VOLKSWAGEN FINANCIAL SERVICES

THE KEY TO MOBILITY

ANNUAL REPORT
OF VOLKSWAGEN FINANCIAL SERVICES AG

2016

Key Figures

VOLKSWAGEN FINANCIAL SERVICES AG

In € million (as of December 31)	2016	2015	2014	2013	2012[1]
Total assets	130,148	121,251	107,231	90,992	87,378
Loans to and receivables from customers attributable to					
Retail financing	53,973	50,665	47,663	40,284	38,127
Dealer financing	14,638	13,967	12,625	11,082	10,781
Leasing business	21,997	19,704	18,320	16,298	15,312
Lease assets	14,696	12,982	10,766	8,545	7,474
Customer deposits	36,149	28,109	26,224	24,286	24,889
Equity	16,951	14,811	11,931	8,883	8,802
Operating profit	1,641	1,416	1,293	1,214	945
Profit before tax	1,650	1,513	1,317	1,315	992
Income tax expense	–509	–304	–420	–373	–264
Profit after tax	1,141	1,209	897	942	728

In % (as of December 31)	2016	2015	2014	2013	2012
Cost/income ratio[2]	64	63	60	58	60
Equity ratio[3]	13.0	12.2	11.1	9.8	10.1
Common Equity Tier 1 capital ratio[4]	11.7	12.0	10.3	-	-
Tier 1 capital ratio[4]	11.7	12.0	10.3	8.6	9.2
Total capital ratio[4]	12.6	12.1	10.7	9.6	9.8
Return on equity[5]	10.4	11.3	12.7	14.9	12.0

Number (as of December 31)	2016	2015	2014	2013	2012
Employees	11,819	11,746	11,305	9,498	8,770
Germany	6,145	6,167	5,928	5,319	4,971
International	5,674	5,579	5,377	4,179	3,799

1 The figures for 2012 have been restated in line with the amended IAS 19.
2 General and administrative expenses divided by the sum of net income from lending, leasing and insurance transactions (after provision for credit risks) and net fee and commission income.
3 Equity divided by total assets.
4 The regulatory capital ratios for the years 2012 and 2013 were calculated in accordance with the Solvabilitätsverordnung (SolvV – German Solvency Regulation). Since January 1, 2014, these ratios have been calculated in accordance with article 92 of the Capital Requirements Regulation (CRR). The Common Equity Tier 1 capital ratio has been added in accordance with the requirements in the CRR and other terminology has been aligned with that in the CRR.
5 Profit before tax divided by average equity.

RATING (AS OF DECEMBER 31)	STANDARD & POOR´S			MOODY´S INVESTORS SERVICE		
	Commercial Paper	Senior Unsecured	Outlook	Commercial Paper	Senior Unsecured	Outlook
Volkswagen Financial Services AG	A-2	BBB+	Watch Negative	P-1	A2	Negative
Volkswagen Bank GmbH	A-2	A-	Watch Negative	P-1	Aa3	Negative

All figures shown in the report are rounded, so minor discrepancies may arise from addition of these amounts. The figures from the previous fiscal year are shown in parentheses directly after the figures for the current reporting period.

COMBINED MANAGEMENT REPORT

Fundamental Information about the Group

Steady international growth confirms the business model of Volkswagen Financial Services AG.

BUSINESS MODEL

Over the years, the companies in the Volkswagen Financial Services AG Group have evolved increasingly dynamically into providers of comprehensive mobility services. The key objectives of Volkswagen Financial Services AG include:

- to promote Group product sales for the benefit of the Volkswagen Group brands and the partners appointed to distribute these products;
- to strengthen customer loyalty to Volkswagen Financial Services and the Volkswagen Group brands along the automotive value chain (among other things, by targeted use of digital products and mobility solutions);
- to create synergies for the Group by pooling Group and brand requirements in relation to finance and mobility services;
- to generate and sustain a high level of return on equity for the Group.

ORGANIZATION OF THE VOLKSWAGEN FINANCIAL SERVICES AG GROUP

The companies of the Volkswagen Financial Services AG Group provide financial services to the following customer groups: private/corporate customers, fleet customers and direct banking customers. The close integration of marketing, sales and customer service focused on customers' needs goes a long way towards keeping the processes lean and the sales strategy efficient. Volkswagen Financial Services AG has consolidated all after-sales activities in a separate key account structure for purposes of exploiting the services business to optimal effect.

From January 1, 2016, Lars Henner Santelmann was responsible – in addition to his function as Chairman of the Board of Management of Volkswagen Financial Services AG – for Corporate Management, Insurance, Truck & Bus and the China/India/ASEAN and Latin America regions.

Dr. Christian Dahlheim was appointed as a new member of the Board of Management on January 1, 2016 and took over responsibility for Sales & Marketing as well as the Germany, Europe, and International regions of Volkswagen Financial Services AG from Lars Henner Santelmann.

Information Technology and Processes are the responsibility of Dr. Mario Daberkow.

Frank Fiedler's remit is Finance and Procurement.

Christiane Hesse is in charge of Human Resources and Organization, while Dr. Michael Reinhart is responsible for Risk Management and Credit Analysis.

The integration of MAN Finance International GmbH, Munich, and its subsidiaries into the Volkswagen Financial Services AG Group within the Truck & Bus Division was completed in 2016. This included the integration from a company law perspective of national companies of MAN Finance International GmbH into the existing national companies of Volkswagen Financial Services AG as well as the integration into Volkswagen Financial Services AG in accordance with the concept for international cooperation.

In 2016, Volkswagen Financial Services AG initiated a reorganization of its structures under company law. The aim of the restructuring is to segregate the European lending and deposits business from the other financial services activities going forward and to pool this business under Volkswagen Bank GmbH, structured in the future as a direct subsidiary of Volkswagen AG. During the course of 2017, further detailed plans will be drawn up for this restructuring and preparations will be carried out for its implementation in terms of any necessary changes to organizational structures. The intention of the restructuring is to increase transparency and clarity for supervisory authorities, optimize the use of equity and reduce complexity. A new company, Volkswagen Financial Services Digital Solutions GmbH, will in the future develop and provide system-based services for its parent companies Volkswagen Bank GmbH and Volkswagen Financial Services AG. The other activities will remain in Volkswagen Financial Services AG, which will still be a direct subsidiary of Volkswagen AG.

INTERNAL MANAGEMENT

The Company's key performance indicators are determined on the basis of IFRSs and are presented as part of the internal reporting system. The most important non-financial performance indicators are penetration, current contracts and new contracts. The financial key performance indicators are the volume of business, deposit volume, operating profit, return on equity and the cost/income ratio.

KEY PERFORMANCE INDICATORS

	Definition
Nonfinancial performance indicators	
Penetration	Ratio of new contracts for new Group vehicles under retail financing and leasing business to deliveries of Group vehicles, based on Volkswagen Financial Services AG's consolidated entities.
Current contracts	Contracts recognized as of the reporting date
New contracts	Contracts recognized for the first time in the reporting period
Financial performance indicators	
Volume of business	Loans to and receivables from customers arising from retail financing, dealer financing, leasing business and lease assets.
Volume of deposits	Customer deposits, i.e. total liabilities from deposits arising from direct banking business, dealer current account and from nondirect banking business.
Operating profit	Net income from lending, leasing and insurance transactions after provision for credit risks, plus net fee and commission income, less general and administrative expenses, plus other operating income and less other operating expenses. As in the segment reporting, some amounts under net interest income, net other operating income/expenses and general and administrative expenses are eliminated.
Return on equity	Return on equity before tax, which is calculated by dividing profit before tax by average equity.
Cost/income ratio	General and administrative expenses divided by the sum of net income from lending, leasing and insurance transactions after provision for credit risks and net fee and commission income.

CHANGES IN EQUITY INVESTMENTS

Fleetzil Locações e Serviços Ltda., Curitiba, Brazil, was established on May 31, 2016. Autovisão Brasil Desenvolvimento de Negocios Ltda., a wholly owned subsidiary of Volkswagen do Brasil, holds one share, while all remaining shares being held by Volkswagen Finance Overseas B.V., Amsterdam, Netherlands. Fleetzil Locações e Serviços Ltda. will offer the local “Locação” product to further expand the activities in the fleet business in Brazil. The Go Live is scheduled for the third quarter of 2017.

On September 26, 2016, Volkswagen Financial Services Holding Argentina S.R.L., Buenos Aires, Argentina, acquired 49% of the shares in Volkswagen Financial Services Compañia Financiera S.A., Buenos Aires, Argentina, from Volkswagen Argentina S.A. The remaining 51% of shares were purchased by BBVA Banco Francés S.A. Starting with a number of pilot dealers, Volkswagen Financial Services Compañia Financiera S.A. changed its business model on November 1, 2016 from that of a financial products intermediary to that of an asset-bearing supplier of these products. The changeover was completed nationwide by the end of 2016; the company is also offering dealer financing since November 18, 2016. The company plans to expand its product portfolio in 2017 to include leasing products for retail customers and individual business customers.

