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New Issue: Driver UK Master S.A., Compartment 4

Up to £2 Billion Asset-Backed Floating-Rate Notes Program

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Ratings Detail

Ratings Assigned

Class	Rating*	Amount (mil. £)	Overcollateralization and subordination (%)	Cash reserve (%)	Available credit enhancement (%)§	Interest (%)†	Legal final maturity
A 2018-1	AAA (sf)	456.5	26.5	0.97	27.47	One-month LIBOR plus 0.65%	June 25, 2028
B 2018-1	A+ (sf)	43.5	19.5	0.97	20.47	One-month LIBOR plus 1.20%	June 25, 2028
Subordinated loan	NR	108.1	N/A	N/A	N/A	One-month LIBOR plus a margin	June 25, 2028

*Our ratings address timely payment of interest and payment of principal no later than the legal final maturity date. §Includes the class B notes' subordination (for the class A notes only), a subordinated loan, overcollateralization, and a cash reserve (see "Transaction Key Features"). †Subject to a floor of zero. NR--Not rated. N/A--Not applicable.

Transaction Participants

Originator and servicer	Volkswagen Financial Services (UK) Ltd.
Arranger and lead manager	Royal Bank of Canada PLC
Seller	Volkswagen Financial Services (UK) Ltd.
Security trustee	Wilmington Trust SP Services (Frankfurt) GmbH
Corporate services provider	Circumference FS (Luxembourg) S.A.
Servicer collection account bank, transaction account bank, and cash administrator	Citibank N.A. (London Branch)
Paying agent, calculation agent, interest determination agent, and custodian	Citibank N.A. (London Branch)
Subordinated lender	Volkswagen International Luxemburg S.A.
Interest rate swap counterparty	ING BANK N.V.
Data protection trustee	Wilmington Trust SP Services (Frankfurt) GmbH

Supporting Ratings

Institution/role	Rating
Citibank N.A. (London Branch) as transaction bank account provider*	A+/Stable/A-1
ING BANK N.V.	A+/Stable/A-1

*Rating derived from the rating on the parent entity.

Transaction Key Features*

Closing date	June 25, 2018
Collateral	Auto loan receivables under loan contracts with borrowers resident in England, Wales, and Scotland

Transaction Key Features* (cont.)	
Portfolio balance (£)	621,132,246.24
Number of loans	33,495
Assets' country of origin	England, Scotland, and Wales
Transaction structure	Revolving pool, true sale
Replenishment period	24 months
New issuance	The program maximum issuance amounts according to the transaction limit are £2 billion. Further issuance of class A and B notes, either by further amounts of existing series or issuing new series, up to the maximum issuance amount will rank pari passu with the initially issued notes and will have the same levels of credit enhancement and liquidity support. Further notes can be issued with overcollateralization floor levels of 26.50% and 19.50% for the class A and B notes, respectively.
Notes redemption profile	Sequential after revolving period, switching to pro rata after additional overcollateralization builds up, subject to compliance with the transaction's performance tests.
Loan redemption profile	Straight amortizing hire purchase agreements with equal monthly installments; and personal contract plan agreements with equal monthly installments, except for the last optional installment (balloon payment).
Cash reserve	Amortizing reserve; equal to the greater of 1.2% of the class A and B notes' outstanding principal balance, and the lower of (i) 0.6% of the maximum discounted receivables balance, and (ii) the aggregate outstanding principal amount of the class A and B notes (the floor level). The reserve was fully funded at closing to mitigate any liquidity shortfalls during the transaction's life and to redeem the class A and B notes at the end of the transaction's life.

*As of May 31 2018.

Transaction Summary

S&P Global Ratings today assigned its credit ratings to Driver UK Master S.A., Compartment 4's series 2018-1 class A and B notes.

At closing, Driver UK Master used the rated notes' issuance proceeds, as well as an unrated subordinated loan, to purchase a portfolio of auto loans that Volkswagen Financial Services (UK) Ltd. (VWFS UK) originated for its customers in England, Scotland, and Wales. The proceeds were also used to fund the cash reserve.

Further issuance of class A and B notes, either by further amounts of existing series or issuing new series, up to the maximum issuance amount (£2 billion) will rank pari passu with the initially issued notes and will have the same levels of credit enhancement and liquidity support.

Table 1

Capital Structure As Of June 2018

	Balance	Receivables balance (%)	Closing overcollateralization (%)
Total class A	456,500,000	73.50	26.50
Total class B	43,500,000	7.00	19.50
Sub loan	108,100,752	17.40	N/A
Overcollateralization	13,031,494	2.10	N/A
Total receivables	621,132,246	N/A	N/A

N/A--Not applicable.

The issuer can purchase further eligible receivables during the 24-month revolving period after closing, as long as no early termination events occur. New receivables will be discounted at 6.3718%, but the issuer will purchase them at

96.0 pence to the pound (or at a 3.8% purchase price discount).

Under the transaction documents, the revolving period can be extended subject to certain conditions, including confirmation from S&P Global Ratings that it would not lead to downgrades of the class A and B notes. At the time of the extension, each class of notes can either be extended or amortized. During the revolving period, depending on certain conditions, the issuer can potentially issue further classes of notes.

The 6.3718% discount rate includes a buffer (approximately 2% at closing), which is designed to meet any cost fluctuations if the replenishment period were to be extended. Provided that VWFS UK is solvent, the buffer will be released back to VWFS UK over time, if it is not used to pay the cost of fluctuations.

Credit enhancement for the rated class A and B notes arises from a combination of subordination, overcollateralization, and a cash reserve.

Rationale

Operational risk

The originator is a wholly owned subsidiary of Volkswagen Bank GmbH (A-/Negative/A-2) (which is, in turn, a subsidiary of Volkswagen AG). In our view, the Volkswagen group's track record of stable, strong-quality asset origination is among the best of all European asset-backed securities (ABS) issuers. Our preliminary ratings on the notes reflect our assessment of the company's origination policies. There is no back-up servicer. We have reviewed VWFS UK as the servicer in line with our operational risk criteria, based on the prime auto loan assets (see "Global Framework For Assessing Operational Risk In Structured Finance Transactions," published on Oct. 9, 2014). We have concluded that operational risk does not constrain our ratings on the notes.

Economic outlook

We forecast U.K. GDP growth of 1.3% in 2018 before rebounding to 1.5% and 1.6% in 2019 and 2020, respectively. We estimate an unemployment rate of 4.5% in 2018, increasing further to 4.6% in 2019 and 2020. Our consumer price index inflation forecast for 2018 is 2.3%, which will drop to 1.9% in 2019 and in 2020 (see "Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative," published on April 27, 2018). In our view, changes in GDP growth and the unemployment rate are key determinants of portfolio performance. Based on our forecast for modest economic growth and slightly rising unemployment, we expect that U.K. auto loans performance will moderately deteriorate over the next 12 to 24 months.

Credit risk

We analyzed credit risk by applying our European auto ABS criteria (see "Methodology And Assumptions For European Auto ABS," published on Oct. 15, 2015). We have used performance data from VWFS UK's loan portfolio and from recently reviewed related transactions (Driver UK Master S.A., Compartment 2 [Series 2018-1], Driver UK Master S.A., Compartment 3 [Series 2016-1], and Driver UK Multi-Compartment S.A., Compartment Private Driver UK 2018-1) to analyze credit risk.

