New Issue: DRIVER UK Multi-Compartment S.A., Compartment Driver UK four

£741.8 Million Floating-Rate Asset-Backed Notes (Including An Unrated Subordinated Loan)

Primary Credit Analyst:
Ignacio T Estruga, Madrid (34) 91-389-6964; ignacio.estruga@spglobal.com

Secondary Contact:
Miguel Barata, London (44) 20-7176-7132; miguel.barata@spglobal.com

Table Of Contents

Transaction Summary
Notable Features
Rating Rationale
Strengths, Concerns, And Mitigating Factors
Transaction Structure
Mitigation Of Seller Risks
Collateral Description
Credit And Cash Flow Analysis
Scenario Analysis
Table Of Contents (cont.)

Monitoring And Surveillance

Related Criteria And Research
New Issue: DRIVER UK Multi-Compartment S.A., Compartment Driver UK four

£741.8 Million Floating-Rate Asset-Backed Notes (Including An Unrated Subordinated Loan)

Ratings Detail

<table>
<thead>
<tr>
<th>Class</th>
<th>Rating*</th>
<th>Amount (mil. £)</th>
<th>Available credit enhancement (%)§</th>
<th>Interest (%)†</th>
<th>Legal final maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>AAA (sf)</td>
<td>579.0</td>
<td>24.0</td>
<td>One-month LIBOR plus 0.57</td>
<td>March 2025</td>
</tr>
<tr>
<td>B</td>
<td>A+ (sf)</td>
<td>51.8</td>
<td>17.1</td>
<td>One-month LIBOR plus 1.25</td>
<td>March 2025</td>
</tr>
<tr>
<td></td>
<td>Subordinated loan</td>
<td>NR</td>
<td>2.3</td>
<td>One-month LIBOR a margin</td>
<td>March 2025</td>
</tr>
</tbody>
</table>

*Our ratings address timely payment of interest and ultimate principal §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.

Transaction Participants

Originator and servicer: Volkswagen Financial Services (UK) Ltd.
Seller: Volkswagen Financial Services (UK) Ltd.
Co-arrangers: Volkswagen Financial Services AG and RBC Capital Markets LLC
Joint lead managers: RBC Capital Markets LLC and Lloyds Bank PLC
Managers: Commerzbank AG, DZ BANK AG, Deutsche Zentral-Genossenschaftsbank, and ING Bank N.V.
Security trustee: Wilmington Trust SP Services (Frankfurt) GmbH
Corporate services provider: Wilmington Trust SP Services (Luxembourg) S.A.
Data protection trustee: Volkswagen Bank GmbH
Bank account provider, collection account provider, paying agent, calculation agent, cash administrator, and interest determination agent: Citibank N.A., London branch
Subordinated lender: Volkswagen International Luxembourg S.A.
Interest rate swap counterparty: DZ BANK AG Deutsche Zentral-Genossenschaftsbank

Supporting Ratings

<table>
<thead>
<tr>
<th>Institution/role</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Citibank N.A., London branch as servicer collection bank account provider and transaction bank account provider*</td>
<td>A/Watch Pos/A-1</td>
</tr>
<tr>
<td>DZ BANK AG Deutsche Zentral-Genossenschaftsbank as interest rate swap counterparty</td>
<td>AA-/Stable/A-1+</td>
</tr>
</tbody>
</table>

*Based on the rating on the parent company, Citibank N.A.
Transaction Key Features

