Request For Comment: Global Framework For Assessing Operational Risks Specific To Wireless Device Payment Plan Agreements

Analytical Contacts:
Allyn Arden, CFA, New York (1) 212-438-7832; allyn.arden@spglobal.com
John Anglim, New York (1) 212-438-2385; john.anglim@spglobal.com
Mark W O'Neil, New York (1) 212-438-2617; mark.o'neil@spglobal.com
James F Traynor, New York (1) 212-438-2627; james.traynor@spglobal.com
Farooq Omer, CFA, New York (1) 212-438-1129; farooq.omer@spglobal.com
Mark M Risi, New York (1) 212-438-2588; mark.risi@spglobal.com

Criteria Contacts:
Joseph F Sheridan, New York (1) 212-438-2605; joseph.sheridan@spglobal.com
Sarah E Wyeth, New York (1) 212-438-5658; sarah.wyeth@spglobal.com
Felix E Herrera, CFA, New York (1) 212-438-2485; felix.herrera@spglobal.com

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Request For Comment: Global Framework For Assessing Operational Risks Specific To Wireless Device Payment Plan Agreements

OVERVIEW AND SCOPE

1. S&P Global Ratings is requesting comments on its proposed criteria for assessing operational risk specific to securitizations of wireless device payment plan receivables. A wireless device payment plan agreement (wireless DPPA) allows the obligor to purchase a wireless device under which the obligor is required to make periodic payments, along with a legally separate payment obligation for a monthly cellular service fee, to the same telecommunications entity.

2. This article presents our proposed criteria for analysis that is supplemental to the criteria outlined in "Global Framework For Assessing Operational Risk In Structured Finance Transactions," published Oct. 9, 2014. This article relates to our criteria articles "Principles Of Credit Ratings," published on Feb. 16, 2011, and "Methodology: Credit Stability Criteria," published May 3, 2010. Selected criteria articles that are applicable to these securities as well as other consumer asset-backed securities (ABS) are listed in the Related Criteria and Research section at the end of this article.

3. These proposed criteria would apply to all new and existing ratings on wireless DPPA ABS.

QUESTIONS

4. We are seeking responses to the following questions, in addition to other general comments on the proposed criteria:

- What are your views on the specific assumptions and methodology we have outlined in this article?
- Are there any other factors you believe should be considered in this proposed criteria that are not already noted in this proposal?

IMPACT ON OUTSTANDING RATINGS

5. We expect that the proposed criteria will have no impact on our outstanding ratings on wireless DPPA ABS.

Key Publication Dates

- Original publication date: July 11, 2017
- Response deadline: Aug. 11, 2017
- Effective date: Immediately upon publication of final criteria
RESPONSE DEADLINE

6. We encourage interested market participants to submit their written comments on the proposed criteria, by Aug. 11, 2017, to http://www.standardandpoors.com/en_US/web/guest/ratings/rfc where participants must choose from the list of available Requests for Comment links to launch the upload process (you may need to log in or register first). We will review and take such comments into consideration before publishing our definitive criteria once the comment period is over. S&P Global Ratings, in concurrence with regulatory standards, will receive and post comments made during the comment period to www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/requests-for-comment/filter/all#rfc. Comments may also be sent to CriteriaComments@spglobal.com should participants encounter technical difficulties. All comments must be published, but those providing comments may choose to have their remarks published anonymously or they may identify themselves. Generally, we publish comments in their entirety, except when the full text, in our view, would be unsuitable for reasons of tone or substance.

PROPOSED METHODOLOGY AND ASSUMPTIONS

Overview of Global Framework for Assessing Cellular Network Related Risks for Wireless DPPA

7. Wireless DPPA receivables are generally consumer receivables. We propose to analyze them similarly to other consumer ABS (i.e., unsecured consumer loans, auto loans, etc.), but with an important difference to address the presence of a unique operational risk: the cellular network may be unavailable, or there is a prolonged disruption, in connection with the bankruptcy of the cellular network provider. In such a scenario, we believe a significant number of obligors may stop making loan payments because of the limited utility of the related phone that secures that wireless DPPA loan.

8. This unique operational risk of wireless DPPA ABS is a key distinction from typical consumer ABS. For example, we believe the level of defaults on the loans for an auto loan ABS transaction would be significantly less sensitive to the liquidation of the related auto manufacturer. For wireless DPPA loans, we believe the cellular device obligors' willingness to make loan payments depends in large part on the continued availability of the cellular service provider's network and corresponding utility of the related phone. Therefore, we propose to assess the maximum rating stress scenario under which the cellular service network will continue to function without a prolonged disruption of service to the obligor, which will determine the maximum potential rating (MPR) for a wireless DPPA ABS under these proposed criteria.

