S&P Global Ratings

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DRAFT: New Issue: VCL Multi-Compartment S.A., Compartment VCL 42

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DRAFT: New Issue: VCL Multi-Compartment S.A., Compartment VCL 42

Ratings Detail

Ratings							
Class	**Rating***	**Amount (mil. €)**	**Overcollateralization and subordination (%)**	**Cash reserve (%)**	**Available credit enhancement (%)§**	**Interest (%)†**	**Legal final maturity**
A	AAA (sf)	954.00	4.60	1.20	5.80	1ME + 40 bps	March 2030
B	AA (sf)	18.00	2.80	1.20	4.00	1ME + 90 bps	March 2030
Subordinated loan	NR	19.60	N/A	N/A	N/A	N/A	N/A

*Our ratings address timely payment of interest and ultimate principal. §Includes subordination, overcollateralization (€8.4 million or 0.84% of the discounted pool balance), and a cash reserve (initial amount of €12.0 million or 1.20% of the discounted pool balance). †Subject to a floor of zero. 1ME--One-month Euro Interbank Offered Rate. NR--Not rated. N/A--Not applicable.

Transaction Summary

- S&P Global Ratings has assigned its credit ratings to VCL Multi-Compartment S.A., Compartment VCL 42's (VCL 42) class A and B notes. At closing, VCL 42 was also granted an unrated subordinated loan.
- Our ratings address timely payment of interest and ultimate payment of principal on the class A and B notes.
- VCL 42's notes securitize a portfolio of German auto lease receivables, which Volkswagen Leasing GmbH (VW Leasing) originated to its mostly retail customer base in the ordinary course of business. The lease receivables arise from fixed-term, level payment lease contracts, with payments due monthly. The residual values of the leased vehicles corresponding to the lease receivables were not sold to VCL 42, so no direct residual value risk is present in this transaction.
- The transaction is static (i.e., it has no replenishment period) with notes starting to amortize immediately. Amortization is sequential but will switch to pro rata after further overcollateralization builds up, assuming no performance triggers are breached.
- A combination of subordination, overcollateralization, and a cash reserve provides credit enhancement to the rated notes. VCL 42 benefits from excess spread if a servicer replacement event occurs, or the cumulative net loss ratio exceeds 1.6%. There is no principal deficiency ledger mechanism in place.
- A fixed-to-floating interest rate swap agreement is in line with our counterparty criteria and mitigates the risk of potential interest rate mismatches between the fixed-rate assets and floating-rate liabilities.
- All the securitized receivables were previously refinanced through the existing warehousing facility, VCL Master S.A. Compartment 1.
- The transaction's capital structure is similar to that of VCL Multi-Compartment S.A., Compartment VCL 40 (VCL 40), which we rated in October 2023. The cash reserve in VCL 42 amortizes at 1.2% of the aggregate discounted

receivables balance as of the end of the relevant monthly period. This is subject to a floor amount of the greater of (i) €7.5 million and (ii) the aggregate outstanding principal amount of the class A and B notes as of the end of the relevant monthly period, which remains unchanged from VCL 40's cash reserve mechanism.

- Like in VCL 40, seller-related risks (German trade tax and value-added tax [VAT] risks) are mitigated by a non-amortizing seller risk reserve (1.10% of the initial discounted pool balance), which VW Leasing funded at closing. In our view, the seller risk reserve only partially mitigates the potential German trade tax and VAT risks. Therefore, we have considered the uncovered portion (approximately 0.8% of the initial discounted pool balance in a 'AAA' scenario) as a loss in our cash flow analysis.
- Similar to our other rated recent VCL transactions, the servicer will advance collections to cover potential commingling risk if our ratings on its parent company, Volkswagen Financial Services AG, fall below 'BBB/A-2' (or 'BBB+' in the absence of a short-term rating) or if we consider that the servicer is no longer deemed eligible under our counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019). We deem that commingling risk is fully mitigated by this servicer advance mechanism.
- Given the sovereign rating on Germany (unsolicited; AAA/Stable/A-1+), our ratings in this transaction are not constrained by our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).
- The final documentation and the presented remedy provisions adequately mitigate counterparty risk and address any operational risk in line with our counterparty criteria.

The Credit Story

Strengths, concerns, and mitigating factors

Strengths	Concerns and mitigating factors
In our view, VW Leasing has a strong market position as one of the largest leasing companies in Europe, with more than 50 years' business experience.	Although historical net loss data provided by VW Leasing covers the period between 2014 to March 2024, it does not include any gross default or recoveries information. We have factored this into our analysis when deriving our credit and stress assumptions.
The preliminary pool is granular and diversified. As of May 31, 2024, it comprised 99,799 lease contracts for a total of 78,149 lessees. The largest single lessee concentration is 0.22% and the top 20 lessees comprise just 1.64% of the pool's discounted principal balance.	The transaction's payment structure is not fully sequential. Once certain target overcollateralization levels have been reached (and as long as certain performance triggers are met), the issuer will pay pro rata principal on the class A and B notes. We have stress-tested appropriate cash flows for each rating level, which included modeling the potential effect of the pro rata payment structure with a back-loaded loss curve.
As of the pool cut-off date May 31, 2024, the pool did not contain any contracts with overdue payments.	The transaction is exposed to commingling risk (as the pool collections are paid to the servicer's accounts before being transferred to the issuer), VAT risk (in accordance with section 13c of the German VAT Act), and German trade tax risk. A specific advance mechanism fully mitigates commingling risk, in our view. To mitigate the VAT and trade tax risks, the seller funded at closing a non-amortizing seller risk reserve representing 1.10% of the initial discounted pool balance. In our view, the seller's risk reserve only partially mitigates these potential tax risks. Therefore, we stressed the uncovered portion (approximately 0.8% of the initial discounted pool balance in a 'AAA' scenario) as an additional loss in our cash flows.
The portfolio does not revolve, failing to result in a shift in pool quality due to substitution.	
The structure benefits from an amortizing liquidity reserve, initially sized at 1.2% of the initial discounted pool balance, which was fully funded at closing. The liquidity reserve primarily serves as liquidity support to mitigate any cash strains. Ultimately, it is available to repay the notes at the end of the transaction's life.	