<table>
<thead>
<tr>
<th>Feature</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing date</td>
<td>Nov. 25, 2016</td>
</tr>
<tr>
<td>Collateral</td>
<td>Auto loan receivables under loan contracts with borrowers resident in England, Wales, and Scotland.</td>
</tr>
<tr>
<td>Total receivables, discounted receivable</td>
<td>Balance (£)*: 750,002,082.83</td>
</tr>
<tr>
<td>Country of origination</td>
<td>U.K.</td>
</tr>
<tr>
<td>Transaction structure</td>
<td>Revolving pool, true sale</td>
</tr>
<tr>
<td>Replenishment period</td>
<td>Six months</td>
</tr>
<tr>
<td>Redemption profile</td>
<td>Sequential after revolving period, switching to pro rata after additional overcollateralization builds up, subject to compliance with the transaction's performance tests.</td>
</tr>
<tr>
<td>Credit enhancement for the class A notes</td>
<td>Subordination: 21.7%, overcollateralization: 1.1%, cash reserve: 1.2%, and excess spread (initial percentage per year): 0.0%</td>
</tr>
<tr>
<td>Credit enhancement for the class B notes</td>
<td>Subordination: 14.8%, overcollateralization: 1.1%, cash reserve: 1.2%, and excess spread (initial % per year): 0.0%</td>
</tr>
<tr>
<td>Cash reserve description</td>
<td>An amount to cover liquidity shortfalls during the life of the transaction and redeem notes at the end of the transaction; amortizing at 1.2% of outstanding asset balance, subject to a floor of 1.0% of the initial discounted pool balance.</td>
</tr>
<tr>
<td>Commingling reserve</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

*Based on the pool as of Oct. 31, 2016.

Transaction Summary

S&P Global Ratings has assigned credit ratings to DRIVER UK Multi-Compartment S.A., Compartment Driver UK four's (Driver UK four) class A and B notes. At closing, Driver UK four also issued an unrated subordinated loan (see list below).

Driver UK four securitizes a portfolio of U.K. auto loan receivables, which Volkswagen Financial Services (UK) Ltd. originated and granted to its private and small-commercial customer base. This is Volkswagen Financial Services (UK)'s fourth public U.K. auto loan transaction. The issuer can purchase further eligible receivables during the six-month revolving period, as long as no early termination events occur.

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

Since we assigned preliminary ratings to the transaction, the arranger has not made material changes.

We believe that the irregularities discovered in specific software installed in diesel engines (1.2, 1.6, and 2.0 liter EA 189) in 11 million passenger cars and commercial vehicles, so that when the vehicles were experiencing test conditions the characteristics of nitrogen oxides (NOx) emissions were affected, could ultimately affect the transaction in a number of areas: potential declines in the realization proceeds if loans default, potential dilution of the receivables backing the transaction as a result of vehicle owner claims against Volkswagen AG (VW), and potential increase in the operational risk associated with VW.
On Feb. 2, 2016, VW announced its schedule for the first wave of remediation actions to repair the affected vehicles in Europe. The wave started with the VW Amarok fitted with the EA 189 2.0 liter diesel engine and should continue over the course of the year. On April 28, 2016, VW disclosed the start of the technical modification of the Golf Blue Motion Technology with a 2.0 liter diesel engine following the German authority confirmation that the proposed solution does not result in any changes to the fuel consumption levels, performance data, or noise emissions of the vehicles concerned. Later, on June 8, 2016, VW announced that the technical solutions for several affected 2.0 liter diesel engine variants used in the high-volume Golf, Passat, and Tiguan ranges had been confirmed by the German authorities. More recently, in Aug. 14, 2016, VW stated they have received approval from German authorities for the technical solutions for the Volkswagen Polo and SEAT Ibiza models with 1.2 liter diesel affected engines.

We understand from the transaction's legal counsel that if VW does not successfully fix the affected vehicles or if the engines' parameters are negatively affected following the repair, borrowers may have a right to claims and rescind the contract, if the customer can demonstrate that excessive NOx emissions or negative effects on the engine parameters following the defeat device repair result in a material defect of the vehicle.

In this transaction, Volkswagen Financial Services (UK) has made certain representations and warranties in respect of the securitized receivables. We understand from the transaction counsel that, if the borrower takes any of the above actions, it may be regarded as a misrepresentation by seller, and the seller would have to cure or remedy such breach or repurchase the receivable.

Based on VW's public announcements, we assume that the proposed remediation actions will not result in a change to the fuel economy figures, performance figures, or CO2 or noise emissions, and that the vehicles will remain roadworthy until and after the recall. Hence, based on the currently available information, we do not assume potential dilution of the loan receivables backing the transaction as a result of vehicle owner claims against the seller.

As of the cut-off date, about 6.75% of the discounted pool balance related to vehicles equipped with diesel engines affected by the NOx exhaust emissions issue.

