VCL Multi-Compartment S.A. Compartment VCL 27

New Issue

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Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (February 2018)

Analysts

Michael Ecke
+49 69 768 076 139
michael.ecke@fitchratings.com

Thomas Krug, CFA, CAIA
+49 69 768 076 252
thomas.krug@fitchratings.com

Capital Structure

Class	Rating	Outlook	Amount (EURm)	CE[a] (%)	Interest Rate (%)	Final Maturity
A	AAAsf	Stable	900.0	7.0	1m Euribor + 0.4%	August 2024
B	A+sf	Stable	18.2	5.1	1m Euribor + 0.68%	August 2024
Subordinated Loan	NRsf	n.a.	29.6	n.a.	1m Euribor + 1.32%	August 2024
Total Issuance (excl. sub-loan)			918.2			

Closing occurred on 26 November 2018. The transfer of the portfolio to the issuer occurred on 26 November 2018. The ratings assigned above are based on the portfolio information as of 31 October 2018, provided by the originators. The offering circular and other material should be reviewed prior to any purchase.
[a] The credit enhancement (CE) figure includes overcollateralisation (6.0%) and the reserve fund floor of 1% of the initial portfolio balance. The initial size of the reserve is 1.2%.

Transaction Summary

VCL Multi-Compartment S.A. Compartment VCL 27 (VCL 27) is a securitisation of auto lease receivables originated to German companies and individuals by VW Leasing GmbH (VWL, the seller), a subsidiary of Volkswagen Financial Services AG (VWFS), itself a subsidiary of Volkswagen AG (VW, BBB+/Stable/F2).

Key Rating Drivers

Small Loss Expectation: Fitch Ratings determined a loss base case of 0.5% for the portfolio. Fitch views the benign economic environment in Germany and VWL's robust underwriting and collections process as main performance determinants. The loss base case is based on default and recovery base cases of 1.5% and 67.5%, respectively. Fitch applied a 'AAA' default multiple of 6x to reflect the low default base case and the agency's through-the-cycle approach.

Sensitivity to Pro Rata Period: The transaction features a pro rata allocation mechanism if certain target overcollateralisation (OC) conditions are fulfilled and loss triggers are not breached. The length of the pro rata period and thus outflow of funds to junior positions in the waterfall is driven by the lifetime loss in combination with loss timing and the amortisation profile together with prepayments.

As such, smaller losses in combination with a back-loaded timing may lead to a later switch back to sequential note amortisation and could be more detrimental for the notes than larger losses with a front-loaded timing.

Reserves Cover Seller-Related Risks: There is no back-up servicer. However, payment interruption risk is addressed by an adequately sized cash reserve providing for at least 10 monthly payments of senior fees, swap payments and notes' interest. Furthermore, a dedicated risk reserve serves as protection against potential seller-related obligations (including tax risks).

Commingling Risk Addressed: Upon VW's rating falling below 'BBB' or 'F2', or the profit-and-loss sharing agreement between VW and VWFS or between VWFS and VWL ceasing to be in effect, expected monthly collections will need to be distributed in advance by VWL to the issuer's account. Fitch considers this mechanism to adequately address commingling risk.

Transaction Comparison Table

Issuer	VCL Multi-Compartment S.A. Compartment 27	VCL Multi-Compartment S.A. – Compartment 22	Bavarian Sky S.A. Compartment German Auto Loans 8	Red & Black Auto Lease Germany 2 S.A.
Type	Static	Static	Static	Revolving (12m)
Closing date	November 2018	November 2015	May 2018	December 2016
Seller	VW Leasing GmbH	VW Leasing GmbH	BMW Bank GmbH	ALD AutoLeasing D GmbH
Issuance volume (EURm)	918.2	820.5	1,075.3	730
Class A				
Rating	AAAsf	AAAsf	AAAsf	AAAsf
Amount (EURm)	900.0	800.0	1,000.0	500.0
Credit enhancement (%)	7.0	7.7	7.5	32.1
Class B				
Rating	A+sf	A+sf	NR	NRsf
Amount (EURm)	18.2	20.5	75.3	230.0
Credit enhancement (%)	5.1	5.3	n.a.	n.a.
Portfolio summary as of closing				
Type of receivables	Auto leases	Auto leases	Auto loans	Auto leases
Total outstanding balance (EURm)	957.4	857.2	1,075	730.0
Number of receivables	94,478	82,644	56,071	45,125
Average outstanding balance (EUR)	10,134	10,371	19,177	49,714
WA seasoning (months)	7.2	9.0	9.1	16
WA remaining term (months)	32.0	30.6	35.1	25
Age of vehicle (%)				
New vehicles	95.4	95.5	47.6	100
Used/demo vehicles	4.6	4.5	52.4	0
Debtor type (%)				
Private	0.1	n.a.	73.5	0
Commercial	99.9	n.a.	26.5	100
Type of repayment				
Direct debit Payments	94.2	95.4	99.8	90
Fitch assumptions (%)				
Cumulative default rate assumption	1.5	1.9	1.7	2.0
Recovery rate assumption	67.5	66.4	65.0	70.0
Prepayment rate assumption	4.0	5.0	15.0	5.2