Environmental, Social, And Governance

Our rating analysis considers a transaction's potential exposure to environmental, social, and governance (ESG) credit factors. For the auto ABS sector, we view the exposure to environmental credit factors as above average, social credit factors as average, and governance credit factors as below average (see "ESG Industry Report Card: Auto Asset-Backed Securities," March 31, 2021). In our view, the exposure to ESG credit factors in this transaction is in line with our sector benchmark.

Environmental credit factors are generally viewed as above average given that the collateral pool primarily comprises vehicles with internal combustion engines (ICE), creating emissions of pollutants including greenhouse gases. While the adoption of electric vehicles and future regulation could in time lower ICE vehicle values, we believe that our current approach to evaluating recovery values adequately accounts for vehicle values over the relatively short life of the transaction. As a result, we have not separately identified this as a material ESG credit factor in our analysis.

Asset Description

As of the cut-off date, the collateral pool backing the notes comprised 99,799 lease contracts for a total of 78,149 lessees with a total discounted principal balance of €1,000 million.

Table 1

Collateral key features*

Compartment of VCL Multi-Compartment S.A.	VCL Multi-Compartment S.A., Compartment VCL 42	VCL Multi-Compartment S.A., Compartment VCL 40	VCL Multi-Compartment S.A., Compartment VCL 38	VCL Multi-Compartment S.A., Compartment VCL 37	VCL Multi-Compartment S.A., Compartment VCL 35
Originator	Volkswagen Leasing GmbH	Volkswagen Leasing GmbH	Volkswagen Leasing GmbH	Volkswagen Leasing GmbH	Volkswagen Leasing GmbH
Country	Germany	Germany	Germany	Germany	Germany
Type of assets	Auto leases	Auto leases	Auto leases	Auto leases	Auto leases
Pool cut-off (date)	May 31, 2024	Sep. 30, 2023	Feb. 28, 2023	Oct. 31, 2022	Feb. 28, 2022
Closing date	June 2024	Oct. 25, 2023	March 27, 2023	Nov. 25, 2022	March 25, 2022
Pool volume (mil. €)	1,000	750	1,250	1,000	1,000
Number of receivables	99,799	70,860	129,356	108,887	118,391
Discount rate or weighted-average yield (%)	5.70	5.70	5.70	5.70	5.70
Buffer rate (%)	1.05	0.60	0.82	1.21	4.06
Discount rate minus buffer release rate (%)	4.65	5.10	4.88	4.49	1.64
Weighted-average original term (months)	39.6	39.5	39.6	39.6	39.8
Weighted-average remaining term (months)	31.7	32.8	32.7	32.3	31.6
Weighted-average seasoning (months)	7.9	6.8	6.9	7.3	8.2
Contract type (%)					
Amortizing	100	100	100	100	100
Balloon	0	0	0	0	0
Vehicle status (%)					
New	92.7	92.7	94.3	93.9	90.9
Used and demonstration	7.3	7.3	5.7	6.1	9.1
Vehicle type (%)					
Car	100	100	100	100	100
Business segment (%)					
Private	23.0	21.8	22.2	22.7	23.3
Commercial	77.0	78.2	77.8	77.3	76.7
Engine type (%)					
Gasoline	39.9	37.2	29.5	32.6	28.7

Table 1

Collateral key features* (cont.)

Compartment of VCL Multi-Compartment S.A.	VCL Multi-Compartment S.A., Compartment VCL 42	VCL Multi-Compartment S.A., Compartment VCL 40	VCL Multi-Compartment S.A., Compartment VCL 38	VCL Multi-Compartment S.A., Compartment VCL 37	VCL Multi-Compartment S.A., Compartment VCL 35
Diesel	39.5	39.3	35.7	40.1	41.5
Electric	15.0	17.1	17.7	13.3	12.5
Hybrid	5.6	6.2	16.9	13.8	17.1
Other	0.1	0.1	0.2	0.2	0.2
Vehicle brand (%)					
Audi	26.0	28.8	29.4	28.2	30.0
Volkswagen	36.8	37.9	36.8	35.6	34.2
Volkswagen LCV (%)	7.8	7.1	8.3	10.0	10.4
Seat (%)	12.7	14.4	14.2	14.7	15.9
Skoda (%)	16.5	11.5	11.2	11.1	9.1
Geographic concentration (%)					
Top 1	23.9	23.7	23.7	22.8	22.9
Top 2	17.7	17.9	17.5	17.7	17.2
Top 3	15.5	15.3	15.1	15.2	15.0

*Percentages are expressed as a percentage of the outstanding discounted principal balance. TBD--To be determined. LCV--Light commercial vehicle.

