New Issue: Driver China ten Trust

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Ratings Detail

### Ratings As Of March 27, 2020

<table>
<thead>
<tr>
<th>Class</th>
<th>Rating</th>
<th>Amount (mil. RMB)</th>
<th>Minimum credit support (%)*</th>
<th>Credit support provided by subordination and overcollateralization (%)§</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>AA (sf)</td>
<td>5,380.0</td>
<td>6.80</td>
<td>10.33</td>
</tr>
<tr>
<td>Subordinated</td>
<td>NR</td>
<td>590.0</td>
<td>N/A</td>
<td>0.50</td>
</tr>
</tbody>
</table>

*Minimum credit support only reflects estimated losses arising from borrower default and does not reflect the results of cash flow analyses which consider potential commingling loss and prepayment loss. §Available credit support for the notes consists of overcollateralization of RMB30,030,372.47 and note subordination. NR—Not rated. N/A—Not applicable.

### Profile

- **Closing date**: March 27, 2020
- **Legal maturity date**: Jan. 26, 2028
- **Collateral**: Renminbi-denominated loans to prime-quality borrowers, secured by mortgaged vehicles
- **Issuer**: Driver China ten Trust
- **Originator, seller, and servicer**: Volkswagen Finance (China) Co. Ltd.
- **Trustee**: China Foreign Economy And Trade Trust Co. Ltd.
- **Primary credit enhancement**: Note subordination and overcollateralization

### Supporting Ratings

- **Bank account provider**: Bank of China

### Loan Pool Statistics As Of Feb. 29, 2020

- **Total number of contracts**: 100,377
- **Total discounted receivables balance of contracts (RMB)**: 6,000,030,372
- **Maximum discounted receivables balance of contracts (RMB)**: 3,951,786
- **Average discounted receivables balance of contracts (RMB)**: 59,775
- **Weighted average down-payment (%)**: 39.01
- **Weighted average interest rate (%)**: 3.18
- **Discount rate (%)**: 4.6281
- **Total balloon loans as a percentage of total pool balance (%)**: 0.73
- **Weighted-average contract seasoning (months)**: 8.59
- **Weighted-average remaining term to maturity (months)**: 22.82

### Rationale

This is the tenth auto loan securitization transaction originated by Volkswagen Finance (China) Co. Ltd. (VWFC). S&P Global Ratings has rated similar-structure Driver series transactions from Volkswagen group in China and other markets. The ratings assigned to the notes issued by China Foreign Economy And Trade Trust Co. Ltd. as trustee of Driver China ten Trust (the issuer) reflect the following factors.
The credit risk associated with the underlying collateral portfolio and the credit support available are commensurate with our view of credit risk under 'AA' rating stress. Our assessment of credit risk takes into account originator VWFC's underwriting standards and centralized approval process, which are largely consistent with parent company Volkswagen Financial Services AG (VWFS AG)'s global practice and risk-management approach, with some local adaptation.

Credit support for the class A notes comprises the subordination of the subordinated notes and overcollateralization via Chinese renminbi (RMB) 30 million of additional collateral. In addition, any balance remaining in the cash reserve on the legal maturity date of the notes or when the receivables pool balance reaches zero may be applied toward redemption of the class A notes, providing additional support.

The transaction's cash flows can meet the timely payment of interest and ultimate payment of principal to the rated noteholders under stresses commensurate with the ratings assigned. All rating stresses are assessed on the basis that the issuer does not call the notes on or beyond the call-option threshold date, and that the notes must be fully redeemed via the mechanisms under the transaction documents.

The timely payment of senior expenses and rated note coupon is supported by the use of interest and principal collections from the underlying pool of loans and a liquidity reserve equal to 1.2% of the aggregate discounted receivables balance as of the cut-off date. The liquidity reserve will be fully funded by VWFC at closing and may be used to support senior expenses and rated note interest on any trust payment date. The reserve will be maintained at 1.2% of the aggregate outstanding discounted receivables balance, subject to a floor of RMB60 million or the aggregate outstanding balances of the class A notes.

The legal structure of the trust, established as a special-purpose trust (SPT) under China's Trust Law, and the transaction structure and terms, which are consistent with the governance of China Banking and Insurance Regulatory Commission (CBIRC) and The People's Bank of China (PBOC)'s credit assets securitization (CAS) scheme. The legal structure of the SPT reflects our criteria for insolvency remoteness.

Our ratings also reflect the counterparty exposure to Bank of China as a bank account provider. The rating on the bank account provider, coupled with the replacement trigger of the bank account provider if the rating on it falls below a certain level, is consistent with our counterparty criteria to support a 'AA' rated transaction.

The ratings on the notes are higher than our sovereign rating on China. We applied our "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumption," criteria published Jan. 30, 2019. Based on our analysis, the criteria allows a maximum differential of six notches above the sovereign rating. Therefore, the highest rating that can be assigned to this transaction is 'AAA' under our criteria for a rating above the sovereign.

**Strengths And Weaknesses**

**Strengths**

In our opinion, the strengths of the transaction observed in the rating analysis are:

- The sound credit quality of the loan portfolio at close. All underlying loans have a full-recourse feature and most of
the receivables contracts are fully amortizing loans backed by new passenger vehicles for personal use. The initial portfolio is well-diversified, with a single borrower concentration of less than 0.08%, and it is seasoned by more than eight months in weighted-average terms. Our observations in other markets suggest these features tend to support consistent and stronger performance.

- The limited exposure period. The remaining terms of most loans at close are 36 months or less, with a weighted-average asset life of around two years. Although the pool has a revolving period of a year, we believe the risk exposure period of the pool—or weighted-average life of the notes—is likely to remain short, considering VWFC's current product strategy and underwriting practice of extending most loans with terms of 36 months or less.

- The highly integrated risk-management and technology platform used in the servicer's operation with its parent group. VWFC leverages the experience and capability of parent company VWFS AG and global affiliates for risk management, with adaptations and local expertise reflective of more than a decade of operation in China. VWFC also employs a comprehensive information technology system to support loan operations. Its information technology infrastructure, which is integrated into a global auto loans securitization support platform, can flag loans and track payments. Such support is critical in preventing operational risk. In our view, VWFC's information technology operations, system back-up, and business continuity management reflect strong parent support and meet global standards.

**Weaknesses**

In our opinion, the weaknesses of the transaction and the corresponding mitigants observed in the rating analysis are:

- The shorter operating history of China's auto finance sector, which has seen rapid growth only in the past decade. As a result, the sector has limited historical performance data available for analysis. Unlike the sector in the U.S., it has not experienced true periods of economic stress. We have factored this potential weakness into our credit risk analysis of the transaction. We also note that China's regulators have set forth quite stringent requirements on auto loan origination, and have adopted continued supervision and administrative guidelines on loan quality control. In our view, such regulatory oversight, along with the less-competitive industry environment due to low auto loan penetration, will prevent a lowering of the origination standards in the Chinese auto finance sector, and are the main reasons for the reasonable credit performance we have observed in the vintage loan pools.

- Lack of experience in servicing transition in China's securitization market. Despite the recent rapid development of Chinese securitization, only a few transactions to date have experienced the critical stress of a failure of important counterparties such as the servicer, and the potential for negative effect on the transaction's cash flow. In this transaction, the risk of servicer transition and cash-flow continuity are partly mitigated by the payment arrangements. Most loan payments in this transaction will be collected through the direct debit of borrowers' cash accounts in major national banks rather than by other more demanding collection processes. This will reduce the process complexity and make it easier to find a replacement servicer. Moreover, the transaction sets up a liquidity reserve upfront that could cover three-four months of transaction expenses and note interest if asset collections are temporarily unavailable to meet the transaction obligations. In our view, this will allow the transaction sufficient time to find a new servicer and resume the asset collections.