Consistent with our analytical approach for recently rated VW deals, we maintained higher gross loss base-case and stress multiples for all rating levels to account for increased uncertainty in light of the current situation regarding VW's NOx exhaust emissions issue. At this stage, we consider that our stressed recovery rate and adjusted market value decline assumptions cover the potential for recoveries to deteriorate due to any reduction in resale values.

On Nov. 3, 2015, VW also announced that internal investigations had identified irregularities related to CO2 levels and fuel consumption levels in certain vehicles, at that time estimated to affect about 800,000 vehicles globally. At closing of previous VW related transaction, Volkswagen Financial Services (UK) funded a dedicated market risk reserve to mitigate the risk from loans related to vehicles that could be subject to irregularities related to CO2 emissions. Since that time, VW announced on Dec. 9, 2015 that significantly fewer vehicles, about 36,000 globally, remain potentially affected by fuel consumptions levels of about 0.1 to 0.2 liters per 100 kilometers higher than originally determined.

Similarly to other VW rated deals in other jurisdictions, the market risk reserve has been removed or is not present to address the remaining CO2 related risk (see "Ratings Unchanged In German Auto ABS Transaction VCL Master Residual Value, Compartment 2 After Transaction Amendments," published on Jan. 29, 2016). We perceived that the...
risk of termination and damages to be higher in the U.K. than in other European jurisdictions. Based on available information, we believe CO2 related risks have significantly diminished from our initial estimation back in November 2015; nevertheless we do not consider this risk to be remote in this transaction. We have resized the expected remaining exposure in our credit analysis taking into consideration the most updated information.

As part of our ongoing monitoring of VW’s transactions, we will seek further information regarding the extent to which vehicle owners may be entitled to compensation claims or similar remedies against VW, as any such claims could reduce the amount of their securitized lease receivable.

**Notable Features**

The transaction's documented payment structure and capital structure is very similar to its rated predecessor, Driver UK three ("New Issue: DRIVER UK Multi-Compartment S.A., Compartment Driver UK three," published on Sept. 25, 2015). In Driver UK four, the class B notes and subordinated loan as a percentage of the pool principal balance is 6.9% and 14.8%, respectively, while in Driver UK three it was 8.8% and 13.2%, respectively. Further, the overcollateralization increased to 1.1% from 0.8%. Therefore, Driver UK four's B notes have 1.9% more available credit support, than Driver UK three's B notes. The class A notes have the same available credit support as in Driver UK three. Similarly, the class B notes' targeted overcollateralization amounts have increased to 17.9% from 16% in the revolving period, and to 21.1% from 19.0% during the amortization stage, compared with Driver UK three.

**Rating Rationale**

**Operational risk**

The originator is a wholly owned subsidiary of Volkswagen Financial Services AG (which is, in turn, a subsidiary of Volkswagen AG). Volkswagen Financial Services is an auto financing company with a strong presence in the global asset-backed securities (ABS) market. In our view, the company's track record of stable, strong-quality asset origination is among the best of all European ABS issuers. Our ratings on the notes reflect our assessment of the company's origination policies. There is no back-up servicer at closing. We have reviewed Volkswagen Financial Services (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**

There are signs that the uncertainty surrounding the Brexit is already weighing on economic activity. Still, the U.K.’s economic pulse was already weakening before the vote. We forecast a relatively benign hit to U.K. growth in the short-term. However, we have revised our growth projections for 2017 and 2018 sharply downward. Our U.K. base case GDP growth expectations for 2016 and 2017 are 1.8% and 1.0%, respectively, from 2.2% in 2015. We expect the U.K. unemployment rate to decline to 5.0% in 2016, and then increase to 5.5% in 2017 and to 6.3% in 2018, from 5.4% in 2015 (see "Europe Navigates Brexit Storm--For Now," published on Oct. 11, 2016). In our view, changes in GDP growth and the unemployment rate largely determine portfolio performance. We set our credit assumptions to reflect our economic outlook. Our near- to medium-term view is that the U.K. economy will remain resilient and record...
positive growth.