Geographic distribution

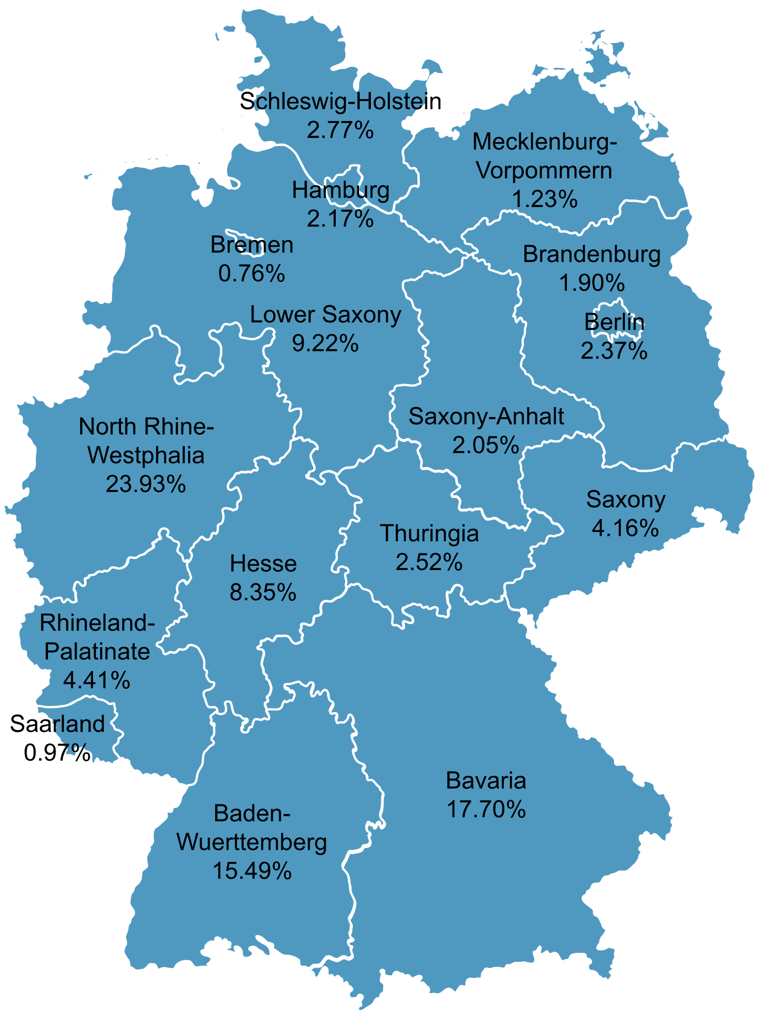
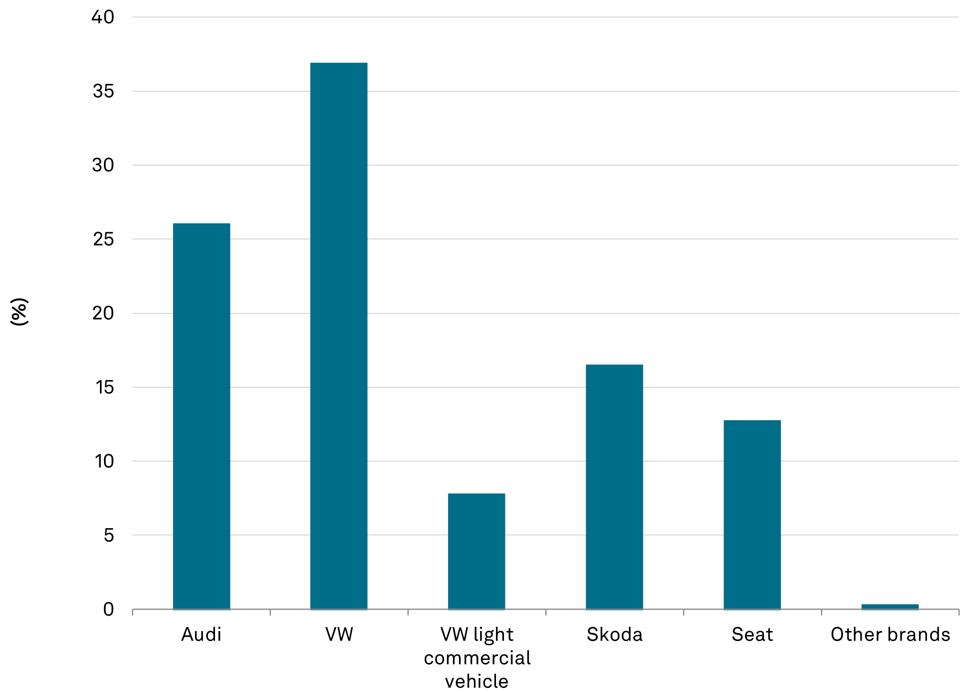


Chart 2

Pool distribution by brand

As of May 31, 2024



Eligibility Criteria

The transaction documents set out the eligibility criteria for receivables in the pool. Simplified, these state that:

- Contracts are legally valid and binding agreements and their enforceability is not impaired.
- Receivables are denominated and payable in euro.
- The leased vehicles are in Germany.
- The seller may freely dispose of the receivables.
- Receivables are free of defenses and from the rights of third parties. Lessees have no setoff claim.
- No receivable was overdue at the cut-off date.
- None of the lessees is an affiliate of Volkswagen AG, Family Porsche Stuttgart, or Family Piech Salzburg Group.
- Contracts are governed by the laws of Germany.
- Lessees have their registered office/place of residence in Germany.
- At least two lease instalments have been paid.
- Lease contracts require monthly payments to be made within 12 to 60 months after origination.

- The total amount of purchased lease receivables due from one and the same lessee does not exceed 0.50% of the initial aggregate discounted pool balance.
- VW Leasing's acquisition of the leased vehicles is financed in compliance with the requirements of section 108 (I) sentence 2 of the German Insolvency Code ("Insolvenzordnung").
- The share of the discounted pool corresponding to non-VW group vehicle does not exceed 5%.
- None of the lessees has exercised their right of revocation, if any.

