RATING ACTION COMMENTARY

Fitch Affirms Driver UK Master S.A. - Compartment 2 Following Revolving Period Extension

Tue 26 May, 2020 - 7:52 AM ET

Fitch Ratings - London - 26 May 2020: Fitch Ratings has affirmed Driver UK Master S.A. - Compartment 2’s class A and B notes with Stable Outlooks, as detailed below.

There are two additional series not rated by Fitch - the class A series 2013-5 and class B series 2019-1.

<table>
<thead>
<tr>
<th>Class A Series</th>
<th>LT</th>
<th>AAsf</th>
<th>Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XS1322871044</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Class A Series</th>
<th>LT</th>
<th>AAsf</th>
<th>Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016-2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XS1434683998</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The transaction is a securitisation of UK auto loan receivables originated by Volkswagen Financial Services (UK) (VWFS UK). The portfolio consists predominantly of personal contract purchase (PCP) loans, and is subject to both residual value (RV) and voluntary termination (VT) risk.

The programme was established in 2013 and has a revolving master structure. The revolving period has been extended by six months, expiring in November 2020, and can be further extended subject to consent from investors. The rated notes pay floating interest linked to one-month LIBOR, while the asset pool pays fixed interest.

**KEY RATING DRIVERS**

Coronavirus Impact on Assumptions: Fitch expects defaults and delinquencies to increase beyond recently observed levels as a result of the coronavirus crisis. The short-term severity of the shock is likely to be unprecedented, but the duration should be shorter than the 2008 crisis. The scale of the impact may also be dampened by measures taken by the servicer and the UK government, which are in stark contrast to the austerity measures of 2010. Nevertheless, we view a material deterioration in performance as inevitable. The impact of the coronavirus shock is embedded in the existing assumptions, as revised in April 2020, which we have maintained: the weighted-average default base case is 1.7%, stressed with a 'AAA' multiple of 5.1x.

Recoveries from defaulted receivables are also likely to be impaired in the near term. Carrying out the repossession and remarketing process is challenging in a lockdown environment, while physical auctions have come to a halt. This
suggests downward pressure on vehicle sale proceeds. The impact of depreciation will take a toll while vehicles wait for auctions to reopen. We also expect an aftershock even once markets reopen due to the high stock of used vehicles re-entering the market. The base case recovery rate is 60%, stressed with a 'AAA' haircut at 45%. The assumption is based on a scenario where there is a short-term compression in recoveries during a period where defaults are increasing, followed by a later revival as lockdown measures are eased.

Disruptions in used car markets will also have a negative impact on RV recoveries from vehicles returned at the end of PCP agreements. However, the impact will be reduced by the asset payment profile. Although the transaction's pool is relatively seasoned, less than 15% of the total RV exposure is due in the next 12 months. The majority of PCP handbacks cannot occur within the next year, giving more time for the health crisis to subside and markets to stabilise. Fitch has accounted for this stress in its base case sale proceeds assumption of 97%. The 'AAA' RV market value decline is 35%.

There may be a greater impact from vehicles returned due to VT, as this risk can materialise before maturity. Consumer credit legislation allows borrowers to return their vehicle in lieu of any further instalments after they have paid 50% of the total amount payable. The uptake of the VT option may increase during this crisis, either due to obligors suffering financial distress or due to the weakening equity position of the borrower as car values come under pressure. However, Fitch's rating approach already accounts for the risk of VT clustering at times of used car price troughs by applying higher market value decline assumptions for VT. The 'AAA' VT market value decline assumed is 40%.

Finally, Fitch maintains a base case prepayment rate of 15%, a level comparable with that observed during the 2008 crisis. Prepayments as a result of early part-exchange will reduce for at least as long a car dealerships remain closed, while times of economic stress are usually associated with lower voluntary payments either due to lower disposable incomes or a higher propensity to save.

Liquidity Risk Mitigated: In April 2020 the FCA set out its expectation that motor finance companies should grant customers with coronavirus-related financial difficulties a three-month interest-accruing payment deferral. It is also expected that firms should not recalculate the RV of the car based on a temporary decrease in used cars prices due to the pandemic, charging more on the monthly instalments to compensate for the projected loss in car value. Firms should also not terminate the contract and repossess vehicles if the borrower needs the vehicle but is experiencing temporary payment difficulties due to the coronavirus.
Separately, VWFS UK has also made changes to its policies, including payment deferrals, payment plans of up to 12 months for borrowers in distress and other forbearance measures, and extensions to maturing PCP contracts for up to three months. A higher share of delinquent contracts, the increased prevalence of payment deferrals and delayed sale of vehicles is likely to at least temporarily reduce collections and subsequently issuer available funds. However, Fitch believes the liquidity risk is addressed by the coverage provided by the cash reserve. In addition, principal receipts can also be used to pay interest. Extended PCPs will be treated as early settled.

Sensitivity to Pro-Rata Period: The transaction features a pro-rata amortisation of notes if certain overcollateralisation conditions are fulfilled and performance triggers are not breached. The length of the pro-rata period and therefore outflow of funds to junior positions on the waterfall are driven by the lifetime losses, combined with the default and recovery timing. Lower losses with back-loaded timing may lead to a later switch back to sequential amortisation and could be more detrimental for the notes than higher losses with a front-loaded timing. As the trigger based on cumulative defaults has been removed, the transaction relies on triggers based on dynamic defaults. In high rating scenarios, we expect such triggers being breached before the target overcollateralisation is reached.

Seller-Related Risks Addressed: Commingling risk is mitigated by a cash advance mechanism that comes into effect upon the seller losing eligibility in line with Fitch's counterparty criteria. Payment interruption risk is addressed by the liquidity from the cash reserve fund, while Fitch views servicer continuity risk to be adequately reduced by the high availability of replacement servicers in the UK market.