- This is not a closed-pool transaction, which means that new receivables can be added during the transaction's revolving period, and this could cause a shift in the collateral pool's credit quality and diversification. There are limited portfolio parameters that could prevent potential concentrations in certain geographies, or riskier assets such as balloon contracts; or ensure diversification, for example, in contract sizes and terms. We have taken into account in our opinion of minimum credit support for credit losses the potential for a shift in the credit quality of the
collateral pool. We have considered the seller’s relatively stable loan-underwriting strategies in our credit risk assessment. We have observed numerous Volkswagen Financial Services securitization transactions and collateral pools in several countries, including similar revolving transactions, and over a long period of time in some countries.

- During the revolving period, collections that would otherwise be allocated to pay principal on the notes are retained in the accumulation account. If the issuer is unable to reinvest the cash in eligible receivables, this creates negative carry risk because the interest on the notes exceeds the interest earned on the bank account. However, this is mitigated by a requirement that the transaction enter amortization should the amount retained in the accumulation account on two consecutive payment dates exceed 15% of the then-current aggregate discounted receivables balance.

- The target overcollateralization arrangements could reduce the credit enhancement amount provided to the rated notes under a pro-rata payment structure once the transaction enters amortization. The transaction’s principal payment structure is not fully sequential during the notes amortization period. Collections on the receivables could be allocated to the subordinated notes (subject to a floor if clean-up call is not exercised) if the relevant class A note overcollateralization target is met. The transaction includes documented cumulative loss tests, which, if breached, would switch the transaction’s payment structure from pro-rata to sequential. The tests are documented at cumulative loss levels higher than those assumed by us at the relevant points in time. However, the credit support provided at transaction close and the target overcollateralization percentages are set at levels that somewhat mitigate this concern. We have taken into account the transaction’s target overcollateralization levels and loss tests in our cash-flow analysis.

- Potential commingling risk if the servicer defaults. VWFC as the servicer in this transaction can hold the collections for a period of one month before remittance to the SPT account. If a certain rating trigger is hit, then VWFC will remit the collections on a semi-monthly basis and advance the expected half-a-month collections twice per month. However, we believe there is a risk that the collections could be lost or delayed if the servicer were to become the subject of insolvency proceedings (i.e., commingling risk). That’s given that the holding period could be up to one month, the commingling reserve is not funded at close, and receivable collections are not remitted to SPT accounts directly or to a specific lock box upon receipt. In assessing this risk, we have considered VWFS AG’s announcement in its annual report that it will ensure its affiliated companies, including VWFC, will meet their liabilities and associated transaction arrangement. We also have factored into our cash-flow analysis the potential commingling loss.

**Notable Features**

The transaction has a revolving period for a year, during which additional receivables can be purchased via monthly collections after meeting transaction senior expenses and rated notes interest, provided an early amortization event has not occurred.

The receivables portfolio is purchased by the issuer at a single, fixed discount rate. The issuer is acquiring some of the receivables at a price that is above the notional amount of the contract, and some below the notional amount, depending upon the interest rates of the receivables. This could result in prepayment losses if those receivables with higher interest rates prepay before their stated maturity. We however believe the risk of prepayment loss is remote in this transaction, primarily due to the generally low interest rate on loans compared with the fixed discount rate. The discount rate is set by VWFC at a rate that is intended to match the yield on the transaction to the issuer’s expenses.
Consequently, there is no excess spread in the transaction.

In addition, the transaction has a single—rather than separate "income" and "principal"—cash-flow priority of payments, and there is no concept of a principal deficiency ledger. There are no note charge-off arrangements nor note invested/stated amount differentiation in the transaction.

Under the transaction's payment structure, collections—after payment of senior expenses and class A note interest—initially will be allocated to the class A and subordinated notes on a sequential-payment basis during the amortization period. If class A notes' overcollateralization level reaches the relevant targeted level, subject to cumulative gross loss triggers, then remaining collections will be allocated to the subordinated notes. As a result, the transaction may pay interest and principal to the subordinated notes (subject to a floor if clean-up call is not exercised) before the class A notes are fully redeemed. This may consume part of the credit support in this transaction.

### Transaction Structure

This is a securitization transaction based on China's CAS scheme set up by CBIRC and PBOC.

VWFC sells a pool of auto loan receivables, along with all related rights such as mortgages, to an SPT, which is set up by the trustee for the purpose of securitization. To fund the receivables purchase, the trustee will issue, on behalf of the SPT, two classes of trust certificates: class A and subordinated notes. Such transfer will segregate the assets from the originator under China's Trust Law, and the SPT reflects our criteria in relation to bankruptcy remoteness.

The collateralized assets are loans extended to individual borrowers and institutional borrowers, the majority of which were used to finance the purchase of new cars manufactured by Volkswagen AG group, including those made by local joint ventures. The loans have original terms of up to 60 months, but 96% of the loans initially transferred have remaining terms within 36 months. Initial loan-to-value (LTV) ratios of most loans initially transferred range from 40% to 70%, and the weighted-average initial LTV ratio is 61%. Vehicles financed by these loans are mortgaged for the benefit of the originator.

The issuer purchases the receivables portfolio at a single, fixed discount rate, which means that some underlying assets are purchased at a price above the par value. This could result in prepayment losses. VWFC sets the discount rate at a rate that is intended to match the yield on the transaction to the issuer's expenses. Consequently, there is no excess spread in the transaction.

The asset pool will be revolving for a year before becoming static (i.e., no further asset substitution or reinvestment is allowed). The transaction will also enter amortization upon the occurrence of an early amortization event or the end of revolving period, whichever is earlier. During the revolving period, asset collections—inclusive of interest, principal, penalties, and any other payments—after the payment of senior items will be used to purchase new receivables. In the amortization period, collections will be used to pay down the principal of the class A notes, after satisfying SPT taxes, senior expenses, interest on the class A notes, and the replenishment of the liquidity reserve. In other words, the transaction adopts a sequential turbo repayment structure using a single waterfall upon transaction amortization.

During the amortization period, the class A and subordinated notes will initially receive principal repayments on a
sequential basis until the class A notes reach a target balance, determined by the applicable class A target overcollateralization percentage. Thereafter, provided certain performance triggers have not been breached and the class A target balance is maintained, collections may be allocated to pay items that rank below principal repayments on the class A notes.

A cash liquidity reserve equal to 1.2% of the initial asset pool balance will be funded upon transaction close. The liquidity reserve provides liquidity support to the transaction's senior expenses and interest on the rated notes, if needed.

The originator will be the transaction's servicer to collect borrower payments and to manage arrears.

Chart 1 depicts the transaction structure.

**Chart 1**

**Driver China ten Trust**  
Transaction structure
Asset Segregation And Issuer's Bankruptcy Remoteness Under The CAS Scheme

The CAS pilot program under the management of the PBOC and CBIRC shares the typical features of international securitization transactions, such as asset sale and issuer bankruptcy remoteness. The program is primarily for bank and nonbank financial institution originators under the management of CBIRC. It started in 2005 and has since undergone multiple reviews and amendments. The related guidelines under the CAS pilot program specify asset eligibility and protection of transferred assets and issuers.

We are of the view that the asset true sale and issuer's bankruptcy remoteness in this transaction reflect our special-purpose entity criteria. The primary reason is this securitization transaction adopts an SPT structure by referring to China's Trust Law, in line with the regulations in the CAS pilot program. With the 2001 Trust Law in place and general acceptance of trusts' legal position, we believe there is a remote risk of issuer bankruptcy due to reasons unrelated to collateral performance, or reconsolidation of the assets with the seller's bankruptcy estate when the seller becomes insolvent.

