

VOLKSWAGEN FINANCIAL SERVICES

THE KEY TO MOBILITY

REMUNERATION REPORT

OF THE FINANCIAL HOLDING GROUP OF VOLKSWAGEN FINANCIAL SERVICES AG
IN ACCORDANCE WITH SECTION 16 OF THE INSTITUTSVERGÜTUNGSVERORDNUNG
(GERMAN REGULATIONS GOVERNING REMUNERATION AT INSTITUTIONS, INSTITUTSVERGV)
IN CONJUNCTION WITH ARTICLE 450 OF REGULATION (EU) NO. 575/2013 (CRR)
AS OF DECEMBER 31,

2016

Remuneration Report of Volkswagen Financial Services AG

Volkswagen Financial Services AG (hereinafter VW FS AG) and Volkswagen Bank GmbH are subject to supervision by the European Central Bank (ECB). VW FS AG, the parent entity in the financial holding group, must therefore implement the Institutsvergütungsverordnung (InstitutsVergV – German Regulations Governing Remuneration at Institutions) as amended December 16, 2013 throughout the group. Under section 16(1) of the InstitutsVergV, VW FS AG must disclose information regarding its remuneration policy and practices. The disclosure obligations are based on article 450 of Regulation (EU) No. 575/2013 (CRR – Capital Requirements Regulation). Article 450 of the CRR specifies that certain quantitative and qualitative information must be disclosed for those categories of staff whose professional activities have a material impact on the risk profile of the organization (such staff being referred to as “risk takers”). This remuneration report includes the relevant information for fiscal year 2016.

Reporting is on an accrual basis. In other words, the report covers details of payments relating to expenses that were incurred in fiscal year 2016. It therefore also includes payments, such as payments of variable remuneration, that were made in 2017 but that were incurred in fiscal year 2016. The reporting relates to those employees whose variable remuneration is not governed by or based on a collective agreement. The remuneration report is published on the website of VW FS AG.

REMUNERATION GOVERNANCE

The senior management team, which comprises the members of the Board of Management of VW FS AG and the directors of the institutions, is responsible for the design of the employee remuneration system. The remuneration of the members of the Board of Management is specified in their respective employment contracts and is the responsibility of the Supervisory Board.

VW FS AG follows the management remuneration system operated by Volkswagen AG. The basic principles of this system are enshrined in writing in organizational policies and are reviewed each year by VW FS AG to ensure that they remain appropriate. A report on the design of the remuneration system and its appropriateness is also submitted once a year to the Supervisory Board of VW FS AG. The Remuneration Control Committee, which was set up in 2014 to address and implement the requirements specified in the InstitutsVergV and deal with various other matters, comprises three members and held three ordinary meetings in the reporting year. Additionally, there was one extraordinary meeting. After consulting the Supervisory Board, the Board of Management appointed a Remuneration Officer and a deputy for the VW FS AG financial holding group. The primary responsibility of the Remuneration Officer is to ensure that there is appropriate, permanent and effective monitoring and control of the remuneration systems and employee remuneration.

The works council agreement on variable remuneration, which was drawn up in cooperation with employee representatives to implement the special requirements laid down in the InstitutsVergV, establish a common understanding and create more transparency for employees, was also applied in 2016.

BASIC PRINCIPLES OF REMUNERATION

The remuneration strategy and systems aid implementation of the business and risk strategy and are geared toward ensuring the sustainability of the business model. This fosters a responsible and risk-conscious approach by employees.

The remuneration system forms an important basis for one of the areas of activity in the ROUTE2025 corporate strategy, namely the positioning of the company as a top employer. The competitive, performance-oriented remuneration system enhances the appeal of VW FS AG as an employer and is part of the HR strategy, enabling the company to attract the best applicants and to nurture its employees, providing them with professional development on a systematic and targeted basis. The system also helps to ensure that the company has adequate human resources in terms of both quality and quantity.

The remuneration system comprises fixed and variable components. There is a reasonable ratio between the components, ensuring that there are no incentives to take excessive risks. The fixed ratio between fixed and variable remuneration introduced in 2014 continued to be applied in 2015. Generally speaking, the maximum ratio is 1:1. In this regard, the sole shareholder made a decision in accordance with section 6 of the InstitutsVergV in conjunction with section 25a(5) sentence 5 of the Kreditwesengesetz (KWG – German Banking Act) that there will be a maximum ratio of 1:2 between the fixed and variable remuneration components for the members of upper management and top management, and the senior management team. These details have been communicated to the German Federal Financial Supervisory Authority (BaFin).

The remuneration systems are designed such that they are not in conflict with the monitoring functions of the control units (e.g. risk management, compliance, back office, internal audit and HR). Overall, remuneration in the control units focuses on the fixed remuneration component, enabling these units to have an appropriate level of human resources in terms of quantity and quality.

As a rule, employees at VW FS AG are not awarded any guaranteed variable remuneration. Exceptions may be agreed in justified individual instances and in compliance with section 5(6) of the InstitutsVergV.