Source: Fitch Ratings

Transaction Parties

Role	Counterparty	Rating
Issuer	VCL Multi-Compartment S.A. Compartment 27	NR
Originator, seller and servicer	Volkswagen Leasing GmbH	NR
Security trustee	Intertrust Trustees GmbH	NR
Data protection trustee	Amsterdamsch Trustee's Kantoor B.V.	NR
Subordinated lender	Volkswagen Financial Services AG	NR
Account bank, paying agent	Elavon Financial Services DAC, U.K. Branch	AA-/Stable/F1+
Arranger	BNP Paribas S.A., London Branch	A+/Stable/F1
Joint lead managers	BNP Paribas S.A., London Branch UniCredit Bank AG	A+/Stable/F1 BBB+/Negative/F2
Swap provider	ING Bank N.V.	A+/Positive/F1/A+(dcr)

Source: Transaction documents, Fitch Ratings

Related Research

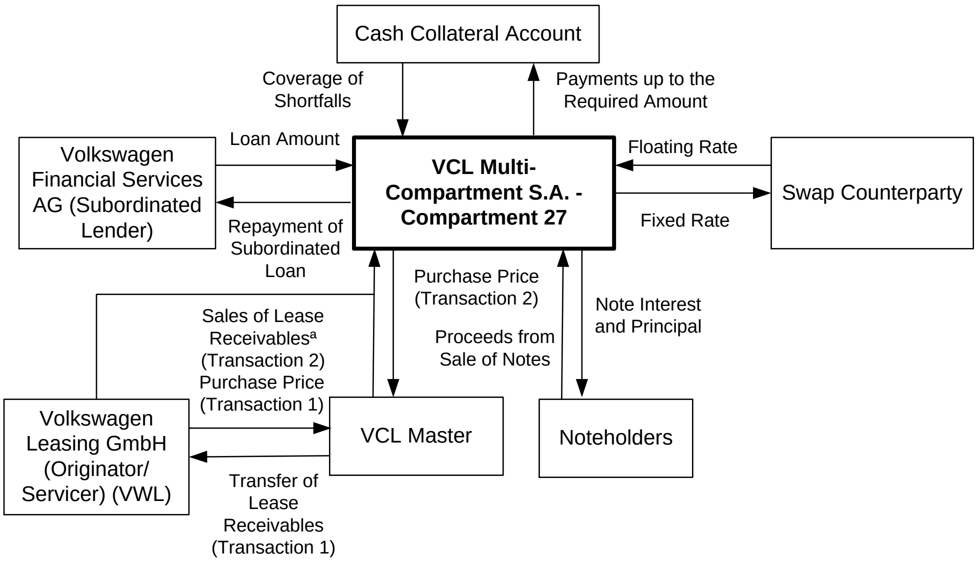
European Car Financing Vulnerable to Residual Value Outlook (October 2018)

Risks to German Used Diesel Car Prices, Demand Persist (August 2018)

German Court Ruling Underscores Risk to Diesel Car Prices (March 2018)

Transaction and Legal Structure

Structure Diagram



[a] Receivables out of VCL Master will be sold by VWL on the authority granted by VCL Master.
Source: Fitch, transaction document

Issuer and True Sale

VCL Multi-Compartment S.A. is a Luxembourg-based securitisation company subject to Luxembourg securitisation law. VCL Master S.A. Compartment 1 (VCL Master) – another Luxembourg-based securitisation company, intended to function as a warehousing vehicle – originally acquired certain lease receivables related to selected lease contracts from the seller. At closing, the issuer will purchase certain receivables from VWL (transaction 2), selling on the authority granted by VCL Master (transaction 1).

The receivables are the finance portion, which amortises the purchase price of the vehicle to its agreed residual value (RV). The RV component itself is not refinanced via VCL 27. Certain other receivables are excluded, for example, payments for contractually agreed maintenance services. Furthermore, the VAT portion of any payments due from the lessee will be excluded from the pool and retained by VWL to be advanced to the tax authorities.

To secure the performance of the lease receivables, the security title to the leased vehicles will be forwarded to VCL 27. In case of a lessee's default, the Issuer will be entitled to the proportion of recovery proceeds equivalent to its funding share in the sum of then outstanding lease receivables and the residual value.

Capital Structure and Credit Enhancement

At closing, the balance sheet of the issuer looks as per the table below.

VCL 27 Balance Sheet

Asset	Amount (EURm)	Liabilities	Amount (EURm)	Size in % of receivables
Receivables	957.4	Class A	900.0	94.0
Cash reserve	11.5	Class B	18.2	1.9
		Subordinated loan	29.6	3.1
		PPD cash reserve	11.5	1.2
		PPD OC	9.6	1.0
Sum	**968.9**		**968.9**	**101.2**

PPD: Purchase Price Discount
Source: Fitch Ratings, transaction documents

The issuance consists of the class A and B notes as well as a subordinated loan. Credit enhancement is provided by OC and the amortising cash reserve. The initial size of the reserve is 1.2%. However amounts in excess of the 1.0% floor may flow back firstly to the subordinated lender and secondly to the seller outside the waterfall depending on portfolio performance.