The 2001 Trust Law indicates:

- The trust assets are segregated from the originator's other assets, and are not part of the bankruptcy estate;
- There is proper separation between the trust assets and the trustee's own assets;
- The enforcement of trust assets can only be done under very limited situations;
- Limitation on trustee's set-off rights; and
- The trust will continue to survive under the insolvency of the entruster (the originator) and the trustees and will terminate only under limited conditions.

A trust set-up perfection process in accordance with the Trust Law will be followed before transaction closing, through public announcements of the loans to be entrusted, and the trust set-up based on the entrusted loans. In addition, one of the precedent conditions for trust set-up is the payment of the asset purchase price by the trustee to the originator (the asset seller). Given this, it is a remote risk that the entrusted assets would be considered assets of the seller in the event that an external administrator is appointed in respect of the seller. The legal opinion in this transaction also explains the effective asset transfer for initial transfer and subsequent transfer during the revolving period.

Moreover, the characteristic of the assets that can be securitized through SPT structures is stipulated in the related guidelines under the CAS pilot program. We believe the securitized assets are eligible to be transferred through the trust structure pursuant to the CAS guidelines because the transaction needs to be registered with the CBIRC and PBOC. This assurance, coupled with the linkage of CAS program to the Trust Law, supports our view that the SPT will be protected by the Trust Law, and the entrusted assets will be segregated from the originators.

Having recognized the regulators' support for securitization in China, we note that there is no official securitization legislation in China for asset segregation and issuer bankruptcy remoteness. The CAS program guidelines provided by CBIRC and PBOC are administrative measures rather than legislation. And therefore there is a residual risk that the
measures may be subject to court challenges to the extent that they conflict with laws or other regulations.

**Collateral Assignment**

Typical car loan contracts in China have clauses addressing the transferrable and assignable nature of the receivables, meaning that the originators can sell/transfer the contracts to third parties without the borrowers' consent, pursuant to China's Contract Law. The asset eligibility criteria stipulated in this transaction confirms that the purchased receivables are assignable.

Legally, the issuer will have the title of the loans and the associated rights, including the mortgage, after the asset sale. Practically, however, the transfer will not be effective against the borrowers if the originator does not notify the borrowers of the transfer. Without such notification, although the receivables have been legally acquired by the issuer, the borrowers' payments will continue to be made to the originator or the initial servicer. This issue could be more complicated if the originator becomes insolvent, making it unable to issue a notice to borrowers that a trust has been created over the related loan and that borrowers should redirect their payments to the new lender.

The transaction addresses this concern by introducing a rights-perfection event upon the termination of the initial servicer. The occurrence of a rights-perfection event will cause the title and rights transfer to be perfected through the originator's notification to each borrower, each guarantor, if any, and the vehicle's insurance company. Such notification will state a trust has been created over the related loan and all payments on the loans should be made to the issuer accounts or the replacement servicer's account from then on.

Through an executed power of attorney upon transaction close, the originator has empowered the trustee to issue the transfer notices to individual obligors directly if the servicer does not do so, and to redirect the loans payments to the replacement servicer's account or the issuer's accounts.

**Note Terms And Conditions**

**Interest payments and overcollateralization percentages**

The class A notes are fixed-rate, pass-through notes. Interest payments on the class A notes rank in priority to interest payments on the subordinated notes. The subordinated notes will receive payments only after the class A notes' targeted overcollateralization level is reached.

The transaction does not have a principal deficiency ledger mechanism. Consequently, the concepts of charge offs, note invested amounts, and note stated amounts are not applicable in this transaction. Interest paid on each class of notes will be calculated on the outstanding principal, which is the initial principal as reduced by each principal repayments on previous payment dates.

The overcollateralization percentage for the class A notes is determined by subtracting the current balance of the class A notes from the current discounted receivables balance of the collateral pool--plus the accumulation account balance, if any, during the revolving period--and dividing the resultant figure by the current discounted receivables balance of the collateral pool--plus the accumulation account balance, if any, during the revolving period.
Principal payment structure: revolving period
Collections after meeting payment obligations in transaction expenses and note interest, and topping up the liquidity reserve will be allocated to the accumulation account during the revolving period to purchase new receivables from the seller. There will be no principal repayment to class A notes during the revolving period.

The transaction revolves for a year. However, if any of the early amortization events occur, the transaction will start amortizing. The acquisition of additional receivables in the revolving period is subject to documented eligibility criteria.

Principal payment structure: amortization
The transaction’s principal payment structure during amortization is not fully sequential. Principal will be initially paid to class A notes and subordinated notes on a sequential basis, until the class A notes reach a target balance, determined by the applicable class A target overcollateralization percentage. Thereafter, provided certain performance triggers have not been breached, and the class A target balance is maintained, collections may be allocated to payments that rank below principal payments on the class A notes.

There is no documented lock-out period from the commencement of amortization before collections may be allocated to paying subordinated note principal. Nevertheless, our cash-flow analysis of the transaction suggests that, under rating stresses commensurate with the rating assigned to the class A notes, collections would not be applied to pay subordinated note principal during the first two years of the amortization period.

In addition, the repayment structure will switch back to fully sequential principal repayments after the collateral pool has reached 10% of its initial discounted receivables balance, further mitigating tail-end risk.

Clean-up call
The originator has a "clean-up call" option to purchase the auto loans from the trust if the discounted receivables balance at the end of any month is 10% or less of the initial discounted receivables balance. The originator may exercise its clean-up call option only if the clean-up call price for the loans, together with amounts in certain issuer accounts, will be sufficient to repay in full the notes and all fees and expenses of the trust. Upon the originator's exercise of its clean-up call option, the notes will be redeemed and repaid in full and the trust will be liquidated.

Priority Of Payments
The transaction has a combined interest and principal cash-flow priority of payments. The pre-enforcement priority of payments after the revolving period has ended is summarized in table 1.

Table 1
<table>
<thead>
<tr>
<th>Priority Of Payments (Summarized)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Taxes: To pay any taxes of the trust due under PRC laws that have not been paid, if any</td>
</tr>
<tr>
<td>2 Servicer fee</td>
</tr>
<tr>
<td>3 Senior fees and expenses: To pay trustee, account bank, notes custodian and paying agent, rating agencies, and auditor</td>
</tr>
<tr>
<td>4 Interest on the class A notes</td>
</tr>
<tr>
<td>5 Top up the liquidity reserve to its required level</td>
</tr>
<tr>
<td>6 Class A note principal to the targeted balance</td>
</tr>
</tbody>
</table>
Table 1

<table>
<thead>
<tr>
<th>Priority Of Payments (Summarized) (cont.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>9</td>
</tr>
</tbody>
</table>

After the revolving period ends, the notes will be amortized sequentially until the class A notes reach their target balance, which is determined by the applicable class A note target overcollateralization level. Following that, provided the class A target balance is maintained, collections may be allocated to payments that rank below principal payments on the rated notes, such as the interest and principal payments on subordinated notes.

The target overcollateralization levels applied to determine the target balance of the notes depend on whether an asset performance trigger has been breached. If a trigger has not been breached, the class A and subordinated notes would continue to be amortized; however, there would be no further build up in credit support in percentage terms for class A notes because the target overcollateralization percentage would remain unchanged. If a performance trigger is breached, then the target overcollateralization level for the class A notes would increase, and principal payments would not be made on subordinated notes unless the class A notes had already reached and maintained their target balance.