**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 Volkswagen Financial Services (UK)’s loan portfolio and from the transaction’s predecessors (Driver UK two and Driver UK three) to analyze credit risk. We consider it unlikely that performance will deteriorate to levels seen before 2009 due to the relatively stable macroeconomic outlook and Volkswagen Financial Services (UK)’s more stringent underwriting and servicing procedures since then. We have taken into account the credit risk from balloon payments, and losses due to prepayments.

About 7.6% of the pool (by volume) 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 also offset the potential for recoveries to deteriorate due to any reduction in resale values for these vehicles.

The transaction is also exposed to residual values. Since we rate the predecessor Driver UK three, and in line with Driver UK Master S.A., Compartment 2, we have increased our loss assumption for residual values, incorporating a higher market value decline risk, considering the potential decline due to irregularities related to NOx emissions in the pool.

We have also factored in our analysis potential losses that could arise in relation to any potential risks for vehicles affected by the CO2 emission issue.

**Cash flow analysis**
We have assessed the transaction’s documented payment structure. After the six-month replenishment period, the notes will start to amortize sequentially and will switch from sequential to pro rata amortization once the notes reach certain documented overcollateralization levels. We also assessed the transaction’s purchase price mechanism, which leads to the purchase of assets at a discounted cash flow valuation. 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 assigned 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). The replacement mechanisms in the transaction documents mitigate these risks in line with our counterparty criteria. The swap agreements at closing are in line with our counterparty criteria.

**Legal risk**
The issuer is bankruptcy remote, in line with our European legal criteria (see “Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance,” published on Sept. 13, 2013). The legal opinion received at closing indicates that the sale of the assets would survive the insolvency of Volkswagen Financial Services (UK) as the seller.

In relation to seller related risks, 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 CO2 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).

Strengths, Concerns, And Mitigating Factors

Strengths

• Volkswagen Financial Services (UK) is a wholly owned subsidiary of Volkswagen Financial Services AG. 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 43,487 loans. The pool has low borrower concentration risk, with the top 20 borrowers accounting for about 48 basis points.

• As of the pool cut-off date, Oct. 31, 2016, the pool did not contain any contracts with payments that are overdue.

• Under certain conditions related to deteriorating asset performance, the transaction will switch from pro rata to sequential amortization.

• The structure benefits from a fully funded liquidity reserve, initially sized at 1.2% of the initial asset balance and amortizing subject to a floor (minimum level). The liquidity reserve serves primarily as liquidity support to mitigate any temporary shortfalls. 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 credit quality of the pool may shift, and the transaction's performance may deteriorate as a result of the substitution of amortizing assets. However, the transaction features a relatively short six-month revolving period along with several 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 composition.

• Unlike most other European auto ABS transactions, the structure does not have any excess spread. Volkswagen Financial Services (UK) matches the transaction's interest receipts and expenses through the discounting mechanism, and any remaining amounts are paid back to Volkswagen Financial Services (UK).
The cash reserve amortizes, subject to a floor (minimum level). This reduces protection for the note holders 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 contract’s end. As a result, the transaction is exposed to market value risk and borrower payment shock. The initial credit enhancement level has been adequately sized to cover 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 balloon loans.

The issuer purchased the assets at a discounted cash flow valuation. Due to this revaluation, cash shortfalls could arise from prepayments, because when borrowers prepay, they only repay the loan’s nominal value. To mitigate this loss, the transaction has an interest compensation reserve. The reserve works by taking from the collections, each month, an amount (1.91%, multiplied by the future discounted receivables balance).

Based on available information, we believe CO2 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 sized 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 effective interest available to the issuer is reduced, leaving no excess spread in the transaction. Therefore, interest receipts are equal to the sum of:

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

During the revolving period, the issuer uses collections from the assets and also the proceeds, if any, from the new issuance of notes and subordinated loan to purchase new receivables from the seller. The transaction will revolve for six months, as long as none of the early amortization events occur. The transaction's early amortization events are as follows:

