

ICANN

Document for Public comment – Replenishment Strategy for the ICANN Reserve Fund

This document is the second consultation paper on the Reserve Fund. It offers a strategy for the replenishment of the Reserve Fund, for consideration by the ICANN community and the public.

For information, the first consultation paper on the Reserve Fund was posted at the end of 2017 (see Section A below), and the third and final consultation paper on the Reserve Fund will be posted in the autumn of 2018 (see Section C below).

### **A - First Consultation Paper**

The ICANN Reserve Fund was created in 2007 with a target level of 12 months of ICANN's Operating Expenses. Since then, operational surpluses and investment returns have been allocated to the Reserve Fund, to progressively reach the intended target level. By 2014, the Reserve Fund had reached 11 months of Operating Expenses.

Starting in 2014, withdrawals from the Reserve Fund were made to fund the IANA Stewardship Transition ("Transition") expenses. In total, US\$36 million were withdrawn for this purpose. Since 2014, successive budgets did not contribute any surplus due to the increase in ICANN's Operating Expenses, with the exception of FY18 during which ICANN Org allocated US\$5 million to the Reserve Fund. As a result of these two factors, the level of the Reserve Fund dropped significantly. Today, that level represents approximately 6 months of Operating Expenses.

Based on its fiduciary duties, and considering the significant growth and risk profile that ICANN has seen since the creation of its Reserve Fund, the Board determined that the Reserve Fund required to be reviewed, especially in light of the significant drop in its level.

The Board therefore created a working group, supported by the ICANN org, which evaluated the Reserve Fund. This evaluation led to defining an updated rationale and target level for the Reserve Fund. Considering the importance of the Reserve Fund to ICANN's financial stability and sustainability, the Board determined that public input was necessary and requested ICANN org to post the analysis performed on the rationale and target level in a first consultation paper for public comment at the end of 2017.

### **B - Agreed Target Level**

After taking into account public comments, the ICANN Board approved, during its recent meeting in Los Angeles on 4 Feb 2018, a resolution that recommended changes to the ICANN Investment Policy to include (a) an updated rationale for the Reserve Fund and (b) a

confirmation that the target level of the Reserve Fund will be set at a minimum of 12 months of Operating Expenses (See resolution <https://features.icann.org/confirmation-reserve-fund-target-level>).

### **C - Second and Third Consultation Papers**

The Board also determined that, once the rationale and target level have been updated, further work would be required to define a strategy to replenish the Reserve Fund from its current level to its minimum target level of 12 months of Operating Expenses, which is the subject of this second consultation paper on the Reserve Fund.

After the the community comments on this second consultation paper and the Replenishment Strategy has been agreed, work will commence on the mechanism required to govern access and withdrawals from the Reserve Fund. Notably, the Reserve Fund Governance (the “Governance”) should (a) achieve strict standards of compliance with the intended purpose and agreed rationale as described in the 4 Feb 2018 Board resolution, (b) contain clear definitions of authority for disbursement, and (c) include controls that allow for public transparency. The Governance will be the subject of a third and final consultation paper on the Reserve Fund and will be posted for public comments in the autumn of 2018.

### **D - Shortfall**

The most recently published level of the Reserve Fund is US\$ 70 million (as of end December 2017). Using the FY19 Draft Budget as a measurement for the 12 months of Operating Expenses, the Reserve Fund minimum level should be US\$ 138 million, resulting in a minimum shortfall between the currently published level and the minimum target level of US\$ 68 million.

### **E - Sources of funding**

The following section provides a list of the possible sources of funding that could be considered for the purpose of replenishing the Reserve Fund. The list is not an exclusive list; any alternate sourcing model proposed will also be considered:

- **Contribution from ICANN Org:** Future adopted budgets could be made to provide a contribution to the Reserve Fund on an annual basis. This would require ICANN Org to plan each fiscal year for expenses to be lower than funding by an amount explicitly designated for the purpose of replenishing the Reserve Fund. Given ICANN’s funding constraints, contributions from ICANN org to the Reserve Fund replenishment result from a reduced allocation of ICANN’s resources to its on-going activities, in order to produce a surplus that is allocated to the Reserve Fund. Such allocation is and needs to continue being the subject of community engagement and input.

