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## 2.7 Financial Capability Evaluation

### 2.7.1 Introduction

The Financial Capability evaluation was one of the seven evaluation streams defined in the AGB. The financial questions the Applicant Guidebook (AGB) gathered information from the applicant regarding its plans for operations and financial planning so that the evaluation panel could assess whether the applicant demonstrated the financial capability to run a TLD.

### 2.7.2 Relevant Guidance

The following guidance is relevant to the topic of the Financial Capability evaluation and will be discussed in further detail in Sections 2.7.3 and 2.7.4 of this report:

- GNSO Principle E: “A set of capability criteria for a new gTLD registry applicant must be used to provide an assurance that an applicant has the capability to meet its obligations under the terms of ICANN’s registry agreement.”<sup>117</sup>
- GNSO Recommendation 1:

*ICANN must implement a process that allows the introduction of new top-level domains. The evaluation and selection procedure for new gTLD registries should respect the principles of fairness, transparency and non-discrimination. All applicants for a new gTLD registry should therefore be evaluated against transparent and predictable criteria, fully available to the applicants prior to the initiation of the process. Normally, therefore, no subsequent additional selection criteria should be used in the selection process.*

- GNSO Recommendation 8: “Applicants must be able to demonstrate their financial and organisational operational capability.”
- GNSO Recommendation 9: “There must be a clear and pre-published application process using objective and measurable criteria.”
- Applicant Guidebook, Module 1: Introduction to the gTLD Application Process<sup>118</sup>
- Applicant Guidebook, Section 2.2.2: Applicant Reviews
- Applicant Guidebook, Section 2.3.2: Technical/Operational or Financial Extended Evaluation
- Applicant Guidebook, Section 2.4: Parties Involved in Evaluation
- Applicant Guidebook, Attachment to Module 2: Evaluation Questions and Criteria

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<sup>117</sup> ICANN. (8 August 2007) ICANN Generic Names Supporting Organization Final Report Introduction of New Generic Top-Level Domains, Part A. Retrieved from <http://gnso.icann.org/en/issues/new-gtlds/pdp-dec05-fr-part-a-08aug07.htm>

<sup>118</sup> ICANN. (4 June 2012) gTLD Applicant Guidebook Version 2012-06-04. Retrieved from <http://newgtlds.icann.org/en/applicants/agb/guidebook-full-04jun12-en.pdf>

## 2.7.3 Background

The AGB anticipated that Initial Evaluation (IE) (see Section 2.1: Initial and Extended Evaluation of this report) would take five months to complete, all IE results would be published at the conclusion of IE, and the Contracting process would commence at the end of IE. This would allow applicants that passed IE to move expeditiously toward signing an RA if there were no other issues that the application must resolve (i.e., contention resolution, dispute resolution).

The Financial Capability evaluation was “intended to gather information about the applicant’s financial capabilities for operation of a gTLD registry and its financial planning in preparation for long-term stability of the new gTLD.”<sup>119</sup> The Financial section of the application (Questions 45 through 50) had three main components:

1. The applicant’s financial statements (Question 45),
2. Information about the applicant’s intended business model (Question 46 – Question 49), and
3. A Continuing Operations Instrument (COI) to ensure that the registry could be guaranteed to fund registry operations for a minimum of three years following the termination of the RA, for the protection of registrants (Question 50).

There were 11 points available within the Financial section, and a total of eight points were required (with no zeros on an individual question) in order to pass.

The AGB, Attachment to Module 2, Section III stated, “Given the requirement that technical and financial planning be well integrated, the panels will work together and coordinate information transfer where necessary.” To support this, ICANN selected the same panel firms for the Technical and Operational Capability evaluation and the Financial Capability evaluation, and allocated both sections of an application to the same panel firm. The panel firms for the Technical and Operational Capability Evaluation and Financial Capability evaluation were Ernst & Young, KPMG, and JAS Global Advisors. For more information, see Section 8.2: Service Provider Coordination of this report.

The overall evaluation process was described in Module 2 of the AGB. The implementation of the evaluation process was performed in alignment with the AGB-defined processes, and has been described in further detail in Section 2.1: Initial and Extended Evaluation of this report.