- A servicer replacement event occurs;
- A foreclosure event occurs;
- On two consecutive payment dates, the amounts sitting in the issuer accumulation account exceed 15% of the nondefaulted asset balance;
- On any payment date that falls after three consecutive payment dates following initial issuance, the "Actual Class A Overcollateralization Percentage", under the transaction documents, will be lower than 22.8%;
- Volkswagen Financial Services (UK) is no longer an affiliate of Volkswagen Financial Services, or any of its successors;
- On any payment date the balance in the interest compensation ledger is zero; 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 Volkswagen Financial Services (UK). Furthermore, defaulted or insolvent borrowers are excluded.
• Receivables are denominated and payable in pounds sterling.
• No receivable is overdue.
• Receivables come from valid financing contracts under the laws of England, Scotland, and Wales.
• Volkswagen Financial Services (UK) is the legal and beneficial owner of the receivables.
• Receivables were originated during the normal course of Volkswagen Financial Services (UK)'s activities and comply with the Consumer Credit Act.
• The maximum initial term of the receivables is 72 months, and maximum remaining term of the receivables is 70 months.
• Receivables from loans with the same borrower cannot be higher than £500,000.
• At least two installments have been paid on each receivable.

In accordance with the transaction's eligibility criteria, after replenishment, the pool must comply with a concentration limit on used vehicles. We took this into consideration 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 discounted principal balance, after the addition of new purchased receivables.

**Originator**

Volkswagen Financial Services (UK) is a wholly owned subsidiary of Volkswagen Financial Services AG, a captive arm of the car manufacturer Volkswagen AG. Volkswagen Financial Services (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**

Volkswagen Financial Services (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 data pertaining to the customer profile is then assessed.

**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. This coupon is floored at zero. The first interest payment date (IPD) is on Dec. 28, 2016. The legal final maturity of the notes is in March 2025.

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 1.

**Table 1**

<table>
<thead>
<tr>
<th>Priority Of Payments (Simplified)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes.</td>
</tr>
</tbody>
</table>
Table 1

| Priority Of Payments (Simplified) (cont.) | Payments to the trustee. |
| 2 | Servicer fees. |
| 3 | Senior fees, including payments to the corporate services provider, and data protection trustee. |
| 4 | Payments to the swap counterparty (except termination payments if the swap counterparty is the defaulting party or downgraded below threshold). |
| 5 | Interest on the class A notes. |
| 6 | Interest on the class B notes. |
| 7 | Top-up cash reserve (only if drawn upon previously). |
| 8 | Class A notes' principal (sequential or pro rata). |
| 9 | Class B notes' principal (sequential or pro rata). |
| 10 | Payments to the swap counterparty not paid above. |
| 11 | Interest and principal on the subordinated loan. |
| 12 | All remaining amounts back to Volkswagen Financial Services (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 will use the excess proceeds to pay the subordinate 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. At any time the transaction will switch back to sequential amortization, if there is a credit enhancement increase condition, if the servicer becomes insolvent, or if the aggregate discounted asset balance falls below 10% if the initial discounted asset balance.

The credit enhancement increase condition will be in effect if the cumulative net loss ratio exceeds (i) 1.2% either before or during February 2018; (ii) 2.3% between March 2018 and November 2018; or (iii) 3.5% after November 2018.

Table 2 describes the initial overcollateralization levels and target overcollateralization levels, both during and after amortization, and once the credit enhancement increase condition is in effect. A target overcollateralization level of 100% implies a permanent switch to sequential amortization from pro-rata, which could happen at any time once a credit enhancement increase condition is in effect, or if the servicer becomes insolvent.

Table 2

<table>
<thead>
<tr>
<th>Overcollateralization Levels</th>
<th>Actual overcollateralization (%)</th>
<th>Target overcollateralization levels (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class</td>
<td>At closing</td>
<td>Revolving period</td>
</tr>
<tr>
<td>A</td>
<td>22.8</td>
<td>26.0</td>
</tr>
<tr>
<td>B</td>
<td>15.9</td>
<td>17.9</td>
</tr>
</tbody>
</table>

Cash reserve

The issuer deposited 1.2% of the initial discounted asset balance 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. As soon as the aggregate discounted receivables balance
has been reduced to zero or on the final maturity date, the issuer can also use the cash reserve to redeem the class A and B notes. The cash reserve amortizes at 1.2% of the outstanding discounted asset balance, subject to a floor, which is the lesser of (i) 1.0% of the initial discounted pool balance; and (ii) the class A and B notes' outstanding amount. The amounts that are released from the reserve are paid directly to the subordinated loan, provided that no credit enhancement increase condition is in effect.