9. The proposed criteria will supplement our operational risk criteria to address the risk of a prolonged disruption in the cellular service network due to the bankruptcy of the cellular service provider. Under the criteria outlined in "Global Framework For Assessing Operational Risk In Structured Finance Transactions," published Oct. 9, 2014, (Global Operational Risk), we may determine a MPR on a structured finance issue based on the operational risk associated
with a key transaction participant (KTP). In the application of the global framework, we would generally consider the potential severity of a servicer disruption and the likelihood that the servicer could be replaced following such disruption (portability risk) to be low or moderate risk, depending on the credit quality of the receivables and other considerations, in rating scenarios that are at or below the MPR determined under these proposed criteria. Thus, the MPR for wireless DPPA will be the lower of: 1) the MPR determined under these proposed criteria; and 2) the MPR determined under the Global Operational Risk criteria for all relevant KTPs.

10. The proposed framework for determining the MPR for wireless DPPA ABS will typically be based on the cellular service network provider's business risk profile (BRP) assessment and other analytical considerations. We determine the cellular network provider's BRP according to our corporate methodology (for more information, see "Corporate Methodology," published Nov. 19, 2013).

11. The proposed framework will incorporate two assessments:

- First, we will determine the "adjusted anchor" by combining the cellular service provider's BRP, as determined according to our corporate methodology, with a financial risk profile (FRP) of "minimal".
- Second, we will consider additional key factors to assess the level of relative strengths and weaknesses of the cellular provider's business and wireless network to determine whether the MPR can be higher or lower than the adjusted anchor. We will generally limit any rating elevation above the adjusted anchor to three notches (see paragraph 18; Key Factors Considered).

**Criteria Framework**
12. This proposed criteria is a global framework for determining the MPR for wireless DPPA ABS based on an assessment of the cellular service network provider's business risk and other analytical considerations. The analysis is broken into two primary assessments:

- Step 1: Determination of the adjusted anchor.
- Step 2: Modifiers: notching assessment from the adjusted anchor.

**Step 1: Determine the adjusted anchor**

13. We typically determine the adjusted anchor as the starting point for our assessment by combining the cellular service provider's BRP, as determined using our corporate methodology, with a FRP assessment of "minimal". For providers that are members of groups (see "Group Rating Methodology," [GRM] published Nov. 19, 2013), we will use either the BRP assessment of the ultimate parent or of the provider itself, depending on the provider's importance to the group's identity and strategy. If the issuer's group status, as reflected in its GRM classification, is "core" or "highly strategic," we would use the BRP assessment of the group. If the issuer's group status is "strategically important," "moderately strategic," or "nonstrategic," we would use the BRP assessment of the issuer's stand-alone credit profile (see

14. We view the cellular service provider's BRP assessment as a key differentiating factor affecting the MPR of wireless device ABS. In our view, many of the factors that are considered in the cellular service provider's BRP assessment (e.g., market position and share, strength or weaknesses of the cellular network, brand recognition, etc.) are also differentiating factors of the continued functionality of a cellular network. Accordingly, we will use the BRP assessment as the primary factor for determining the adjusted anchor.

15. In our operational risk analysis, we assume the least amount of financial risk under the corporate matrix (see column 1 in the table below) because we believe that financial risk is less relevant when assessing whether a cellular service provider’s network will continue to operate beyond the provider's bankruptcy. While the matrix in some cases suggests a choice of two adjusted anchor assessments for a cellular service provider with BRP assessments of “fair” or better, the adjusted anchor will be based on the lower of the two assessments.

Table 1

<table>
<thead>
<tr>
<th>Financial risk profile</th>
<th>1 (minimal)</th>
<th>2 (modest)</th>
<th>3 (intermediate)</th>
<th>4 (significant)</th>
<th>5 (aggressive)</th>
<th>6 (highly leveraged)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business risk profile</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 (excellent)</td>
<td>aaa/aa+</td>
<td>aa</td>
<td>a+/a</td>
<td>a-</td>
<td>bbb</td>
<td>bbb-/bb+</td>
</tr>
<tr>
<td>2 (strong)</td>
<td>aa/aa-</td>
<td>a+/a</td>
<td>a-/bb+</td>
<td>bbb</td>
<td>bb+</td>
<td>bb</td>
</tr>
<tr>
<td>3 (satisfactory)</td>
<td>a/-</td>
<td>bbb+/bb-</td>
<td>bbb-/bb-</td>
<td>bbb-</td>
<td>b+</td>
<td>b+</td>
</tr>
<tr>
<td>4 (fair)</td>
<td>bbb/bbb-</td>
<td>bbb-</td>
<td>bb+</td>
<td>bb-</td>
<td>b</td>
<td>b-</td>
</tr>
<tr>
<td>5 (weak)</td>
<td>bb+</td>
<td>bb-</td>
<td>bb</td>
<td>bb-</td>
<td>b+</td>
<td>b/b-</td>
</tr>
<tr>
<td>6 (vulnerable)</td>
<td>bb-</td>
<td>bb-</td>
<td>bb-/b+</td>
<td>b+</td>
<td>b</td>
<td>b-</td>
</tr>
</tbody>
</table>

BRP--Business risk profile. FRP--Financial risk profile.