All securitised receivables are discounted with a single discount rate of 5.7016%. The following components have been considered when determining the discount rate.

Discount Rate Calculation

	(%)
Weighted average swap rate (including sub-loan)	0.21
Servicing fee	1.00
Senior expenses	0.03
Subtotal	1.24
Buffer release rate	4.46
Sum	**5.70**

Source: VW Leasing

As the buffer release rate will be directly released to the seller, the issuer benefits from a discount rate of 1.24% only. Should VWL become insolvent, the buffer release rate would become available to the issuer.

Fitch does not take into account the buffer release rate as potential excess spread available for note redemption. This is because, in Fitch's view, structural elements that are relied upon in order to pay timely interest and ultimate principal on the notes cannot be conditional on the occurrence of events like a seller/servicer default.

Reserve Fund

The cash reserve, which initially amounts to EUR11.5 million or 1.2% of the discounted receivables' balance, is funded through a purchase price discount (PPD). It is available to cover senior expenses, swap payments and notes' interest. The reserve is subject to a floor, amounting to EUR9.6 million or 1% of the receivables' balance at closing or the outstanding note balance, if lower.

Available funds will top up the reserve fund each period to an amount of 1.2% of the outstanding lease balance. As long as the cumulative net loss trigger is not breached, excess release amounts from the reserve are paid back to the subordinated lender and the seller outside the waterfall. The floor amount can be used for note redemption upon the earlier of the legal final maturity date or the discounted lease balance reaching zero.

There is a further cash reserve (VWL risk reserve) to cover seller-related risks, in particular tax-related risks mentioned under tax risk. The VWL risk reserve amounts to EUR10.54 million or 1.1% of the discounted receivables' balance at closing.

Hedging

At closing, the issuer entered into two swaps to hedge itself against the fixed-floating interest rate mismatch. While it will receive fixed interest payments from the receivables, its obligations under the notes will be linked to one-month Euribor.

The first swap will be referenced to the interest due on the class A notes and the second to interest payments due on the class B notes. The floating amounts will be subject to a floor of zero. The fixed rates the SPV needs to pay on the swaps are 0.18% for class A notes and 0.51% for class B notes. Both swaps will be linked to the outstanding balance of the respective notes.

Priority of Payments

The transaction has a combined waterfall for all collections on outstanding receivables. The amount available to be distributed contains the following positions:

Amount Available for Distributions

+	Collections received by the servicer.
+	Share of realisation proceeds from vehicles belonging to the issuer.
+	Amounts from the general cash reserve.
+	Net swap receipts.
+	Investment earnings from the distribution account.
+	Amounts from the VWL risk reserve in case of failure by VWL to pay any secured obligations or in case of a German trade tax event.
-	Less the buffer release amount (provided no insolvency event with respect to VWL has occurred).

Source: Fitch Ratings

Transaction Waterfall

1	Taxes, senior and servicing fees;
2	Net swap payments other than in case of a default of the swap counterparty.
3	Interest class A.
4	Interest class B.
5	To the cash collateral account up to its required balance.
6	In case of an increase in German trade tax, to the VWL risk reserve the increased trade tax risk reserve amount.
7	Class A principal until class A is at its target size (i.e. target OC class A).
8	Class B principal until class B is at its target size (i.e. target OC class B).
9	Swap payments other than those under item 2 (i.e. subordinated swap payments).
10	Interest on the sub-loan.
11	Redemption of the sub-loan until reduced to zero.
12	Remainder to VWL as a final success fee.

Source: Transaction documents, Fitch Ratings

Performance Triggers and Note Amortisation

The targeted balance of the notes is set to meet a required OC amount, defined as the excess of the assets (excluding write-offs) over respective liabilities, i.e. the class A and class B notes.

Incoming funds will first be used to redeem the class A notes until their target OC is achieved. At this point, incoming funds will also amortise the class B notes, building up their target OC, while the target OC for the class A notes is maintained. As soon as the asset balance has amortised to 10% of the initial balance or upon the occurrence of a servicer replacement event, note amortisation will again be strictly sequential.

Should a performance trigger recording losses be breached, target OC will rise, meaning amortisation will again be sequential until the increased target OC is reached. Finally, should losses exceed 1.6% of the initial balance, the notes' amortisation would also become strictly sequential.

Required OC levels are as follows and are unchanged from previous transactions.

Amount Available for Distributions

Trigger	Class A (%)	Class B (%)
Initial available OC level	6.0	4.1
Target OC, if no trigger breach	12.25	7.50
Target OC, if level 1 trigger breached	14.00	8.25
Target OC, if level 2 trigger breached	100.00	100

Source: Fitch Ratings

A level 1 trigger is hit if the cumulative losses exceed the following thresholds:

- Prior (and including) to the 15th payment date (February 2020): 0.50%; and
- after the 15th payment date (February 2020) until the 24th payment date (November 2020): 1.15%.