**Purchase at the discounted cash flow valuation**

The special-purpose entity (SPE) purchases the assets at a discounted cash flow valuation. Due to this revaluation, cash shortfalls could arise from prepayments, because when borrowers prepay, they only repay the loan's nominal value.

In this case, the SPE suffers a loss, which is the difference between the nominal value and the outstanding discounted balance. The earlier the loan prepays, the higher the prepayment loss. Generally, Volkswagen Financial Services is obliged to cure this loss under the transaction documents. However, under our rating scenarios, we assume that losses are not cured because Volkswagen Financial Services (UK)' default risk is not mitigated to a level that is commensurate with our rating scenarios.

As the issuer purchased the receivables at a discounted cash flow value, prepayments will typically result in a prepayment loss for the SPE, as the prepayments will be at a nominal value. To mitigate this loss, the transaction has an interest compensation reserve. The reserve works by taking from the collections, each month, an amount (equal to 1.91%, multiplied by the outstanding collateral 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, the seller directly receives any remaining excess.

At closing, the issuer used a portion of the purchase price discount to fund the cash reserve.

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

**Mitigation Of Seller Risks**

**Commingling risk**

Borrower collections are paid into the servicer collection bank account provider with a sufficiently rated bank, which was opened in the name of, and for the benefit of, Volkswagen Financial Services (UK) as the servicer. These collections are not heavily concentrated on any specific monthly day and the majority of collections are received via direct debit. Transfers from the servicer collection bank account provider into the issuer distribution account occur monthly on each payment date, if the "monthly remittance condition" under the transaction documents is satisfied.

Volkswagen Financial Services (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.
In order to mitigate potential commingling risk, if the monthly remittance condition is no longer satisfied, i.e., if the servicer becomes ineligible, in accordance with our current counterparty criteria, the servicer will advance an amount of collections to the issuer.

The servicer will, within 14 days after the monthly remittance condition is no longer satisfied, but no later than 11 business days of the preceding monthly period, transfer two weeks' worth of expected collections in advance from its own funds. Therefore, the SPE will always receive at least one month of expected collections in advance. Twice a month, the servicer will net collections advanced in the previous month against the collections that it has actually received for the relevant two-week period.

Given the biweekly account sweeps after the monthly remittance condition is no longer satisfied, and the servicer's well-established operational capacities in combination with the swift borrower notification requirement implemented in the transaction documents, we have assumed that the transaction's structure mitigates commingling risk.

**Set-off risk**

Volkswagen Financial Services (UK) is not a deposit taking institution, so there is no deposit set-off risk in the transaction. However, there is set-off 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 Oct. 31, 2016, based on the pool, the collateral pool backing the notes comprises 43,487 loan contracts (see table 3). The discount rate for the pool is 4.3013%. The largest single borrower concentration is 0.04%, and the top 20 borrowers comprise about 0.48% of the pool, by discounted principal balance. The average outstanding loan balance is £16,693. There aren't any maintenance components in the contracts sold. Each borrower has paid at least two installments. This transaction contains:

- **92.14% PCP loans** that 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—the issuer is therefore directly exposed to market value risk.
- **7.86% hire purchase (HP) agreements** are loans, which amortize in equal installments.

**Table 3**

<table>
<thead>
<tr>
<th>Collateral Distribution Of The Pool</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pool characteristics</strong></td>
</tr>
<tr>
<td>Principal outstanding (£)*</td>
</tr>
<tr>
<td>Aggregate discounted principal balance outstanding (£)*</td>
</tr>
<tr>
<td>Discount rate (%)</td>
</tr>
<tr>
<td>Weighted-average yield (%)</td>
</tr>
<tr>
<td>Average remaining discounted loan principal balance (£)*</td>
</tr>
<tr>
<td>Weighted-average life (months)*</td>
</tr>
<tr>
<td>Weighted-average original term (months)*</td>
</tr>
<tr>
<td>Weighted-average remaining term (months)*</td>
</tr>
</tbody>
</table>
Table 3

