Background: Financial Questions Principles

Current policy new policy guidelines include "Recommendation 8: Applicants must be able to demonstrate their financial and organizational operational capability"

Threats being addressed include:
- o Insolvent registry
- o Lack of market performance
- o Parent company extinction or business line closure
- o Unwillingness to provide financial statements to contract due diligence
- o Applying to more TLDs that one can handle

In discussing what other ways can be used to address those threats, some possibilities like current financials have not gained support since unprofitable (at a moment time) or start-ups wouldn't be able   to   apply.

A deterrence effect of having financial evaluation was also mentioned but hasn't been tagged as existent and useful or not addressing the above threats.

Background: 2012 Initial Evaluation

2012 Financial Evaluation was based on questions and responses, including a standard financial template. They were:
- o Q45: Financial Statements
- o Q46-Q49: Projections template, funding and costs, contingency planning
- o Q50: COI (Continued Operation Instrument)

Despite supplemental notes before and during application submission, 90% of applications received CQs (Clarification Questions). It also assessed each application individually, not considering that applications from what would become the same registry could both share synergies and limitations across a TLD portfolio.

All questions were deemed confidential so their responses were not published; besides verifying financial capability, those responses were cross-checked with registry services and technical questions responses, to verify whether the proposed services or resources were budgeted for.

All applications passed eventually, but 25 failed initial evaluation. They can be divided in:
- o 2 failed multiple financial and technical questions
- o 18 failed Q45 (Financial Statements) – See note #1
- o 2 open TLDs and 1 brand TLD failed Q50 (Contingency Planning) – See note #2
  - ▪ Likely a fail to get a funding commitment from officers
- o 1 GeoTLD failed Q48 (Funding and Revenue) – See note #3

1 Why so many failures of Financial Statements? Unwillingness to provide such statements to an unknown (to applicants) organization (ICANN) and issues with disclosure guidelines of publicly traded companies are two of the possibilities.
2 These 3 TLDs likely failed to get a funding commitment from officers
3 That TLD currently has 14k registrations and seems profitable. Were they punished for not wanting to make a guess on sales and revenues?

Background: 2012 Program Review Feedback

ICANN itself suggested "Consider whether an alternative approach to the Financial Capability evaluation would be worthwhile"; that suggestion was in line with CC2 comments, so there is both a community consensus and ICANN Org support for a complete revamp of the financial evaluation. So while ICANN also suggested "Review Financial Capability CQs and responses to determine whether improvements to the application questions can be made", it was agreed that this wouldn't be of much use.

Policy Proposals: Introduction

The four financial evaluation models below are listed in complexity order, from the simpler to the more complex ones. Such order does not reflect any type of preference from work-track members so far.

Policy Proposal: Straw-Mushin

Some CC2 comments suggested ditching financial model evaluation (Q46-Q49); some CC2 comments suggested removing financial statements request, as Q45 was also one that made some applicants fail initial evaluation.

A consensus merge of all suggestions would be to not require anything; for its simplicity, this model was called Straw-Mushin, a Zen expression meaning "the mind without mind".

That wouldn't prevent ICANN Org from requiring financial statements or any other documents it sees fit for due diligence at contracting time; they would only not be part of the evaluation process and, consequently, contention set resolution.

Draft language to this model has been proposed as:
"Applicant will certify that funding for at least the critical registry services will be available even in worst-case scenarios.
ICANN Org will provide sample financial spreadsheets of common registry models (Brand TLDs, Current ROs adding more Open TLDs, new ROs applying for Open TLDs) for applicants to make informed decisions before making such commitment.

ICANN Org will provide before application process an initial non-exhaustive but believed to be complete list of financial documentation that will be required for contracting "

Possible advantages of this model include streamlining the process, reducing application fee, reducing application evaluation time, increasing evaluation throughput, more easily providing fairness among applicants regarding application results reveal, and decreasing how many people would have access to sensitive information.

Possible disadvantages of this model include approving an application that won't meet requirements and be able to sign a contract, not disqualifying weak applications whose only goal was to obtain money in contention set resolution and not being useful as cross-check of technical and registry services responses.

Precedents for self-assessment in other industries exist even when dealing with sensitive customer data, like Payment Card Industry (PCI) levels 2 to 4 SAQs (Self-Assessment Questionnaires).

Possible cross-implications with application fee floor and application support, being defined by other work-tracks, were agreed as existent.