Nature of the leases

A lease contract comprises two elements. The first, typically the regular lease instalments, relates to the payments from the lessee covering the vehicle's value depreciation over the contract's duration. The second relates to the vehicle's residual value when the lease contract expires. VCL 42 only purchased the regular lease instalments, and not the residual value. Furthermore, it also purchased rights associated with the premature termination of a lease receivable or with the transfer of the lease receivable, plus rights to payments from the realization of vehicles. It did not buy rights to insurance premiums, any VAT payments, and the residual value element.

Commercial retail lessees typically have no contractual right to prepay the lease contract. If VW Leasing allows prepayment, it will pay the outstanding net present value of the future lease payments due to VCL 42, discounted at the rate at which the issuer initially purchased the receivables.

VCL 42 purchased the lease receivables in this transaction from the VCL Master Compartment 1 securitization, where they have been warehoused. Furthermore, the corresponding residual values can be refinanced via the VCL Master Residual Value S.A. Compartment 2 securitization. The legal title over the leased vehicles is held by the trustee of VCL 42.

Originator/Seller

VW Leasing is a limited liability company and has underwritten auto leasing contracts in Germany since 1966. It is wholly owned by Volkswagen Financial Services AG, which in turn is a 100% subsidiary of Volkswagen AG. In the overall car financing market, VW Leasing is the leading captive car leasing provider in Germany. Its objectives are to lease motor vehicles and other movable assets from brands such as Volkswagen, Audi, SEAT, Skoda, and Volkswagen Nutzfahrzeuge vehicles, service-leasing to commercial and non-commercial customers, and leasing of used vehicles of all makes, including demonstration vehicles as used vehicles.

In our view, the company's track record of stable, strong quality asset origination is among the best of all European auto ABS issuers.

Servicing

We conducted a review of VW Leasing's origination, underwriting, collections, and risk management practices. We consider these to be in line with general market practice and our criteria for assessing operational risk (see "Related Criteria"). In our operational risk analysis, we look at the risk that cash flows may be disrupted following an operational failure of the servicer. Our preliminary ratings on the class A and B notes reflect our assessment of the company's origination policies, as well as our evaluation of VW Leasing's ability to fulfil its role as servicer under the transaction documents. Our operational risk analysis does not impose any cap on the maximum achievable rating.

At closing, no back-up servicer has been specified but under the transaction documents, the issuer is entitled to replace the servicer if a servicer replacement event occurs. We rely on the general availability of servicing in the German market to mitigate the risk of servicing disruption and have applied a stressed servicing fee in our cash flow analysis, in line with market standards.

Credit Analysis and Assumptions

We analyzed the transaction's credit risk under various stress scenarios by applying our global auto ABS criteria (see "Related Criteria").

Economic outlook

In our base-case scenario for Germany, we forecast GDP growth of 0.3%, 1.2%, and 1.2%, in 2024, 2025, and 2026 respectively. Our baseline forecast was informed by our economic outlook for the Eurozone published on March 26, 2024 (see "Related Research"). We expect Germany's economy to grow by a modest 0.3% in real terms in 2024, as domestic and external demand recover toward the second half of the year.

We expect inflation to be 2.7%, 2.2%, and 1.9% in 2024, 2025, and 2026, respectively. We set our credit assumptions to reflect our economic outlook for Germany.

Lessees in this transaction pay a fixed rate. As a result, in the short to medium term, borrowers are protected from rate rises but will face cost-of-living pressures. We consider these borrowers to be prime and as such generally resilient to inflationary pressures.

Defaults

A written-off purchased lease receivable is one that has been reduced by recoveries and that VW Leasing has finally written off in its capacity as servicer in accordance with its customary accounting practice. The net loss definition used in the performance data is in line with the net loss definition used in the transaction documents.

Cumulative net losses (VW Leasing's own books)

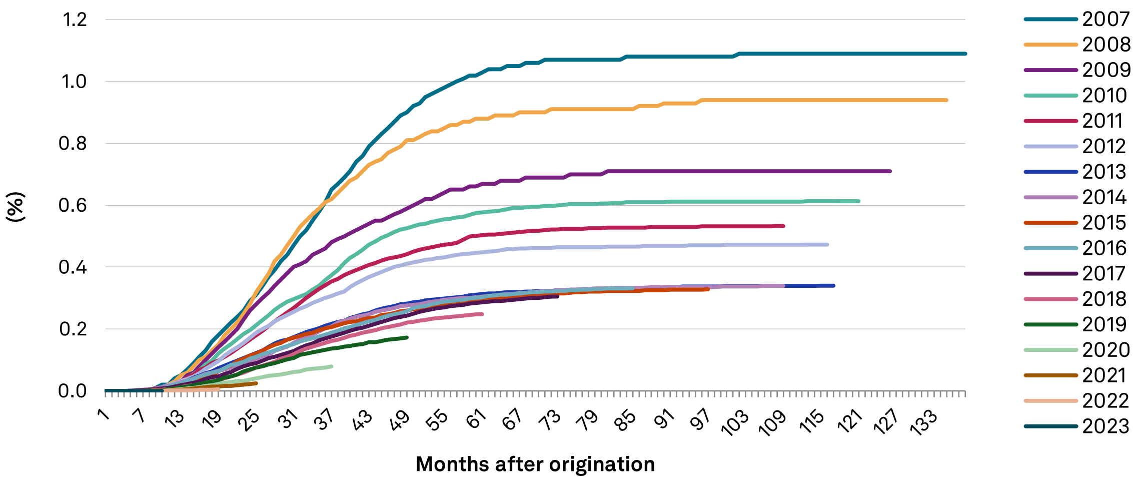
We received monthly static net loss data, from January 2014 to March 2024, showing cumulative net losses (i.e., actual write-offs after recoveries) as a percentage of VW Leasing's origination volume in its entire lease book. The originator did not provide us with separate recovery or prepayment data. To arrive at a gross loss proxy, we "gross up" the net loss data, using a recovery rate assumption of 74%.