- **Auction Proceeds:** ICANN currently has US\$ 104 million collected from auctions that were held as the mechanism of last resort to resolve string contention in the new gTLD program (including investment returns). This amount excludes US\$ 132 million relating to the auction of the .WEB string net of auction fees (<https://www.icann.org/resources/pages/ruby-glen-v-icann-appeal-2017-01-23-en>).
- **Leftover funds at the end of the new gTLD program:** the most recent financial projections for the new gTLD program indicate that an amount of US\$ 80 million remains designated for the purpose of covering for “hard-to-predict costs”, including legal risks. Should the program’s risks lead ICANN to incur lower expenses than the current designated amount, then funds could be left over at the end of the program.
- **Additional Funds from Contracted Parties:** either as a one-time fee entirely allocated to the Reserve Fund or as a fee increase allowing to generate on-going operational surpluses which would then be allocated to the Reserve Fund.

The various sources of funding can be combined into a multi-faceted replenishment strategy.

## **F - Guiding Principles**

The following section provides a list of guiding principles for the proposed replenishment strategy:

- i. The replenishment period must be appropriate. A very short period could prevent any material contribution from ICANN org, and a very long period could be inadequate given ICANN’s risk profile.
- ii. The ICANN org should make an annual contribution to the Reserve Fund, without impairing its ability of carrying out its on-going operational activities in support of ICANN’s mission and the community.
- iii. Any financial burden on contracted parties, and by default registrants, should be avoided.
- iv. The various comments on replenishment received during the public comment period on the first consultation paper should be taken into account.

## **G - Public Comments on the First Consultation Paper**

The following section contains a summary of the comments relating to replenishment, submitted during the recent public comment process on the first consultation paper regarding the rationale and target level of the Reserve Fund held at the end of 2017. The comments are summarized below by topic followed, for each, by the individual community members, community organizations, or members of the public who explicitly offered a comment.

- Replenishment Strategy: In support of establishing a long-term plan / strategy to replenish the Reserve Fund: ccNSO SOP Working Group, ALAC, GNSO-IPC, GNSO-BC, i2Coalition,
- Contribution from ICANN org: In support of ICANN Operations to control expenses in order to allow for allocations to the Reserve Fund: i2Coalition, RrSG, RySG, NCSG, ccNSO SOP Working Group,
- Auction Proceeds:
  - In support of using auction proceeds to replenish the Reserve Fund, without specific qualification of an amount: ccNSO SOP Working Group, Stephen Deerhake,
  - In support of using auction proceeds to replenish the Reserve Fund: RySG, for the \$36 million spent on the IANA Stewardship Transition expenses,
  - In opposition to using auction proceeds to replenish the Reserve Fund: RrSG, NCSG
- Leftover funds at the end of the New gTLD program: In support of transferring potential remaining funds from the new gTLD program: ccNSO SOP Working Group, RrSG,
- Additional Funds from Contracted Parties: In opposition of increasing fees on registrants (via contracted parties): i2Coalition, RrSG (for registrar per-domain fees).

## H - Replenishment strategy

The Board has considered the above the possible sources of funding (Section E), the guiding principles (Section F), and public comments made by the community on the first consultation paper (Section G), and proposes the following strategy to replenish the Reserve Fund shortfall of US\$ 68 million:

- The replenishment period should not exceed 5 years, in line with principle (i).
- Over the 5-year period, the ICANN Org should plan for operational savings in order to make a contribution of US\$ 15 million in total, in line with principle (ii)
- A contribution from the Auction Proceeds should be considered. The amount under consideration would be US\$ 36 million, corresponding to the total amount of withdrawals from the Reserve Fund to finance the IANA Stewardship transition.
- The remaining shortfall of US\$ 17 million (\$68m less \$15m and less \$36m above) could possibly come from one of the following sources, in no specific order of preference:
  - Contribution from leftover funds from the new gTLD program, if any.
  - Additional contribution from ICANN Org.
  - Additional contribution from the Auction Proceeds.

## **I - Assumptions**

The shortfall is unlikely to change significantly, given that the minimum target level of US\$ 138 million (equivalent to 12 months of the FY19 Operating Expenses) is likely to stabilize over the foreseeable future. Nevertheless, changes could take place as a result of increased/decreased returns on invested funds, and a future increase/decrease in ICANN's annual Operating Expenses.

As per its duty of accountability to the Community and the public, the Board welcomes input on the above strategy to inform its decision.