We have taken the transaction's revolving nature into account, as well as its limited replenishment criteria. Under our view of the worst pool composition, our gross loss cumulative default base-case assumption for the securitized pool is

1.85%, and 5.00% for voluntary terminations (VT). We applied our base-case multiples of 4.60x and 3.10x for defaults and of 2.10x and 1.73x for VT, at the 'AAA' and 'A+' rating levels, respectively. Moreover, we sized stressed recoveries of 40% for all rating levels based on recovery data from VWFS UK.

About 0.05% of the pool (by percentage of outstanding balance) relates to vehicles equipped with EA 189 diesel engines affected by the NOx emissions issue. At this stage, we consider that the stressed recovery rate assumptions cover the potential for recoveries to deteriorate due to any reduction in resale values.

The transaction is also exposed to residual values. Our loss assumption for residual values incorporates a higher market value decline (MVD) risk, considering the potential decline due to irregularities related to NOx emissions in the pool and the overall car market environment in the U.K.

We have also taken into account the credit risk from losses due to prepayments and purchase above par.

Revolving structure

Our ratings on all of Driver UK Master, Compartment 4's issuances reflect our assessment of the transactions' documented payment structures. Series 2018's tranches have the same terms and will rank pari passu with any class A and B notes issued in the future.

Cash flow analysis

We have assessed the transaction's documented payment structure. The issuer can extend the transaction's revolving period several times. The revolving period is for 24 months, if not extended. Once the revolving period ends, the transaction amortizes sequentially until certain overcollateralization targets for the class A and B notes are reached. However, the amortization between the class A and B notes and the subordinated loan switches to pro rata amortization from sequential if certain conditions (for instance, the credit enhancement increase condition not being in effect) are fulfilled, or when class-specific target overcollateralization levels are reached. Our analysis indicates that the available credit enhancement for the class A and B notes is sufficient to withstand the credit and cash flow stresses that we apply at the respective rating levels.

Counterparty risk

We have analyzed counterparty risk by applying our current counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013). We consider that the transaction's documented replacement mechanisms adequately mitigate counterparty risk.

Legal risk

The issuer is bankruptcy remote, in line with our legal criteria (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). The legal opinion received at closing indicates that the sale of the assets would survive the insolvency of VWFS UK as the seller.

In our view, the advance payment mechanism fully mitigates the transaction's commingling risk exposure. We believe that the transaction may be exposed to setoff risk, as its documented eligibility criteria for the inclusion of receivables does not exclude loans that the originator granted to its employees. We have sized this risk and incorporated the resulting loss in our cash flow modeling. We have also factored in our analysis potential losses that could arise in relation to any potential risks for vehicles affected by the emissions issue. We have sized and incorporated the resulting exposure as a loss in our cash flow modeling.

Credit stability

We have analyzed the effect of a moderate stress on our credit assumptions and their ultimate effect on our ratings on the notes. We have run two scenarios and the results are in line with our credit stability criteria (see "Methodology: Credit Stability Criteria," published on May 3, 2010).

Sovereign risk

The application of our structured finance ratings above the sovereign criteria does not cap the ratings in this transaction (see "Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016).

Strengths, Concerns, And Mitigating Factors

Strengths

- Volkswagen Financial Services (UK) is a wholly owned subsidiary of Volkswagen Bank. It has over 16 years' origination and servicing experience. It is currently the Volkswagen group's second-largest retail financing subsidiary, after its German parent company.
- The pool is granular and geographically diversified in England, Scotland, and Wales, comprising 33,495 loans. The pool has low borrower concentration risk, with the top 20 borrowers accounting for about 65 basis points. The pool is also well diversified by product type.
- Under certain conditions related to deteriorating asset performance, the transaction switches from pro rata to sequential amortization.
- The structure benefits from an amortizing cash reserve, which the issuer fully funded at closing through the purchase price discount. The cash reserve serves primarily as liquidity support to mitigate any cash shortfalls in the items of the combined waterfall up to payment of interest on the class B notes. Ultimately, it is available to repay the notes at the end of the transaction's life.
- In order to mitigate negative carry, where the cost of borrowing exceeds the return obtained from it, during the revolving period, if the issuer is not able to reinvest its cash in eligible receivables (more than 15% of the performing collateral), the notes will have to start amortizing.

Concerns and mitigating factors

- The transaction's payment structure is not fully sequential. Once certain target overcollateralization levels have been reached (and as long as they are maintained), the issuer pays principal pro rata on the class A and B notes. We have accordingly stressed cash flows for each rating level, which included modeling the potential switch from pro rata to sequential payment.
- During the revolving period, the pool's credit quality may shift, and the transaction's performance may deteriorate as a result of the substitution of amortizing assets. However, the transaction has few structural mitigants, such as a cap on used vehicles (which cannot comprise more than 50%) and certain performance triggers (see "Credit enhancement increase condition"), which would stop the replenishment period if the transaction's performance were to deteriorate substantially. Furthermore, our base-case loss assumptions take into account deteriorating credit quality due to changes in the portfolio's composition.

- Unlike most other European auto ABS transactions, the structure does not have any excess spread. VWFS UK matches the transaction's interest receipts and expenses through the discounting mechanism, and if it is solvent, it receives any remaining amounts.
- The cash reserve amortizes, subject to a floor (minimum level). This reduces protection for the noteholders as the transaction nears maturity. We have incorporated the amortizing features in our cash flow model to account for its effect on available credit enhancement.
- There are balloon loans (personal contract plan agreement [PCP] loans), which do not fully amortize with the regular installments, and therefore have a single large payment at the contract's end. Under PCP contract provisions, borrowers have the option to either pay the balloon or return the car. As a result, the transaction is exposed to market value risk in the PCP loans. Additionally, during the revolving period the exposure to balloons might increase as there is no replenishment condition limiting the exposure to balloon payments. The initial credit enhancement level is sufficient to mitigate the risk of back-loaded losses, and the potential losses on larger contract exposures at the end of the transaction. Moreover, we have applied additional stresses to address market value risk, the risk that the asset's value is lower than anticipated at the end of the contract term for PCP loans.
- The issuer is exposed to potential gross losses from VT, as permitted by the U.K. Consumer Credit Act. We have considered this when sizing the gross loss base-case assumptions.
- Of the pool, 35.45% comprises contracts related to diesel vehicles. In our view, recent debates in Europe that diesel nitrogen dioxide (NO_2) emissions are a threat to public health will add further pressure on the resale value of used diesel vehicles. We have considered this risk in our market value decline analysis.
- The transaction is exposed to commingling and setoff risk if the originator becomes insolvent. A specific advance mechanism fully mitigates commingling risk. In our cash flow assumptions, we have stressed for the set-off open exposure.
- Based on available information, we believe CO_2 related risks have significantly diminished from our initial estimation back in November 2015; nevertheless we do not consider this risk to be remote for this transaction. We have resized the remaining expected exposure in our credit analysis, and in our view the available credit enhancement is sufficient to mitigate the exposure.