On December 23, 2016, Volkswagen Financial Services AG acquired PayByPhone, Vancouver, Canada, the world’s leading cashless parking provider, from PayPoint plc. PayByPhone services are also available in the US, France, the United Kingdom, Switzerland and Australia. PayByPhone is an ideal service to complement Volkswagen Financial Services AG’s existing product portfolio, enabling the Company to systematically expand its international presence based on the mobile processing of parking charges and digital payment solutions. Volkswagen Financial Services AG has been the leading provider in the German parking market since 2015 when it acquired what is now around 94% of the shares in sunhill technologies GmbH, Bubenreuth. This company offers cashless payment solutions for parking facilities in more than 90 German towns and cities. PayByPhone will therefore join sunhill as a key component of the parking business at Volkswagen Financial Services AG.

In light of the expected business growth in existing and new markets and to comply with regulatory requirements, Volkswagen AG increased the capital of Volkswagen Financial Services AG by approximately €1.2 billion in 2016.

During the reporting period, Volkswagen Financial Services AG implemented the following material capital increases to strengthen the respective capital bases:

- Volkswagen Bank GmbH, Braunschweig, Germany, by approximately €2.1 billion;
- Volkswagen New Mobility Services Investment Co., Ltd., Beijing, China, by around €18 million;
- Volkswagen Financial Services Holding Argentina S.R.L., Buenos Aires, Argentina by some €16 million;
- Volkswagen Financial Services South Africa (Pty) Ltd., Sandton, South Africa, by around €6 million.

These measures serve to expand our business and support the growth strategy we are pursuing together with the brands of the Volkswagen Group.

There were no other significant changes with respect to equity investments. Detailed disclosures can be found in the list of all shareholdings in accordance with section 313(2) of the HGB and in accordance with IFRS 12.10 and IFRS 12.21, which can be accessed at www.vwfsag.com/listofholdings2016.

Report on Economic Position

The pace of global economic growth was slightly slower in 2016 than in the previous year. In contrast, the global demand for cars was higher than in the year before. Profit before tax at Volkswagen Financial Services AG was up from the previous year.

GLOBAL ECONOMY GROWS MODERATELY

The moderate growth rate of the global economy slowed to 2.5 (2.8)% in fiscal year 2016. While economic momentum decelerated in the industrialized countries as a whole, growth rates in emerging economies remained virtually constant year-on-year. Inflation increased as a result of the expansionary monetary policies pursued by many central banks and due to rising energy and commodity prices.

Europe/Other Markets

The economy of Western Europe continued to recover in the reporting period. At 1.7 (2.0)%, growth in gross domestic product (GDP) was slightly lower than in the previous year. The picture was mixed as regards economic growth in both Northern and Southern Europe. The UK's Brexit referendum in June, when a small majority voted to leave the EU, had a dramatic effect, with direct consequences including uncertainty in the financial markets and dimmer economic prospects for the United Kingdom and Europe as a whole. The eurozone unemployment rate continued to decrease, falling to an average of 10.6 (11.3)%, though rates remained considerably higher in Greece and Spain.

Although GDP grew by a total of 1.3 (0.8)% in Central and Eastern Europe in the reporting period, it remained at a relatively low level. Whereas the comparatively high rate of growth in Central Europe weakened considerably compared with the previous year, the recessionary period of the previous year in Eastern Europe came to an end. The recovery in energy prices was the main positive factor in this trend, while the unresolved conflict between Russia and Ukraine continued to have a negative impact. The decline in economic output in Russia by 0.6 (–3.7)% was much less pronounced in the reporting period than in 2015.

South Africa's GDP expanded by just 0.4 (1.3)%, thus falling substantially short of the already low figure of the previous year. In addition to a severe drought, ongoing structural deficits and social unrest weighed on the economy.

Germany

The German economy continued to profit from positive consumer sentiment and a good labor market, with the 1.8 (1.5)% rise in GDP being somewhat stronger than in the previous year.

North America

At 1.6 (2.6)%, economic growth in the USA was slightly lower year-on-year. The economy was supported primarily by private consumption and expansionary monetary policy, whereas private investment growth was weak. The average unemployment rate during the reporting period was 4.9 (5.3)%. The US dollar remained strong, putting domestic goods exports under pressure. At 1.3 (0.9)%, GDP growth in Canada showed only little momentum.

Latin America

Brazil experienced its second consecutive year of recession, with economic output falling by 3.6% (–3.8)%. Weak domestic demand, continuing relatively low global commodity prices and political uncertainty weighed on the economy. Argentina's GDP declined by 2.3 (+2.6)%, with structural deficits and high inflation continuing to hamper growth. Mexico's economic output fell to 2.1 (2.6)%.

Asia-Pacific

Economic growth in China weakened slightly in 2016, mainly due to structural changes. At 6.7 (6.9)%, however, it was still high compared with other countries worldwide. The Indian economy continued its positive trend with a gain of 6.8 (7.5)% and thereby grew somewhat more slowly than in the previous year. Japan once again posted weak GDP growth of just 1.0 (1.2)%.

FINANCIAL MARKETS

In 2016, global financial markets were characterized by some degree of uncertainty and the environment continued to be dominated by the expansionary monetary policies pursued by international central banks. The main sources of uncertainty included recurring doubts about economic growth in key industrialized nations, the United Kingdom's membership of the EU, geopolitical conflicts, political developments and the unexpected instability in the price of oil. The European Central Bank (ECB) maintained its expansionary monetary policy to achieve its inflation targets; in March, it cut its key interest rate to 0.0% and increased its negative interest rate for bank deposits at the ECB to −0.4%. This reduced rates of return to negligible levels and led to a shift toward a willingness to invest in higher risk equities and paper. In June, the ECB extended its bond-buying program to include unsecured corporate bonds and raised the volume of monthly buying. At the end of the year, the ECB decided to reduce the program's monthly volume but to extend the bond-buying once again to the end of 2017.

The uncertainty in the Italian banking system has persisted, even after the change of government in December, and government bailouts are becoming necessary in some cases. The Bank of England reduced its key interest rate and announced an asset-buying program covering government and corporate bonds. Coupled with hopes for a slow rise in interest rates in the US, this led to a rally on stock markets. The US presidential election in the fall of 2016 generated uncertainty in financial markets. At the moment, it is not yet possible to assess the long-term impact from the new political situation in the US.

Following falls in market prices at the end of the third quarter, hopes for an extension to the ECB'S bond-buying program and for a cut in the basic interest rate by the People's Bank of China initially led to a rise in equity prices in the fourth quarter. However, at the same time, market players were unnerved by negative economic indicators from China and the fall in the oil price. European stock markets responded positively to the widely expected hike in the benchmark rate by the US Federal Reserve (Fed) towards the end of the fourth quarter. The rate increase was implemented in December, with the Fed nudging up the target range for its federal funds rate by 25 basis points to 0.5%-0.75%. Three further rises are planned for 2017, taking the range to 1.25%-1.5%.

Europe/Other Markets

The ECB's bond-buying program and the improved economic outlook for the eurozone had an impact on market prices. Viewed across the eurozone as a whole, the indicators continued to point to modest growth, which was slightly below the prior year. In June, the United Kingdom held a referendum in which a narrow majority voted in favor of leaving the EU. This led to uncertainty in financial markets but there has been no significant impact on capital markets to date other than heightened volatility affecting the pound sterling exchange rate. In Portugal and the Netherlands, economic growth has weakened slightly, whereas in Eastern Europe the recovery in energy prices has had a positive impact. The Russian economy rebounded to the extent that economic output only contracted to a minor degree compared with the previous year.

Germany

Growth in the German economy was robust, although some momentum was lost at the end of the year compared with the first six months. A slide into deflation was successfully averted, and consumer spending and a sustained high level of exports remain the drivers of the German economy. A significant acceleration in inflation was apparent at the end of the year, fueled by the expansionary monetary policy pursued by the ECB.

North America

Economic growth in the US slowed markedly compared with the previous year. The expansionary monetary policy maintained by the Fed and household spending bolstered the economy. Currently, the political changeover in the US has only had a minor impact on the US economy and the world awaits the Trump administration's economic policy with bated breath.

Latin America

Economic growth in Brazil and Argentina continued to weaken. Persistent political uncertainty, sluggish domestic demand, relatively low commodity prices, structural deficits and high inflation had an adverse effect on both economies.

Asia-Pacific

Trends in the countries of the ASEAN region were mixed. China's economic growth was slightly below the previous year's rate, but still at a high level, although the Chinese government has introduced measures to support the economy, for example by offering tax breaks to boost the sale of passenger cars. The Indian economy also continued to grow strongly. In an enduring period of uncertainty caused by various global crises, the performance of the Japanese yen was better than expected. Although there was no apparent strengthening as economic growth remained weak, there were no longer any fears that the currency would fall in value.