The target overcollateralization level will be 100% for the class A notes, which translates to a fully sequential principal amortization structure for the transaction, if a performance trigger has been breached, a servicer replacement event occurs, or the discounted receivables balance is less than 10% of its initial balance.

Performance triggers

The performance triggers are as follows:

- Trigger level 1: The cumulative gross loss ratio exceeds 1.2% for any payment date before or during April 2021; 1.6% for any payment date from May 2021, but before or during December 2021.
- Trigger level 2: The cumulative gross loss ratio exceeds 2.0% at any time.

The target overcollateralization levels are set out in table 2.

Table 2

<table>
<thead>
<tr>
<th>Actual overcollateralization (%)</th>
<th>Target overcollateralization levels after revolving period (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>At closing</td>
<td>No trigger breached</td>
</tr>
<tr>
<td>Class A notes</td>
<td>10.33</td>
</tr>
</tbody>
</table>

Before the call date, after the class A notes reach their initial targeted balance, the transaction would only revert to a completely sequential principal payment structure if the cumulative gross loss ratio exceeds 2.0%. We analyzed the effect of a moderate stress on the transaction to determine whether the maximum expected rating transition of the notes under such a scenario would be in line with those set out in our “Methodology: Credit Stability Criteria,” published on May 3, 2010. The results of our analysis suggest that under a moderate rating stress, the maximum expected rating transition on the class A notes within time horizons of one year and three years would fall within the
bounds of those outlined in the criteria.

**Originator/Servicer Overview**

**Company background**

Volkswagen Finance (China) Co. Ltd. (VWFC) was founded in Beijing in August 2004. It is a wholly owned subsidiary of Volkswagen Financial Services AG (VWFS AG), the captive financing subsidiary of Volkswagen AG. As a manufacturer captive finance company, VWFC's primary business is to provide retail and wholesale financing for vehicle purchases in China that are related to Volkswagen AG Group, including vehicle brands such as Volkswagen, Audi, Škoda, Jetta, SOL, Porsche, Bentley, Scania, Lamborghini, and MAN. Supported car sales include locally manufactured vehicles from SAIC Volkswagen, JAC Volkswagen, and FAW-Volkswagen, and imported vehicles from Volkswagen AG. Only loan contracts financing the purchase of passenger cars will be securitized. VWFC also finances car purchases related to non-Volkswagen group manufacturers, but the percentage is as low as under 2.5% in the initial securitized pool.

The company's management team has extensive experience in either the automotive or finance industry, or both. In addition to its own risk and compliance/auditing function, VWFC benefits from its parent's support in risk management and the implementation of global policies and systems.

As of Dec. 31, 2018, VWFC conducts business in 308 cities in China and has 3,088 cooperative dealers. Total outstanding loan amount has seen stable growth since setup, reaching RMB60.31 billion as of Dec. 31, 2018--among the largest in all auto finance companies in China. VWFC's penetration rate in the car financing market remained stable at 12.8% as of Sept. 30, 2019.

The loan products being securitized in this transaction include VWFC's retail auto loan contracts secured by various brands of vehicles.

**Risk management**

VWFC's risk-management practice leverages the experience and capability of its parent company and global affiliates, with more than a decade of experience operating in China. Its local risk-management team plays a key role in credit risk assessment and suggestions, assurance of regulatory compliance, and operational risk prevention and management. The function also includes collection management and internal reviews.

Fraud prevention is a major risk-management item for the whole company. The primary fraud-prevention controls at VWFC include the limitation of access rights to loan-application documents, verifying each borrower's identity, and checking income and property. Additional measures include monitoring the performance of dealers, reviewing borrowers' other financial activities, and conducting telephone interviews. The company's historical default as a result of fraud has declined in recent years due to the implementation of many antifraud measures, although there were some rising cases of fraudulence in 2019 amid the economic slowdown.

The risk-management team also conducts periodic reviews of its credit-scoring system. The frequency and scope of such reviews is similar to those of its global affiliates. The results of reviews and historical loan performance can be fed into the system to improve their predictability.
VWFC uses a comprehensive IT system to support loan application, underwriting and settlement; loan performance tracking; loan collections; and other critical business functions. The IT infrastructure also supports the full life of ABS, including loan performance extraction, loan selection and flagging, and payment tracking. Such support is critical to the prevention of operational risk. In our view, VWFC’s IT operation guidelines, system back-up, and BCM reflect strong parent support, and meet global standards.

**Loan origination and underwriting**

More than 3,000 auto dealerships across China act as the first-contact points for potential borrowers of VWFC auto loan products. The dealerships provide loan product introductions, preliminary loan terms suggestions, verify each borrower’s identity, and collect supplementary documents. The dealerships enter loan application data in VWFC’s contract management system.

VWFC has five major retail auto loan products:

- **Non-Balloon Credit—New Car**: This is VWFC’s most common loan contract. A customer repays the loan in equal monthly payments during the term of the contract. The term of the loan is usually between 12 months and 60 months. The down payment must be at least 20% of the car price for traditional power vehicles and 15% for new energy cars. VWFC also offers structured contract with different monthly payments set for different stages. The total term of the structured contract should be less than 36 months. Currently, tier-down payment, whereby the monthly payments reduce at pre-set stages over the life of the loan, prevails in such structured contracts.

- **Non-Balloon Credit—Used Car**: This is a traditional monthly level repayment loan applied to preowned car financing. The term of the loan is usually between 12 to 36 months. The down payment must be at least 30% of the car price. In terms of structured contract for used car loans, VWFC only offers tier-down monthly payment option.

- **Balloon Credit**: A customer can maximize flexibility on monthly payments by providing a down payment and final balloon payment under such contracts. The term of loan is usually between 12 months and 48 months. The down payment must be at least 20% of the car price. The maximum size of balloon payment is 25% of the original loan amount.

- **Exquisite Easy Loan**: This is another balloon loan product, but has a higher down payment and higher balloon amount, (and hence lower monthly payment).

- **Enjoyable Balance Loan**: This is a short balloon loan with interest-only payment before the loan maturity. The down payment ratio could be high and the tenor is short.

Although dealers refer borrowers and help to enter loan-application data, VWFC undertakes all credit review and checking processes thereafter. The dealers cannot influence the review/approval process; all credit decisions are centralized within VWFC. Additionally, VWFC’s credit review and approval department is separated from the company’s sales department, which manages the relationship with the dealerships.

After VWFC receives a loan application and related documents from the dealerships, VWFC's credit-scoring system will review the application and suggest it for automatic approval, refer the application for a manual review, or reject the application. Loan applications are subject to a manual review if the score deviates from that required for automatic rejection or approval, the borrower's credit history is insufficient, or due to other risk-based features such as a large loan amount.
VWFC’s credit-scoring system uses the same framework as VWFS AG’s global practices, but has different parameters to reflect local borrower features. The scoring system considers borrowers’ credit history, contract terms, and borrower information. It is a behavior-prediction model that can be calibrated with past performance data. Key reasons for rejection include credit history, borrowers’ financial background, job stability, and income level.

Credit reviewers and approvers will handle cases referred by the credit-scoring system. They might conduct telephone interviews, validate information, do on-site visits, and make suggestions for the credit decisions.

The credit process includes checks on each borrower’s identity, the borrower’s credit history, and affordability in the PBOC Credit System, a nationwide credit reference system.

According to VWFC, the scoring system automatically approves nearly 70% of loan applications. The remaining applications are reviewed manually.