A level 2 trigger is hit if cumulative losses exceed 1.6% at any payment date.

Due to the improved performance of the portfolio over recent years, loss triggers are now hit relatively late even under the agency's stress assumptions. As a result, notes may amortise in a pro rata style longer than in earlier VCL transactions. This may be problematic in a back-loaded default scenario, where the target OC may not be sufficient to absorb losses once they arise. Based on Fitch's cash flow model, assumptions notes are repaid in the respective rating scenarios. However, more back-loaded losses or higher loss levels may lead to insufficient funds for full note repayment. Please refer to the *Financial Structure and Cash Flow Analysis* section for more details.

Disclaimer

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Asset Analysis

Originator Overview

VWL is a wholly owned subsidiary of VWFS, which is part of Volkswagen Group.

VWL's main activities are to promote the sale of the Volkswagen Group's automotive products (VW, Audi, SEAT, Skoda and VW Nutzfahrzeuge) and to strengthen customer loyalty to the Volkswagen Group brands. VWFS has more than 60 years' experience in the auto-financing business.

Lease Products

VWL offers leasing for new and used Volkswagen, Audi, SEAT, Skoda and VW Nutzfahrzeuge to commercial and non-commercial customers. Initially, the car is purchased by VWL. At the expiration of the leasing contract the vehicle will be sold by the car dealer or VWL. If the lessee wants to keep the car, it has to purchase the vehicle.

Depending on contract terms, the risk of the residual value being different from the market value of the car is borne by the car dealer or, in a few cases, the lessee. Residual value protection schemes have grown in popularity, whereby the car dealer can transfer such residual value risk fully or partially, against a premium, to VWFS or the car manufacturer.

Underwriting

As VWL is a repeat seller, Fitch conducts an annual on-site review. The last review was held in March 2018 by the agency's analysts. Overall, Fitch deems the underwriting and servicing capacities of VWL to be in line with market standards among the top German car finance companies; VWL also has a proven track record in its securitisation activity.

VWL manages its underwriting and distribution channel through the Leasing Operations/Underwriting (LOU) department. The LOU processes all leases and co-operates/builds relationships with a network of more than 3,500 dealers. Supported by a separate fraud prevention team, the LOU is also responsible for fraud detection. LOU employees are expected to undergo three months of training before carrying out any operational tasks in the teams and are offered a wide range of additional internal training to improve the consistency and quality of standards within the LOU.

Generally, the system works such that for contracts that fulfil the respective criteria, the steps including the approval are carried out in a fully automated fashion. The evaluation is, in essence, based on the following main categories: customer data, product type(s), vehicle information, payment history and scoring/credit rating. If a problem occurs, such as inconsistencies found or negative credit information, the request requires manual processing. The underwriter then sees the outcome of the scoring and other information sources (such as Schufa, Buergel, Creditreform or payment history if applicable) and needs to approve the application manually.

The authority to approve a lease depends on the seniority of staff. A junior lease administrator, for example, can approve a lease up to EUR50,000, while applications greater than EUR50,000 are approved by a senior lease administrator. Leases with a balance greater than EUR200,000 are managed by the special clients team.

Servicing and Collections

The debt management team is responsible for dealing with delinquent contracts.

Lessees receive calls from VWFS's call centre as soon as possible after the due date to determine the reasons for the missed payment. A first reminder letter is sent out 12 days, a second 24 days and third 36 days after the due date. Once payment agreements are in place, reminders in case of non-payments are sent out every five days.

VWFS has introduced scores to handle delinquent contracts according to priority. Team members have the authority to approve payment holidays or maturity extensions. For corporate customers, a contract is terminated after two missed instalments. For private clients, the point of termination is dependent on the ability of VWFS to terminate as prescribed by consumer protection regulation.

The collection centre is responsible for the handling of terminated contracts, second-hand marketing, court collections and charge-offs. It employs external collection agencies, which are compensated on the basis of their performance and success rates.

Vehicles can be repossessed following the effective date of the contract termination. After threatening repossession, a portion of the terminated contracts has historically become current again. Most vehicles relating to non-performing contracts are repossessed. For the remainder, VWFS judges whether it is worthwhile to pay for the repossession expenses as expected sale prices may be considered too low. VWFS normally obtains three bids from the dealer network before the vehicle is sold. A court settlement, to determine the borrower's outstanding obligation, is initiated around four months after the due date. The foreclosure process normally commences six months after the due date and is followed by the charge-off.