GLOBAL DEMAND FOR PASSENGER CARS REACHES RECORD HIGH

Worldwide, the number of new passenger car registrations increased to 81.1 million vehicles in fiscal year 2016, exceeding the previous year's record level by 5.4%. Demand rose in the Asia-Pacific, Western Europe, North America and Central Europe regions, while new passenger car registrations in South America, Eastern Europe and Africa failed to match the prior-year levels.

Sector-specific environment

The sector-specific environment was influenced significantly by fiscal policy measures, which contributed substantially to the mixed trends in sales volumes in the markets last year. The instruments used were tax cuts or increases, incentive programs and sales incentives, as well as import duties.

In addition, non-tariff trade barriers to protect the respective domestic automotive industry made the free movement of vehicles, parts and components more difficult. Protectionist tendencies were particularly evident where markets were on the decline.

Europe/Other Markets

New passenger car registrations in Western Europe rose by 5.8% in the reporting period to 14.0 million vehicles, the highest level since 2007. This better-than-expected trend was mainly attributable to the positive overall economic environment, low interest rates, low fuel prices and manufacturers' incentive programs. Double-digit growth rates were achieved in Italy (+15.4%) and Spain (+10.9%), especially due to the release of pent-up demand for replacement vehicles. By contrast, growth in new passenger car registrations was relatively moderate in France, at 5.2%. Demand volume in the United Kingdom (+2.3%) was slightly higher than the record level of the previous year.

At 2.7 million vehicles, the number of new passenger car registrations in Central and Eastern Europe was down 2.3% year-on-year. The decline in Eastern Europe was mainly attributable to the Russian market, which contracted for the fourth year in succession (–11.7%) primarily because of the continuing weak economy and ongoing political tensions. By comparison, new passenger car registrations in the EU member states of Central Europe increased by a substantial 15.2% to 1.1 million units.

Passenger car sales in the South African market declined by 12.4% in the reporting period to 361 thousand vehicles, the lowest level since 2010. In addition to the weak economic environment, the main reasons for this decrease were low consumer confidence, high interest rates and double-digit growth in new car prices.

Germany

In Germany, 3.4 million new passenger vehicles were registered in 2016, 4.5% more than in the previous year. This positive demand trend was due in particular to higher real incomes, the strong labor market and attractive financing options. New passenger car registrations for both private (+6.8%) and commercial (+3.3%) customers contributed to this increase, which resulted in the highest passenger car market volume since 2009. A slight increase in domestic production (up 0.6% to 5.7 million vehicles) contributed to the ongoing recovery of the German passenger car market, whereas passenger car exports (up 0.2% to 4.4 million vehicles) were on a par with the high levels of the previous year.

North America

At 21.1 million vehicles, sales of passenger cars and light commercial vehicles (up to 6.35 tonnes) in the North American markets were slightly higher in 2016 (+1.8%) than the record level of the prior year. In the USA, demand reached the record set in the previous year with 17.6 million vehicles sold (+0.5%). In addition to the strong labor market, high consumer confidence, low fuel prices and attractive financing and leasing conditions were the main factors in this stable market trend. Models from the SUV, pickup and van segments were the only ones to benefit from this environment (+7.2%), whereas the passenger car segment contracted substantially (–8.1%).

In Canada (up 2.6% to 1.9 million vehicles), sales of passenger cars and light commercial vehicles continued to grow, topping the record of the prior year in this market.

Latin America

The South American markets for passenger cars and light commercial vehicles fell by a substantial 11.5% in the reporting period, to 3.7 million units. This trend was mainly due to the prolonged slump in Brazil, where the number of new registrations fell by 19.9% to 2.0 million vehicles, the fourth successive year of decline. This, the lowest number of vehicle registrations since 2006, was chiefly due to the recessionary economic environment, characterized by rising unemployment, lower real incomes and restricted access to loans. By contrast, Brazil's vehicle exports rose by 24.7% to 520 thousand units.

In Argentina, new registrations of passenger cars and light commercial vehicles increased by 9.8% from the previous year's low level to 677 thousand vehicles. High manufacturer discounts helped to boost demand.

In Mexico (up 18.6% to 1.6 million vehicles), sales of passenger cars and light commercial vehicles continued to grow, topping the record of the prior year in this market.

Asia-Pacific

The passenger car market volume in the Asia-Pacific region rose by 11.9% in the reporting period to 35.3 million units. In terms of unit numbers, this was the highest increase in new vehicle registrations worldwide. The Chinese market was by far the biggest driver of this growth. The 22.9 million vehicles sold in China (+17.9%) represented a new record. One of the factors contributing to this growth was the tax relief on the purchase of vehicles with engine sizes of up to 1.6 l introduced on October 1, 2015, from which attractively priced entry-level models in the SUV segment benefited most.

The number of new vehicle registrations in the Indian passenger car market reached 2.8 million units, up 7.0% year-on-year. This trend was driven by the positive economic environment and the large number of new models.

In Japan, new passenger cars registrations fell by 1.6% to 4.1 million vehicles, mainly because of a substantial drop in the mini passenger car segment (up to an engine size of 660 cm3).

MIXED REGIONAL DEMAND FOR COMMERCIAL VEHICLES

In 2016, demand for light commercial vehicles was up slightly overall on the previous year: in total, around 9.6 (9.5) million vehicles were registered worldwide.

In Western Europe, the number of new vehicle registrations rose by 10.0% during the year to 1.8 million units, driven by the region's positive economic performance. The markets in Italy (+28.9%), Spain (+11.6%) and France (+9.4%) recorded high growth rates. In Germany, the 2015 figure was significantly exceeded by 10.2%.

The markets in Central and Eastern Europe saw significant growth on the whole with 303 (287) thousand vehicle registrations. In Russia, ongoing political and economic tensions resulted once again in a decline in demand. The other markets in the region maintained or surpassed their prior-year results, with registrations in Poland in particular rising to 61 (52) thousand units.

In North and South America, the light vehicle market is reported as part of the passenger car market, which includes both passenger cars and light commercial vehicles.

Registrations of light commercial vehicles in the Asia-Pacific region increased to 6.6 million units in the reporting period (+1.9%). In China, the region's dominant market, demand for light commercial vehicles of 4.1 million units was up 4.4% on the prior-year figure. Tax relief for vehicles with engine sizes of up to 1.6 l contributed to this growth. As a consequence of the sustained economic growth in India, more vehicles were registered than in 2015; here, 520 (481) thousand new units were registered. The market volume fell in Japan as a result of the persistently weak economic trend (−8.5%).

Global demand for mid-sized and heavy trucks with a gross weight of more than six tonnes was higher in fiscal year 2016 than in the previous year, with 2.3 million new vehicle registrations (+0.9%). The volume of vehicles rose by 0.5% in the markets that are relevant for the Volkswagen Group.

In Western Europe, the number of new truck registrations increased by 8.6% to a total of 280 thousand vehicles on the back of positive economic stimulus. The markets in Italy (+41.9%), France (+13.7%) and Spain (+11.6%) in particular recorded high growth rates. In Germany, Western Europe's largest market, the prior-year figure was exceeded by 3.9%.

Central and Eastern Europe saw demand rise by 10.3% to 129 thousand units. Registrations in Russia moved up 6.9% from a low prior-year level to 48 thousand vehicles, while Poland, among others, generated strong growth (+19.3%).

In North America, the slowdown in the US economy caused demand in the truck market to dwindle slightly; in this region, 488 (531) thousand mid-sized and heavy trucks were registered. The number of new registrations in the US market declined sharply.

South America saw a considerable decline in market volume compared with the previous year. Here, the number of new vehicle registrations fell by 25.0% to 95 thousand units. In Brazil, the region's largest market, demand for trucks, at 48 (68) thousand vehicles, was down substantially on the already low prior-year figure as a result of persistently weak economic output and high inflation rates. New vehicle registrations slumped in Argentina (−22.8%) due to pull-forward effects in 2015 attributable to the introduction of the Euro 5 emission standard in addition to the economic downturn.

At 545 (526) thousand new registrations, the volume of vehicles in the Asia-Pacific region – excluding the Chinese market – was higher than in 2015. Demand in India increased in the reporting period: a total of 292 thousand vehicles were registered, 9.9% more than in the previous year. This was due to the country's positive economic performance, demand for replacement vehicles and the improved investment climate. Demand in China, the world's largest truck market, surged in 2016 to a total of 600 thousand units from a weak prior-year level (+11.4%).

Demand for buses in the markets that are relevant for the Volkswagen Group was perceptibly lower than in the previous year. Negative economic trends in South America led to a marked decline in demand, though the markets in Central and Eastern Europe expanded considerably.