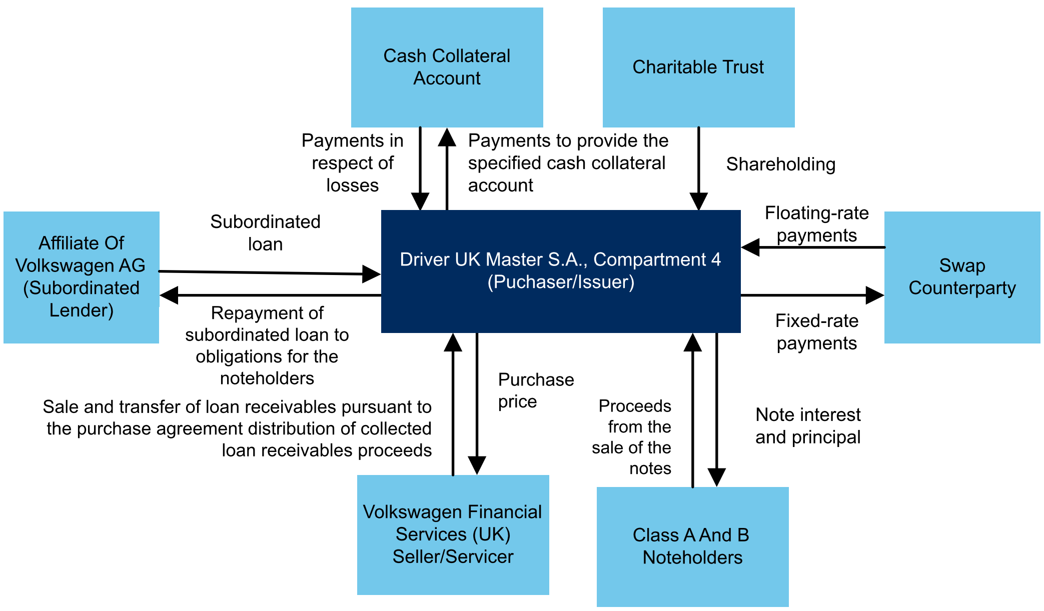
Transaction Structure

At closing, the issuer purchased a pool of auto loan receivables (see chart 1). The loan receivables are discounted at a fixed rate of interest, so that the interest available to the issuer is reduced, leaving no excess spread in the transaction. Therefore, the discount rate is equal to the sum of:

- The weighted-average fixed rate due to the swap counterparty under the terms of the swaps on the class A and B notes;
- The hypothetical swap rate due under the subordinated loan;
- The amount due to the interest compensation rate;
- The buffer rate; and
- Administrative expenses and a servicing fee.

Chart 1

Driver UK Master S.A., Compartment 4
Transaction Structure



The issuer also entered into fixed-to-floating interest swap agreements with ING Bank N.V. (A+/Stable/A-1) to hedge the risk between the fixed rate of interest paid by the assets and the floating rate of interest payable on the notes. The swaps are entered into for both the class A and B notes. The initial replacement option of the interest swap counterparty under the interest rate swap agreements can switch during the transaction's life under our current counterparty criteria, depending on the counterparty's election. At closing, the initial option chosen was option 2.

Issuer available funds

Before the issuer available funds calculation, provided that VWFS UK is solvent, the buffer release rate, of approximately 2% per annum at closing) is deducted from the interest collections and paid to the seller outside the waterfall. Based on this, the effective yield of the portfolio equals 4.37% per annum (6.37% per annum discount rate, minus buffer release rate). The buffer release could change if the revolving period were extended to compensate for changes in the interest rate in the structure. If the servicer becomes insolvent, the buffer rate will not be released and will be part of the issuer available funds.

Revolving period

During the revolving period, the issuer uses collections from the assets to purchase new receivables from the seller. The transaction revolves for 24 months ending in June 2020, as long as none of the early amortization events occur, or a credit enhancement increase condition comes into effect. The transaction's early amortization events are as follows:

- Servicer replacement event;
- On two consecutive payment dates, the amounts sitting in the issuer accumulation account exceed 15% of the non-defaulted asset balance;
- On any payment date that falls after six consecutive payment dates following further issuance, the "Actual Class A Overcollateralization Percentage," under the transaction documents, is lower than 26.50%;
- The seller fails to perform its obligations under the receivables purchase agreement;
- VWFS UK is no longer an affiliate of Volkswagen Bank, or any of its successors;
- Foreclosure event; and
- A credit enhancement increase condition is in effect.

The transaction documents set out certain eligibility criteria for the initial pool and for the subsequent subpools added during the revolving phase. The main items are as follows:

- Borrowers are resident in England, Scotland, or Wales and are not affiliated with VWFS UK. Furthermore, defaulted or insolvent borrowers are excluded.
- Receivables are denominated and payable in British pound sterling.
- No purchased receivables are overdue.
- Receivables come from valid financing contracts under the laws of England, Scotland, and Wales.
- VWFS UK is the legal and beneficial owner of the receivables.
- Receivables were originated during the normal course of VWFS UK's activities and comply with the Consumer Credit Act.
- Receivables from loans with the same borrower cannot be higher than 0.5% of the pool balance.
- No receivable is overdue and maximum original maturity is 72 months.
- The borrower must have paid at least one instalment.

In accordance with the transaction's eligibility criteria, after replenishment, the pool must comply with a concentration limit on used vehicles. We considered this in our cash flow analysis when creating the worst potential pool at the end of the revolving period. Under the documentation, used vehicles cannot exceed more than 50% of the portfolio's outstanding principal balance, after the addition of new purchases.

Originator

VWFS UK is a wholly owned subsidiary of Volkswagen Bank, a captive arm of the car manufacturer VW. VWFS UK provides financial services to support all of the Volkswagen group automotive brands (e.g., Volkswagen, Audi, Bentley, SEAT, Skoda, and Porsche). The originator cooperates closely with approximately 800 Volkswagen group dealerships.

Underwriting policy

VWFS UK checks the credit profile of the customer prior to it accepting an application. During the application process it utilizes an automated scoring system. Following this stage of the underwriting process, it then assesses information from the credit reference agencies and assesses the customer profile data.

Priority of payments

The class A and B notes pay interest in arrears on a designated date each month, at a rate of LIBOR plus a respective margin. The first interest payment date (IPD) is on July 25, 2018. The legal final maturity of the notes will be in June 25, 2028.

On each monthly IPD, the issuer applies to the priority of payments any asset collections, net swap receipts, and amounts from the cash reserve over the previous month, in the order outlined in table 2.

Table 2

Priority Of Payments (Simplified)	
1	Taxes.
2	Payments to the trustee.
3	Servicer fees.
4	Senior fees, including payments to the corporate services provider, and data protection trustee.
5	Payments to the swap counterparty (except termination payments if the swap counterparty is the defaulting party or downgraded below threshold).
6	Interest on the class A notes.
7	Interest on the class B notes.
8	Top-up cash reserve (only if drawn upon previously).
9	Class A notes' principal (sequential or pro rata).
10	Class B notes' principal (sequential or pro rata).
11	Payments to the swap counterparty not paid above.
12	Interest and principal on the subordinated loan.
13	All remaining amounts back to VWFS UK through a final success fee.

During the revolving period, once the target overcollateralization levels for class A and B notes are reached, the issuer uses the excess proceeds to pay the subordinated loan.