For an approved case, VWFC will notify the dealer/customer, and ask the dealer to send documentation. The retail customer care department’s disbursement team is responsible for loan disbursement. The team checks loan documents and vehicle registration. VWFC systematically manages contract document creation, receipt, use and storage to ensure proper documentation and maintenance of legal enforceability against the loan borrowers.

**Stringent regulatory oversight and characteristics of prime loans**

VWFC’s loan underwriting policies reflect the more stringent regulatory control on auto loan risks. The 2017 amended “Auto Loans Management Guideline” promulgated by the PBOC and CBIRC constitutes certain basic loan underwriting requirements that all auto finance companies and commercial banks must follow in their auto loan business. These are:

- The borrowers need to have good credit history, demonstrating stable income or other property to support the down payment and continued debt servicing.
- The term of the loan financing a new vehicle should not be longer than five years, and the terms for a preowned vehicle loan should not be longer than three years.
- The highest LTV ratio on retail loans is 80% for new vehicles, except defined new energy cars, and 70% for preowned vehicles.
- The value of the vehicle for the calculation of LTV ratio should be the lower of the manufacturer’s suggested vehicle price and the amount actually paid by the purchaser (for new vehicles).

Borrowers with good credit quality and debt serviceability are no longer required to mortgage the vehicles financed by such loans or other collateral to the lenders after the amendment. However, all loans in the securitized pool as of the initial cut-off date and relevant cut-off date during the revolving period when new loans are purchased are secured by mortgages over the financed vehicles, and mortgage registration or mortgage contract is required.

In January 2008, CBIRC (the former CBRC) announced an administrative guideline in relation to auto loan risks, and asked financial institutions to enhance their fraud-prevention measures, validation of documents, use of credit check systems, and collection management. Since then, the CBIRC and PBOC have carried out ongoing surveillance of industry developments and loan quality trends, and they could intervene by issuing growth targets or loan-origination
guidelines to the industry.

We believe the strict regulatory oversight and continued surveillance explains the generally sound performance of auto loans in China since 2009. Moreover, although auto loan penetration has increased to 40%-50% in China in recent years, competition within the industry has not been as fierce as in other markets. We have observed that auto financiers do not try to use looser underwriting practices or higher-risk products as leverage to grow their business. This also partly explains the stable loan performance observed in China's auto loans industry.

The stringent regulations that apply to loan underwriting and the industry's aversion to riskier borrowers and products support prudent underwriting. We believe the characteristics of VWFC's auto loan borrowers are consistent with those we typically observe for prime borrowers in other markets. Our view is supported by VWFC's information checks and document-verification processes, its centralized and independent loan-review process, and the low default and loss rate that we have observed in its historical arrears performance data.
Loan servicing
VWFC will be responsible for servicing the receivables in the collateral pool. Its customer care and risk-management departments track and manage loan repayments.

Almost all borrowers repay their loans through direct-debit repayments into VWFC's account. To do this, all borrowers need to maintain a bank account at VWFC-designated banks, and deposit sufficient money for periodic loan repayments. Each of these banks has a nationwide network in China for such service.

VWFC's internal information technology system tracks whether borrowers make payment on time and in full, and alerts the customer service department of delinquencies. VWFC has defined processes and timelines for the management of contracts in arrears and post-delinquency collection. For example, the collection team conducts or coordinates telephone contact for overdue loans, on-site collection for severe delinquency, manages outsourced collection activities, and manages the legal and foreclosure process with support from the legal department.

The collection measures and method of borrower contact depend on the length of delinquency. The whole process starts days before the payment date with a loan payment reminder, and ends when VWFC believes the prospect of loan recovery is remote and decides to write off the loan, or when the whole owed amount is fully repaid. VWFC may arrange obligors' repayment, and voluntary or involuntary vehicle sales for borrowers to repay the loans. For any remaining amount owed to VWFC after vehicle sale, including costs and expenses incurred during the collection process, VWFC has the right to continue pursuing the borrowers, due to the full-recourse nature of the loans. The guidelines and practice for collections are comprehensive and detailed, in our view.

Collateral
The initial pool contains 100,377 consumer loan contracts, secured by vehicles manufactured by Volkswagen AG group, its local affiliates, and other producers. The aggregate discounted receivables balance is about RMB6 billion. VWFC will entrust the receivables and associated rights to the issuer. Title can be perfected if any servicer replacement event occurs, such as servicer insolvency and an unremedied breach of a material covenant that has a material adverse effect.

Some of the distinct features of the initial collateral pool are as follows:

- Some 95.66% of the portfolio comprises receivables that are backed by new passenger vehicles. Historical data in other markets show that losses are typically lower for loans when new vehicles are financed than for used vehicles being financed.

- Less than 1% of the loans in the asset pool are balloon loans. The remainder are fully amortizing, with level payments of principal and interest each month.

- The transaction has a diversified pool of 100,377 loans, with the largest single loan accounting for 0.08% of the initial discounted receivables balance. Borrower concentrations consequently do not present an additional risk for this transaction.

- The collateral pool is somewhat seasoned, with a weighted-average contract seasoning of 8.59 months, as of the cut-off date.
• All contract payments, including interest, principal, and expenses, are full-recourse obligations of the borrowers. As a result, the trust is not exposed to any market-value risk associated with the sale of the motor vehicles (on performing receivables), which is a risk that may be associated with other products, such as operating leases.

The receivables pool for Driver China ten Trust as of Feb. 29, 2020, is summarized in table 3.

**Table 3**

<table>
<thead>
<tr>
<th>Pool Characteristics (Percentage Of Pool By Outstanding Discounted Receivables Balance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer type</td>
</tr>
<tr>
<td>Individual</td>
</tr>
<tr>
<td>Corporate</td>
</tr>
<tr>
<td>New and used (financed vehicle)</td>
</tr>
<tr>
<td>New</td>
</tr>
<tr>
<td>Used</td>
</tr>
<tr>
<td>Loan payment method</td>
</tr>
<tr>
<td>Direct debit</td>
</tr>
<tr>
<td>Seasoning (months)</td>
</tr>
<tr>
<td>Less than or equal to 12</td>
</tr>
<tr>
<td>Greater than 12 and less than or equal to 24</td>
</tr>
<tr>
<td>Greater than 24 and less than or equal to 36</td>
</tr>
<tr>
<td>Greater than 36 and less than or equal to 48</td>
</tr>
<tr>
<td>Greater than 48 and less than or equal to 60</td>
</tr>
<tr>
<td>Remaining term to maturity (months)</td>
</tr>
<tr>
<td>Less than or equal to 12</td>
</tr>
<tr>
<td>Greater than 12 and less than or equal to 24</td>
</tr>
<tr>
<td>Greater than 24 and less than or equal to 36</td>
</tr>
<tr>
<td>Greater than 36</td>
</tr>
<tr>
<td>Effective interest rate (after considering subsidy from VW) (%)</td>
</tr>
<tr>
<td>Less than or equal to 5.00</td>
</tr>
<tr>
<td>Greater than 5.00 and less than or equal to 6.00</td>
</tr>
<tr>
<td>Greater than 6.00 and less than or equal to 7.00</td>
</tr>
<tr>
<td>Greater than 7.00 and less than or equal to 8.00</td>
</tr>
<tr>
<td>Greater than 8.00 and less than or equal to 9.00</td>
</tr>
<tr>
<td>Greater than 9.00 and less than or equal to 10.00</td>
</tr>
<tr>
<td>Greater than 10.00 and less than or equal to 11.00</td>
</tr>
<tr>
<td>Greater than 11.00 and less than or equal to 12.00</td>
</tr>
<tr>
<td>Greater than 12.00 and less than or equal to 13.00</td>
</tr>
<tr>
<td>Greater than 13.00 and less than or equal to 14.00</td>
</tr>
<tr>
<td>Greater than 14.00 and less than or equal to 15.00</td>
</tr>
<tr>
<td>Greater than 15.00 and less than or equal to 16.00</td>
</tr>
<tr>
<td>Discounted receivables balance (RMB)</td>
</tr>
<tr>
<td>Less than or equal to 50,000</td>
</tr>
<tr>
<td>Greater than 50,000 and less than or equal to 100,000</td>
</tr>
</tbody>
</table>
Table 3

