VCL Multi-Compartment S.A. Compartment VCL 28

New Issue

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Related Criteria

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Fitch Ratings Interest Rate Stress Assumptions for Structured Finance and Covered Bonds (March 2019)

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Capital Structure

Class	Rating	Outlook	Amount (EURm)	CE[a] (%)	Interest Rate (%)	Final maturity
A	AAAsf	Stable	941.0	6.9	1m Euribor + 0.4%	January 2025
B	A+sf	Stable	19.0	5.0	1m Euribor + 0.65%	January 2025
Subordinated Loan	NRsf	n.a.	33.0		1m Euribor + 1.28%	January 2025
Total issuance (excl. sub-loan)			960.0			

Closing occurred on 25 April 2019. The transfer of the portfolio to the issuer occurred on 25 April 2019. The ratings assigned above are based on the portfolio information as of 31 March 2019, 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 (5.9% and 4.0% for Class A and Class B, respectively) 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 28 (VCL 28) 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, reflecting VWL's historical data and our expectations for the German economy. 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 6.0x to reflect the low default base case and our 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, lower 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 higher 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 initially providing for 11 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 adequately addresses commingling risk.

Transaction Comparison Table

Issuer	VCL Multi-Compartment S.A. Compartment VCL 28	VCL Multi-Compartment S.A. Compartment VCL 27	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	April 2019	November 2018	May 2018	December 2016
Seller	VW Leasing GmbH	VW Leasing GmbH	BMW Bank GmbH	ALD AutoLeasing D GmbH
Issuance volume (EURm)	960.0	918.2	1,075.3	730
Class A				
Rating	AAAsf	AAAsf	AAAsf	AAAsf
Amount (EURm)	941.0	900.0	1,000.0	500.0
Credit enhancement (%)	6.9	7.0	7.5	32.1
Class B				
Rating	A+sf	A+sf	NR	NRsf
Amount (EURm)	19.0	18.2	75.3	230.0
Credit enhancement (%)	5.0	5.1	n.a.	n.a.
Portfolio summary as of closing				
Type of receivables	Auto leases	Auto leases	Auto loans	Auto leases
Total outstanding balance (EURm)	1,000.0	957.4	1,075	730.0
Number of receivables	102,761	94,478	56,071	45,125
Average outstanding balance (EUR)	9,731	10,134	19,177	49,714
WA seasoning (months)	8.0	7.2	9.1	16
WA remaining term (months)	31.6	32.0	35.1	25
Age of vehicle (%)				
New vehicles	94.6	95.4	47.6	100
Used/demo vehicles	5.4	4.6	52.4	0
Debtor type (%)				
Retail	68.7	68,7	n.a.	n.a.
Corporate	31.3	31,3	n.a.	n.a.
Type of repayment				
Direct debit payments	95.8	94.2	99.8	90
Fitch assumptions (%)				
Cumulative default rate assumption	1.5	1.5	1.7	2.0
Recovery rate assumption	67.5	67.5	65.0	70.0
Prepayment rate assumption	4.0	4.0	15.0	5.2

Source: Fitch Ratings

Transaction Parties

Role	Counterparty	Rating
Issuer	VCL Multi-Compartment S.A. Compartment VCL 28	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 and calculation agent	Elavon Financial Services DAC	AA-/Stable/F1+
Arranger	Lloyds Bank Corporate Markets Public Limited Company	A/Rating Watch Negative/F1
Joint lead managers	Lloyds Bank Corporate Markets Public Limited Company	A/Rating Watch Negative/F1
	Skandinaviska Enskilda Banken AB	AA-/Stable/F1+
Swap provider	Skandinaviska Enskilda Banken AB	AA-/Stable/F1+/AA-(dcr)