During the amortization period, the issuer redeems the notes sequentially until they reach the target overcollateralization levels. Once the target overcollateralization levels have been reached, the transaction switches to pro rata amortization from sequential. Moreover, the transaction switches back to sequential amortization, if there is a credit enhancement increase condition, or if the servicer becomes insolvent.

A credit enhancement increase condition becomes effective if:

- For three consecutive payment dates, the dynamic net loss ratio exceeds: (i) 0.25%, if the weighted-average seasoning is less than or equal to 12 months; (ii) 0.45%, if the weighted-average seasoning is between 13 and 22 months (inclusive); (iii) 2.009%, if the weighted-average seasoning is between 23 and 34 months (inclusive); or (iv) Not applicable, if the weighted-average seasoning is greater than 34 months.
- The cumulative net loss ratio exceeds: (i) 2.7%, if the weighted-average seasoning is less than or equal to 34 months (inclusive); or (iv) 4.0%, if the weighted-average seasoning is greater than 34 months.
- The originator becomes insolvent.
- The cash reserve falls below its required amount.

Table 3 describes the initial overcollateralization levels and target overcollateralization levels, both during and after amortization, and after a trigger breach. A target overcollateralization level of 100% implies a permanent switch to sequential amortization from pro rata, which could happen at any time after a credit enhancement increase event occurs, or if the servicer becomes insolvent.

Table 3

Overcollateralization Levels

	Actual overcollateralization (%)	Documented floor overcollateralization (%)			
Class	**At closing**	**For any new issuance**	**Revolving period**	**Amortization period**	**Breach of a credit enhancement increase event**
A	26.5	26.5	28.5	32.5	100.0
B	19.5	19.5	21.5	25.5	100.0

Further notes can be issued, subject to overcollateralization floor levels of 26.50% and 19.50% for the class A and B notes, respectively. We have therefore considered these levels for our cash flow assumptions.

Cash reserve

The issuer deposited 1.2% of the nominal amount of the class A and B notes as a general cash reserve at closing. Amounts deposited in the general cash reserve account are available to mitigate any liquidity shortfalls in the payment of senior costs and expenses, and interest on the class A and B notes. On the scheduled maturity date, the issuer can also use the cash reserve to redeem the class A and B notes. The cash reserve amortizes at the greater of: (i) 1.2% of the nominal amount of the notes' balance, and (ii) the lesser of (a) 0.6% of the pool closing balance and (b) the class A and B notes' outstanding amount. If no credit enhancement increase condition is in place, the amounts that are released from the reserve are paid directly to the subordinated loan.

Purchase at the discounted cash flow valuation

In contrast with more recent transactions that we have rated from VW, the special-purpose entity (SPE) purchases the assets at a discount as opposed to at a premium. The rationale for this is due to the discount rate in this deal (6.3718%) being greater than the weighted-average interest rate on the assets (6.26%). This discounted purchase price mitigates prepayment risk. As a result, we have not modelled a prepayment loss in our cash flow analysis as we did in those recent transactions.

Nevertheless, to mitigate any potential prepayment losses that may occur due to early redemption of a loan, the transaction has an interest compensation reserve. The reserve works by taking from the collections, each month, an amount (1.330%, multiplied by the future discounted receivables balance). The issuer then uses this amount to credit an interest compensation ledger up to a maximum limit. When a prepayment loss is recorded, then an amount equal to that loss is released from the ledger into the priority of payments. If prepayment losses are greater than what is available in the interest compensation reserve, then a debit is recorded in the ledger, which is to be cleared on subsequent payment dates. After compensating for prepayment losses and the reserve being at target level, provided that the seller is solvent it directly receives any remaining excess.

The issuer has also entered into fixed-to-floating interest swap agreements with ING BANK to hedge the risk between the assets' fixed-rate interest and the notes' floating-rate interest.

Mitigation Of Seller Risks

Commingling risk

VWFS UK as the servicer receives borrower collections. These collections are not heavily concentrated on any specific monthly day and the majority of collections are received via direct debit.

VWFS UK does not provide a declaration of trust for the issuer or security trustee's benefit connected with these collections sitting in the servicer collection bank account.

Collections from the purchased receivables are deposited in the servicer collection account. The servicer transfers received collections into the special-purpose entity's transaction account bank opened with Citibank N.A., London Branch in the issuer's name. Collections are swept monthly.

An advance mechanism will be applied to address the commingling risk if:

- Our short term rating on Volkswagen Bank falls below 'A-2';
- Our long-term rating on Volkswagen Bank falls below 'BBB+' if there is no short term rating; or
- We consider that the servicer is no longer deemed eligible.

If the conditions above are not met, the servicer advances collections expected for the following two weeks, two weeks in advance.

Therefore, the issuer always receives two weeks of expected collections in advance. Twice a month, the servicer nets collections advanced in the previous two weeks against the collections that it has actually received for the relevant two-week period. We consider that the updated mechanism fully mitigates commingling risk.

Setoff risk

VWFS UK is not a deposit taking institution, so there is no deposit setoff risk in the transaction. However, there is setoff risk from borrowers who are also the seller's employees and we have sized for this potential loss when running our cash flow stresses.

Collateral Description

As of May 31, 2018, based on the pool, the collateral pool backing the notes comprised 33,495 loan contracts (see table 3). The discount rate for the pool was 6.37%. The largest single borrower concentration was 0.04%, and the top 20 borrowers comprised about 0.65% of the pool, by discounted principal balance. The average outstanding loan balance was £18,544, rounded to the nearest pound.

There were no maintenance components in the contracts sold. Each borrower paid at least one installment. This transaction contained:

- 92.87% PCP loans, which have a larger final installment at the end of the contract. In the case of PCP loans, at contract maturity, the borrower can choose between: (i) Retaining the vehicle and making the balloon payment; or

(ii) returning the vehicle to the lender, thereby discharging all liability, directly exposing the issuer to market value risk.

- 7.13% hire purchase (HP) agreements are loans, which amortize in equal instalments.

Table 4

Collateral Distribution Of The Pool

Pool characteristics	Driver UK Master, Compartment 4	Driver UK Master, Compartment 3	Driver UK Master, Compartment 2	Private Driver UK 2018-1
Originator	VWFS UK	VWFS UK	VWFS UK	VWFS UK
Country	U.K	U.K	U.K.	U.K.
Pool cut-off date	May 31, 2018	April 30, 2018	April 30, 2018	Feb. 28, 2018
Closing date	June 2018	May 2018	May 25, 2018	March 26, 2018
Aggregate discounted principal balance outstanding (£)	621,132,246.24	600,189,835.96	5,542,036,312.70	1,250,005,566.84
Discount rate (%)	6.3718	6.3718	5.8720	5.1544
Average remaining discounted loan principal balance (£)	18,544.03	21,933.56	14,313.30	18,479.73
Weighted-average life (months)	32	21	22	30
Weighted-average original term (months)	46.46	44.54	46.44	46.25
Weighted-average remaining term (months)	43.23	26.26	28.81	40.35
Weighted-average seasoning (months)	3.19	18.25	17.58	5.84
Share of PCP	92.87	82.69	94.72	93.66
Share of HP	7.13	4.03	5.28	6.34
Share of LP	N/A	13.28	N/A	N/A
Balloon/residual value component	48.50	66.47	59.86	49.39
Share of new vehicles	66.83	61.58	74.06	67.97
Engine type				
Gasoline	64.55	50.44	52.06	56.55
Diesel	35.45	48.89	47.91	43.45
Other	-	0.67	0.04	-
EA 189 affected engines	0.05	0.34	0.51	1.76
Collection method - direct debit	99.90	99.44	99.66	99.89
Private obligor	97.11	89.49	97.24	97.04
Commercial obligor	2.89	10.51	2.76	2.96
Audi	48.32	9.66	51.41	51.49
Volkswagen	32.12	18.93	32.03	30.93
Skoda	10.05	3.17	8.90	8.79
Seat	6.59	1.72	5.59	5.64
Porsche	0.69	64.21	0.42	-

PCP--Personal contract plan. HP--Hire purchase. N/A--Not available.

