Moody's has assigned definitive ratings to UK auto ABS of Driver UK Master S.A., Compartment 4

25 Jun 2018

GBP 500M of debt securities rated

London, 25 June 2018 -- Moody's Investors Service ("Moody's") has assigned the following definitive ratings to Notes issued by Driver UK Master S.A., acting for its Compartment 4:

....GBP 456.5M Class A Series 2018-1 Floating Rate Asset Backed Notes due June 2028, Assigned Aaa (sf)
....GBP 43.5M Class B Series 2018-1 Floating Rate Asset Backed Notes due June 2028, Assigned A1 (sf)

RATING RATIONALE

The transaction is a revolving cash securitisation of hire purchase and Personal Contract Purchase ("PCP") receivables and related residual value cash flows extended by Volkswagen Financial Services (UK) Limited ("VWFS UK") (not rated) (fully owned by Volkswagen Bank GmbH (A3/P-1 (Senior Unsecured); Aa3(cr)/P-1(cr)) to obligors located in the UK. The revolving period ends in June 2020 for the issued Notes.

The portfolio of underlying assets consists of auto financing agreements distributed through auto dealers in the UK and will have a total amount of approximately GBP 621.1 million.

As at May 2018, the pool cut shows 33,495 contracts with a weighted average seasoning of 3.19 months.

The portfolio is collateralised by approximately 67% new cars and 33% used cars, and the vast majority of the financed vehicles are VW brands. PCP agreements constitute approximately 93% and hire purchase agreements approximately 7% of the portfolio. PCP agreements include a final balloon payment and permit obligors to return their vehicle at the end of the contract in lieu of final payment. Therefore, portfolio cash flows result from fixed periodic instalment cash flows (approx. 51%) and residual value cash flows at the end of the PCP agreement (approx. 49%). There is no guarantee that actual RV cash flows will match the expectation, since such cash flows are by their nature subject to market value fluctuations.

According to Moody's, the transaction benefits from credit strengths such as (i) the granularity of the portfolio, and (ii) financial strength and securitisation experience of the originator. However, Moody's notes that the transaction features some credit challenges such as residual value risk, a high degree of linkage to VWFS UK and commingling risk.

The revolving master structure allows for flexibility which could change the composition of the portfolio and the credit enhancement levels. Additional assets sold during the replenishment period have to comply with the eligibility criteria and the replenishment criteria. The replenishment criteria limit the share of used cars to 50% of the pool and non-VW branded cars to 10% of the pool. There are no limits on the size of RV exposure in the pool, which we have incorporated into our analysis. The structural flexibility includes (i) the increase of the Notes' balances of existing series to the maximum issuance amounts, (ii) the issuance of additional series of Notes, and (iii) the take-out of assets in order to securitize them in form of a term transaction ("term take-out").

Various mitigants have been put in place in the transaction structure, such as early amortization triggers, performance related triggers to switch to sequential amortization, eligibility criteria and provisions to ensure that the transaction is not negatively affected by the execution of the flexibility outlined above. Furthermore, rating triggers will provide additional reserves in case of a trigger breach. Collections are commingled at the issuer account during monthly collection periods. The resulting commingling risk is partially mitigated by (i) the current rating of the servicer's ultimate parent Volkswagen Bank GmbH, (ii) cash advances upon a downgrade of Volkswagen Bank GmbH, and (iii) borrower notification to pay into the issuer account upon servicer insolvency.

Moody's analysis focused, amongst other factors, on (i) an evaluation of the underlying portfolio of receivables; (ii) historical performance on defaults and recoveries from Q3 2002 to Q4 2017; (iii) the credit enhancement
provided by subordination and cash reserve; (iv) the liquidity support available in the transaction by way of the cash fund, principal to pay interest, and excess spread, and (v) the legal and structural aspects of the transaction.

Exposure to Diesel Cars: Cars with diesel engines constitute approximately 35.5% of the closing portfolio. The public and political debate about the future of diesel engines has heated up in recent months due to new proposals restricting diesel cars in various metropolitan areas in Europe. The UK government, for example, has recently proposed a clean air zone framework, which includes a minimum emissions standard that would charge diesel vehicles that do not meet EURO 6 standards of emissions. It is generally regarded that diesel engines, in particular engine types older than EURO 6, are failing to improve the air quality in metropolitan areas under actual "on the road" driving conditions. As a consequence, diesel car registrations are continuing their negative trend and the residual value premium of diesel over petrol cars is declining, which puts pressure on residual values. Transaction cash flows can be impacted in two ways: (1) Banning diesel cars in urban areas can diminish cars' attractiveness to its users, potentially putting pressure on diesel car prices and subsequently reducing recoveries and residual value cash flows. Moody's is closely monitoring developments, but at this time believes that such risks are reflected in our rating assumptions, i.e. recovery rate and residual value haircuts. (2) Obligors whose cars are banned from residential or daily commuting areas could try to challenge finance contracts. Moody's views, at this time, the risk of customer set-off rights and/or early termination rights linked to any Government or Local Authority bans on diesel cars to be marginal. Even in this case, the risk would only materialise for investors if not remedied by the seller under the transaction's representations and warranties.