VW FS AG recognizes a provision for variable remuneration in the fiscal year to which it is attributable based on the accrual principle. Variable remuneration is only measured and paid out when the criteria specified in section 7 of the InstitutsVergV have been satisfied at group level and it has been firmly established that VW FS AG, including its subsidiaries, has generated positive overall earnings for the fiscal year concerned. Risk-bearing capacity, multi-year capital planning and financial performance are taken into account. VW FS AG must ensure that it has adequate capital and liquidity, and that it maintains over the long term, or re-establishes, compliance with the combined capital buffer requirements in accordance with section 10i of the KWG. The total amount of variable remuneration comprises the variable remuneration at VW FS AG and the equivalent remuneration at all the subsidiary institutions in the group.

REMUNERATION SYSTEM

The remuneration system comprises fixed and variable remuneration components (personal performance bonus and company bonus), ancillary benefits, occupational pension benefits and a group bonus, which depends solely on the performance of the Volkswagen Group. VW FS AG pays appropriate remuneration at standard market rates.

The remuneration framework is based on the significance of the role undertaken by the person concerned. It takes into account the requirements relating to specified assessment criteria applicable throughout the Group and a classification based on employee level and salary group. These categories are allocated basic salary bands and a bonus framework relevant for all the functions in these employee levels and salary groups. The remuneration structure for control functions is also based on the significance of the function in question. Action is taken to ensure that responsibilities of the same significance are given the same remuneration structure and also that there are no limitations on control activities.

When determining the levels of remuneration, any evaluation takes into account both standard market rates and the remuneration levels and structures in the Volkswagen Group to ensure that employees can transfer between the companies. The remuneration framework is structured in such a way that there is no incentive to take excessive risks.

Fixed (Non-Performance-Related) Remuneration

The individual monthly salary ensures a level of basic remuneration that is sufficient for the employees to meet their living expenses and that allows them to focus on the interests of the company without becoming dependent on variable remuneration. The basic remuneration recompenses the employees for their work.

The underlying remuneration bands are reviewed on a regular basis and adjusted if required. Within this framework, VW FS AG aims to pay remuneration at market rates to attract and retain employees with suitable skills and qualifications.

Variable (Performance-Related) Remuneration

The remuneration system rewards individuals for their contribution and enables employees to share in the success of the VW FS AG financial holding group and the Volkswagen Group as a whole. The variable remuneration within the meaning of the InstitutsVergV for salaried employees not covered by a collective agreement comprises two components: a personal performance bonus and a company bonus. The basis for variable remuneration is measured over a number of years and consists of performance at group, organizational unit and individual levels. The relevant key performance indicators and metrics are derived from the business and risk strategy and take into account the key figures specified for risk, capital and liquidity. Negative contributions to earnings reduce the amount of variable remuneration, including in situations in which employment contracts are terminated (prematurely). The bonus amount is accounted for and paid to employees after the relevant annual financial statements for the fiscal year concerned have been formally approved, generally in May of the subsequent year. The variable remuneration is granted to employees as a cash benefit; it is not a fixed component of the annual salary, but a voluntary benefit, allowing employees to share in the success of the business.

The personal performance bonus rewards employees for their individual performance in the previous year and is determined by the attainment of targets specified in an individual target agreement and by an appraisal carried out by line managers. The bonus is thus based on quantitative and qualitative factors. Following the same approach used by Volkswagen AG, the standard process of holding special meetings to agree targets applies to all managers worldwide. These meetings are used not only to determine the targets for the forthcoming fiscal year but also to evaluate the extent to which the previous year's targets have been met. They also assess how well the manager has performed in terms of professionalism, leadership and collaboration and how far the manager thinks and acts from a business perspective. The personal performance bonus is determined individually in a comparative review process from a number of angles involving the HR department, the line manager and the relevant member of the senior management team. A guidance matrix for personal performance bonuses is used as the basis for specifying the actual amounts. The matrix includes guide values for the different combinations of performance appraisal and target attainment levels, but individual interim stages are also explicitly permitted. The personal performance bonus can fluctuate within specified upper and lower limits.

The company bonus is a reward for the sustained successful performance of VW FS AG. All employees entitled to receive this bonus participate according to their individual salary group. The amount depends on the performance of the relevant group company in which the employee works and is determined on the basis of a three-year measurement period. In this way, the bonus takes account of corporate success in the long term. The amount of the company bonus is decided by the relevant senior management team and is approved by the company's sole shareholder. The figures used to determine the performance of the company are profit before tax and operating profit compared with the prior year. In a second step, the preliminary level of target attainment/company bonus is multiplied by a risk factor reflecting the utilization of the limit at group level. The risk factor is specified by the Supervisory Board and the Board of Management of VW FS AG as they reasonably see fit, taking into account the utilization of the limit. The combination of operating profit and risk factor ensures that both the financial performance over a number of years and the level of risk taken on by the company are appropriately factored into the calculation of the company bonus.