We have also used the performance information available from the predecessor transactions (from January 2007). The quality of data provided is in line with our standards in relation to quality, timeliness, and reliability.

Performance in the originators' books has significantly improved between 2007 and 2017 and has stabilized at very low levels since then (see chart 3).

Chart 3

Cumulative net losses (VW Leasing's own books)



Based on the historical performance of receivables originated by VW Leasing and of the outstanding VCL transactions, we sized an average net loss of 0.40% for the pool. We then derived a gross loss assumption of 1.52% by assuming a 74% recovery rate. Given the book's and predecessor transactions' good performance, we decreased the base-case gross loss assumption.

At the same time, we increased our base-case multiples to 4.8x from 4.2x and to 3.7x from 3.2x for defaults at the 'AAA' and 'AA' ratings, respectively.

Recoveries and recovery timing

Under our global auto ABS criteria, we establish recovery rate assumptions based primarily on an analysis of historical recovery rates for the issuer and the market, the volatility of past performance, and credit, operational, or other factors that might affect the timing, amount, and sustainability of recovery rates. Additionally, considering the share of ICE and BEV/hybrid engines, we set the weighted average recovery rate at 74%.

For VCL 42, we sized stressed recoveries of 37.0% and 44.4% for the 'AAA' and 'AA' ratings, respectively, based on recovery data provided for previous VCL transactions, the share of engine types, and a peer comparison with other German auto leasing transactions. Overall, considering the new gross loss and recovery base cases and multiples, our net loss assumptions at 'AAA' remain unchanged from VCL 40. However, at 'AA', the stressed net losses are slightly lower than VCL 40, down to 3.13% from 3.32%.

Table 2 summarizes our credit assumptions.

Table 2

Credit assumption summary

Rating level	Net loss base case (%)	Recovery rate (for gross up) (%)	Gross loss base case (%)	Multiple	Stressed cumulative default rate (%)	Recovery rate haircut	Stressed recovery rate (%)*	Stressed cumulative net losses (%)
AAA (sf)	0.40	74	1.52	4.80	7.31	50.0	37.0	4.61
AA (sf)	0.40	74	1.52	3.70	5.64	40.0	44.4	3.13

*We assume that 100% of recoveries are realized nine months after default in our cash flow model.

Residual value risk

VCL 42 is not directly exposed to residual value risk as it has not purchased this type of receivables.

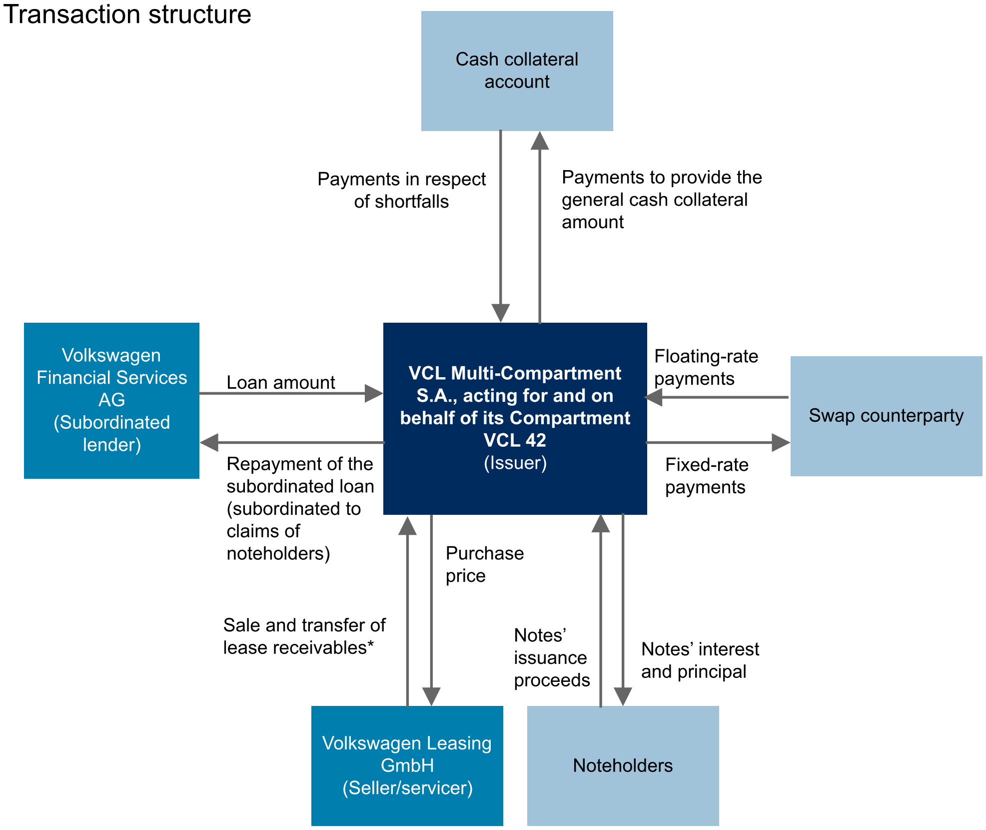
Transaction Structure

At closing, the issuer purchased a pool of auto lease receivables with a net present value of €1,000 million. The lease receivables were discounted at a fixed rate of 5.7016%. However, the effective interest available to the issuer will be reduced in a way to leave no excess spread in the transaction, unless VW Leasing becomes insolvent, or the cumulative net loss ratio exceeds 1.6% at any time. Therefore, interest receipts will be equal, in practice, to the sum of:

- Administrative expenses and a servicing fee;
- The weighted-average interest due to the swap counterparty under the terms of the swaps on the class A and B notes; and
- The interest due under the subordinated loan considering a hypothetical hedging of the latter.