Credit And Cash Flow Analysis

Our rating analysis includes an assessment of the credit risk inherent in the transaction. We analyze various stress scenarios and their effects on the transaction's cash flow by applying our European auto ABS criteria.

Credit Analysis

Managed portfolio

VWFS UK's managed portfolio shows continued decreases in 90+ days delinquencies. The balance of 90+ days delinquent contracts as a percentage of the end of month outstanding balance remained relatively stable at about 0.18% in December 2017, compared with 0.16% in December 2016.

Table 5

VWFS U.K. Managed Portfolio

	Year ended Dec. 31							
	2017	**2016**	**2015**	**2014**	**2013**	**2012**	**2011**	**2010**
No. of total retail contracts outstanding at end of the period (excluding terminations; mil.)	11,160	9,796	8,209	6,621	5,205	4,081	3,261	2,695
Delinquencies (%)*								
31-60 days	0.31	0.22	0.19	0.22	0.29	0.34	0.32	0.40
61-90 days	0.13	0.11	0.10	0.12	0.14	0.14	0.15	0.16
90-plus days	0.18	0.16	0.26	0.21	0.25	0.19	0.26	0.33
Total delinquencies	0.62	0.48	0.55	0.54	0.68	0.67	0.73	0.89
Country index 90-plus days (if available)	0.13	0.12	0.17	0.10	0.17	0.08	0.11	0.17

*As a percentage of the month-end receivables balance.

Gross losses and gross loss multiples

We received from the originator quarterly static gross loss and net loss data from September 2002 to December 2017. Charts 2 to 5 show aggregated gross losses after loans were classified by the servicer as HT or VT for HP, and PCP loans for new and used vehicles. We have analyzed four different subpools depending on the type of vehicle (new or used), or the type of loan (HP, or PCP).