Key Asset Eligibility Criteria

The purchase of lease receivables by the issuer at closing is subject to a number of conditions that need to be met as of the relevant purchase date, stipulating, among others:

- Lease contracts are denominated in euros, monthly payment;
- Lease contracts are legally valid, binding agreements and governed by German law;
- More than 95% of leased vehicles are VW, Audi, SEAT, Skoda or VW utility vehicles;
- No insolvency proceedings have been initiated against the lessee;
- Leased vehicles are situated in Germany, which is assumed to be fulfilled if the lessee is resident in Germany;
- Receivables are free from rights of third parties and of defences and set-off claims of lessees;
- No terminations have occurred or are pending;
- No lease receivable was overdue as of the cut-off date;
- On the cut-off date, at least two lease instalments have been paid in respect of each of the lease contracts;
- Lease contracts require substantially equal monthly payments to be made within 12-60 months from origination, and
- The total amount of lease receivables attributable to any single lessee will not exceed 0.5% of aggregate discounted receivables balance at cut-off date.

In the event of any breach of the eligibility criteria, which materially and adversely affects the interests of the noteholders as of the closing date, the seller will have to remedy or repurchase the receivables within 60 days of becoming aware of the breach.

Portfolio Summary

The lease contracts finance vehicles manufactured by the Volkswagen Group, including VW, Audi, SEAT, Skoda and VW utility vehicles, as well as a smaller portion of cars produced by other manufacturers. The characteristics of the final portfolio as of 31 October 2018 are shown in the table below.

VCL 27 (Final Pool as of 31 October 2018)

Discounted pool size (EUR)	957,449,751
Number of lease contracts	94,478
Average outstanding discounted balance per contract (EUR)	10,134
WA seasoning (months)	7.2
WA remaining term (months)	32.0
New vehicles (% of outstanding discounted balance)	95.4
Used/demo vehicles (% of outstanding discounted balance)	4.6
Corporate customers (% of outstanding discounted balance)	31.3
Retail customers (% of outstanding discounted balance)	68.7
Direct debit payments (% of outstanding discounted balance)	94.2
Largest 20 customers (% of outstanding discounted balance)	0.8
Largest regional concentration (NRW, % of outstanding discounted balance)	22.0
Closed-end contracts (% of contracts)[1]	99.3
Diesel share (% of outstanding discounted balance)	61.3
Motor type: EA189 unfixed, (% of contracts)	0.0

Source: Transaction documents, Fitch Ratings

The portfolio is well diversified in terms of single obligors, geographical distribution and industry sectors of the lessees, according to VWL's classifications.

[1] Upon return of the car, the residual value risk is borne by the dealer (or VWL).

Portfolio Credit Analysis

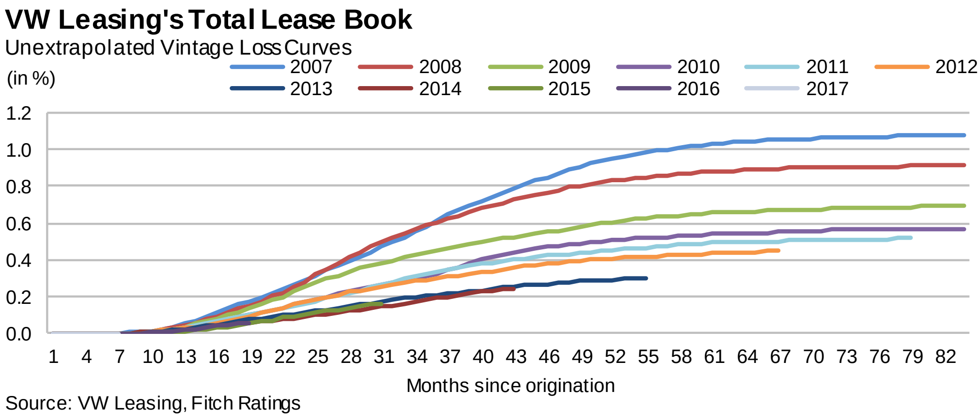
Loss Risk

As VWL's data do not support the derivation of default and recovery rates, Fitch had to use the available information in reverse order, compared to its standard approach.

- Firstly, a base-case loss rate was set, based on VWL's total leasing book loss data.
- Secondly, a base-case recovery rate was set, based on data from previous VCL transactions and the experience of the servicer's collection department.
- Thirdly, the set recovery rate was used to scale the set loss rate up to a default rate.

Loss data from VWL have been provided, reflecting write-offs according to the originator's accounting policy. These data are consistent with the loss definition in the transaction, on which the triggers are based. Recovery collections that are received after the lease has been written off belong to VWL, according to the servicing agreement.

The loss rate data for historical originations of VWL are shown below.



Source: VW Leasing, Fitch Ratings

Loss vintage curves have been improving, which Fitch believes is mainly due to the continued benign economic environment in Germany, and a robust underwriting and collection process of VWL. Corporate insolvency rates – which Fitch deems to be the main driver of the performance of lease portfolios granted to micro, small and medium-sized companies – have fallen because of the benign economy and are at historic lows. Based on these factors, Fitch has set its base case loss rate assumption to 0.5%.