<table>
<thead>
<tr>
<th>Collateral Distribution Of The Pool (cont.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted-average seasoning (months)*</td>
</tr>
<tr>
<td>Percentage of pool discounted principal balance (%)*</td>
</tr>
<tr>
<td>Share of new vehicles</td>
</tr>
<tr>
<td>Share of private customers</td>
</tr>
<tr>
<td>Audi</td>
</tr>
<tr>
<td>Volkswagen</td>
</tr>
<tr>
<td>Skoda</td>
</tr>
<tr>
<td>Seat</td>
</tr>
<tr>
<td>Other</td>
</tr>
</tbody>
</table>

*Based on the pool as of Oct. 31, 2016.

The balloon payment is a payment obligation of the borrower, who can settle it:

- Keeping the vehicle and paying in cash;
- Selling the vehicle to the car dealer for a purchase price that equals the balloon payment; or
- Refinancing the balloon payment by entering into a new loan with Volkswagen Financial Services (UK).

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 consumer finance criteria.

Gross losses and gross loss multiples

We received from the originator quarterly static gross loss and net loss data from September 2002 to August 2016. Charts 2 to 5 show aggregated gross losses after loans were classified by the servicer as hostile terminated (HT) or voluntary terminated (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).
New Issue: DRIVER UK Multi-Compartment S.A., Compartment Driver UK four

Chart 3

Cumulative Annual Gross Loss Curves: HP Used Vehicle Loans

Quarters after origination

Copyright ©2016 by Standard & Poor's Financial Services LLC. All rights reserved.
Chart 4

Cumulative Annual Gross Loss Curves: PCP New Vehicle Loans

Quarters after origination

Copyright © 2016 by Standard & Poor’s Financial Services LLC. All rights reserved.
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 pool composition. We set our gross loss multiples taking into consideration the originator’s experience and the quality of the data provided. Table 4 summarizes our credit assumptions.

Table 4
Cumulative Default, Cumulative Recovery, And Recovery Rate Haircut Assumptions

<table>
<thead>
<tr>
<th>Sub-pools</th>
<th>Base-case gross losses (%)</th>
<th>Stressed recoveries for HT and VT (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HT</td>
<td>VT</td>
</tr>
<tr>
<td>HP new</td>
<td>1.3</td>
<td>0.6</td>
</tr>
<tr>
<td>HP used</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>PCP new</td>
<td>1.3</td>
<td>3.2</td>
</tr>
</tbody>
</table>
The loss numbers in table 4 comprise both hostile and voluntary terminations. We analyzed both types of terminations separately. Under HP and conditional sale agreements (PCP), losses incurred through voluntary terminations 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 voluntary termination generally arises when obligors are in negative equity. We have assumed a gross loss multiple for HT receivables of 4.5x at a ‘AAA’ rating and 3.0x at a ‘A+’ rating level. We assumed a multiple of 2.00x for VT receivables at a ‘AAA’ rating level and 1.63x at a ‘A+’ rating level. We stressed PCP residual value risk as an additional loss to the figures in table 4.

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 August 2016. 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 4.

We have set our stressed assumptions with a recovery period of 12 months. Under our assumptions, amounts will be recovered in month 12.

Senior fees
We have considered stressed servicing fees equal to 1% of the portfolio balance and stressed fixed annual fees of £100,000.

Prepayments
We have stressed the prepayment rate up to 30% and down to 0.5%, considering historical prepayment rates.

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 5).

**Table 5**

<table>
<thead>
<tr>
<th>Scenario Stresses</th>
<th>Scenario 1 (relative stress to base case)</th>
<th>Scenario 2 (relative stress to base case)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross loss rate</td>
<td>30.0</td>
<td>50.0</td>
</tr>
<tr>
<td>Recovery rate</td>
<td>(30.0)</td>
<td>(50.0)</td>
</tr>
<tr>
<td>Constant prepayment rate</td>
<td>(20.0)</td>
<td>(33.3)</td>
</tr>
</tbody>
</table>

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 6 and 7 show the implied base-case stresses and scenario stress results.