Chart 2

Cumulative Gross Loss Curves: HT Total Pool

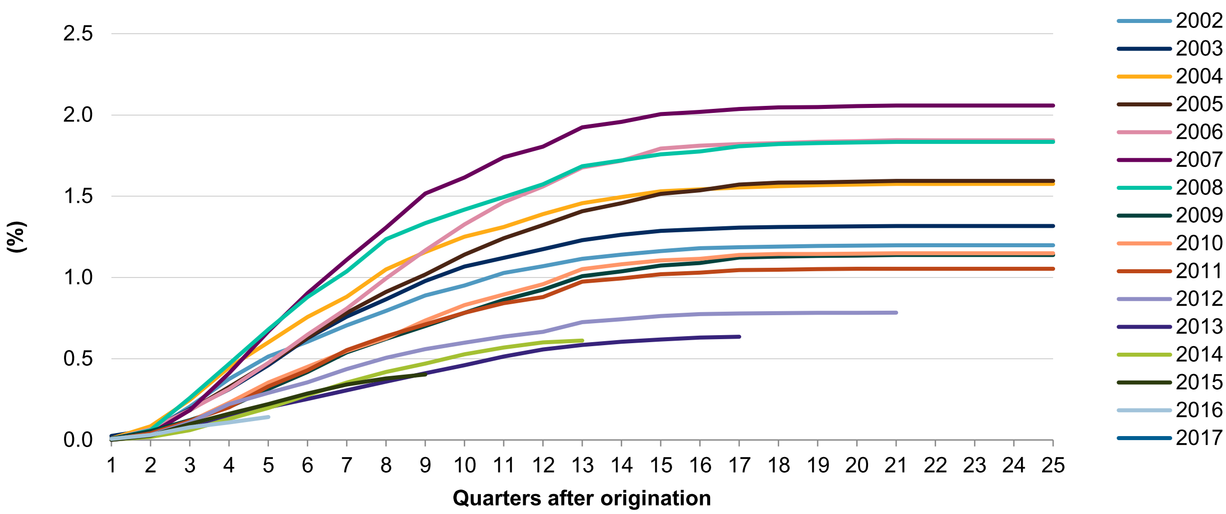


Chart 3

Cumulative Gross Loss Curves: VT Total Pool

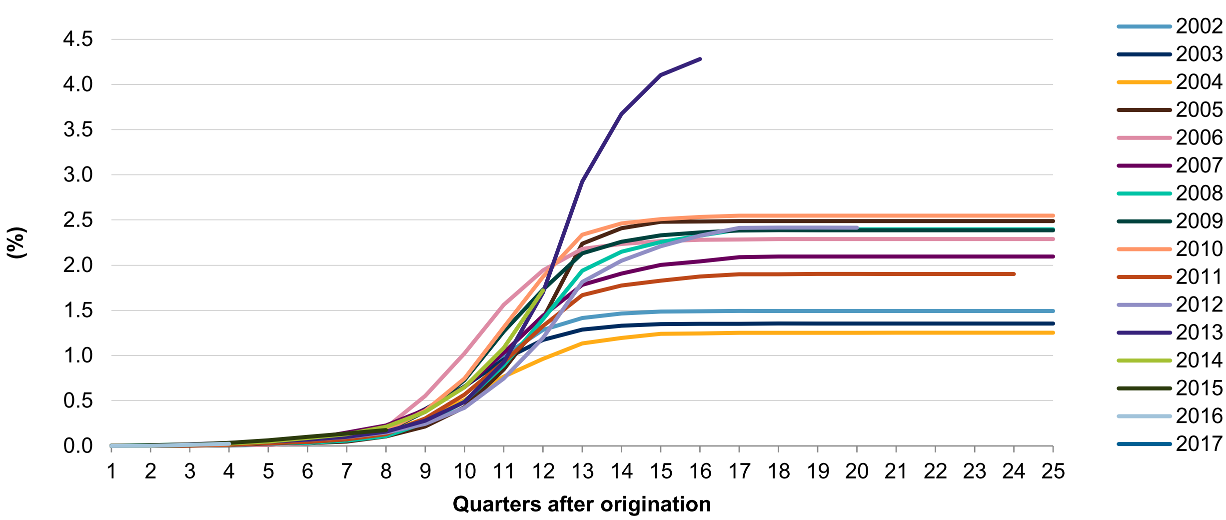


Chart 4

Cumulative Net Loss Curves: HT Total Pool

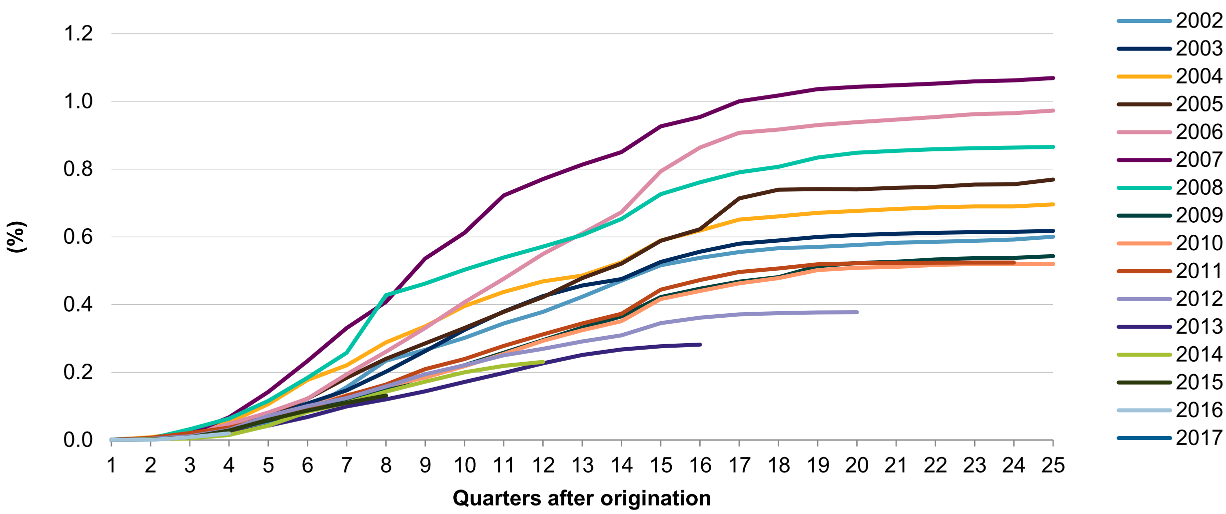
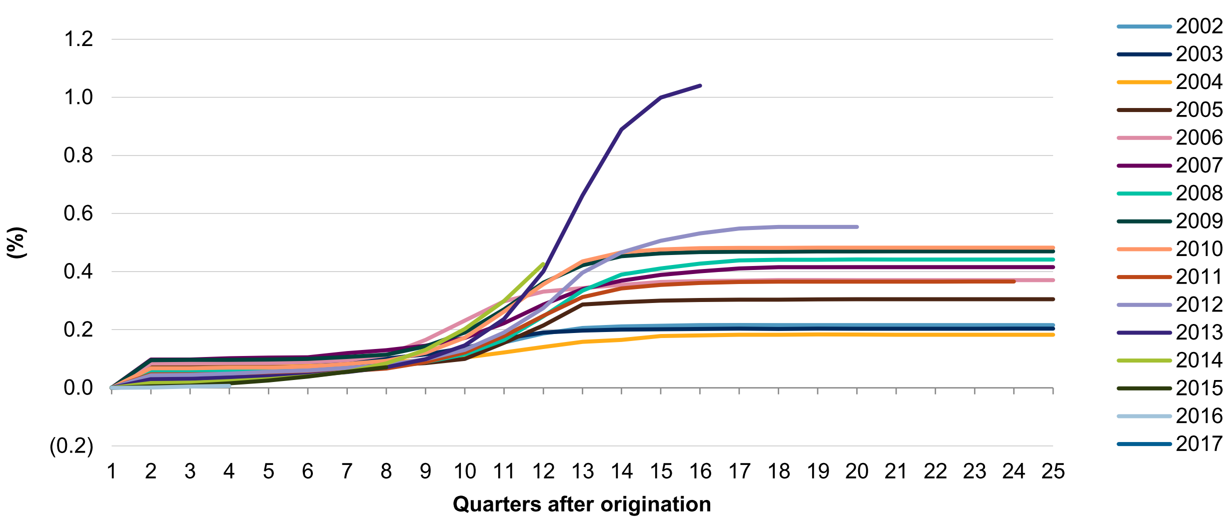


Chart 5

Cumulative Net Loss Curves: VT Total Pool



We set our gross loss base-case assumptions for a total of eight subpools split between loan type (HP or PCP), vehicle type (new or used), and gross loss type (HT or VT). When sizing our base-case gross loss assumptions we took into consideration our latest U.K. economic outlook and the performance of the outstanding Driver UK transactions. To incorporate the risk of portfolio deterioration through adverse replenishment, we have constructed a worst-case pool based on the portfolio concentration limits dictated by the eligibility criteria and have calculated the weighted-average gross loss base case for the total pool based on this, rather than on the preliminary pool composition. We set our gross loss multiples considering the originator's experience and the quality of the data provided. Table 6 summarizes our credit assumptions.

Table 6

Cumulative Gross Loss Rate And Cumulative Recovery

Subpools	Closing pool (%)	WPC (%)	Base-case gross losses (%)		Stressed recoveries for HT and VT	
			HT	VT	HT	VT
PCP new	65.54	50.00	1.30	5.00	40.00	40.00
PCP used	27.33	50.00	2.40	5.00	40.00	40.00
HP new	1.29	0.00	1.30	1.00	40.00	40.00
HP used	5.84	0.00	1.70	1.70	40.00	40.00
Weighted-average closing pool	N/A	N/A	1.62	4.76	40.00	40.00
Weighted-average WPC	N/A	N/A	1.85	5.00	40.00	40.00

HP--Hire purchase agreements. PCP--Personal contract plan. HT--Hostile terminated. VT--Voluntary terminated. WPC--worst pool composition. N/A--Not applicable.

The loss numbers in table 6 comprise both HT and VT loans. We analyzed both types of terminations separately. Under HP, and conditional sale agreements (PCP) losses incurred through VT are borne through the obligor's option, arising under the U.K. Consumer Credit Act, to hand the car back once the obligor has paid 50% of the total cost of credit. The risk of VT generally arises when obligors are in negative equity.

In relation to HTs, borrowers' credit performance has slightly improved during the last couple of years; we consider that the U.K. auto securitization performance witnessed to date may begin to weaken due to the macroeconomic environment. Our credit assumptions reflect this outlook. We have maintained our assumptions for each subpool compared with our May 2018 review for Driver UK Master Compartment 2 and Compartment 3.

On the other hand, the performance of the VTs sub-pool has deteriorated in recent years, in our view. Losses and the frequency of contracts exercising the right to voluntarily terminate have increased over the past two years. In our opinion, this is mainly due to the used car market worsening performance. The rapid expansion of the new car market after the financial crisis, particularly through PCP lending, is translating into an increasing number of used vehicles now being returned, therefore putting pressure in the used car market. Historical information for VTs that the seller provided to us confirmed this trend, and shows deterioration for the younger cohorts. We have maintained the VTs assumptions for all subpools that we used in our analysis of Driver UK Master Compartment 2 and Compartment 3.

Under our view of the worst pool composition, our gross loss base-case assumption for the securitized pool is 1.85% for HTs, and 5.00% for VTs.

We have assumed a gross loss multiple for HT receivables of 4.6x at a 'AAA' rating level and 3.1x at a 'A+' rating level. We have assumed a multiple of 2.1x for VT receivables at a 'AAA' rating level and 1.73x at a 'A+' rating level. This has decreased to 4.5x and increased to 2.0x at the 'AAA' rating level in Driver UK Compartment 2 for HTs and VTs, respectively. The higher multiples in this transaction reflect the longer revolving period than in compartment 2 (24 months versus 12 months). We stressed PCP residual value risk as an additional loss to the figures in table 7.