Defaults and Recovery Rates

Fitch has not been provided with recovery information on VWL's total book. The agency therefore derived its recovery assumption from default and loss information contained in the investor reporting of previous VCL transactions and peer transactions. Fitch has applied a recovery rate base case assumption of 67.5%. This results in a default base case assumption of 1.5%. Fitch views the default rate as similar to comparable transactions.

Expectations (%)

	Default rate expectations (%)	Recovery rate expectations	Loss rate expectations
Base case	1.5	67.5	0.5

Source: Fitch Ratings

The agency has stressed its assumptions in higher rating scenarios to account for the impact of an unexpected economic deterioration on the transaction's cash flows.

In line with its criteria, Fitch has applied a higher multiple to the default rate expectation of 1.5% (6.0x for 'AAA', 4.0x for 'A+'). The default multiple reflects the low absolute level of the base case assumption and Fitch's through-the-cycle rating approach.

To derive the applicable stressed recovery haircut, the agency considered the expected (base case) recoveries, the secured nature of the assets and the robust recovery processes of VWL as key determining factors. Fitch derives a median recovery haircut ('AAA': 45%, 'A+': 30%).

Stressed Assumptions (%)

	Rating Default Rate (RDR)	Rating Recovery Rate (RRR)	Rating Loss Rate (RLR)
AAA	9.0	37.1	5.7
A+	6.0	47.3	3.2

Source: Fitch Ratings

Diesel Considerations

The fixing of VW group cars equipped with an EA189 engine is largely completed and the issue has instead developed into a market-wide uncertainty around diesel cars. Fitch therefore assessed the potential risks from diesel cars in the transaction, considering the general market developments. Used diesel car prices in Germany have fallen moderately and risks to demand for diesel cars remain, including potential restrictions in more German cities, see Fitch: *Risk to German Used Diesel Car Prices, Demand Persist*.

However, we do not expect price declines inconsistent with our recovery rate and stress assumptions and did not adjust our recovery rate expectations and stresses to account for the share of diesel-powered vehicles in the portfolio.

Fitch tested the sensitivity regarding additional used-car market stresses for the estimated diesel exposure in the pool. For more details, please see *Rating Sensitivity*.

Prepayment Risk

Fitch derived its base-case prepayment assumption using data from previous VCL transactions and peer transactions, as the originator has not provided the agency with overall book data on prepayments.

Prepayments in earlier VCL transactions hardly exceed an annualised rate of 4%, which is the figure Fitch assumed as a base case for VCL 27. This was then stressed to test the impact of high and low prepayments in the respective rating scenarios. For example, the base case was multiplied by 1.5x in the 'AAA' scenario. Due to the very low historically observed prepayments, Fitch also tested a scenario with zero prepayments.

The lease contracts do not contain provisions that allow customers to prepay a contract so prepayments are at the discretion of VWL. If a prepayment is granted, customers are generally obliged to settle the outstanding instalments, comprising both principal and interest, in full. VWL may, however, waive part of the repayment amount out of courtesy to the customer. In such cases, VWL would need to indemnify the issuer for any associated reduction in the principal balance.

Asset Outlook

Fitch expects German GDP to grow by 2.0%, 1.6% and 1.4% in 2018, 2019 and 2020, respectively. There are no clear signs that the domestic economy is weakening materially as the labour market continues to tighten with wages increasing (please see the *Global Economic Outlook- September 2018* forecast for more details).

The outlook for German Auto ABS asset performance and the structured finance sector in general is stable.

Financial Structure and Cash Flow Analysis

Fitch used its proprietary cash flow model to test whether the available cash flows were sufficient to enable timely payment of interest and ultimate payment of principal on the notes by final maturity in various stress scenarios.

The defaults were allocated using the default timings for short-term portfolios outlined in Fitch's *Consumer ABS Rating Criteria*. The recovery timing was derived from lease-by-lease default and loss data from previous VCL transactions. The agency assumed that a vehicle is typically sold within six months after default and distributed the recoveries over a period of six months.

The portfolio amortisation was modelled based on the data provided to Fitch for the provisional pool. Defaults, recoveries and prepayments were applied as per the stressed assumptions. Interest income was generated on non-delinquent receivables at a rate equal to the discount rate less the buffer release rate. Available cash was distributed in line with the transaction's waterfall.

Fitch tested the transaction's sensitivity to different default distributions (front-loaded, evenly distributed and back-loaded), combined with high or low prepayments as well as rising, decreasing or stable interest rates.

The transaction is particularly sensitive to the length of the pro rata period which is determined by the amortisation profile (and assumed prepayments), the lifetime loss as well as the loss timing assumptions.

A high prepayment scenario leads to target OCs being reached sooner and thus an earlier pro-rata allocation towards the class B notes and the unrated sub-loan. At the same time, assuming back-loaded losses, a switch (back) to sequential note amortisation occurs later even in a stressed scenario due to the improved loss performance and unchanged cumulative loss triggers compared to previous transactions.

Fitch considers the available credit enhancement for the rated notes adequate under all considered stress scenarios.