Table 6
Scenario Stresses

<table>
<thead>
<tr>
<th>Rating variable</th>
<th>Base-case</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross loss rate (HT)</td>
<td>1.6</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Recovery rate (HT)</td>
<td>40.0</td>
<td>28.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Gross loss rate (VT)</td>
<td>3.6</td>
<td>4.7</td>
<td>5.4</td>
</tr>
<tr>
<td>Recovery rate (VT)</td>
<td>40</td>
<td>28.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Constant prepayment rate</td>
<td>10.0</td>
<td>8.0</td>
<td>6.7</td>
</tr>
</tbody>
</table>

HT—Hostile terminated. VT—Voluntary terminated.

Table 7
Scenario Stress Analysis: Rating Transition Results

<table>
<thead>
<tr>
<th>Scenario stress</th>
<th>Class</th>
<th>Initial rating</th>
<th>Scenario stress rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario 1</td>
<td>A</td>
<td>AAA (sf)</td>
<td>AAA</td>
</tr>
<tr>
<td></td>
<td>B</td>
<td>A+ (sf)</td>
<td>A+</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>A</td>
<td>AAA (sf)</td>
<td>AA-</td>
</tr>
<tr>
<td></td>
<td>B</td>
<td>A+ (sf)</td>
<td>BBB</td>
</tr>
</tbody>
</table>

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;
- Progress on the implementation of the technical measures in the affected vehicles, including any change to the fuel economy figures, performance figures, or CO2 or noise emissions, and any effect on resale values;
- The supporting ratings in the transaction; and
- The servicer's operations and its ability to maintain minimum servicing standards.
Related Criteria And Research

Related criteria

- Criteria - Structured Finance - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 08, 2016
- Criteria - Structured Finance - General: Methodology: Criteria For Global Structured Finance Transactions Subject To A Change In Payment Priorities Or Sale Of Collateral Upon A Nonmonetary EOD, March 02, 2015
- Legal Criteria: Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Criteria - Structured Finance - General: Criteria Methodology Applied To Fees, Expenses, And Indemnifications, July 12, 2012
- General Criteria: Methodology: Credit Stability Criteria, May 03, 2010

Related research

- Europe Navigates Brexit Storm--For Now, Oct. 11, 2016
- Volkswagen Financial Services AG, July 5, 2016
- Volkswagen Bank GmbH, July 5, 2016
- New Issue: Driver UK Master S.A., Compartment 2 (Series 2016), June 27, 2016
- Bulletin: Volkswagen's Additional €9.5 Billion Charge For Emissions Has No Immediate Rating Impact, April 22, 2016
- How We Rate And Monitor EMEA Structured Finance Transactions, March 24, 2016
- Europe's Carmakers Face A Long Road To Clear The Air On Emissions, Feb. 2, 2016
- German Automaker Volkswagen Downgraded To 'BBB+' from 'A-' On Adverse Emissions Impacts; Outlook Negative, Dec. 1, 2015
- Volkswagen Ratings Currently Unaffected By CO2 Irregularities As Long-Term Rating Already On CreditWatch Negative, Nov. 4, 2015
- German Automaker Volkswagen Ratings Lowered To 'A-/A-2' On Governance; L-T Ratings Remain On Watch Neg
On Ongoing Risks, Oct. 12, 2015

- Volkswagen Financial Services Ratings Lowered To 'A-/A-2'; Still On CreditWatch Negative, Oct. 12, 2015
- Recent Volkswagen Announcement Has Potential To Affect Related ABS Transactions, Oct. 2, 2015
- New Issue: DRIVER UK Multi-Compartment S.A., Compartment Driver UK three, Sep. 25, 2015
- 2015 EMEA ABS Scenario And Sensitivity Analysis, Aug. 6, 2015
- European Structured Finance Scenario And Sensitivity Analysis 2014: The Effects Of The Top Five Macroeconomic Factors, July 8, 2014
- Scenario Analysis: Gross Default Rates And Excess Spread Hold The Answer To Future European Auto ABS Performance, May 12, 2009