Table 7

Loss Multiples

Rating level	Hostile terminations-gross loss multiple	Voluntary terminations-gross loss multiple
AAA	4.60	2.10
A+	3.10	1.73

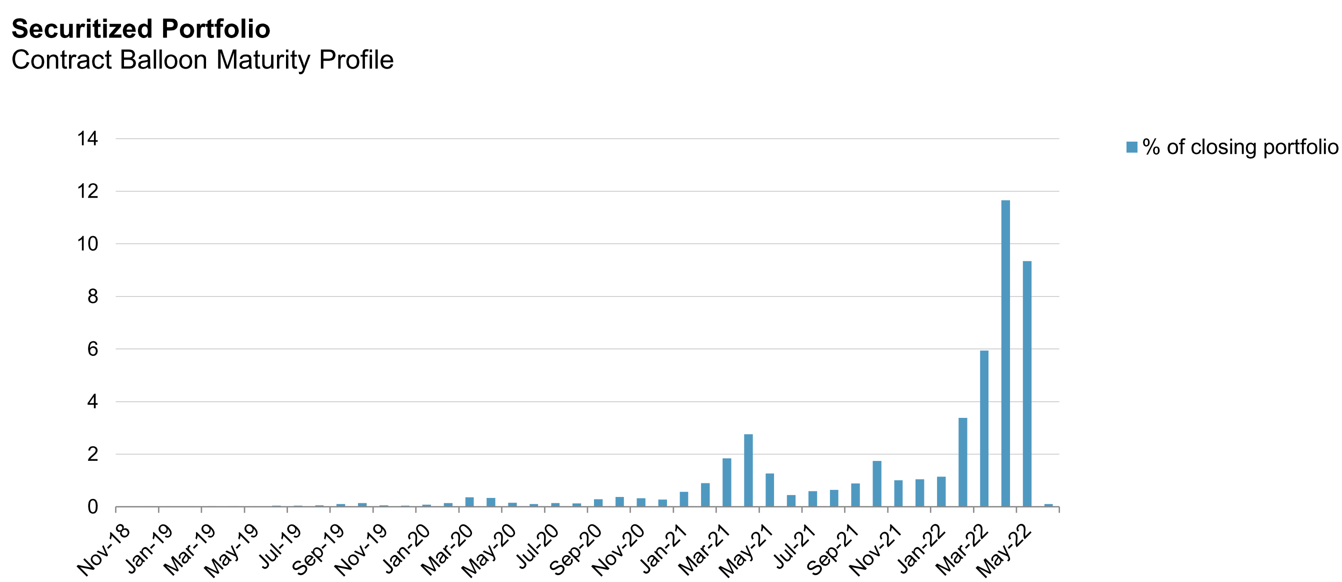
Residual value analysis

In addition to the HT (credit losses) and VT losses applied as outlined in table 5 above, we applied separate residual value losses to the balloon instalments of the PCP loans that remain after considering prepayments and the other losses. If a car dealer does not meet its obligation under the dealer repurchase agreement, the transaction would be fully exposed to residual value risk.

We assumed an adjusted MVD of 32.68% and 21.78% in our 'AAA' and 'A+' rating scenarios. These MVD assumptions reflect a softening of diesel vehicles market values (see below), fleet composition, and the originator residual value setting policy, in addition to our standard market value decline assumption.

On Feb. 27, 2018, Germany's Supreme Administrative Court ruled that states and cities may legally impose vehicle bans to try to lower NO2 air pollution levels to be in line with the limits imposed by the European Commission (EC) (see "German Diesel Ban Brings Bad Air For Carmakers And Auto ABS," published on Feb. 28, 2018). Diesel restriction proposals have also arisen in other jurisdictions. For example, the U.K. government has recently proposed a clean air zone framework. In addition, on May 17, 2018, the EC referred six European states, among them the U.K., to the EU Court of Justice for failing to respect air quality limits and for failing to take appropriate measures, further increasing the likelihood of measures like vehicle bans. We consider diesel vehicle resale values could suffer from this public debate, potentially eroding recoveries and residual value cash flows.

Chart 6



Recovery timings and recovery rate haircuts

Recoveries comprise of a combination of vehicle sale proceeds and ancillary payments (invoices, guarantees, etc.) received from the borrowers. The originator has provided monthly static cumulative recoveries data from January 2005 to December 2017. In a similar manner to gross losses, we have assigned base-case recoveries to eight subpools split between loan, vehicle, and gross loss type as shown in table 5.

We have set our base-case assumptions with a recovery period of 12 months.

No title over the equipment

The issuer does not have any rights over the vehicles itself, but only in connection with the sale proceeds of the assets. Accordingly, if the seller becomes insolvent, the issuer relies on any insolvency official taking appropriate steps to sell the assets. Because the sale proceeds have been assigned to the issuer, the insolvency official does not have any financial incentive to take such steps as it does not benefit the bankruptcy estate's creditors.

This risk is mitigated by the inclusion, at a senior level in the priority of payments, of an insolvency administrator's incentive fee.

In our analysis, to account for this risk, we considered that 2% of recovery proceeds would have to be paid to the insolvency administrator. We consider this level is sufficient to incentivize the insolvency official.

Cash Flow Analysis

In our cash flow modeling, we did not consider the revolving period, and so we analyzed the transaction's cash flows only during the amortization stage.

Table 8

Cash Flow Assumptions

	Class A	**Class B**
Scenario	AAA (sf)	A+ (sf)
HT cumulative gross loss (%)	8.51	5.74
VT cumulative gross loss (%)	10.50	8.63
Recession start	Closing	Closing
HT & VT cumulative gross loss curve 1 (%) (evenly distributed across 32 months)	1/32 per period	1/32 per period
HT & VT cumulative gross loss curve 2 (%) (months 4/8/12/16/20)	20/20/30/30	20/20/30/30
Recoveries (%)	40	40
Recovery lag (months)	12	12
Residual loss (applied over the survivor balloon portion after prepayment and defaults) (%)	32.68	21.78
Residual realization lag (months)	0	0
WAC (%)	4.37	4.37
WAC after compression/WAC compression (%)	4.37	4.37
Servicing fee (%)	1.03	1.03
Fixed fees (£)	100,000	100,000

Table 8

Cash Flow Assumptions (cont.)

	Class A	Class B
Other fees (%) (insolvency administrator incentive fee, as a percentage over recoveries [HTs, VTs, and RVs])	2.0	2.0
CPR high (%)	30	30
CPR low (%)	0.5	0.5
Interest up	Up from current level to 14% in 2% monthly increase	Up from current level to 14% in 2% monthly increase
Interest down	From current level to 0% in 2% monthly decrease	From current level to 0% in 2% monthly decrease
Interest flat	At current level	At current level
Commingling loss (%)	0	0
Set-off loss (%) (employee set off, other risks) applied on day 1 over closing balance	0.56	0.56
Balloon/amortizing share (%)	48.5/51.5	48.5/51.5

HT--Hostile termination. VT--Voluntary termination. WAC--Weighted-average coupon. RV--Residual value. CPR--Constant prepayment rate.