MAIN MODEL ASSUMPTIONS

Moody's determined the portfolio lifetime mean loss rate of 1.35% and Aaa portfolio credit enhancement ("PCE") of 8.5% related to borrower receivables. The mean loss rate captures our expectations of performance considering the current economic outlook, while the PCE captures the loss we expect the portfolio to suffer in the event of a severe recession scenario. Mean loss and PCE are parameters used by Moody's to calibrate its lognormal portfolio loss distribution curve and to associate a probability with each potential future loss scenario in its ABSROM cash flow model to rate Auto ABS.

The portfolio expected net loss of 1.35% is lower than the EMEA auto ABS average and is based on our assessment of the lifetime expectation for the pool, taking into account (1) analysis of the historical cohort performance and historical recovery vintages, (2) the current and future macroeconomic environment in the UK, (3) benchmarking with other UK auto ABS transactions, and (4) other quantitative considerations.

The portfolio PCE of 8.5% is lower than the EMEA auto ABS average is based on the analysis of the data variability, taking into account (1) quantity, quality and relevance of historical performance data; (2) originator quality; (3) servicer quality; (4) certain pool characteristics, such as share of used vehicles; and (5) certain structural features, such as the revolving period and related replenishment criteria.

RESIDUAL VALUE RISK CREDIT ENHANCEMENT ("RV CE")

RV CE captures additional portfolio losses which would arise on the securitised RV receivables following a decline in the market prices of used cars in a severe recession environment. PCP contracts permit lessees to return their vehicle at the end of the agreement in lieu of the final payment, which is not a default and thus is not captured in the loss assumptions for the periodic installment receivables described in the previous section.

In deriving the RV CE, Moody's assumes a haircut to the portfolios forecasted used car prices of 34% for the Aaa (sf) rated Notes and 24% for the A1 (sf) rated Notes taking into account (i) robustness of RV setting, (ii) good track record of car sales, and (iii) comparatively low diversification of brands in the RV portfolio. The analysis results in an RV CE of 17.6% for the Aaa (sf) rated Notes and 13.8% for the A1 (sf) rated Notes. The sum of the RV CE and the credit enhancement for the lessee receivables, as described above, determines the total credit enhancement that is needed to be consistent with each Notes rating.

METHODOLOGY

The principal methodology used in these ratings was 'Moody's Global Approach to Rating Auto Loan- and Lease-Backed ABS' published in October 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS:
Factors that may cause an upgrade of the ratings of the Class B Notes include significantly better than expected performance of the pool together with an increase in credit enhancement of Notes.

Factors that may cause a downgrade of the ratings of the Notes include a worsening in the overall performance of the pool, or a meaningful deterioration of the credit profile of the servicers or sponsor.

The ratings address the expected loss posed to investors by the legal final maturity of the Notes. In Moody's opinion, the structure allows for timely payment of interest and ultimate payment of principal with respect to the Class A Notes and Class B Notes by legal final maturity. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed but may have a significant effect on yield to investors.

LOSS AND CASH FLOW ANALYSIS:

Moody's used its cash-flow model 'Moody's ABSCORE' as part of its quantitative analysis of the transaction. Moody's ABSCORE model enables users to model various features of a standard European ABS transaction, including the specifics of the loss distribution of the assets, their portfolio amortisation profile, yield as well as the specific priority of payments, swaps and reserve funds on the liability side of the ABS structure.

STRESS SCENARIOS:

In rating auto lease ABS, RV haircut and mean net loss rate are two key inputs that determine the transaction cash flows in the cash flow model. Parameter sensitivities for this transaction have been calculated in the following manner: Moody's tested 9 scenarios for the Class A and Class B Notes derived from the combination of RV CE: 17.6%/13.8% (base case), 18.5%/14.5%, 19.4%/15.2% and mean net loss rate: 1.35% (base case), 1.60% (base case + 0.25%), 1.85% (base case + 0.5%). The 17.6%/13.8% and 1.35% scenario would represent the base case assumptions used in the initial rating process.

At the time the rating was assigned, the model output indicated that the Class A Notes would have achieved Aa2 (sf) if the Aaa RV CE was as high as 19.4% with a mean net loss rate as high as 1.85% (all other factors unchanged).

Parameter sensitivities provide a quantitative/model indicated calculation of the number of notches that a Moody's rated structured finance security may vary if certain input parameters used in the initial rating process differed. The analysis assumes that the deal has not aged. It is not intended to measure how the rating of the security might migrate over time, but rather how the initial model output for Class A and Class B Notes might have differed if the two parameters within a given sector that have the greatest impact were varied. Results are model outputs, which are only one factor considered by rating committees that take quantitative and qualitative factors into account in determining actual ratings. Results for Class B Notes can be found in Moody's credit opinion. Parameter sensitivities provide a quantitative/model indicated calculation of the number of notches that a Moody's rated structured finance security may vary if certain input parameters used in the initial rating process differed. The analysis assumes that the deal has not aged. It is not intended to measure how the rating of the security might migrate over time, but rather how the initial model output for Class A and Class B Notes might have differed if the two parameters within a given sector that have the greatest impact were varied. Results are model outputs, which are one of many inputs considered by rating committees, which take quantitative and qualitative factors into account in determining actual ratings.

REGULATORY DISCLOSURE

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's describes its loss and cash flow analysis in the section "Ratings Rationale" of this press release.

Moody's describes the stress scenarios it has considered for this rating action in the section "Ratings Rationale" of this press release.

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