Source: Fitch Ratings, VCL 28

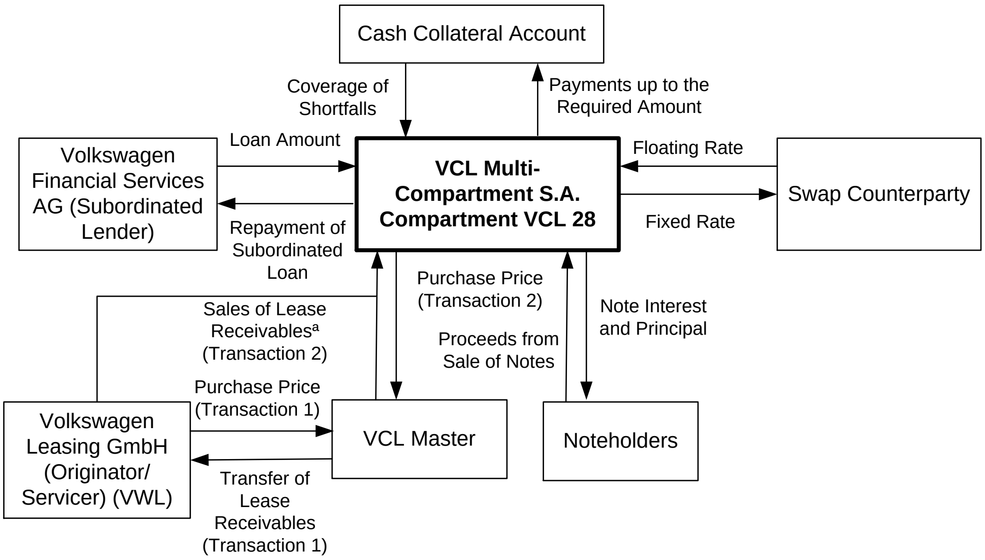
Related Research

Fitch Ratings: German Diesel ABS Risks May Be Easing, but Have Not Disappeared (March 2019)

European Car Financing Vulnerable to Residual Value Outlook (October 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 Ratings, VCL 28

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 purchased 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 28. Certain other receivables are excluded, for example, payments for contractually agreed maintenance services. Furthermore, the VAT portion of any payments due from the lessee was 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 was forwarded to VCL 28. 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 is as per the table below.

VCL 28 Balance Sheet

Asset	Amount (EURm)	Liabilities	Amount (EURm)	Size in % of receivables
Receivables	1,000.0	Class A	941.0	94.1
Cash reserve	12.0	Class B	19.0	1.9
		Subordinated loan	33.0	3.3
		PPD cash reserve	12.0	1.2
		PPD OC	7.0	0.7
Sum	**1,012.0**		**1,012.0**	**101.2**

PPD: Purchase Price Discount
Source: Fitch Ratings, VCL 28

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)	0.13
Servicing fee	1.00
Senior expenses	0.03
Subtotal	1.16
Buffer release rate	4.54
Sum	**5.70**

Source: Fitch Ratings, VWL

As the buffer release rate will be directly released to the seller, the issuer benefits from a discount rate of 1.16% 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

An amortising cash reserve, which amounts to EUR12.0 million or 1.2% of the discounted receivables' balance, will be 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 EUR10 million or 1% of the receivables' balance at closing or the outstanding balance of class A and B notes, if lower.

Available funds will top up the reserve fund each period to its target amount. 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 EUR11.0 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 covers the interest due on the class A notes and the second interest payments due on the class B notes in exchange for a fixed rate. The floating amounts are subject to a floor of zero. The fixed rates the SPV needs to pay on the swaps are 0.092% for class A notes and 0.346% for class B notes. Both swaps are 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: Fitch Ratings, VCL 28

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.

Additionally, should a performance trigger recording losses be breached, target OCs 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.

Credit Enhancement Increase Conditions

Trigger	Class A (%)	Class B (%)
Initial available OC level	5.9	4.0
Target OC, if no trigger breach	12.25	7.50
Target OC, if level 1 trigger breached	14.0	8.25
Target OC, if level 2 trigger breached	100	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 (July 2020): 0.50%; and
- after the 15th payment date (July 2020) until the 24th payment date (April 2021): 1.15%.

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

Please refer to the *Financial Structure and Cash Flow Modelling* section for more details on the increased sensitivity of the pro rata structure towards certain modelling assumptions.