We applied two different default curves distributed over a 32-month period (equivalent to the weighted-average life of the pool). We stressed the prepayment rates and ran interest rate scenarios at the current levels, down to 0% and up to 14%. We have also considered losses coming from prepayments due to asset price revaluations.

We also tested a negative interest rate scenario on the interest rate swaps, as the floating leg of the swaps does not contain a floor. We considered the exposure to negative interest rates for the amounts held in the issuer accounts, mainly collections and the cash reserve.

We have assumed asset yield to be equal to the discount rate net of the buffer component set out in the transaction documents, and have not sized any further coupon compression.

The model incorporates the payment structure including the sequential/pro rata amortization feature of the notes and the cash reserve's amortizing nature.

Our analysis indicates that the available credit enhancement for the class A and B notes is sufficient to withstand the credit and cash flow stresses that we apply at the 'AAA' and 'A+' rating levels, respectively.

Our ratings address not only the availability of funds for the full payment of interest and principal, but also the timeliness of these payments in accordance with the terms of the rated securities.

Scenario Analysis

This scenario analysis section incorporates:

- A description of our methodology and scenario stresses,
- Results of the effects of the stresses on ratings, and
- Results of the effects of the stresses on our cash flow analysis.

Methodology

When rating European auto and consumer ABS transactions, we have developed a scenario analysis and sensitivity-testing model framework. This demonstrates the likely effect of scenario stresses on the ratings in a transaction over a one-year outlook horizon. For this asset class, we consider scenario stresses over a one-year horizon to be appropriate, given the relatively short weighted-average life of the assets backing the notes. For these types of securities, there are many factors that could cause the downgrade and default of a rated note, including asset performance and structural features. However, for the purposes of this analysis, we focused on the three fundamental drivers of collateral performance, namely:

- Gross loss rate;
- Recovery rate; and
- Prepayment rate.

Given current economic conditions, the proposed stress scenarios reflect negative events for each of these variables. Increases in gross default rates could arise from a number of factors, including rises in unemployment and company insolvencies, together with falls in house prices and a reduction in the availability of credit. In addition, these effects would most likely cause collateral recovery rates to fall as the structural imbalance between supply and demand leads to reductions in asset prices. In this environment, we also expect prepayment rates to fall as fewer refinancing options leave obligors unable to prepay finance agreements and demand for replacement vehicles falls.

For this analysis, we have included two stress scenarios to demonstrate the transition of a rating on the notes (see table 9).

Table 9

Scenario Stresses

Rating variable	Scenario 1 (relative stress to base case)	Scenario 2 (relative stress to base case)
Gross loss rate	30.0	50.0
Recovery rate	(30.0)	(50.0)
Constant prepayment rate	(20.0)	(33.3)

We intend our base-case assumptions for each transaction to be best estimates of future performance for the asset pool. Our approach in determining these base cases would take account of historically observed performance and an expectation of potential changes in these variables during the life of the transaction. The sensitivity of rated notes in each transaction will differ depending on these factors, in addition to structural features of the transaction including its reliance on excess spread, payment waterfalls, and levels of credit enhancement at closing.

For each proposed scenario stress, we separate the applied methodology into three distinct stages. In the first stage, we stress our expected base-case assumptions over a one-year period to replicate deviations away from our expected performance over the stress horizon. We assume that the stresses that we apply occur at closing, and apply gross losses based on our expectation of a cumulative default curve for the pool.

The second stage applies our usual rating methodology, including revising our base-case assumptions at the one-year horizon to reflect the assumed deviations as a result of the stressed environment.

In the final stage of the analysis, we re-rate the transaction at the one-year horizon, after revising our base-case assumptions and applying our standard credit and cash flow stresses at each rating level. The output of the analysis shows the likely rating transition of the rated notes, given the applied stresses and the value and timing of any forecasted principal and interest shortfalls under the most stressful scenario.

Scenario stress and sensitivity analysis

When applying scenario stresses in the manner described above, we intend the results of this modeling to be a simulation of what could happen to the ratings on the notes for the given transaction. For the purposes of our analysis for this transaction, we applied the two scenarios described above in our cash flow modelling. Tables 10 and 11 show the implied base-case stresses and scenario stress results.

Table 10

Scenario Stresses

Horizontal stress of 12 months

Rating variable	Base-case	Scenario 1	Scenario 2
Gross loss rate (HT)	1.85	2.50	2.90
Recovery rate (HT)	40.00	28.10	20.10
Gross loss rate (VT)	5.00	6.50	7.50
Recovery rate (VT)	40.00	28.10	20.10
Constant prepayment rate	10.00	8.00	6.70

HT--Hostile termination. VT--Voluntary termination.

Table 11

Scenario Stress Analysis: Rating Transition Results

Scenario stress	Class	Initial rating	Scenario stress rating
Scenario 1	A	AAA (sf)	AAA
	B	A+ (sf)	A+
Scenario 2	A	AAA (sf)	AA
	B	A+ (sf)	A

Where interest or principal shortfalls occur under the most senior notes, the holders of these notes and/or the trustee can call an event of default. This could lead to multiple events, such as the swap terminating (with the issuer needing to make termination payments), and the post-enforcement priority of payments being applied. All of these events would have an effect on the transaction's cash flows. For the purposes of the analysis above, we make a simplified assumption that the trustee will not call an event of default.

Monitoring And Surveillance

As part of our ongoing surveillance of this transaction, we regularly assess:

- The performance of the underlying pool, including defaults, delinquencies, and prepayments;
- The supporting ratings in the transaction; and
- The servicer's operations and its ability to maintain minimum servicing standards.

Related Criteria

- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 8, 2016
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- Criteria - Structured Finance - ABS: Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables, Oct. 9, 2014
- Criteria - Structured Finance - General: Global Framework For Cash Flow Analysis Of Structured Finance Securities, Oct. 9, 2014
- General Criteria: Methodology Applied To Bank Branch-Supported Transactions, Oct. 14, 2013
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Criteria - Structured Finance - General: Global Derivative Agreement Criteria, June 24, 2013
- Criteria - Structured Finance - General: Criteria Methodology Applied To Fees, Expenses, And Indemnifications, July 12, 2012
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- Criteria - Structured Finance - General: Standard & Poor's Revises Criteria Methodology For Servicer Risk Assessment, May 28, 2009

Related Research

- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 27, 2018
- EMEA March 2018--Trade And market Volatility Threaten To Overshadow Brexit, March 28, 2018
- German Diesel Ban Brings Bad Air For Carmakers And Auto ABS, Feb. 28, 2018
- Summary: Volkswagen AG, Dec. 6, 2017
- Hope Overcomes Fears As The Fundamentals Propel Europe Forward, Dec. 5, 2017
- 2017 EMEA ABS Scenario And Sensitivity Analysis, July 6, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- European Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic

Factors, Dec. 16, 2016

- How We Rate And Monitor EMEA Structured Finance Transactions, March 24, 2016
- Recent Volkswagen Announcement Has Potential To Affect Related ABS Transactions, Oct. 2, 2015
- S&P Comments On Possible Effect Of A Higher Court's Ruling On Certain German Auto Leasing Contracts, Sept. 2, 2013
- Scenario Analysis: Gross Default Rates And Excess Spread Hold The Answer, May 12, 2009