



# 2016 USF Reform

## Further Implementation of the 2011 USF/ICC Transformation Order

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### Executive Summary

The Universal Service Fund (USF) was established as part of the Telecommunications Act of 1996 and provides subsidies to telecommunications providers as a means of increasing the availability and affordability of advanced telecommunications services. In 2011, significant reform was introduced, including the creation of the Connect America Fund (CAF), to help modernize the USF and promote support of these telecom services in the nation’s high-cost areas.

Now in 2016, additional reform has been announced to further transition the CAF from supporting the provision of voice services to the provision of broadband services. On March 30, 2016, the Federal Communications Commission (FCC) issued a Report and Order (the “2016 Order”) that adopts the following changes to the USF for rate-of-return carriers:

- Establishes a voluntary cost model
- Creates specific broadband deployment obligations
- Provides a mechanism for support of broadband-only deployment
- Gradually reduces the authorized rate-of-return from 11.25 percent to 9.75 percent
- Eliminates support in those local areas served by unsubsidized competitors
- Establishes “glide-path” transition periods for all the new changes
- Maintains the \$2 billion budget established by the 2011 Transformation Order

While the 2011 USF/ICC Transformation Order established CAF Phase I and CAF Phase II as high-cost support mechanisms for the price-cap carriers (i.e., the larger, national local exchange carriers such as Verizon and AT&T), it was not as specific about how subsidies would change for the rate-of-return carriers (i.e., the smaller local exchange carriers, including all rural local exchange carriers). In contrast, the 2016 Order focuses on the rate-of-return carriers, announces specific changes to existing funding mechanisms as well as a new funding mechanism, and provides rural telecommunications providers with greater certainty about future support.

Given the heavy reliance that many rural local exchange carriers have on USF as a source of cash flow, this new reform is potentially very meaningful and will directly affect their bottom lines and future financial performance.