Once the evaluation panel’s evaluation was complete, they presented their results to ICANN. The results reports provided by the Financial Capability evaluation panel included detailed rationale for applications that did not meet the AGB criteria. ICANN reviewed the results for consistency and to confirm that the results appeared to be in alignment with the AGB. After review, for each application, ICANN consolidated the results received from the panels for publication and to share with the applicant.

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<sup>119</sup>ICANN. (4 June 2012) gTLD Applicant Guidebook Version 2012-06-04, Section 2.2.2.2: Financial Review. Retrieved from <http://newgtlds.icann.org/en/applicants/agb/guidebook-full-04jun12-en.pdf>

A total of 1,777 applications passed the Financial Capability evaluation during IE, and 26 applications were eligible for EE. Ultimately, all applications that participated in the Financial Capability evaluation during EE passed.

## 2.7.4 Assessment

GNSO Recommendation 8 stated, “Applicants must be able to demonstrate their financial and organisational operational capability.” In support of this recommendation, the AGB criteria in Questions 45 through 50 were developed. The AGB stated, “The process must provide for an objective evaluation framework, but allow for adaptation according to the differing models applicants will present.”<sup>120</sup> The financial criteria were not intended to be universal, rigid criteria, and were developed with the intention of being flexible enough to accommodate various business types. However, in order to ensure a consistent evaluation across all applications, the panel defined guidelines to interpret the application information as objectively and consistently as possible.

In order to provide additional clarity around the AGB criteria, before and during the application window, ICANN developed Supplemental Notes for each of the questions in the Financial section.<sup>121</sup> Table 2.7.i displays the number of Supplemental Notes (or updates) created for each of the Financial questions.

*Table 2.7.i: Supplemental Notes by Question*

Financial Question	# Supplemental Notes and Updates to Supplemental Notes
Q45	9
Q46	10
Q47	2
Q48	2
Q49	1
Q50	9

Once the panel had evaluated some applications and was developing its CQs, it was evident that a high volume of application would receive multiple CQs. To help applicants prepare for clarifying questions, ICANN issued five Applicant Advisories relating to questions in the Financial section (see table 2.7.ii).<sup>122</sup>

<sup>120</sup> ICANN. (4 June 2012) gTLD Applicant Guidebook Version 2012-06-04, Attachment to Module 2: Evaluation Questions and Criteria. Retrieved from <http://newgtlds.icann.org/en/applicants/agb/guidebook-full-04jun12-en.pdf>

<sup>121</sup> ICANN. Supplemental Notes. Retrieved from <http://newgtlds.icann.org/en/applicants/agb/supplemental-notes>

<sup>122</sup> ICANN. Applicant Advisories. Retrieved from <http://newgtlds.icann.org/en/applicants/advisories>

Table 2.7.ii: Applicant Advisories by Question

Financial Question	Question Description	# Advisories and Updates to Advisories
Q45	Financial Statements	0
Q46	Projections Template: Costs and Funding	0
Q47	Costs: Setup and Operating	0
Q48	Funding and Revenue	1
Q49	Contingency Planning: Barriers, Funds, Volumes	0
Q50	Continuity: Continued Operations Instrument	4

Despite efforts to provide clarification, observations from the implementation of the Financial Capability evaluation suggest that there was a lack of clarity around the Financial criteria. The panel issued CQs on the Financial section for 90% of applications, which indicates that 90% of applications did not initially meet the AGB criteria based on the original application information submitted (see table 2.7.iii). A total of 4,378 CQs on the Financial Section were issued.

Table 2.7.iii: Clarifying Questions Issued by Question

Financial Questions	Question Description	# Applications	% Applications
Q45	Financial Statements	587	31%
Q46	Projections Template: Costs and Funding	126	7%
Q47	Costs: Setup and Operating	986	53%
Q48	Funding and Revenue	857	46%
Q49	Contingency Planning: Barriers, Funds, Volumes	292	16%
Q50	Continuity: Continued Operations Instrument	1,530	82%

Based on the number of Supplemental Notes, Applicant Advisories, and CQs issued, ICANN should examine the CQs issued and responses received. Consideration should be given to whether the financial criteria could be developed to better address a variety of business models and require less clarification and interaction among ICANN, applicants, and the panel.