Rating Sensitivity[2]

This section of the report provides a greater insight into the model implied sensitivities the transaction faces when one or more risk factors are stressed, while holding others equal. The modelling process first uses the estimation and stress of base case assumptions to reflect asset performance in a stressed environment, and secondly, the structural protection was analysed in a customised proprietary cash flow model (see *Financial Structure & Cash Flow Analysis*). The results below should only be considered as one potential outcome given that the transaction is exposed to multiple risk factors that are all dynamic variables.

Rating Sensitivity to Default Rates

The change in rating resulting from a relative increase in the base-case probability of default for each lease receivable is demonstrated below. For example, increasing the base-case default rate by 25% could result in a one-notch downgrade of the class A notes, from 'AAAsf' to 'AA+sf'.

Rating Sensitivity to Increased Default Rates

	Class A	Class B
Original rating	AAAsf	A+sf
Increase default base by 10%	AAAsf	A+sf
Increase default base by 25%	AA+sf	A-sf
Increase default base by 50%	AA+sf	BBB+sf

Source: Fitch Ratings

[2] These sensitivities only describe the model-implied impact of a change in input variables. This is designed to provide information about the sensitivity of the rating to model assumptions. It should not be used as an indicator of possible future performance.

Rating Sensitivity to Recovery Rates

The change in rating if the base case recovery rates are adjusted is demonstrated below. The Class A notes' rating shows limited sensitivity to a change in the base-case recovery assumption.

Fitch considers the sensitivities in the table below to also provide an indication on rating changes upon a deterioration of used car prices of vehicles equipped with diesel engines (see reference to Fitch's diesel research in *Related Research*). The originator quantified the total diesel share in the final pool as about 61% of the portfolio volume.

Assuming a decrease of 25% in all diesel vehicles' recovery proceeds, while leaving recovery proceeds for non-diesel vehicles unchanged, the resulting rating sensitivity lies within the 10% and 25% standard sensitivities (that are applied to the entire pool) below.

Rating Sensitivity to Reduced Recovery Rates

	Class A	Class B
Original rating	AAAsf	A+sf
Decrease recovery rate by 10%	AAAsf	A+sf
Decrease recovery rate by 25%	AAAsf	A-sf
Decrease recovery rate by 50%	AA+sf	BBB+sf

Source: Fitch Ratings

Rating Sensitivity to Shifts in Multiple Factors

The table below summarises the rating sensitivity to stressing two factors simultaneously. Two scenarios are evaluated to demonstrate the sensitivity of the rating to varying degrees of stress to the expected level of defaults and recoveries.

Rating Sensitivity to Multiple Factors

	Class A	Class B
Original rating	AAAsf	A+sf
Default rate increase by 10%, recovery rate decrease of 10%	AAAsf	Asf
Default rate increase by 25%, recovery rate decrease of 25%	AA+sf	BBB+sf
Default rate increase by 50%, recovery rate decrease of 50%	A+sf	BBsf

Source: Fitch Ratings

Counterparty Risk

Operational Risk

VWL will act as a servicer for the transaction. Remedial actions regarding the servicer foresee the replacement of the servicer in the event of servicer disruption. No replacement servicer has been named. However, the transaction documents state that the issuer shall find a replacement servicer after no longer than three months.

Despite the intrinsic problems Fitch sees with the issuer being tasked to find a replacement servicer, the agency thinks that the reserve fund would cover payment obligations long enough to be able to find a replacement and other parties in this transaction (i.e. the security trustee) would have an interest to lend support in order to act in the best interest of noteholders.

Account Bank

The issuer will hold its accounts (distribution account, cash collateral account, counterparty downgrade collateral account and the swap termination payment account) at Elavon Financial Services DAC, U.K. Branch.

Under the transaction documents, should the account bank's long- or short-term deposit rating (if assigned and applicable, otherwise its Issuer Default Rating) be below the minimum required rating ('A' or 'F1'), it must, within 30 calendar days: (i) find an eligible replacement; (ii) find a suitably rated guarantor, or (iii) take any other action to maintain or restore the rating of the notes.

Fitch notes that option (iii) is not in line with its counterparty criteria and could lead to a prolonged process as regards remedial actions if option (iii) is favoured over options (i) or (ii).

Commingling Risk

Commingling risk is considered a secondary risk driver in this transaction in line with Fitch's *Structured Finance and Covered Bonds Counterparty Rating Criteria*.

According to the transaction documents the servicer is entitled to commingle collected payments with its own funds if VW is not rated below 'BBB' or 'F2' by Fitch or the profit and loss sharing agreement between VW and VWFS or between VWFS and VWL is no longer in place. Otherwise it would have to advance expected collections including 2% prepayments for the following monthly period to the issuer's collection account.

The agency considers the provisions to sufficiently cover commingling risk.

Payment Interruption Risk

Fitch tested whether the cash reserve was able to cover the issuer's obligations under the swaps, the ongoing senior expenses and notes' interest. Based on the agency's calculations, the available cash reserve is sufficient to maintain these payments for at least 10 months. Fitch deems this horizon sufficient to cover a disruption in the collection process and to re-establish the same, even with a third party.