Disclaimer

For the avoidance of doubt, Fitch relies, in its credit analysis, on legal and/or tax opinions provided by transaction counsel. As Fitch has always made clear, Fitch does not provide legal and/or tax advice or confirm that the legal and/or tax opinions or any other transaction documents or any transaction structures are sufficient for any purpose. The disclaimer at the foot of this report makes it clear that this report does not constitute legal, tax and/or structuring advice from Fitch, and should not be used or interpreted as legal, tax and/or structuring advice from Fitch. Should readers of this report need legal, tax and/or structuring advice, they are urged to contact relevant advisers in the relevant jurisdictions.

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 (open-end contracts). The car dealer can transfer the residual value risk of closed-end contracts 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 most recent review was held in April 2019 by the agency's analysts. Overall, Fitch deems the underwriting and servicing capacities of VWL to be in line with market standards amongst the top German car finance companies; VWL has also a proven track record in its securitisation activity.

VWL manages its underwriting and distribution channel through the leasing operations/ underwriting (LOU) department. LOU processes all leases and co-operates with a network of more than 3,500 dealers. Supported by a separate fraud prevention team, 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 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 as well as a client's exposure. 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 large portion of the terminated contracts has historically returned to performing status. 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 several 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 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 the 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 brands. The characteristics of the portfolio as of March 2019 are shown in the table below.

VCL 28 (Final Pool as of March 2019)

Discounted pool size (EUR)	1,000,018,756
Number of lease contracts	102,761
Average outstanding discounted balance per contract (EUR)	9,732
WA seasoning (months)	8.0
WA remaining term (months)	31.6
New vehicles (% of outstanding discounted balance)	94.6
Used/demo vehicles (% of outstanding discounted balance)	5.4
Corporate customers (% of outstanding discounted balance)	31.3
Retail customers (% of outstanding discounted balance)	68.7
Direct debit payments (% of outstanding discounted balance)	95.8
Largest 20 customers (% of outstanding discounted balance)	1.0
Largest regional concentration (NRW, % of outstanding discounted balance)	22.4
Closed-end contracts (% of outstanding balance)[1]	99.3
Diesel share (% of outstanding discounted balance)	73.0
Motor type: EA189 unfixed, (% of outstanding balance)	0.0

Source: Fitch Ratings, VCL 28

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

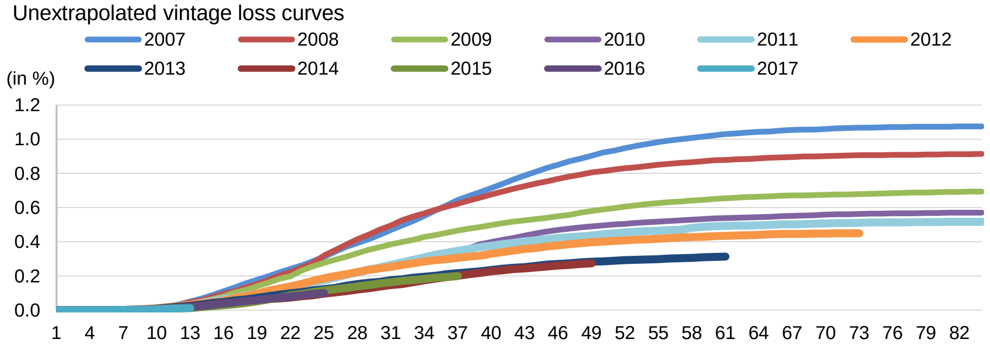
As VWL neither provides default nor recovery vintage data, Fitch used the available information in reverse order, compared to its standard approach.

- 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, a lifetime default rate was implicitly derived from the set lifetime loss and recovery rates.

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.