GLOBAL DELIVERIES TO CUSTOMERS OF THE VOLKSWAGEN GROUP[1]

	DELIVERIES OF VEHICLES		
	2016	2015	Change in percent
Deliveries of passenger cars worldwide[2]	**9,635,484**	**9,320,687**	**+3.4**
Volkswagen passenger cars	5,980,307	5,823,414	+2.7
Audi	1,867,738	1,803,246	+3.6
ŠKODA	1,126,477	1,055,501	+6.7
SEAT	408,703	400,037	+2.2
Bentley	11,023	10,100	+9.1
Lamborghini	3,457	3,245	+6.5
Porsche	237,778	225,121	+5.6
Bugatti	1	23	−95.7
Deliveries of commercial vehicles worldwide	**661,513**	**609,909**	**+8.5**
Volkswagen commercial vehicles	477,932	430,874	+10.9
Scania	81,346	76,561	+6.2
MAN	102,235	102,474	−0.2

1 The delivery figures for 2015 have been restated following statistical updates.
2 Including the Chinese joint ventures.

OVERALL ASSESSMENT OF THE COURSE OF BUSINESS AND THE GROUP'S POSITION

The Board of Management of Volkswagen Financial Services AG considers the course of business in the year 2016 to have been positive. Operating profit was better than forecast, coming in above the 2015 level despite the diesel issue. Thus, operating profit was not adversely impacted by the diesel issue. New business worldwide also recorded positive growth over the reporting period. Funding costs were down slightly year-on-year amid higher business volume. The provision for credit risks from lending and leasing business was held at the prior-year level; the margins remained stable.

On September 18, 2015, the US Environmental Protection Agency (EPA) issued a Notice of Violation, publicly announcing that irregularities in relation to nitrogen oxide (NOx) emissions had been discovered in emissions tests on certain vehicles with Volkswagen Group diesel engines. This was followed by further notifications regarding the extent of the diesel issue. As a result of this situation, the Board of Management set up a task force in 2015. This task force initially continued its activities in 2016, i.e. reporting regularly to the Board of Management, interfacing with the Volkswagen Group and its brands, and maintaining close contact with the international subsidiaries, regulatory authorities and investors. Concerns focused on funding, the credit quality of the dealer network and residual value risk. The impact from the diesel issue on these concerns is currently receding. Further details are described in the relevant sections of this report. The work of the task force was brought to an end in December 2016 because the effects from the diesel issue on the Volkswagen Financial Services AG subgroup are now dissipating and can be handled within normal management processes. The Volkswagen Group provided support in dealing with the effects.

Volkswagen Financial Services AG also continued its efforts to better leverage the potential along the automotive value chain. The integration of financial services into the sales activities of the Volkswagen Group's core brands, already greatly expanded in recent years, was stepped up. A consistent focus on customer wishes makes it possible to accompany the customer and the vehicle throughout its lifecycle. Incorporating service and maintenance packages as well as insurance services has further increased the value contribution of each customer for the Volkswagen Group and further strengthened the dealer network by generating additional revenue streams.

The share of leased and financed vehicles among worldwide deliveries to customers (penetration) at the end of 2016 remained very high at 30.0% (previous year: 28.3%). The positive trend has arisen largely from the growth in penetration in Europe from 38.8% to 40.2% and the very significant increase in the Asia-Pacific region from 11.6% to 15%.

Fiscal year 2016 saw a continuation in the positive development in credit risk in Germany, the market in which the Group generates its highest volume of business. A sustained economic recovery was evident in European markets. This led to further growth in vehicle markets with a positive impact on the credit risk situation. The UK market saw substantial portfolio growth overall measured in local currency. However, the currency depreciation of the pound sterling offset some of the growth effects. Trends in the Brazilian company in 2016 were largely dominated by the development in local macroeconomic situation, which remained challenging. The exposure in local currency declined year-over-year but the equivalent figure in euros remained at the prior-year level because of currency conversion effects. Measures to reduce risk were implemented. The diesel issue in the Volkswagen Group did not have any impact on the credit risk portfolio of Volkswagen Financial Services AG in 2016. The monitoring measures introduced for the dealer portfolio remained in place. These measures did not reveal any impact on dealer credit quality. Overall, the credit risk situation remained stable in 2016.

Volkswagen Financial Services AG also saw continued growth of contracts in the residual value portfolio in fiscal year 2016, advantaged by the recovery of vehicle markets in Europe. The diesel issue in the Volkswagen Group only had a marginal effect overall on the development in the residual value portfolio of Volkswagen Financial Services AG in 2016. The used vehicle market was not materially affected by this issue in the year under review either. It was therefore possible to reduce the provision for residual value risk, which had been increased at the end of 2015. The remaining risks continue to be adequately covered. Overall, it was observable that the risk situation in the residual value portfolio had stabilized in fiscal year 2016.

Events after the balance sheet date are reported in the notes to the consolidated financial statements of Volkswagen Financial Services AG in note 72 (page 150).

CHANGES IN KEY PERFORMANCE INDICATORS FOR FISCAL YEAR 2016 COMPARED WITH PRIOR-YEAR FORECASTS

	Actual 2015		Forecast for 2016	Actual 2016
Nonfinancial performance indicators				
Penetration (percent)	28.3	> 28.3	Slight increase	30.0
Current contracts (thousands)	12,081	> 12,081	Slight increase	13,244
New contracts (thousands)	4,886	> 4,886	Slight increase	5,603
Financial performance indicators				
Volume of business (€ million)	97,318	> 97,318	Slight increase	105,303
Volume of deposits (€ million)	28,109	> 28,109	Slightly rising balance	36,149
Operating profit (€ million)	1,416	= 1,416	At prior-year level	1,641
Return on equity (percent)	11.3	< 11.3	Slightly lower	10.4
Cost/income ratio (percent)	63	≤ 63	Slightly below/at prior-year level	64

FINANCIAL PERFORMANCE

The moderate growth rate of the global economy declined slightly in fiscal year 2016. Nevertheless, Volkswagen Financial Services AG performed well.

Operating profit improved significantly by 15.9% to €1,641 million (€1,416 million). This figure benefited in particular from the positive impact generated by higher volumes and stable margins in the lending and leasing business. Adverse movements in exchange rates had a negative effect on operating profit. The figure also includes support payments from the Volkswagen Group to compensate for higher funding costs resulting from the diesel issue. These payments were recognized as other operating income. The operating profit was not therefore negatively affected by the diesel issue.

Profit before tax was up year-on-year at €1,650 million (€1,513 million).

Return on equity fell to 10.4% (11.3%) as equity rose sharply.

Net income from lending, leasing and insurance transactions before provision for credit risks amounted to €3,824 million, equating to slight decrease on the previous year (€3,836 million). The positive performance in all regions other than Latin America was to some extent offset by exchange rate effects and higher expenses resulting from the confidence-building campaign with the brands and dealers. The impairment losses on lease assets of €188 million (€353 million) included in the figures were attributable to normal fluctuations in the market, whereas the equivalent figure in the previous year had been affected by the diesel issue. In 2016, it was possible to bring the provision for residual value risk back down again; this provision had been increased in 2015. This change is reflected in a number of ways, notably in the reversals of impairment losses on lease assets. It was therefore possible to repay related support amounts received in the previous year.

Risk costs of €672 million were at the same level as in the previous year (€672 million). Credit risks to which the Volkswagen Financial Services AG Group is exposed as a result of various critical situations (economic crises, Brexit impact, block on sales) in some eurozone countries and in the United Kingdom, Russia, Brazil, India and the Republic of Korea were accounted for in the reporting period by recognizing valuation allowances. These valuation allowances were raised by €224 million year-on-year to €876 million.

Net fee and commission income declined significantly compared with the previous year, mainly as a result of higher sales commission paid in the financing business as part of the confidence-building campaign with the brands and dealers.

General and administrative expenses were slightly below the prior-year level at €2,040 million. This reflected the initial positive impact from the efficiency and cost programs. Despite this, the cost/income ratio was higher than in the previous year at 64% (63%) because the reference value (net income from lending, leasing and insurance transactions after provision for credit risks and net fee and commission income) declined year-on-year as described above. A total of €178 million (€197 million) was added to the provisions for legal risks.

The share of profits and losses of equity-accounted joint ventures rose significantly by €53 million year-on-year to €77 million.

Including the net loss on the measurement of derivative financial instruments and hedged items in the amount of €85 million (net gain of €53 million) and the other components of profit or loss, the profit after tax generated by the Volkswagen Financial Services AG Group amounted to €1,141 million (down by 5.6%).

Under the current control and profit-and-loss transfer agreement for Volkswagen Financial Services AG, profits of €130 million reported by Volkswagen Financial Services AG in its single-entity financial statements prepared in accordance with HGB were transferred to the sole shareholder Volkswagen AG.