Nine Supplemental Notes and four Advisories were issued for Question 50, which concerned the Continued Operations Instrument and required that the applicant describe the instrument that they planned to secure or provide an executed instrument. One of these updates to an Advisory, issued on 4 March 2013, was an explanation of the “unconditional withdrawal of funds” requirement within Question 50.<sup>123</sup> As evidenced by the 1,530 applications that received CQs on Question 50, the majority of applicants faced challenges in addressing Question 50, including many which received CQs

<sup>123</sup> ICANN. Continuing Operations Instrument: Unconditional Withdrawal of Funds. Retrieved from <http://newgtlds.icann.org/en/applicants/advisories/coi-withdrawal-05dec12-en>

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regarding the “unconditional withdrawal of funds” requirement. On 5 June 2013, ICANN announced that as a result of some of the challenges faced by applicants, and inconsistent application and usage of the conditional language included in the letters of credit submitted in response to Question 50, the financial evaluation would focus on the financial aspects of the COI (most notably the amount) and address the legal language (such as conditions) during the Contracting process.<sup>124</sup> Continued Operations Instruments are discussed in greater detail in Section 7.1: Continued Operations Instruments of this report.

Another observation from implementation was that there were applicants that applied for many TLDs. As each was evaluated individually by priority number, the evaluation process as implemented in this round did not allow for evaluation of the applicant’s financial scalability in relation to its entire portfolio of applications.

While the criteria were developed to support the GNSO’s recommendation that applicants demonstrate financial capability, the number and nature of Supplemental Notes, Applicant Advisories, and CQs issued suggest that there was some level of administrative burden in the evaluation process for both applicants and the evaluation panels. Eighty-two percent of all applications received a CQ on Question 50, many of which were administrative corrections to the COI.

GNSO Recommendation 8 required that applicants be able to “demonstrate their financial and organisational operational capability.” There were several different options that could have been used to apply this policy, including a question and answer approach, a third-party certification of an applicant’s financial situation, or a mandatory insurance policy in lieu of a financial evaluation. In this application round, a question and answer approach was implemented to address this recommendation. For future rounds, consideration should be given to whether a third-party certification would allow applicants to demonstrate financial capability while providing the flexibility to evaluate various applications’ business models, including applicants that have applied for many TLDs.

## 2.7.5 Conclusion

The Financial Capability Evaluation criteria were developed in support of GNSO Recommendation 8, which stated, “Applicants must be able to demonstrate their financial and organisational operational capability.” The evaluation was performed in alignment with the AGB, and all applications met the AGB criteria in either IE or EE.

However, observations from implementation suggest that there were inefficiencies in the process that should be reviewed. There were many instances where a group of related applications was almost identical, but due to the application-by-application design of the evaluation process, applications were considered individually based on priority number. This reduced efficiency for both the panel and the applicants, and did not allow for an applicant’s financial scalability to be

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<sup>124</sup> ICANN. (Updated 10 June 2013) Continuing Operations Instrument: Unconditional Withdrawal of Funds. Retrieved from <http://newgtlds.icann.org/en/applicants/advisories/coi-withdrawal-05dec12-en>

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considered within evaluation. Additionally, the vast majority of applications received CQs, and for Question 50 (Continued Operations Instrument) in particular, 82% of applications received a CQ.

For future rounds, alternative approaches to the Financial Capability evaluation should be explored. For example, consideration should be given to whether a third-party certification (comparable to an audit performed by a certified auditor) would satisfy the intent of GNSO Recommendation 8 and provide for the flexibility to evaluate various applications' business models. ICANN should also review the CQs issued and consider whether criteria could be developed that would require less clarification among the evaluation panel, ICANN, and applicants.

In summary:

**2.7.a** Consider whether an alternative approach to the Financial Capability evaluation would be worthwhile

**2.7.b** Review Financial Capability CQs and responses to determine whether improvements to the application questions can be made