16. Accordingly, the matrix therefore suggests the following adjusted anchor assessment for a given BRP assessments:

Table 2

<table>
<thead>
<tr>
<th>Network Service Provider's BRP Assessment</th>
<th>Adjusted anchor(i)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excellent</td>
<td>aa+</td>
</tr>
<tr>
<td>Strong</td>
<td>aa-</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>a-</td>
</tr>
<tr>
<td>Fair</td>
<td>bbb-</td>
</tr>
<tr>
<td>Weak</td>
<td>bb+</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>bb-</td>
</tr>
</tbody>
</table>

(i) The adjusted anchor assessments listed here are based off the first column in table 1. BRP--Business risk profile.

Step 2: Modifiers - notching from the adjusted anchor

17. After determining the adjusted anchor to be used as the starting point in our analysis, pursuant to step 1, we will then assess the relative strengths and weaknesses of the cellular network provider's business and cellular network compared
to other cellular service operators in the relevant market. Based on our analysis of the key factors (see below), we may determine a MPR for the related wireless DPPA ABS that is lower or higher than the adjusted anchor. Reductions from the adjusted anchor will generally be limited by our view of the wireless network provider's creditworthiness, while increases from the adjusted anchor will generally be limited to three notches.

18. Key factors we may consider in our notching assessment include the following:

- The service provider's franchise and systemic value, as measured by brand recognition, market share (post-paid and overall), and reputation;
- The quality and attractiveness of the customer base;
- The critical nature of the cellular provider's network to the telecom infrastructure of the related market/country;
- The state of the service provider's network and wireless technology used in offering service;
- The company's spectrum position based on diversity of license bands and the amount and market depth;
- The amount of cell site coverage;
- The ownership of fiber backbone and a dense fiber network for future wireless standards; and
- Market- and jurisdiction-specific considerations.

19. In assessing the relative strengths of the above key factors, we place significant emphasis on peer comparisons with other operators within the related market. For example, if the cellular network provider related to the securitized receivables has fewer strengths based on a combination of key factors compared to other operators in the market, then the related MPR may be below the adjusted anchor. In contrast, a wireless DPPA ABS transaction associated with a wireless service provider that has significant strengths relative to other operators will generally achieve a three-notch elevation above the 'adjusted anchor'. Elevation beyond three notches will typically reflect situations where the cellular network related to the securitized receivables does not reflect the overall business that the BRP assessment is based on. This may be the case where a cellular service provider has a strong wireless network, but a BRP assessment of "satisfactory" because it is weighed down by factors outside the wireless business.

Additional considerations

20. In our view, if the cellular network is not likely to continue to function through the provider's bankruptcy, then the MPR on the related wireless DPPA ABS will be capped at the ICR on the provider. A small, regional provider that we believe would likely be liquidated for asset value in a bankruptcy is such an example.

21. The proposed criteria cannot envision or capture facts and circumstances for all wireless DPPA ABS transactions, as they apply to securitizations that encompass varying degrees of linkages to the cellular service provider. Therefore, the MPR of a specific wireless DPPA ABS transaction could be lower or higher by up to two notches than what is indicated by application of the framework (as outlined in paragraphs 11, 17, and 19) based on the risk factors or mitigants specific to a transaction and analytical judgment. For example, if the exposure period of the wireless DPPA notes is longer than five years, then we may determine a MPR that is lower than indicated by these criteria due to an increased potential for technological obsolescence. We may also determine a MPR that is higher than indicated by these criteria to the extent that the risk of a significant adverse impact on receivable performance due to a prolonged cellular network disruption is, in our view, substantially mitigated.
Appendix: Glossary

22. Table 3 includes the definitions of relevant terms for Wireless DPPA transactions:

<table>
<thead>
<tr>
<th>Relevant Terms</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wireless device</td>
<td>Devices such as smartphones, basic phones, tablets and other devices that access a wireless cellular network.</td>
</tr>
<tr>
<td>Wireless device payment plan</td>
<td>An equipment installment contract whereby wireless device customers (obligors) can purchase their devices at unsubsidized prices and repay with periodic payments.</td>
</tr>
<tr>
<td>Wireless spectrum</td>
<td>Refers to the electromagnetic radio frequencies used to transmit sound, data, and video between devices in their network. Low-band spectrum is generally better at transmitting signals over greater distances than higher frequency bands, with better penetration through physical barriers (e.g., buildings, etc.). Mid-band and high-band spectrum have more capacity to carry data at faster speeds over shorter distances, allowing wireless carriers to offer higher upload and download speeds for data-intensive applications (e.g., video streaming) for their customer base.</td>
</tr>
<tr>
<td>Cell site</td>
<td>A site where antennae and other electronic communications equipment are placed on a radio mast, tower, or other raised structure to create a cell in a cellular network.</td>
</tr>
</tbody>
</table>

### RELATED CRITERIA AND RESEARCH

#### Related Structured Finance Criteria
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables, Oct. 9, 2014
- Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013

#### Related Corporate Criteria
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

#### Related Cross-practice Criteria
- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology: Credit Stability Criteria, May 3, 2010
- Understanding Standard & Poor's Rating Definitions, June 3, 2009