The German companies continued to account for the highest business volumes with some 46.5% of all contracts, forming a strong and solid foundation. They generated profit before tax of €659 million (€681 million).

Volkswagen Bank GmbH successfully maintained its strong market position in 2016, supported by an attractive range of products and strong customer and dealer loyalty. It therefore once again delivered a significant contribution to the performance of Volkswagen Financial Services AG.

In 2016, Volkswagen Leasing GmbH again pushed up the number of leases compared with the previous year in a fiercely competitive environment, thereby accounting for a significant share of the Group's operating profit.

In the vehicle insurance segment, Volkswagen Autoversicherung AG continued to stabilize its business and expand its activities in 2016. The number of current contracts held by this company has now swelled to more than half a million policies (vehicle insurance and new-car replacement (new-for-old) cover).

Volkswagen Versicherung AG also continued to expand its direct insurance activities and successfully drove forward the internationalization of its business in fiscal year 2016. The company now operates in twelve international markets, complementing the core business in Germany.

Volkswagen Versicherungsdienst GmbH, which operates as the sales partner in the German market for both Volkswagen Autoversicherung AG and Volkswagen Versicherung AG, has contributed to the successful performance of these companies. Overall, the activities of Volkswagen Versicherungsdienst GmbH help to support the earnings of Volkswagen Financial Services AG on a steady basis.

NET ASSETS AND FINANCIAL POSITION

Lending Business

At €115.3 billion in total, loans to and receivables from customers and lease assets – which make up the core business of the Volkswagen Financial Services AG Group – accounted for approximately 89 % of the Group's total assets.

The volume of retail financing lending rose by €3.3 billion or 6.5 % in the past year to €54.0 billion. The number of new contracts came to 2,002 thousand and exceeded the prior-year level (+11.8 %). As a consequence, the number of current contracts had risen to 5,045 thousand at the end of the year (+6.2 %). Volkswagen Bank GmbH again remained the largest single company with current contracts of 2,197 thousand (+2.2 %).

The lending volume in dealer financing – which comprises loans to and receivables from Group dealers in connection with financing for inventory vehicles, as well as working capital and investment loans – increased to €14.6 billion (+4.8 %).

Receivables from leasing transactions were up 11.6 % year-on-year to €22.0 billion. Lease assets also recorded strong growth of €1.7 billion to €14.7 billion (+13.2 %).

A total of 897 thousand new leases were signed in the reporting period, greatly surpassing the figure for the previous year (+10.1 %). The number of lease vehicles as of December 31, 2016 was 1,964 thousand, a year-on-year increase of 10.1 %. As in previous years, the largest contribution to business growth again came from Volkswagen Leasing GmbH, which had a contract portfolio for 1,282 thousand lease vehicles (+8.5 %).

KEY FIGURES BY SEGMENT AS OF DECEMBER 31, 2016

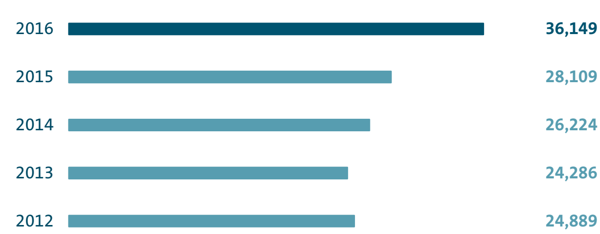
Thousands	VW FS AG	Germany	Europe	Latin America	Asia-Pacific	Other companies[1]
Current contracts	**13,244**	**6,156**	**4,340**	**1,219**	**1,520**	**9**
Retail financing	5,045	1,590	1,526	750	1,178	–
Leasing business	1,964	1,215	632	80	28	9
Service/insurance	6,234	3,351	2,182	388	314	–
New contracts	**5,603**	**2,446**	**1,949**	**478**	**728**	**2**
Retail financing	2,002	507	625	235	635	–
Leasing business	897	555	289	40	10	2
Service/insurance	2,705	1,384	1,035	203	82	–
€ million						
Loans to and receivables from customers attributable to						
Retail financing	53,973	19,993	18,141	4,688	11,151	–
Dealer financing	14,638	4,854	6,517	994	1,718	555
Leasing business	21,997	15,965	5,238	489	294	11
Lease assets	14,696	8,637	5,118	128	675	137
Investment[2]	6,824	3,442	2,963	145	203	71
Operating profit	1,641	684	574	48	227	108
Percent						
Penetration[3]	30.0	58.4	40.2	46.6	15.0	–

1 The Other companies segment comprises VW FS AG, the holding and financing companies in the Netherlands, France and Belgium, EURO Leasing companies in Germany, Denmark and Poland, VW Insurance Brokers GmbH and Volkswagen Versicherung AG.
2 Corresponds to additions to lease assets classified as noncurrent assets.
3 Ratio of new contracts for new Group vehicles under retail financing and leasing business to deliveries of Group vehicles, based on Volkswagen Financial Services AG's consolidated entities.

DEVELOPMENT OF NEW CONTRACTS AND CURRENT CONTRACTS AS OF DECEMBER 31
in thousands

DIRECT BANK CUSTOMERS AS OF DECEMBER 31
Lending and deposit business and borrowings (in thousands)

CUSTOMER DEPOSITS AS OF DECEMBER 31
in € million



Total assets of the Volkswagen Financial Services AG Group rose by 7.3% year-on-year to €130.1 billion. This growth is primarily the result of the increase in loans to and receivables from customers (+8.4%) and lease assets (+13.2%) and hence reflects the business expansion in the past year. The number of service and insurance contracts at the year-end was 6,234 thousand (5,548 thousand). New business volume of 2,705 thousand (2,281 thousand) contracts equated to an increase of 18.5% year-on-year. Since January 1, 2016, a new method has been used to determine the contract figures. The prior year figures have been restated for comparison purposes.

Volkswagen Bank GmbH, France branch, with a business volume of €5.2 billion and Volkswagen Bank GmbH, Italy branch, with a business volume of €3.7 billion are included in the consolidated financial statements of Volkswagen Financial Services AG as significant branches.

Deposit Business and Borrowings

In terms of capital structure, the significant liability items included liabilities to banks in the amount of €17.0 billion (+8.4%), liabilities to customers amounting to €49.5 billion (+13.0%) and notes, commercial paper issued of €37.8 billion (−5.2%). Information on the funding and hedging strategy is provided in a separate section of the management report.

Deposits reported within the liabilities to customers, primarily deposits held by Volkswagen Bank GmbH, were up from the previous year at €36.1 billion (+28.6%). Based on the volume of deposits, Volkswagen Bank GmbH remains one of the largest direct banks in Germany. The total number of direct bank customers as of December 31, 2016 was 1,273 thousand (+6.1%).

Subordinated Capital

Subordinated capital was higher than at the end of the previous year at €3.2 billion (+35.8%) because a subordinated loan of €1.0 billion was taken on to strengthen the regulatory capital base. This subordinated loan satisfies the criteria for eligibility as Tier 2 capital in accordance with Article 63 of the Capital Requirements Regulation (CRR).

Equity

The subscribed capital of Volkswagen Financial Services AG remained unchanged at €441 million in fiscal year 2016. Equity in accordance with IFRSs was €17.0 billion (€14.8 billion). This resulted in an equity ratio of 13.0% (equity divided by total assets) based on total assets of €130.1 billion.

Capital Adequacy According to Regulatory Requirements

Under the provisions of the Capital Requirements Regulation (CRR), appropriate capital adequacy is assumed if the Common Equity Tier 1 capital ratio is at least 4.5%, the Tier 1 capital ratio is at least 6% and the total capital ratio is at least 8%. The ECB, acting on the basis of Article 16 of Council Regulation No. 1024/2013 of October 15, 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, issued a decision on November 25, 2016, establishing regulatory requirements for Volkswagen Financial Services AG. The decision was based on a supervisory review in 2016. Volkswagen Financial Services AG has at all times in the reporting period maintained both the minimum requirements of the CRR and the additional requirements set forth by the supervisory authorities.

The total capital ratio (ratio of own funds to the total risk exposure amount) was 12.6% (12.1%) at the end of the reporting period, well above the statutory minimum ratio of 8%.

The rise in the total capital ratio was largely attributable to total additions of €1.2 billion to Common Equity Tier 1 capital and to the drawdown of a subordinated loan of €1.0 billion eligible as Tier 2 capital.

The Tier 1 capital ratio and Common Equity Tier 1 capital ratio were each 11.7% (12.0%) at the end of the reporting period, likewise well above the respective minimum ratios of 6% and 4.5% specified in the CRR.

The marginal decline in the Tier 1 capital ratio and Common Equity Tier 1 capital ratio was attributable to the disproportionate growth in business volume.