Chart 4

VCL Multi-Compartment S.A., Compartment VCL 42
Transaction structure



*Currently held by VCL Master S.A. acting for and on behalf of its Compartment 1 pursuant to the receivables purchase agreement / distribution of collections.

The issuer is a Luxembourg special-purpose entity, which we consider to be bankruptcy remote under our legal criteria (see "Related Criteria"). The transaction legal opinion at closing confirmed that the sale of the assets would survive the seller's insolvency.

Cash Flow Mechanics

Priority of payments

The class A and B notes pay interest in arrears on a designated date each month, at the Euro interbank offered rate (EURIBOR) plus a respective margin. The first interest payment date (IPD) is July 21, 2024, and the legal final maturity of the notes will be in March 2030.

On each monthly IPD, the issuer applies to the priority of payments any asset collections (less the buffer release amount), net swap receipts, and amounts drawn from the cash reserve from the previous month, in the order outlined in table 3.

Table 3

Priority of payments (simplified)	
1	Taxes and payments to the trustee.
2	Senior fees, including payments to the corporate services provider, data protection trustee, and servicer.
3	Payments to the account bank.
4	Payments to the swap counterparty (except termination payments if the swap counterparty is the defaulting party).
5	Interest on the class A notes.
6	Interest on the class B notes.
7	Top-up cash reserve (only if drawn upon previously).
8	Class A notes' principal (sequential or pro rata).
9	Class B notes' principal (sequential or pro rata).
10	Payments to the swap counterparty not paid above.
11	Interest on the subordinated loan.
12	Principal on the subordinated loan.
13	Final success fee to VW Leasing.

Repayment of the notes

From closing, the issuer will redeem the notes sequentially until it reaches the target overcollateralization levels for the class A and B notes. Once the target overcollateralization levels have been reached, the transaction will switch to pro rata pay-down. Moreover, the transaction will switch back to sequential pay-down if there is a credit enhancement increase condition level 1 or level 2, or if the servicer becomes insolvent (see table 4).

The target overcollateralization levels would increase if one of the following performance triggers is breached:

- Trigger level 1: The cumulative net loss ratio exceeds 0.50% before or during September 2025 or 1.15% between September 2025 (exclusive) and June 2026; or
- Trigger level 2: The cumulative net loss ratio exceeds 1.6% at any time.

Table 4

Overcollateralization levels

	Actual overcollateralization (%)	Target overcollateralization levels (%)		
	At closing	No trigger breach	Trigger level 1 breached	Trigger level 2 breached
Class A	4.60	12.25	14.00	100.00
Class B	2.80	7.50	8.25	100.00

Event of default

If interest on the most senior notes outstanding is not paid timely or principal is not fully paid by the legal maturity, the noteholders or the trustee can call an event of default, leading to multiple events, such as the swap terminating (with the issuer needing to make termination payments), and the post-enforcement priority of payments being applied. However, we consider these events as ratings remote, and as such, we do not model the post-enforcement priority of payments in our analysis. If the trustee were to call an event of default, it could affect the transaction's cash flows.

Cash reserve

The issuer deposited €12.0 million (1.2% of the initial discounted asset balance) as a general cash reserve at closing. Amounts deposited in the general cash reserve account are available to bridge any liquidity shortfalls in the payment of senior costs and expenses, and interest on the class A and B notes. On the earlier of (i) the legal maturity date, or (ii) the date on which the aggregate discounted receivables balance has been reduced to zero, the issuer can also use the cash reserve to redeem the class A and B notes. The cash reserve amortizes at 1.2% of the aggregate discounted receivables balance as of the end of the relevant monthly period. This is subject to a floor amount of the greater of (i) €10.0 million and (ii) the aggregate outstanding principal amount of the class A and B notes as of the end of the relevant monthly period.

Funds in this account can only be invested in cash. After all the lease receivables and notes have been repaid, VW Leasing is entitled to any outstanding balance in the cash collateral account.

Excess spread

There is initially no excess spread in the transaction. All receivables are discounted using a rate equal to 5.7016%. VW Leasing calculated this number for VCL Master Compartment 1 to cover swap, interest and costs, and a buffer in case of increased interest cost for the warehouse facility prior to the subsequent sale to VCL 42. The difference between the 5.7016% discount rate and total interest (i.e., swap payments) and senior costs for this transaction is taken out of the available distribution amount prior to applying the waterfall sequence. Following the servicer insolvency or if the cumulative net loss ratio exceeds 1.6% at any time, the buffer component will not be released, and it will be considered as cash available to the issuer.

Fixed-to-floating interest rate swaps

At closing the issuer entered into fixed-to-floating interest rate swap agreements with DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main to hedge the risk between the assets' fixed-rate interest and the notes' floating-rate interest for the class A and B notes. Under the swap agreements, the issuer pays a fixed rate on the class A and B notes' agreements. The swap counterparty pays one-month EURIBOR plus a class-specific margin. The notional in both contracts is the class A and B outstanding note balance, respectively.

Mitigation Of Seller Risks

Commingling risk

An advance mechanism will be applied to address the servicer commingling risk if our issuer credit rating on Volkswagen Financial Services falls below 'BBB/A-2' (or 'BBB+' if no short-term rating is available) or if we consider that the servicer is no longer deemed eligible under our counterparty criteria. We deem that commingling risk is fully mitigated by this servicer advance mechanism.