Set-off Risk

Deposit Set-off Risk

The originator is not a deposit-taking entity, only its legally separated affiliate (VW Bank GmbH) is. As a result, there is no deposit-related set-off risk.

Set-Off Risk with Regard to the Service Component

Some lessees pay for two components in the lease agreement:

- A lease part, which compensates the lessor for leasing the vehicle to the lessee; and
- A service part, which compensates the lessor for certain services provided during the lifetime of the lease. This part is not securitised.

Fitch received guidance that a set-off possibility for the lessee is only given in case the car service is not fulfilled and his compensation claim and his liability are against the same legal entity. Following the servicer's default and the subsequent notification that VWL is no longer holding the receivables, this prerequisite is no longer given.

In line with Fitch's view in previous VCL transactions, it was also understood that a potential insolvency administrator of VWL would likely uphold the service part against ongoing payments from the lessees.

Fitch therefore views set-off possibilities mainly in case the lessee has a damage claim or needs maintenance to be done during the period between VCL's insolvency and the notification as well as subject to an insolvency administrator not continuing to uphold the servicing part. Overall, the agency judges this risk to be negligible.

Set-Off Risk with Regard to Insurance Products

VWFS offers a range of insurance services as add-on products with its own insurance service, but also cooperates with other third-party insurers. Due to the particularity of the case at hand, Fitch deems that there is negligible set-off risk with regard to insurance products in VCL 27. As with the service component, the premiums are not securitised. Therefore, any set-off risk could only materialise in case claims out of an insured event arise, which the agency deems sufficiently unlikely.

Swap Counterparty

To hedge the interest rate risk arising from the fixed assets and floating liabilities, the issuer will enter into swap agreements with ING Bank N.V. The swap documentation is in line with the minimum rating, replacement and collateralisation conditions stipulated in Fitch's counterparty criteria.

Tax Risk

Based on its understanding of the applicable tax regimes, Fitch considers the risk of significant tax liabilities being imposed on the issuer to be limited.

Nevertheless, there are some remaining legal uncertainties with respect to potential trade tax (ie in case the tax authorities deem the SPV to be taxable in Germany) and secondary VAT liability (ie in case VWL defaults before it has forwarded the VAT portion to the authorities) that may be imposed on the issuer.

The seller has posted and maintains a dedicated risk reserve (VWL risk reserve) in the amount of EUR10.54 million, which can be used to cover tax liabilities of the issuer and other seller-related risks. The agency regards this reserve, together with the available CE, as sufficient to address contingent tax liabilities.

Criteria Application, Model and Data Adequacy

Criteria Application

Fitch has analysed the risk of borrower default – and has set its default, recovery and prepayment assumptions – in accordance with its *Consumer ABS Rating Criteria*. Counterparty risks were analysed based on *Structured Finance and Covered Bonds Counterparty Rating Criteria*, dated August 2018. See *Related Criteria* for the full list of applied criteria.

Model

The asset assumptions outlined above were applied in Fitch's proprietary multi-asset cash flow model, with which the transaction's cash flows were modelled. Click on the link for a description of the model.

EMEA Cash Flow Model

Data Adequacy

The following historical information was provided by VWL to support Fitch's analysis.

Data Adequacy

Data	Time	Period	Frequency	Type
Losses	Jan 07-Jun 18	11.5 years	Monthly	Static
Total bookvolume	Jan 10-Jun 18	8.5 years	Monthly	Dynamic
Delinquency	Jan 10-Jun 18	8.5 years	Monthly	Dynamic

Source: Fitch Ratings

Additionally, Fitch received pool stratifications and an amortisation profile of the provisional pool as of 31 August 2018 and of the final pool as of 31 October 2018.

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

Fitch reviewed the results of a third-party assessment conducted on the asset portfolio information.

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

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

Surveillance

Throughout the life of the transaction, Fitch will monitor the performance of the collateral and any changes at the servicer, or with the structure, that may influence the ratings of the notes.

Fitch will receive monthly investor reports detailing the performance of the portfolio. These will provide the basis for the agency's surveillance of the transaction's performance against base case expectations and the performance of the industry as a whole. The agency assigned an Issuer Report Grade of five stars to the investor reporting in line with previous transactions originated by VWL, as the standards of reporting remain comparable. Where appropriate, the agency may ask to monitor further data from the originator or the servicer. The ratings of the transaction will be reviewed by a committee at least once every 12 months, or when considered appropriate (eg if there is a deterioration in performance, an industry-wide development, or a change at the originators or the servicer that may influence the transaction).

Our quantitative analysis will focus on monitoring the key performance parameters (delinquencies, defaults, recoveries and prepayments) against the base case assumptions. Fitch will further monitor the market developments regarding diesel-powered vehicles.

Fitch's structured finance performance analytics team ensures that the assigned ratings remain an appropriate reflection of the issued notes' credit risk. Details of the transaction's performance are available to subscribers at www.fitchratings.com.

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