<table>
<thead>
<tr>
<th>Pool Characteristics (Percentage Of Pool By Outstanding Discounted Receivables Balance) (cont.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater than 100,000 and less than or equal to 150,000</td>
</tr>
<tr>
<td>Greater than 150,000 and less than or equal to 200,000</td>
</tr>
<tr>
<td>Greater than 200,000 and less than or equal to 250,000</td>
</tr>
<tr>
<td>Greater than 250,000 and less than or equal to 300,000</td>
</tr>
<tr>
<td>Greater than 300,000 and less than or equal to 350,000</td>
</tr>
<tr>
<td>Greater than 350,000 and less than or equal to 400,000</td>
</tr>
<tr>
<td>Greater than 400,000</td>
</tr>
</tbody>
</table>

Manufacturer

| Volkswagen Group                                                                     | 97.79 |
| Non-Volkswagen Group                                                                 | 2.21  |

The obligor concentrations for the collateral pool are set out in table 4.

Table 4

<table>
<thead>
<tr>
<th>Obligor Concentrations (Percentage Of Pool By Outstanding Discounted Receivables Balance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The largest obligor</td>
</tr>
<tr>
<td>The largest 10 obligors</td>
</tr>
<tr>
<td>The largest 20 obligors</td>
</tr>
</tbody>
</table>
Charts 2 to 6 illustrate characteristics of the collateral portfolio.

**Chart 2**

**Securitized Loans**
Outstanding discounted receivables balance

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RMB—Chinese renminbi.

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Chart 3
Securitized Loans
Seasoning distribution

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Chart 4

Securitized Loans

Remaining term to maturity (months)

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Chart 5

Securitized Loans
Effective interest rate distribution

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Eligibility Criteria

The representations and warranties made by VWFC in respect of the receivables on the initial and any additional
cutoff date for each asset transfer during the revolving period include that each loan securitized is an eligible asset,
which is defined as follows:

- All financed objects are insured with the originator named as the first loss payee during the first year of the term of
  the relevant loan;
- The loan contracts constitute legal, valid, binding and enforceable agreements;
- The purchased receivables are assignable, and the loan contracts require monthly payments;
- VWFC is entitled to dispose of the loan receivables free from rights of third parties;
- The purchased receivables are free of defenses, whether peremptory or otherwise, for the agreed term of the loan
  contracts as well as free of rights of third parties and that the borrowers in particular have no set-off claim thereto or
  thereunder or the status and enforceability of the purchased receivables is not impaired by set-off rights;
- No purchased loan receivable is overdue;
• The status and enforceability of the purchased receivables is not impaired due to warranty claims or any other rights of the borrowers;

• None of the borrowers is an employee of an affiliate of Volkswagen AG or of the originator;

• According to the originator's records, no termination of any loan contract has occurred;

• The loan contracts shall be governed by the laws of China and have not been concluded prior to January 2008;

• The loan contracts have been entered into exclusively with the borrowers, which have their registered office in China if they are corporate entities or their place of residence in China if they are individuals;

• On the cutoff date, at least two contractual instalments, which include interest payments, have been paid in respect of each of the purchased receivables and that each purchased loan receivable requires monthly payments to be made within 60 months of the date of origination of each loan contract and may also provide for a final balloon payment;

• Each of the purchased receivables will mature no earlier than six months and no later than 58 months after the cutoff date;

• The total outstanding amount of purchased receivables entrusted hereunder pursuant to the loan contracts with one and the same borrower does not exceed RMB4 million in respect of any single borrower;

• The loan contracts, which are subject to the provisions of PRC law on consumer financing, comply in all material respects with the requirements of such provisions;

• According to the originator's records, no insolvency proceedings have been initiated against any of the borrowers during the term of the relevant loan contract up to the cutoff date;

• Each loan contract under which the relevant loan receivables arise provides for a mortgage of the relevant financed object;

• The purchased receivables are "normal" loans according to CBIRC's "five-category" loan classification method;

• The purchased receivables are denominated in renminbi;

• At the time each loan contract was entered into, the loan receivable under such loan contract was approved by the originator in the ordinary course of the originator's business; and

• The maximum delinquent days of each purchased receivable were historically no more than 60 days.

Commingling Risk

Our counterparty criteria consider a transaction's commingling risk through the rating on the servicer, the amount of funds likely to be held in a servicer account at any given time, and the potential impact of a delay in receipt of those funds on the supported securities. In our opinion, there is potential commingling risk in this transaction if the servicer defaults, because VWFC, acting as the servicer in this transaction, can hold the collections for a period of one month before remittance to the SPT account.

A commingling reserve account--called the monthly collateral account in this transaction--will be established for this transaction with the account bank upon closing. The servicer will deposit an amount equal to about 15 days' expected collections in a monthly collection period into the the monthly collateral account around every 15 days if the servicer's
rating is lowered to a certain level in the scales used by local ratings agencies in China. Under such a scenario, the
servicer would also remit the asset collections to the issuer account about every 15 days.

The mitigating mechanism is in line with transactions we rate in other markets. However, the rating triggers that
require the originator to deposit into the monthly collateral account do not include our ratings. Without the ratings
triggers on VWFC, the current transaction arrangement does not sufficiently mitigate commingling risk in accordance
with our counterparty criteria, given that the collection holding period could be long. However, the servicer commits
to also switch the monthly collections remittance to a 15-day remittance and to post an equivalent level of
commingling loss to the commingling reserve account if VWFC’s parent’s rating falls below a certain rating by S&P
Global Ratings. This arrangement, along with VWFS AG’s public announcement in its annual report that it will exert its
influence to ensure its affiliated companies (VWFC included) meet their liabilities, establishes a creditworthiness
linkage between VWFC and VWFS AG. It also provides a level of comfort that a sudden failure of VWFC without its
parent breaching this rating trigger is a more remote scenario. For this reason, we have assumed that only half a month
of collections might be lost before collections could be redirected to the SPT accounts or the accounts of the
replacement servicer when the original servicer becomes insolvent. We have considered this half-month collection loss
in our cash-flow analysis of the transaction. This results in a higher level of minimum credit enhancement under ‘AA’
rating stress scenarios than that suggested by our credit loss assumptions.

**Set-Off Risk**

There is no set-off risk for cash deposits in this transaction because VWFC is not an authorized deposit-taking
institution in China. In addition, the representations and warranties provided by VWFC in respect of the collateral pool
include that the borrowers in particular have no set-off claim thereto or thereunder the loans, or the status and
enforceability of the purchased receivables is not impaired by set-off rights.

**Counterparty Risk With Respect To The Bank Account Provider**

Issuer accounts for this transaction, including the accumulation account; the distribution account; the cash collateral
account, which is the liquidity reserve account; and the monthly collateral account, which is the commingling reserve
account, will be held with Bank of China pursuant to the account agreement. The agreement requires minimum ratings
for the account provider, as per the ratings scales of ratings agencies in China. Moreover, the bank will be replaced if
the ratings on the bank are lower than ‘A-’ within 30 calendar days of the downgrade. This arrangement meets our
counterparty criteria to support a ‘AA’ rated transaction, considering the transaction’s cash-flow arrangement.