SPECIAL CONSIDERATIONS FOR RISK TAKERS

Special requirements in the InstitutsVergV apply to risk takers, i.e. those employees whose professional activities have a material impact on the overall risk profile. Each year, VW FS AG must carry out its own independent risk analysis to identify the risk takers. The risk analysis for VW FS AG is carried out both at group level and for its significant subsidiaries, VW Bank GmbH and VW Leasing GmbH.

The analysis encompasses all subsidiary institutions that have a material impact on the risk profile of the group, material business units (business units that account for a proportion of more than 2% of internal capital or of the total risk at the significant institution in question or of the total risk in the VW FS AG Group) and the branches of VW Bank GmbH and VW Leasing GmbH.

VW FS AG carried out a risk analysis in fiscal year 2016. The risk takers were identified on the basis of section 18 of the InstitutsVergV in conjunction with the regulatory technical standards in accordance with article 94(2) of Directive 2013/36/EU. In Germany, 94 employees (including 13 senior managers) were identified as risk takers in this process. Twelve other countries outside Germany were found to have a total of 86 employees in this category.

The management remuneration system operated by the Volkswagen Group is also used to measure the variable remuneration for the risk takers. The special requirements laid down in the InstitutsVergV apply to the payment of this variable remuneration. Some of it must be extended over a number of years and also linked to the long-term performance of the business. An amount of 40% of the variable remuneration for risk takers is granted immediately. The remaining 60% is deferred over a retention period of three years. In the case of members of the senior management team, the retention period is four years. If the variable remuneration computed for a fiscal year is below the exemption limit for the fiscal year specified by the competent supervisory authority (currently €50,000 gross), the bonus amount is treated as a cash amount for immediate payment. In the case of risk takers, the variable remuneration determined for a fiscal year does not give rise to the establishment of any claim for a corresponding bonus or the establishment of a corresponding entitlement. The bonus value is solely a value for use in calculations and only confers a right to have the bonus determined without error. A proportion of 50% of the portions granted or deferred depends on a sustained change in the enterprise value of VW FS AG (sustainability component). The amount paid out from the sustainability component is based on a KPI-related determination of enterprise value that reflects the changes in adjusted Tier 1 capital. It is subject to an additional holding period of twelve months.

The deferred portion of variable remuneration for risk takers is subject to a penalty review before it is paid out. It is possible for the variable remuneration to be reduced or withdrawn in full, depending on the findings of the penalty review. The senior management team decides at its discretion whether deferred tranches will be reduced or withdrawn.

DISCLOSURE OF REMUNERATION DETAILS

The details required in accordance with the disclosure obligations specified in section 16 of the InstitutsVergV in conjunction with article 450 of Regulation (EU) No. 575/2013 are presented below. The figures illustrate the fact that the remuneration is mainly fixed remuneration. The upper limit specified in 2014 has been complied with. The tables include discrepancies caused by rounding. Aggregate figures are reported in order to comply with the requirements relating to materiality, data protection and confidentiality, as specified in section 26a of the KWG.

AGGREGATED QUANTITATIVE DISCLOSURES ON REMUNERATION, BROKEN DOWN BY DIVISION

€ million	Control units	Retail banking	Other units	Asset management	Senior management	Total
Total remuneration	11.8	29.5	25.3	1.6	9.7	78.0
of which fixed	7.7	19.1	16.4	1.0	4.8	49.0
of which variable	4.1	10.4	8.9	0.6	4.9	29.0
Number of beneficiaries of variable remuneration	72	181	155	10	13	431

Four employees received more than €1 million in fiscal year 2016. The remuneration for three of these employees was between €1 million and €1.5 million, and for one of them between €1.5 million and €2 million. In addition, the Volkswagen Group granted a Group bonus for fiscal year 2016 that does not constitute variable remuneration within the meaning of the InstitutsVergV. The total of this bonus was approximately €12.1 million.

AGGREGATED QUANTITATIVE DISCLOSURES ON REMUNERATION FOR RISK TAKERS, BROKEN DOWN BY SENIOR MANAGEMENT AND EMPLOYEES

€ million	Senior management	Risk takers, Germany	Risk takers, outside Germany
Total remuneration	9.7	18.6	13.1
of which fixed	4.8	10.7	8.9
of which variable	4.9	7.9	4.2
Number of beneficiaries of variable remuneration	13	81	86

The amount of outstanding retained remuneration for fiscal year 2016 amounts to €12.7 million (including risk takers outside Germany and the senior management team). Of this total amount, €3.2 million is already vested and €9.5 million unvested.

The penalty review in respect of the deferred payments for risk takers in accordance with section 20(5) of the InstitutsVergV was applied in the 2016 fiscal year. The following deferred variable payments were granted, paid out or reduced as a result of performance adjustments:

€ million	Senior management	Risk takers, Germany	Risk takers, outside Germany
Amounts granted	0.6	1.3	0.6
Amounts paid	1.7	3.6	1.6
Amounts reduced	0.0	0.0	0.0

No guaranteed variable remuneration payment was made in connection with the appointment of a risk taker. No severance payments were made.

VOLKSWAGEN FINANCIAL SERVICES AG

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