Setoff risk

The transaction's eligibility criteria for the pool exclude leases granted to VW employees, thereby mitigating employee setoff risk. We also do not believe any setoff risk would arise from lessee deposits, insurance, or maintenance/servicing agreements. Lastly, we are not currently aware of any setoff claims that have arisen due to vehicle defects. As part of our ongoing surveillance of the transaction, we will monitor any potential setoff risk that could arise because of vehicle recalls, and consider the mitigating factors available at that time to determine any potential ratings impact.

Tax risks

Similar to VCL 40, seller-related risks (German trade tax risks, and VAT risks) are mitigated by a nonamortizing seller risk reserve (1.10% of the initial discounted pool balance), which VW Leasing funded at closing. In our view, the seller risk reserve only partially mitigates the potential German trade tax risk and VAT risks. Therefore, we have considered the uncovered portion (approximately 0.8% of the initial discounted pool balance in a 'AAA' scenario) as a loss in our cash flow analysis.

Cash Flow Assumptions

In our cash flow modeling of this transaction, we applied stressed losses equally over the asset portfolio's weighted-average life (17 months). We also ran a back-loaded loss curve to test the impact of the pro rata pay-down mechanism on the available credit enhancement. We stressed the prepayment rates and ran different interest rate scenarios (stressed interest rate curve [up, down, up/down, down/up]). The model incorporates the notes' potential pro rata amortization, and the cash reserve's amortizing features. We did not model commingling losses because we consider that the advance mechanism will fully mitigate these losses. We also modeled tax losses amounting to approximately 0.8% ('AAA' scenario) of the portfolio's initial discounted value because we consider that the seller risk reserve only partially mitigates the related risks. In addition, we modeled the cash credit enhancement's erosion due to negative interest rate scenarios.

Table 5

Cash flow assumptions	
Recession start	At closing
Length of recession	WAL (16 months)
Cumulative gross loss curve 1	Evenly distributed over WAL
Cumulative gross loss curve 2	Back loaded
Recovery lag	9 months
Delinquency	Two-thirds of credit losses recovered six months later
Stressed servicing fees (%)	1.03
Fixed fees (EUR)	100,000
Replacement bank cost	80,000
Prepayments (high/low)(%)	16.0/0.5
Interest rate	Stressed interest rate curve (up, down, up/down, down/up)
Initial WAC (%)	5.7016
Relative WAC compression (%)	N/A as purchased at discount
Commingling stress	None, mitigated through servicer advances subject to rating triggers.

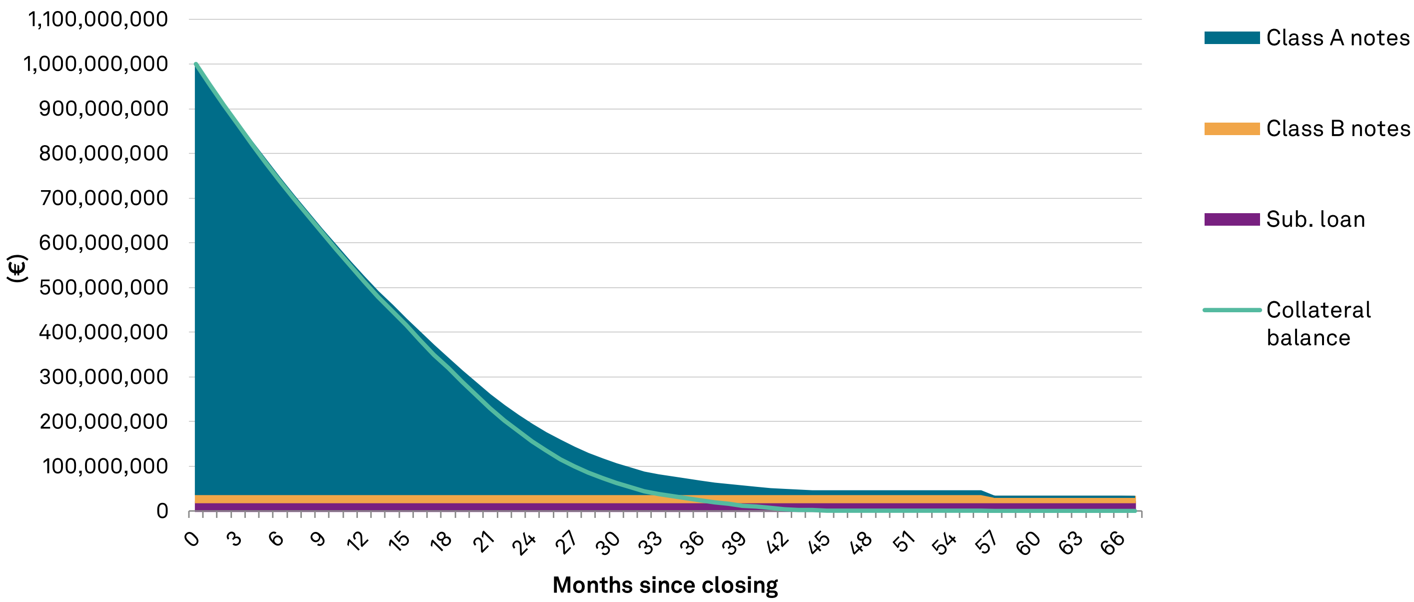
WAL--Weighted average life. WAC--Weighted average coupon. N/A--Not applicable.

The ratings scenarios address 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.

Chart 5 below shows the collateral and the note amortization profile under our most stressful scenario.