The total risk exposure amount is made up primarily of credit risks, market risks, operational risks and credit valuation adjustment (CVA charge). The Credit Risk Standardized Approach (CRSA) is used to quantify credit risk and to determine risk-weighted exposures. The Standardized Approach as specified in Article 317 of the CRR is used to calculate the own funds requirements for operational risk. The own funds requirements for the CVA charge are determined using the standardized method specified in Article 384 of the CRR.

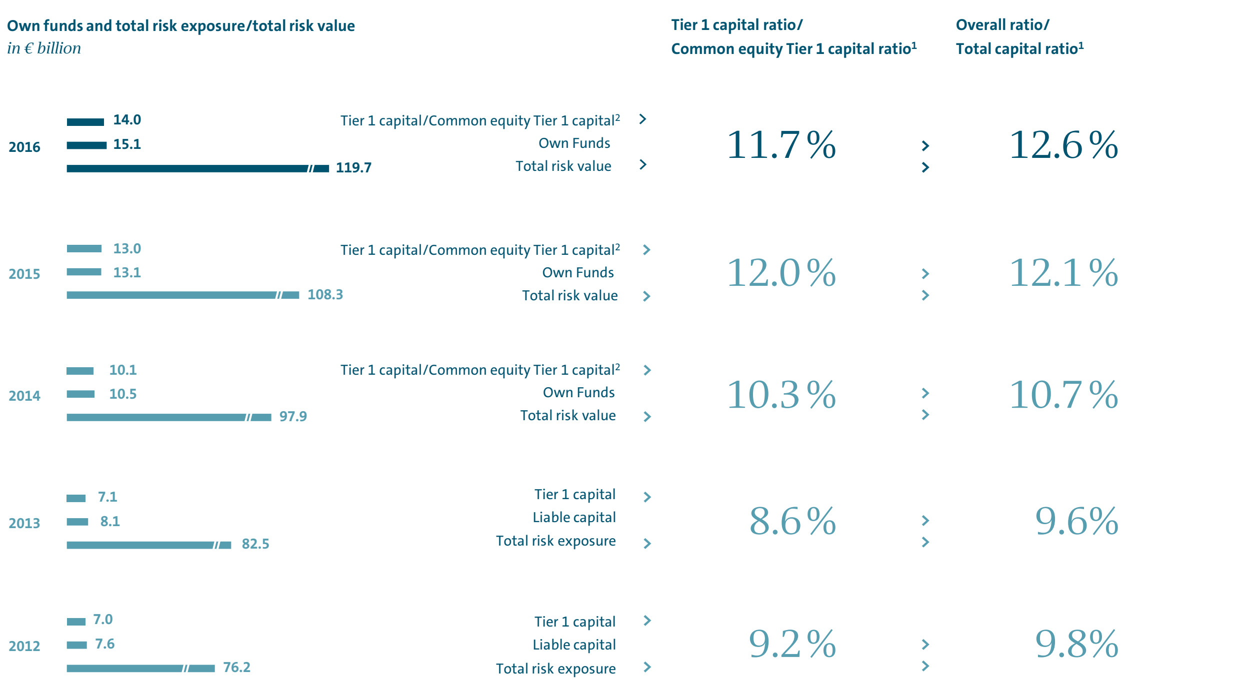
The following overview shows a breakdown of the total risk exposure amount and own funds:

OWN FUNDS AND TOTAL RISK EXPOSURE AMOUNT

	Dec. 31, 2016	Dec. 31, 2015
Total risk exposure amount[1] (€ million)	119,709	108,343
of which risk-weighted exposure amounts for credit risk	104,414	94,824
of which own funds requirements for market risk *12.5	6,982	6,158
of which own funds requirements for operational risk *12.5	7,894	6,906
of which own funds requirements for credit valuation adjustments *12.5	419	455
Eligible own funds (€ million)	15,121	13,109
Own funds (€ million)	15,121	13,109
of which Common Equity Tier 1 capital	13,989	12,966
of which Additional Tier 1 capital	0	0
of which Tier 2 capital	1,132	143
Common Equity Tier 1 capital ratio (percent)[2]	11.7	12.0
Tier 1 capital ratio (percent)[2]	11.7	12.0
Total capital ratio (percent)[2]	12.6	12.1

1 According to Article 92(3) of the CRR
2 According to Article 92(1) of the CRR

REGULATORY CAPITAL RATIOS OF THE FINANCIAL HOLDING GROUP AS OF DECEMBER 31

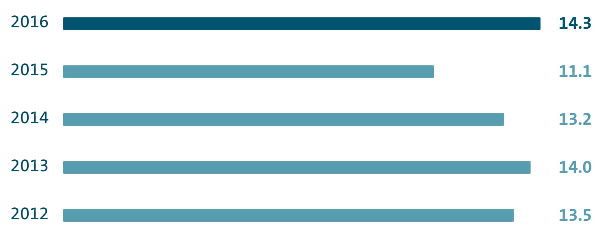


1 Calculation was based on the Solvabilitätsverordnung (SolvV – German Solvency Regulation) for the years 2012 and 2013; since January 1, 2014, it has been based on the CRR.
2 The amounts of Tier 1 capital and Common Equity Tier 1 capital are the same because the financial holding company group has not issued any Additional Tier 1 capital instruments.

Given the importance of Volkswagen Bank GmbH, the following charts show the changes in the Tier 1 capital ratio/Common Equity Tier 1 capital ratio and in the total capital ratio for Volkswagen Bank GmbH: The rise in the capital ratios for Volkswagen Bank GmbH was caused mainly by the additions to Common Equity Tier 1 capital amounting to a total of €2.1 billion.

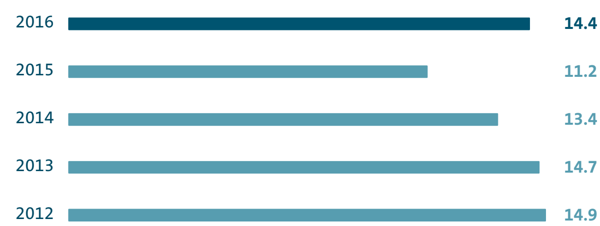
TIER 1 CAPITAL RATIO/COMMON EQUITY TIER 1 CAPITAL RATIO UNDER CRR/SOLVV*

figures in %



OVERALL RATIO/TOTAL CAPITAL RATIO UNDER CRR/SOLVV*

figures in %



* Calculation was based on the SolvV for the years 2012 and 2013; since January 1, 2014, it has been based on the CRR.

Following completion of the restructuring under company law described in the section Organization of the Volkswagen Financial Services AG Group, the regulatory minimum capital requirements will no longer apply in the future for Volkswagen Financial Services AG's financial holding company group. Nevertheless, Volkswagen Financial Services AG will still have an adequate level of capital, even after the restructuring has been implemented.

Changes in Off-Balance-Sheet Liabilities

Off-balance-sheet liabilities increased by a total of €175 million year-on-year to €5,327 million as of December 31, 2016. This increase was attributable primarily to the rise in irrevocable lending and leasing commitments, which went up by €58 million to €4,700 million.

Liquidity Analysis

The companies of Volkswagen Financial Services AG are funded primarily through capital market and ABS programs and by the direct banking deposits held by Volkswagen Bank GmbH. Volkswagen Bank GmbH holds liquidity reserves in the form of securities deposited in its operational safe custody account with Deutsche Bundesbank. Proactive management of the operational safe custody account, which allows Volkswagen Bank GmbH to participate in funding facilities, has proven to be an efficient liquidity reserve approach. The securities deposited as collateral in the operational safe custody account include, in addition to bonds from various countries amounting to €1.8 billion, senior ABS bonds issued by special purpose entities of Volkswagen Leasing GmbH, Volkswagen Finance S.A., Madrid, Spain, and Volkswagen Bank GmbH amounting to €9 billion. Standby lines of credit at other banks are also available to protect against unexpected fluctuations in cash flows. There are no plans to make use of these standby lines of credit; their sole purpose is to serve as backup to safeguard liquidity.

To ensure there is appropriate liquidity management, Treasury prepares four different liquidity maturity balances, carries out cash flow forecasts, uses this information to determine the relevant range of liquidity coverage and takes action as required. In these calculations, the legally determined cash flows are assumed for funding instruments, whereas estimated cash flows are used for other factors that affect liquidity. In the reporting period, the range of liquidity coverage taking into account simulated, limited funding and a partial withdrawal of overnight deposits came to a minimum of 37 weeks.

A stricter constraint on the management of liquidity at Volkswagen Bank GmbH and in the entities within the regulatory basis of consolidation of Volkswagen Financial Services AG is the liquidity coverage ratio (LCR). From January to December in the year under review, this ratio varied between 82% and 157% for the regulatory basis of consolidation and was therefore well above the lower regulatory limit of 70% at all times. The changes in the liquidity ratio are continuously monitored by Treasury and proactively managed by issuing a lower limit for internal management purposes. Central bank balances and government bonds are eligible as highly liquid assets for the purposes of the LCR.