Policy Proposal: Straw-Bee

When the Straw-Mushin model was presented, there were some that found the Straw-Mushin model too simple. The most mentioned item was financial statements, so the compromise model would be to ask for financial statements, not for a financial model. That would bring the following draft language:
"Applicant will certify that funding for at least the critical registry services will be available even in worst-case scenarios.
ICANN Org will provide sample financial spreadsheets of common registry models (Brand TLDs, Current ROs adding more Open TLDs, new ROs applying for Open TLDs) for applicants to make informed decisions before making such commitment.
Financial documentation such as statements, or reason for not having such like being a newly incorporated company, will be requested as part of the application process"

Compared to the Straw-Mushin, it carries most of the advantages, except for having more reviewers accessing sensitive, but usually not that sensitive, financial statements. Besides eliminating companies unwilling to provide financial statements, it would carry similar disadvantages to the Straw-Mushin.

Policy Proposal: Straw-Beetle

Detailed information of that proposal hasn't yet been made available, but one possible difference to Straw-Bee would be to replace self-certification of financial model with outside expert certification. In this case even though the financial model still wouldn't be sent to evaluation, a

third-party certification would be. Considering the lack of details on this proposal, it's suggested that tweaks to Straw-Bee are concentrated to this model in order to have a meaningfully different model when WT4 members have to choose among them.

Policy Proposal: Straw-Cookie Monster

A healthy (no chocolate chips), traditional perspective that balances an applicant's ability to demonstrate their financial and operational capabilities, with the flexibility to use alternative financial models to ensure the applicant can meet the registry agreement terms.

Such an approach would utilize data gathered from the first round to yield insights that can support prudent business practices amongst new TLD applicants while better protecting against the most egregious TLD failures.

Key principles supported in this proposal include: strong financial and operational business practices; accountability on the part of TLD applicants and ICANN; continuous process improvement to better support subsequent TLD rounds.

Please note that discussion of the COI has been put aside for this proposal.

Applications with No Expectation of Revenues

Expenditure Template: Applications with no expectation of revenues such as brands should have a simplified template that reflects direct or increased costs related to the operation of a registry.

Applications with Projected Revenues

Reduce the rigidity of the financial projections by providing applicants with alternate methods to demonstrate their financial capabilities:

A. Basic Financial Templates: Utilization of financial projection templates as per the Applicant Guidebook
B. Custom Financial Templates: Flexibility to submit their own financial model – acknowledge this could be more cumbersome to review but providing the option would be beneficial to all stakeholders. Allowing for the upload of Excel files should also be considered as it would assist in understanding the model.
C. Professional Endorsement: Endorsement from an accountant/auditor confirming the business model and resulting financial model have been evaluated and that the financial projections are aligned with the assumptions and knowledge. A sample letter outlining the expected structure and content should be provided in order to help streamline the process.

The above would provide additional flexibility in the different types of applications and evaluation methods while being receptive to innovative business models that would otherwise not fit in the standard template approach.

Stress-Test Tools

Make it easier for applicants to assess their financial projections by providing applicants with additional financial tools. Provision of an automated tool to stress-test their assumptions in a manner similar to an online mortgage calculator that utilizes registration volumes, prices etc. to evaluate the financial model. A simplified version could provide average volume of the top quartile registration volumes for the first three years in the *high* scenario, second quartile for the *most likely* scenario and third quartile for the *low*

scenario (skipping over the fourth quartile). A more sophisticated tool could include additional data fields such as registration price per year, renewal rates and related fixed and variable costs. Furthermore, functions could be added that inform the applicant to any potential issues such as funding shortfalls with *low* registration volume with *high* expenses.

Consolidated View of Multiple Applications
Evaluate the entire applicant's risk by applying a holistic risk analysis to the portfolio of applications. This could be completed based on a high/med/low rate of success of delegating all of the applications and/or evaluating whether the sum of the parts is less than the whole i.e. is the risk lower if there are multiple TLDs.

Improved Guidance
Expand guidance by including additional areas to consider in the financial commentary, including:
- Addressing losses: Action plan if projected revenues are not met and/or expenses are exceeded
- Addressing funding shortfalls: If the resulting financial model results in losses, demonstrating how the funding will be attained and paid-back.
- Applying checklists: Include checklists to assist applicants in the review of their application such as proposals/contracts for direct expenses (based on availability) such as back-end provider, escrow contracts/proposals

Policy Outcomes
1. Minimize the financial risk of applicants and in turn, ICANN.
2. Ensure applicants have realistic expectations along with a better understanding of the financial obligations of owning and operating a registry.
3. Reducing the number of clarifying questions by providing suggestions on how to improve their applications based on financial results

The also yields benefits to ICANN by ensuring quality applicants that meet the rigorous standards to operate a new gTLD for the long-term.