VWL's Total Lease Book
Unextrapolated vintage loss curves



Source: Fitch Ratings, VWL

Loss vintage curves have been improving, which Fitch believes is mainly due to the continued benign economic environment in Germany in recent years, and robust underwriting and collection processes 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 to historic lows. Based on these factors and taking into account a deteriorating outlook for the German economy, 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 derived a lower to 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 risks from diesel cars in the transaction, considering the general market developments. Used diesel car prices in Germany have stabilised over the last few months and a short-term direct risk from potential driving restrictions in German cities is minimal as the pool at hand is largely backed by new cars equipped with a EURO6-compliant diesel engine. See also *Fitch: German Diesel ABS Risks May Be Easing, but Have Not Disappeared*

We consider the risks are adequately reflected in 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 its base-case assumption for VCL 28. 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

German GDP growth fell to 1.4% in 2018 from a cyclical peak of 2.2% in 2017. Even though there were one-off factors that weighed on growth in the second half of 2018 – the effect of which should naturally unwind in 2019 – Fitch has lowered its GDP growth forecasts to 1.0% and 1.4% for 2019 and 2020, respectively.

The primary driver of the recent weakening in growth is slowing external demand, driven in particular by escalation of trade tensions, growing risks of a "no-deal" Brexit and a slowdown in Chinese demand. Germany's domestic fundamentals remain strong with low unemployment and strong wage growth supporting continued moderate GDP growth and lessees' ability to repay their debt (please see *Germany – March 2019 Global Economic Outlook Forecast* and *Eurozone Growth Hits a Roadblock* for more details).

The outlook for German Auto ABS's asset performance is stable (see *Fitch Ratings 2019 Outlook: EMEA Structured Finance*).

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 of 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 Modelling*). 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.

[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 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	Asf
Increase default base by 25%	AA+sf	A-sf
Increase default base by 50%	AAsf	BBB+sf

Source: Fitch Ratings

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 pool as about 73% 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	Asf
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	BBBsf
Default rate increase by 50%, recovery rate decrease of 50%	Asf	BBsf

Source: Fitch Ratings

Rating Sensitivity to Prepayments and Recovery Timing

	Class A	Class B
Original rating	AAAsf	A+sf
Base-case prepayment assumption increased to 9%	AAAsf	Asf
Write-off timing increased to 8 months after default	AAAsf	Asf

Source: Fitch Ratings

Counterparty Risk

Operational Risk

VWL acts 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 considers 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 holds its accounts (distribution account, cash collateral account, counterparty downgrade collateral account and the swap termination payment account) at Elavon Financial Services DAC.

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 no longer entitled to commingle collected payments with its own funds if VW is 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. In this case, VWL has 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 initially maintain these payments for 11 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

The service component of a lease is not securitised. We therefore view a set-off possibility harmful for the special-purpose vehicle (SPV) only if the lessee has damaged the vehicle or needs maintenance to be carried out during the period between VWL's insolvency and the subsequent notification that VWL is no longer holding the receivables. We judge this risk to be negligible.

Set-Off Risk with Regard to Extended Warranties

VWFS offers (but does not securitise) extended warranties as a complementary product for lease contracts, i.e. protection against unexpected repair needs after the maturity of the two-year car-maker guarantee.

The risk we see here is similar to set-off risk from service components: the lessee may set off future instalments against claims from the extended warranty against VWL. We consider the argumentation from above to be relevant here as well: A set-off possibility is only given in case the claim and the liability are against the same legal entity. From the moment of notification, this is no longer possible. The risk of set-off during the period of VWL's insolvency and the notification is 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. As with the service component, insurance premiums are not securitised. Therefore, the agency deems insurance set-off risk as marginal.

Swap Counterparty

To hedge the interest rate risk arising from the fixed assets and floating liabilities, the issuer has entered into swap agreements with Skandinaviska Enskilda Banken AB. 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 will post and maintain a dedicated risk reserve (VWL risk reserve) equal to EUR11.0 million or 1.1% of the initial discounted asset balance, 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, to be 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 7-Dec 18	12 years	Monthly	Static
Total book volume	Jan 10-Dec 18	9 years	Monthly	Dynamic
Delinquency	Jan 10-Dec 18	9 years	Monthly	Dynamic

Source: Fitch Ratings

Additionally, Fitch received pool stratifications and an amortisation profile of the provisional pool as of 31 January 2019 and of the final pool as of 31 March 2019.
Form ABS Due Diligence-15E was not provided to, or reviewed by, Fitch in relation to this rating action.

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 assigns 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.