**Counterparty Risk With Respect To The Servicer**

VWFC cannot resign from its role as the initial servicer, but can be removed if a servicer termination event occurs.
Such an event might happen if VWFC failed to duly observe or perform in any material respect any of its covenants or
agreements, and which failure materially and adversely affected the rights of the noteholders, or if it were to become
insolvent or is disqualified by the regulators. The transaction does not have a back-up servicer upon transaction close.
Only if the ratings on VWFC fall below a certain level, as per local rating agencies' rating scales, will a noteholders' meeting appoint a back-up servicer. This raises concern because China securitization transactions to date have not experienced the critical stress of a failure of important counterparties, including the servicers. Therefore, the potential resultant negative effect on transaction cash flows is uncertain.

Prime auto transactions in other markets do not typically include back-up servicers upon transaction close, because of the high credit quality and homogeneous nature of the receivables, combined with the availability of institutions experienced in servicing them. Unlike other markets, where the trustees of transactions may become the successor servicer in situations when no other substitute has been appointed, we consider that trustees in China would not take this role due to their trust company nature and the sheer volume of loan accounts and their geographic dispersion. We believe that in China the most likely servicer replacement would be other auto finance companies or commercial banks that have a nationwide network for loan collections.

Moreover, almost all normal loan payments in this transaction will be collected through the direct debit of borrowers' cash accounts in national banks rather than by other more demanding collections processes. This will reduce the workload of the servicer and make it easier to find a replacement. We have also considered the servicer fees level and believe it is sufficient to attract a replacement. The transaction includes a liquidity reserve that is funded up front and could cover three to four months of transaction expenses and rated note interest should asset collections be temporarily unavailable to meet the transaction obligations. In our view, this will allow the transaction sufficient time to find a new servicer and resume asset collections.

**Liquidity Support**

Timely payment of senior expenses and rated note interest is supported by the use of principal collections through the combined waterfall, and a liquidity reserve funded at closing by VWFC, equal to 1.2% of the initial discounted receivables balance.

The liquidity reserve is held in the liquidity reserve account, which is called the cash collateral account in this transaction. It will amortize, but be topped up to and maintained at a floor of RMB60 million or the aggregate outstanding balance of the class A notes to the extent funds are available on each payment date for this purpose. On each payment date, the trustee may draw funds in the cash collateral account if asset collections are insufficient to cover any tax, senior fees/expenses, servicing fees, and interest due to the class A notes.

We assume in its cash-flow adequacy analysis of the transaction that a half-month of collateral collections will be lost due to the potential servicer commingling risk. In such a scenario, the liquidity reserve would provide liquidity support for the transaction. Based on our cash-flow analysis, we believe the risk of a portion of the principal collections required to repay the rated notes being diverted to meet senior expenses under rating stress assumptions, especially in the later months of the transaction life, is partially mitigated by the ability to apply balance of the liquidity reserve toward repayment of principal on the rated notes on their maturity date.
Interest-Rate Risk

The collateralized loans carry fixed interest rates, and the interest rate is fixed on the class A notes. As a result, interest-rate risk arises from the insufficiency of asset yields to cover note coupon payments, rather than basis or fixed-rate to floating-rate mismatching. We have conducted various cash-flow analyses to assess the effect of insufficient asset yields, and the extent of principal usage to cover senior expenses and note coupon payments.

Credit And Cash-Flow Analysis

We consider a significant performance deterioration of the underlying receivables to be the principal factor affecting rating transition in this transaction. We have applied our criteria titled, "Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables," published Oct. 9, 2014, to the credit risk analyses in this transaction.

Historical performance data

We received the following historical performance data for auto loan pools originated by VWFC:

- Static pool data grouped by origination month, including detailed origination amounts, repayments every month, and delinquency every month. The data include vintage performance data from August 2010 to November 2019.


The pay-out ratio for each quarterly vintage is depicted in chart 7.

**Chart 7**

**Volkswagen Finance (China) Co. Ltd.**

Payout ratio of loan vintages

VWFC generally sets 90-plus and 120-plus days delinquencies for the recognition of loan defaults and loan losses, respectively. A loan can also be deemed defaulted or irrecoverable due to termination or detected fraud.

In our credit risk analysis, we have assumed all loans that are delinquent for more than 90 days would default, and used this classification to determine the base-case default frequency for the securitized pool. This assumption reflects the low but stable cure rates—returning from delinquency to current—of loans overdue for more than 90 days, and the practical collection operations VWFC adopts as an aforementioned definition.

We assumed that loans that were charged off would be deemed as a loss due to the remote prospect of recovery. We used this as a benchmark to estimate the recovery after defaults for the collateral pool.
Charts 8 and 9 illustrate the cumulative default and cumulative loss experience of VWFC’s total auto loan portfolio, based on our assumptions of deemed default and deemed loss, from August 2010 to November 2019.

Chart 8
Percentage Of Loans Delinquent For More than 90 Days
Historical performance

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Data limitations

There was a limit to the data we received in respect of the credit risk analysis for this transaction.

**Historical performance data reflect VWFC’s whole portfolio, rather than just the fully amortized loans to finance VW-brand vehicles:** Loans to be securitized are mostly fully amortizing loans, with level interest and principal repayment each month. The aggregate loan pool includes other products, such as balloon loans.

We believe this data constraint has resulted in limited data distortion because the level-payment, fully amortized loans initially represent more than 99% of the loan pool, and there is only a remote chance that balloon loans might perform better than the fully amortized loans, partly offsetting the worse performance of the level-payment fully amortized pool as a result.

**Relatively short operation history of China auto captive finance companies limits the availability of historical performance data under economic stress:** There are around nine years of performance data available for our credit risk analysis in this transaction. However, the loans have not experienced true stress periods. This makes default and loss projections purely based on the historical performance data more difficult.

In this case, we have considered different default extrapolation techniques to gauge the full-life loan default behavior. We also placed more weighting on the worse-performing vintages when determining base-case default rates and
applied a higher stress multiple to reflect higher expected loss under stress conditions.

**Base-case assumptions and stressed default and loss**

Our base-case default assumption for the collateral pool is 1.3%, based on the historical performance observed in the static pool and dynamic pool data. We applied a stress multiple to the base-case default percentage in the 'AA' rating category. The magnitude of the stress multiple that we applied reflects the 'AA' rating on the notes, the underlying pool's revolving nature that could render a portfolio profile different from the initial pool, and our consideration of the relatively short development history of auto loan securitization in China. As a result, the stress multiples assumed in this transaction are slightly higher than those we used in static-pool transactions from the same seller.

We have taken into account the short remaining terms of the initial loans--96% loans are 36 months or less--that make the risk exposure period of the pool relatively short.

We gave limited credit to recoveries. Our base-case recovery assumption for the collateral pool is 10.0%, which we derived from the migration analyses of the "delinquent for more than 90 days" and "delinquent for more than 180 days" buckets. We gave 50% credit to the 10% base-case expected recoveries to arrive at a loss severity assumption of 95% for the 'AA' rating level. Although some loans in the collateral pool may not have mortgage registrations, known as waiving mortgage registration (WMR) loans, VWFC says it targets such WMR loans at borrowers of higher debt serviceability, e.g. those with higher down payment or a guarantor. We consider our stressed default and loss severity assumptions for this transaction to be sufficient to capture any potential increase in risk associated with the inclusion of WMR loans.

Table 5 shows a summary of the credit assessment.