The requirement under the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements for Risk Management) for Volkswagen Bank GmbH and Volkswagen Leasing GmbH to provide a highly liquid cash buffer and appropriate liquidity reserves to cover any liquidity requirements over seven-day and thirty-day time horizons was also satisfied at all times, even under various stress scenarios. Compliance with this requirement is determined and continuously reviewed as part of the liquidity risk management system. In this process, the cash flows for the coming twelve months are projected and compared against the potential funding available in each maturity band. Adequate potential funding to cover the liquidity requirements was available at all times, both in the normal scenario and in the stress tests required by MaRisk.

FUNDING

Strategic Principles

In terms of funding, Volkswagen Financial Services AG generally pursues a strategy of diversification with the aim of achieving the best possible balance of cost and risk. This means accessing the widest possible variety of funding sources in the various regions and countries with the objective of safeguarding funding on a long-term basis at optimum terms.

Implementation

In 2016, the funding situation was shaped by the diesel issue in the Volkswagen Group. Unsecured bonds were only issued for funding purposes in local capital markets outside Europe. Secured bonds (ABSs) were placed very successfully and the volume of customer deposits was increased. The Company was also able to issue commercial paper and make use of bank lines of credit. In addition to these established sources of funding, Volkswagen Financial Services AG has the option of using borrowers note loans to compensate for the impaired access to the capital market. Capital markets were also affected by some uncertainty in 2016. However, the unexpected outcome of the UK's referendum on whether to leave the EU has not had a significant impact on capital markets to date. Similarly, at the moment, it is not yet possible to assess the long-term impact from the new political situation in the US. The anticipated interest rate hike by the Fed was only decided upon and implemented in December 2016. In Europe, the ECB continued its comprehensive bond-buying program to support inflation targets and stimulate the economy, thereby putting the profitability of the banking and insurance sector under pressure.

Despite this unsettled market environment, Volkswagen Financial Services AG was able to successfully pursue a large number of transactions in various currencies and countries.

In the reporting period, Volkswagen Bank GmbH held the Driver Master volume at the same level and did not issue any further securitization transactions.

Volkswagen Leasing GmbH was active in the German market with its ABS program.

Volkswagen's financial service providers were also active in international markets with various ABS transactions.

The following tables show the transaction details:

CAPITAL MARKET

Issuer	Month	Country	Volume and currency	Maturity
Volkswagen Finance (China) Co., Ltd., Beijing	May	China	RMB 2 billion	3 years
Volkswagen Doğuş Finansman A.S., Istanbul	June	Turkey	TRY 117 million	1.5 years
OOO Volkswagen Bank RUS, Moscow	June	Russia	RUB 5 billion	2.5 years
Volkswagen Finance Pvt. Ltd., Mumbai	September	India	INR 2 billion	2 years
Volkswagen Finance Pvt. Ltd., Mumbai	September	India	INR 2 billion	3 years
OOO Volkswagen Bank RUS, Moscow	October	Russia	RUB 5 billion	1.5 years
Volkswagen Finance Pvt. Ltd., Mumbai	October	India	INR 1 billion	2 years

ABSS

Issuer	Transaction name	Month	Country	Volume and currency
Volkswagen Leasing GmbH	VCL 23	April	Germany	EUR 750 million
Volkswagen Leasing GmbH	VCL 24	November	Germany	EUR 1.25 billion
Volkswagen Finance (China) Co., Ltd., Beijing	Driver China three	January	China	RMB 3.0 billion
Volkswagen Financial Services Japan Ltd., Tokyo	Driver Japan five	February	Japan	JPY 60 billion
Volkswagen Finance S.A., Madrid	Driver España three	February	Spain	EUR 1.0 billion
Volkswagen Financial Services Australia Pty. Ltd., Chullora	Driver Australia three	April	Australia	AUD 575 million
Volkswagen Finance (China) Co., Ltd., Beijing	Driver China four	July	China	RMB 3.0 billion
Volkswagen Financial Services (UK) Ltd., Milton Keynes	Driver UK four	November	United Kingdom	GBP 750 million
Volkswagen Finance (China) Co., Ltd., Beijing	Driver China five	December	China	RMB 4 billion

Customer deposits totaled €36.1 billion as of December 31, 2016 (+28.6%).

The Company continued to implement its strategy of obtaining maturity-matched funding as far as possible by borrowing on terms with matching maturities and by using derivatives. A currency-matched funding approach was taken by borrowing liquidity in local currency, and currency risks were eliminated by using derivatives.

The Investor Relations team of Volkswagen's financial service providers reached out to domestic and international analysts and investors through regular reporting in 2016, conducting individual and group meetings around the world with the relevant market players to brief them on the latest developments.

Up-to-date information and presentations were published promptly on the Investor Relations website at www.vwfs.com/ir.

Ratings

Volkswagen Financial Services AG is a wholly owned subsidiary of Volkswagen AG and, as such, its credit ratings with both Moody's Investors Service (Moody's) and Standard & Poor's Global Ratings (S&P) are closely associated with those of the Group's parent company.

Over the whole year 2016, the senior unsecured rating issued by S&P remained at BBB+. The outlook was negative from the beginning of the year until December. On December 15, 2016, S&P placed the rating on CreditWatch while it assessed whether the rating ought to be downgraded because of regulatory changes. The commercial paper rating remained unchanged at A-2. Moody's downgraded the senior unsecured rating for Volkswagen Financial Services AG by one notch to A2 on August 4, 2016; the outlook is negative. The commercial paper rating was confirmed at P-1.

Both agencies also issue ratings for Volkswagen Bank GmbH as a wholly owned subsidiary of Volkswagen Financial Services AG. The senior unsecured rating issued by S&P for Volkswagen Bank GmbH remained at A– over the whole of the year. Again, the outlook was negative from the start of the year until December 15, 2016, when S&P took the same action as it had in the case of Volkswagen Financial Services AG – and for the same reasons – and placed Volkswagen Bank GmbH´s senior unsecured rating on CreditWatch to assess whether a possible downgrade might be required. S&P maintained the commercial paper rating for Volkswagen Bank GmbH at a constant level of A-2 in 2016. Moody's upgraded the senior unsecured rating for Volkswagen Bank GmbH to Aa3 on August 4, 2016, but maintained the negative outlook. The commercial paper rating was affirmed at P-1.

Volkswagen Financial Services AG

(Condensed, in accordance with the HGB)

BUSINESS PERFORMANCE 2016

Volkswagen Financial Services AG reported a result from ordinary activities of €173 million for fiscal year 2016.

Based on the requirements of the Bilanzrichtlinie-Umsetzungsgesetz (BilRUG – Accounting Directive Implementation Act), sales revenue of €700 million has been reported for the first time; on the other side of the equation, the cost of sales amounted to €693 million and this figure has likewise been reported for the first time. These items include the income from cost allocations to Group companies and the expenses related to personnel and administrative costs.

Other operating income totaled €364 million (€859 million), with other operating expenses amounting to €243 million (€704 million). Other operating income included support payments from Volkswagen AG in the amount of €349 million. Other operating expenses included expenses from the transfer of financial assets amounting to €124 million and the repayment of €111 million to Volkswagen AG relating to support provided in 2015.

Net investment income fell by €50 million to €296 million (€346 million). Only four domestic companies did not transfer profits.

The profit after tax of €130 million will be transferred to Volkswagen AG pursuant to the existing control and profit-and-loss transfer agreement.

The intangible assets reported under fixed assets totaling €12 million increased by 101.9%, while property and equipment declined by 3.4% to €44 million. Long-term financial assets rose by 27.3% to €12,400 million. The change resulted from the following items: capital payments to affiliated companies and investees of €2,127 million, business acquisitions of €34 million, loan increases of €728 million, book losses on asset transfers of €124 million, a capital repayment of €101 million and impairment losses of €5 million.

Loans to and receivables from affiliated companies declined by €1,208 million (20.5%). These changes arose largely from the repayment of time deposits and loans. Loans to and receivables from other investees or investors decreased by €76 million (3.7%), and were mainly attributable to time deposits and loans.

The increase in provisions of €47 million (10.5%) arose primarily because of higher provisions for personnel expenses in an amount of more than €20 million and for IT costs in an amount of more than €19 million.

Bonds remained at a total of €1,250 million. Liabilities to banks of €371 million consisted of borrowers note loans. Liabilities to affiliated companies went up by €467 million (9.6%), principally because of a higher level of time deposits and loans. Volkswagen AG added €1,225 million to the capital reserves.

The equity ratio was 57.5% (55.1%). Total assets at the end of the reporting period amounted to €19,125 million.