Chart 5

Collateral and note balances (end of period) in a 'AAA' rating scenario



Counterparty Risk

Our ratings also reflect that the replacement mechanisms in the transaction documents adequately mitigate the counterparty risks to which the transaction is exposed. The chosen swap counterparty, the final documentation, and the presented remedy provisions at closing adequately mitigate counterparty risk in line with our counterparty criteria.

Table 6

Supporting ratings

Institution/role	Ratings	Replacement trigger	Collateral posting trigger
Deutsche Bank AG, Frankfurt am Main as the transaction accounts provider	ICR: A/Stable/A-1	A/A-1 (or 'A+' if no short-term rating available)	N/A
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main	ICR: A+/stable/A-1	A-	A-

ICR--Issuer credit rating. N/A--Not applicable. TBD--To be determined.

Sovereign Risk

Our long-term unsolicited sovereign rating on Germany is 'AAA'. Therefore, our ratings in this transaction are not constrained by our structured finance sovereign risk criteria.

Forward-Looking View

The transaction's resilience to additional stresses to some key variables, in particular defaults and recoveries, determines our forward-looking view.

In our view, borrowers' ability to repay their auto leases will be highly correlated to macroeconomic conditions, particularly the unemployment rate and, to a lesser extent, consumer price inflation and interest rates. Given the loans are fixed-rate, we believe rising interest rates will have a lower effect on these borrowers in the near term, while longer term, they will likely further stretch household finances. As of today, our unemployment rate forecasts for Germany are 3.3%, 3.2%, and 3% for 2024, 2025, and 2026, respectively. Our forecast for inflation in Germany is 2.7% in 2024 and we expect this to decline to 2.2% in 2025 and 1.9% in 2026.

Furthermore, a decline in second-hand car values typically impacts the level of realized recoveries. Although used car prices may decline moderately in Germany in 2024, we do not expect them to fall significantly.

Given our current macroeconomic forecast and forward-looking view of Germany's auto market, our sensitivity scenarios consider, all else being equal, the hypothetical effect on our credit ratings of:

- An increased gross default base-case of up to 30%; and
- A maximum haircut of 30% to the recovery rate base-case.

We therefore ran eight scenarios with increased gross defaults and/or reduced expected recoveries, as shown in the table below.

Sensitivity analysis

Class	Base case	1	2	3	4	5	6	7	8
Default rate base-case increase (%)	0	10	30	0	0	10	30	10	30
Recovery rate base-case decrease (%)	0	0	0	10	30	10	10	30	30
Gross default rate (%)	1.52	1.67	1.98	1.52	1.52	1.67	1.98	1.67	1.98
Recovery rate (%)	74	74	74	66.6	51.8	66.6	66.6	51.8	51.8

Class of notes	Initial rating	1	2	3	4	5	6	7	8
Class A	AAA	AAA	AA+	AAA	AA+	AA+	AA	AA+	AA
Class B	AA	AA	AA-	AA	AA-	AA-	A+	A+	A

No change
One-notch downgrade
Two-notch downgrade
Three-notch or more downgrade

Source: S&P Global Ratings.

The results of the above sensitivity analysis indicate a deterioration of no more than three notches on the notes, which is in line with the credit stability considerations in our rating definitions.

The transaction embeds some strengths that may offset an increase of defaults. The transaction has a short weighted-average life and rapidly gains additional credit enhancement as the transaction amortizes. The underlying receivables and the notes pay a fixed rate of interest, which limits the effect of high interest rates on the transaction's performance in the near term. The interest rate swap mitigates the effect on note coupon payments from rising interest rates on the one-month EURIBOR they are linked to.

Monitoring And Surveillance

As part of our ongoing surveillance of this transaction, we will regularly assess:

- The performance of the underlying pool, including defaults, delinquencies, and prepayments;
- The supporting ratings in the transaction; and
- The servicer's operations and its ability to maintain minimum servicing standards.

Appendix

Transaction participants	
Seller and servicer	Volkswagen Leasing GmbH
Arranger	ING Bank N.V.
Lead managers	ING Bank N.V., Commerzbank Aktiengesellschaft, and SMBC BANK EU AG
Security trustee	Intertrust Trustees GmbH
Expectancy rights trustee	Intertrust Trustees Ltd.
Corporate services provider	Circumference FS (Luxembourg) S.A.
Bank account provider and cash administrator	Deutsche Bank AG
Principal paying agent, calculation agent, and interest determination agent	Deutsche Bank AG, London branch
Data protection trustee	Data Custody Agent Services B.V.
Registrar	Deutsche Bank Luxembourg S.A.
Swap counterparty	DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main

Related Criteria

- Criteria | Structured Finance | ABS: Global Auto ABS Methodology And Assumptions, March 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Methodology To Derive Stressed Interest Rates In Structured Finance, Oct. 18, 2019
- 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 | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Structured Finance | General: Methodology For Servicer Risk Assessment, May 28, 2009

Related Research

- European Auto ABS Index Report Q1 2024, May 17, 2024

- S&P Global Ratings' Approach To GloBE Or Pillar II Tax Liabilities In European Structured Finance Transactions, April 19, 2024
- Economic Outlook Eurozone Q2 2024: Labor Costs Hinder Disinflation As Rate Cuts Loom, March 26, 2024
- Germany 'AAA/A-1+' Ratings Affirmed; Outlook Stable, March 22, 2024
- S&P Global Ratings Definitions, June 9, 2023
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- How Much Is Enough? Information Quality Standards For The EMEA RMBS And ABS Rating Process, Jan. 8, 2019
- 2017 EMEA ABS Scenario And Sensitivity Analysis, July 6, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
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- Scenario Analysis: Gross Default Rates And Excess Spread Hold The Answer To Future European Auto ABS Performance, May 12, 2009