**Table 5**

<table>
<thead>
<tr>
<th>Credit Assessment Summary</th>
<th>AA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base-case default frequency (%)</td>
<td>1.3</td>
</tr>
<tr>
<td>Stress multiple used (x)</td>
<td>5.5</td>
</tr>
<tr>
<td>Default frequency (%)</td>
<td>7.15</td>
</tr>
<tr>
<td>Loss severity (%)</td>
<td>95.0</td>
</tr>
<tr>
<td>Minimum credit support after credit to recovery (%)</td>
<td>6.8</td>
</tr>
</tbody>
</table>

**Cash-flow analysis**

We analyzed the capacity of the transaction's cash flows to support the rated notes during amortization--i.e., timely interest payments and repayment of principal by the legal maturity date--by running several different scenarios correlated with a 'AA' rating level for the class A notes.

Our cash-flow analysis included various scenarios that reflect different combinations of the following factors:

- Level of defaults and recoveries commensurate with the rating level;
- Various default amount and default timing distribution;
- Potential credit losses during the revolving period.
- Recovery period, which we assume to be nine months;
• Stressed fees and expenses upon servicer transition and unexpected expenses increase;
• The loss of collections due to the potential commingling risk; and
• Different prepayment rates.

We modeled three different default curves—front loaded, back loaded, and normal—to evaluate the effect on cash flow of various pool default amounts and default timing distributions. The curves we employed primarily reflected the default timing that we observed in VWFC’s static default curves.

For the prepayment rates, we modeled two different prepayment curves. The prepayment stresses that we assumed include voluntary and involuntary (default) prepayments (table 6). We use a high constant prepayment rate (CPR) test—going to 10% annualized CPR within six months, which is 4x-5x the historical level—to assess the effect of prepayment loss due to the potentially earlier payment of higher-yield assets. We also employed a low CPR test to assess the effect of continued negative carry due to the very high proportion of low-yield contracts in the pool.

Table 6

<table>
<thead>
<tr>
<th>Months from transaction close</th>
<th>Low CPR (% per year)</th>
<th>High CPR (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.0</td>
<td>4.0</td>
</tr>
<tr>
<td>2</td>
<td>0.0</td>
<td>6.0</td>
</tr>
<tr>
<td>3</td>
<td>0.0</td>
<td>7.0</td>
</tr>
<tr>
<td>4</td>
<td>0.0</td>
<td>8.0</td>
</tr>
<tr>
<td>5</td>
<td>0.0</td>
<td>9.0</td>
</tr>
<tr>
<td>6-11</td>
<td>0.5</td>
<td>10.0</td>
</tr>
<tr>
<td>12-17</td>
<td>1.0</td>
<td>10.0</td>
</tr>
<tr>
<td>18-23</td>
<td>1.5</td>
<td>10.0</td>
</tr>
<tr>
<td>24 onward</td>
<td>2.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>

*Total CPR shown is inclusive of voluntary and involuntary (defaults) prepayments.

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

The transaction can sustain all scenarios that we analyzed in our cash-flow adequacy tests. Listed in order of effect on the transaction, the following are some of the noteworthy features of the transaction cash flows:

• There is potential commingling risk in this transaction if the servicer defaults. This is because VWFC, acting as the servicer in this transaction, can hold the collections for a period of one month before remittance to the SPT account. Our cash-flow analyses indicate that the timing and amount of commingling loss play a crucial role in the cash-flow test outcome. According to our analyses, the class A notes can sustain commingling losses happening at all times and in different amounts under their respective rating stresses.

• The cash-flow analysis indicates scenarios with the majority of loan defaults occurring later in the transaction’s life will result in the transaction experiencing more principal collections used to cover fixed transaction costs, which may consume more credit support of the transaction. Our cash-flow analysis shows that under these scenarios, the cash-flow buffer will decrease significantly, but the transaction can still pay note interest on time and repay all notes before the legal maturity.
Receivables with a contractual interest rate above the discount rate are purchased above par value (i.e., the purchase price of the receivable is more than 100% of its actual outstanding principal balance). This may introduce losses from prepayments because when borrowers prepay or default, they repay only the receivable's par value. In this case, the issuer will incur a loss. We however do not incorporate prepayment losses in our cash-flow model. That is because of the relatively high discount rate and low asset yield of the transaction that makes the majority of assets being purchased below par. This in turn contributes to a very remote likelihood of prepayment loss resulting from prepayment of high-yield assets.

Sensitivity Analysis

We cash-flow modeled two additional scenarios to determine how vulnerable the notes would be to a lowered rating under each scenario:

- Scenario 1: Base-case default frequency is 25% higher than our expected level of 1.3%; and
- Scenario 2: Base recoveries are only 75% of our expected base recovery rate of 10%.

The minimum credit support under each scenario is set out in table 7.

<table>
<thead>
<tr>
<th>Table 7</th>
<th>Minimum Credit Support After Credit To Recovery (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario</td>
<td>AA</td>
</tr>
<tr>
<td>Expected</td>
<td>6.8</td>
</tr>
<tr>
<td>Scenario 1</td>
<td>8.5</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Table 8 sets out what the rating level of each class of notes would be at transaction close under each scenario.

<table>
<thead>
<tr>
<th>Table 8</th>
<th>Rating Transition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scenario</td>
<td>Class A notes</td>
</tr>
<tr>
<td>Expected</td>
<td>AA (sf)</td>
</tr>
<tr>
<td>Scenario 1</td>
<td>A (sf)</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>AA (sf)</td>
</tr>
</tbody>
</table>

Potential impact of COVID-19

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak around midyear, and we are using this assumption in assessing the economic and credit implications. In our view, the measures adopted to contain COVID-19 have pushed the global economy into recession which could also hurt employment levels or housing markets (see our macroeconomic and credit updates here: www.spglobal.com/ratings).

At this stage we expect the new coronavirus outbreak is likely to affect China's economic growth for two to three quarters. We believe our 'AA' stressed default frequency already captures the borrower default risk for this transaction. However, we consider that the repayment capability of some obligors in the underlying pool may be temporarily
impaired. Accordingly, we undertook additional cash flow sensitivity analysis, in which we assumed for each of the first six months of the transaction, that receipt of a portion of each month's collections would be delayed for a period of six months. Our analysis shows that the transaction's cash flows are sufficient to meet note interest and senior expenses under our rating stress scenarios. In our view, such potential risk is largely mitigated by the liquidity reserve, ability to apply principal draws to cover interest shortfalls if any, and the credit enhancement provided in this transaction.

Related Criteria

• Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
• Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
• Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
• Criteria | Structured Finance | ABS: Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables, Oct. 9, 2014
• Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
• Criteria - Structured Finance - General: Criteria Methodology Applied To Fees, Expenses, And Indemnifications, July 12, 2012
• General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
• Criteria | Structured Finance | General: Methodology For Servicer Risk Assessment, May 28, 2009

Related Research

• Credit FAQ: How S&P Global Ratings Factors In The Potential Effects Of The COVID-19 Outbreak When Analyzing China Auto ABS And RMBS, March 4, 2020
• China Structured Finance Outlook 2020: Performance To Diverge Amid Flat-To-Modest Issuance Growth, Feb. 6, 2020
• China Auto ABS And RMBS Must Brace For Coronavirus Impact, Feb. 3, 2020
• An Overview Of China's Auto Finance Market And Auto Loan Securitization, March 12, 2019
• Securitization Performance Watch – China, published quarterly
The issuer has not informed S&P Global Ratings whether the issuer is publicly disclosing all relevant information about the structured finance instruments that are subject to this rating report or whether relevant information remains non-public.

REGULATORY DISCLOSURES

Please refer to the initial rating report for any additional regulatory disclosures that may apply to a transaction.