**RATING SENSITIVITIES**

This section provides insight into the model-implied sensitivities the transaction faces when one assumption is modified, while holding others equal. The modelling process uses the modification of these variables to reflect asset performance in up- and down environments. The results below should only be considered as one potential outcome, as the transaction is exposed to multiple dynamic risk factors. It should not be used as an indicator of possible future performance.
Factors that could, individually or collectively, lead to negative rating action/downgrade:

Model-implied impact of increased default rates:

Increase default rate by 10% (class A/class B): 'AA+sf' / 'A+sf'

Increase default rate by 25% (class A/class B): 'AA+sf' / 'A+sf'

Increase default rate by 50% (class A/class B): 'AA+sf' / 'Asf'

Model-implied impact of reduced recovery rates:

Reduce recovery rate by 10% (class A/class B): 'AA+sf' / 'A+sf'

Reduce recovery rate by 25% (class A/class B): 'AA+sf' / 'A+sf'

Reduce recovery rate by 50% (class A/class B): 'AA+sf' / 'A+sf'

Model-implied impact of reduced net sale proceeds from vehicles returned due to RV and VT:

Reduce net sale proceeds by 10% (class A/class B): 'AAsf' / 'Asf'

Reduce net sale proceeds by 25% (class A/class B): 'Asf' / 'BBBsf'

Reduce net sale proceeds by 50% (class A/class B): 'BBBsf' / 'BBsf'

Model-implied impact of multiple, simultaneous stresses:

Increase defaults by 10% and reduce recoveries and net sale proceeds by 10% each (class A/class B): 'AAsf' / 'A-sf'

Increase defaults by 25% and reduce recoveries and net sale proceeds by 25% each (class A/class B): 'Asf' / 'BBB-sf'

Increase defaults by 50% and reduce recoveries and net sale proceeds by 50% each (class A/class B): 'BBB-sf' / 'B+sf'

Factors that could, individually or collectively, lead to positive rating action/upgrade:
Model-implied impact of reduced defaults and increased recoveries:

Reduce defaults by 10% and increase recoveries by 10% (class A/class B): 'AAAsf' / 'AA-sf'

Model-implied impact of increased net sale proceeds:

Increase net sale proceeds by 10% (class A/class B): 'AAAsf' / 'AA+sf'

Model-implied impact from multiple positive factors:

Reduce defaults by 10% and increase recoveries and net sale proceeds by 10% each (class A/class B): 'AAAsf' / 'AA+sf'.

Coronavirus Downside Scenario Sensitivity:

Fitch has added a coronavirus downside sensitivity analysis that contemplates a more severe and prolonged economic stress caused by a re-emergence of infections in major economies, before a slow recovery begins in 2Q21. Under this more severe scenario, Fitch tested an increased default base case of 2.5% as well as lower base case recoveries of 55%. This compares with default and recovery base cases of 1.7% and 60%, respectively in the baseline scenario. The 'AAA' default multiple is reduced 4.2x, compared with 5.1x in the baseline scenario, to reflect the higher degree of stress already included in the base case. Nevertheless, in this downside scenario we still model a material uplift even in 'AAA' default rates. Finally, a base case sale proceeds assumption applicable for RV proceeds of 95% was modelled compared with 97% in the baseline scenario. The model-implied ratings under these assumptions are 'AA+sf' and 'A+sf' for the class A and B notes, respectively.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Structured Finance transactions have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of seven notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of seven notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAAsf' to 'Dsf'. Best- and worst-case scenario credit ratings are based on historical performance. For more
information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

USE OF THIRD PARTY DUE DILIGENCE PURSUANT TO SEC RULE 17G-10

Form ABS Due Diligence-15E was not provided to, or reviewed by, Fitch in relation to this rating action.

DATA ADEQUACY

Fitch has checked the consistency and plausibility of the information it has received about the performance of the asset pool and the transaction. There were no findings that affected the rating analysis. Fitch reviewed the results of a third party assessment conducted on the asset performance information, and concluded that there were no findings that affected the rating analysis.

Prior to the transaction closing, Fitch reviewed the results of a third party assessment conducted on the asset portfolio information and concluded that there were no findings that affected the rating analysis.

Prior to the transaction closing, Fitch conducted a review of a small targeted sample of the originator's origination files and found the information contained in the reviewed files to be adequately consistent with the originator's policies and practices and the other information provided to the agency about the asset portfolio.

Overall, Fitch's assessment of the information relied upon for the agency's rating analysis according to its applicable rating methodologies indicates that it is adequately reliable.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS
The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

FITCH RATINGS ANALYSTS

Thomas Deacon
Senior Analyst
Surveillance Rating Analyst
+44 20 3530 1939
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Markus Papenroth, CFA
Managing Director
Committee Chairperson
+44 20 3530 1707

MEDIA CONTACTS

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Global Structured Finance Rating Criteria (pub. 02 May 2019) (including rating assumption sensitivity)

Fitch Ratings Interest Rate Stress Assumptions for Structured Finance and Covered Bonds (Excel) (pub. 06 Dec 2019)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 06 Dec 2019)

Consumer ABS Rating Criteria - Residual Value Addendum (pub. 11 Dec 2019) (including rating assumption sensitivity)

Consumer ABS Rating Criteria (pub. 11 Dec 2019) (including rating assumption sensitivity)

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 29 Jan 2020)
APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Multi-Asset Cash Flow Model, v2.7.0 (1)
UK Voluntary Termination (VT) Risk Model, v1.6.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

ENDORSEMENT STATUS

Driver UK Master S.A. - Compartment 2 EU Issued

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH’S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH’S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.
is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.
SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.