preclude an examiner from asking clarifying questions or requesting supporting documentation as needed from the applicant. Failure to provide requested information may result in a denied or withdrawn incomplete application.

The review analysis will initially examine five potentially relevant financial ratios and may be expanded if further information is required in order for a determination to be made:

1. **Current Ratio** = Current Assets / Current Liabilities (current means one year or less):

   The current ratio is a liquidity ratio that measures a company's ability to pay short-term and long-term obligations. To gauge this ability, the current ratio considers the current total assets of a company (both liquid and illiquid) relative to that company's current total liabilities. The current ratio is called "current" because, unlike some other liquidity ratios, it incorporates all current assets and liabilities. The Current Ratio is a good gauge of an institution's capacity to meet short-term debt obligations. A higher Current Ratio indicates a more liquid institution.

   Generally, a satisfactory Current Ratio is above 1.8%, while an above average Current Ratio is 1.3-1.8%, a below average Current Ratio is 1.0-1.2%, and an Unsatisfactory Current Ratio is below 1.0%.[1]

   **Liabilities to Assets Ratio** = Total Liabilities / Total Assets **(Alternative to Current Ratio)**: Similar to the Current Ratio, but the calculation also includes long term assets and liabilities. If the ratio is near 100% it is a cause for concern and may require additional information from the applicant.

2. **Tangible Net Worth** = Total Assets – Total Liability – Intangible Assets:

   Tangible net worth (TNW) is most commonly a calculation of the net worth of a company that excludes any value derived from intangible assets such as copyrights, patents and intellectual property in order to help determine the capacity of a company to pay its bills in a few months and assess the real value of a company based on the balance sheet.[2]

3. **Net Worth** = Total Assets – Total Liabilities:

   A negative net worth indicates that if the company were to liquidate on the statement date, some or all creditors may not get paid what they are owed and borrower clients could be left with the inability to obtain a loan. A negative net worth, although not an automatic disqualifier, requires additional information from the applicant on the conditions causing the applicant's negative net worth and what steps the applicant is taking to improve its financial position.

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[1] Using the Mortgage Call Report (MCR) — Financial Condition Report for source information, the fields of the MCR to use: (A010+A034+A036+A040+A060+A062) / (B010+B070+B080+B090+B100+B120)

[2] Using the MCR—Financial Condition Report for source information, the fields of the MCR to use: (B350 - A210 - A190)

4. **Net Income (Loss)** = Revenue – Expenses – Taxes:

   The net income (loss) is an important indicator for financial health and long term business viability. Multiple years of net loss could mean that the business is in trouble and may not be financially viable in the near future. Additionally, a large net loss in a single year may require further evaluation.

   **Start-up companies**: It is fairly common for a start-up company to lose money for several years initially before any profits are made. A net loss trend would be reviewed to determine whether the applicant's financial condition is improving or deteriorating.

5. **Equity Depletion Ratio** = Total Equity / Net Loss (used if a company registers a net loss):

   This ratio measures the amount of time it would take to deplete the value of the company at the current year's net loss amount. This ratio would be used in combination with observations regarding any net loss trend. An Equity Depletion Ratio of three years or less would be of significant concern and would be elevated for additional review or information.

   All preliminary determinations of lack of financial fitness will be elevated to department management for review and final decision.