NUMBER OF EMPLOYEES

Volkswagen Financial Services AG had a total of 5,983 (5,833) employees as of December 31, 2016. Employee turnover of less than 1.0% was significantly below the industry average.

The employees of Volkswagen Financial Services AG also work for the subsidiaries because of the structure of the German legal entities in the Volkswagen Financial Services AG Group. At the close of 2016, 2,786 (2,638) employees were leased to Volkswagen Bank GmbH and 959 (1,279) carried out activities for Volkswagen Leasing GmbH. In addition, 141 (126) employees were leased to Volkswagen Insurance Brokers GmbH, 26 (24) to Volkswagen Versicherung AG, 10 (19) to Volkswagen Autoversicherung AG and, for the first time, 144 to MAN Financial Services GmbH. The employees of Volkswagen Financial Services Beteiligungsgesellschaft mbH (3) were transferred to Volkswagen Financial Services GmbH. Volkswagen Financial Services AG employed 127 vocational trainees as of December 31, 2016.

MANAGEMENT, AND OPPORTUNITIES AND RISKS RELATING TO THE BUSINESS PERFORMANCE OF VOLKSWAGEN FINANCIAL SERVICES AG

Volkswagen Financial Services AG operates almost exclusively as a holding company and is integrated into the internal management concept of the Volkswagen Financial Services Group. It is thus subject to the same key performance indicators and the same opportunities and risks as the Volkswagen Financial Services Group. The legal requirements governing the management of Volkswagen Financial Services AG as a legal entity are observed using key performance indicators specified under commercial law, such as net assets, net income and liquidity. We explain this internal management concept and these opportunities and risks in the section on the fundamental information about the Volkswagen Financial Services Group (pages 3 and 4) as well as in the report on opportunities and risks (pages 23 to 40) of this annual report.

INCOME STATEMENT OF VOLKSWAGEN FINANCIAL SERVICES AG, BRAUNSCHWEIG, FOR FISCAL YEAR 2016

€ million	2016	2015
Revenue	700	–
Cost of sales	–693	–
Gross profit	**7**	**–**
General and administrative expenses	–249	–207
Other operating income	364	859
Other operating expenses	–243	–704
Net investment income/expense	296	346
Financial result	–2	–31
Income tax expense	–43	157
Profit after tax	**130**	**420**
Profits transferred under a profit-and-loss transfer agreement	–130	–420
Net income for the year	**–**	**–**
Profit brought forward	2	2
Net retained profits	**2**	**2**

BALANCE SHEET OF VOLKSWAGEN FINANCIAL SERVICES AG, BRAUNSCHWEIG, AS OF DECEMBER 31, 2016

€ million	Dec. 31, 2016	Dec. 31, 2015
Assets		
A. Fixed assets		
I. Intangible fixed assets	12	6
II. Property and equipment	44	46
III. Long-term financial assets	12,400	9,741
	12,456	9,793
B. Current assets		
I. Receivables and other assets	6,641	7,925
II. Cash-in-hand and bank balances	1	0
	6,642	7,925
C. Prepaid expenses	**27**	**14**
Total assets	**19,125**	**17,732**
Equity and liabilities		
A. Equity		
I. Subscribed capital	441	441
II. Capital reserves	10,449	9,224
III. Retained earnings	100	100
IV. Net retained profits	2	2
	10,992	9,767
B. Provisions	**492**	**446**
C. Liabilities	**7,641**	**7,519**
Total equity and liabilities	**19,125**	**17,732**

Report on Opportunities and Risks

The active management of opportunities and risks is a fundamental element of the successful business model used by Volkswagen Financial Services AG.

RISKS AND OPPORTUNITIES

In this section, we report on the risks and opportunities that arise in connection with our business activities. The risks and opportunities are summarized in various categories. Unless specifically stated, there were no material year-on-year changes to the individual risks or opportunities.

We use analyses of the competitive and operating environment, together with market observations, to identify not only risks but also opportunities, which then have a positive impact on the design of our products, the success of the products in the marketplace and on our cost structure. Risks and opportunities that we expect to materialize have already been taken into account in our medium-term planning and forecast. The following sections therefore describe fundamental opportunities that could lead to a positive variance from our forecast and the risk report presents a detailed description of the risks.

Macroeconomic Risks and Opportunities

Against the backdrop of further economic growth in the vast majority of markets, the Board of Management of Volkswagen Financial Services AG expects to see a modest increase in the number of vehicle deliveries to Volkswagen Group customers. Volkswagen Financial Services AG supports this positive trend by providing financial services products designed to promote sales.

The probability of a global recession is considered to be low overall. However, diminished rates of global economic growth or a period of below-average growth rates cannot be ruled out. The macroeconomic environment could also give rise to opportunities for Volkswagen Financial Services AG if actual trends turn out to be better than forecast.

Strategic Opportunities

As well as continuing its international focus by tapping new markets, Volkswagen Financial Services AG believes that developing innovative products that are tailored to customers' changing mobility requirements offers additional opportunities. Growth areas such as mobility products and service offerings (long-term rental, car sharing) are being systematically developed and expanded. Further opportunities may be created by launching established products in new markets.

The digitalization of our business represents a significant opportunity for Volkswagen Financial Services AG. The aim is to ensure that all products are also available online around the world by 2025, thereby enabling the Company to enhance efficiency. By expanding digital sales channels, we are promoting direct sales and facilitating the development of a platform for used vehicle finance. We are therefore addressing the changing needs of our customers and strengthening our competitive position.

Opportunities from Credit Risk

Opportunities may arise in connection with credit risk if the losses actually incurred on lending transactions turn out to be lower than the prior calculations of expected loss and the associated provisions recognized on this basis. A situation in which the incurred losses are lower than the expected losses can occur particularly in individual countries in which economic uncertainty is dictating a conservative risk approach but in which the economic circumstances then stabilize, resulting in an improvement in the credit quality of the borrowers concerned.

Opportunities from Residual Value Risk

Residual values of vehicles continuously change in line with market circumstances. When vehicles are remarketed, Volkswagen Financial Services AG may be presented with the opportunity to achieve a price that is higher than the calculated residual value if increasing demand pushes up market values more than expected.

KEY FEATURES OF THE INTERNAL CONTROL SYSTEM AND THE INTERNAL RISK MANAGEMENT SYSTEM IN RELATION TO THE FINANCIAL REPORTING PROCESS

The internal control system (ICS) for the consolidated and annual financial statements of Volkswagen Financial Services AG, as far as it is relevant to the accounting system, is the sum of all principles, procedures and activities aimed at ensuring the effectiveness, efficiency and propriety of the financial reporting and compliance with the relevant legal requirements. The internal risk management system (IRMS) related to the accounting system is concerned with the risk of misstatement in the bookkeeping systems at the Company and Group levels as well as in external financial reporting. The sections below describe the key elements of the ICS/IRMS as they relate to the financial reporting processes of Volkswagen Financial Services AG.

- The Board of Management of Volkswagen Financial Services AG is the governing body with responsibility for the executive management of the business. In this role, the Board has set up accounting, customer service, treasury, risk management, compliance and controlling units, each with clearly separated functions and clearly assigned areas of responsibility and authority, to ensure that accounting and financial reporting processes are carried out properly. Key overarching functions are managed by the Board of Management of Volkswagen Financial Services AG and via the Managements of Volkswagen Bank GmbH and Volkswagen Leasing GmbH.
- Group-wide rules and regulations have been put in place as the basis for a standardized, proper and continuous financial reporting process. For example, the accounting policies applied by the domestic and foreign entities included in the consolidated financial statements of Volkswagen Financial Services AG are governed by the Volkswagen Financial Services AG Group's accounting policies, including the accounting requirements specified in the International Financial Reporting Standards.
- Volkswagen Financial Services AG's accounting standards also set out the specific formal requirements for the consolidated financial statements. The standards determine the basis of consolidation and also describe in detail the components of the reporting packages to be prepared by the Group companies. The formal requirements include the mandatory use of a complete, standardized set of forms. The accounting standards also include, for example, specific details relating to the recognition and processing of intragroup transactions and the associated reconciliation of balances.
- At Group level, specific control activities aimed at ensuring that the consolidated financial reporting provide a true and fair view include the analysis and any necessary adjustment of single-entity financial statements submitted by the consolidated entities, taking into account the reports submitted by the independent auditors and the related discussions concerning the financial statements.
- These activities are supplemented by the clear delineation of areas of responsibility and by various monitoring and review mechanisms. The overall aim is to ensure that all transactions are accurately recognized in the accounts, processed and evaluated, and then properly reported.
- These monitoring and review mechanisms are designed with both integrated and independent process components. For example, automated IT process controls account for a significant proportion of the integrated process activities alongside manual process controls, such as double-checking by a second person. These controls are enhanced by specific functions at Group level carried out by the parent company Volkswagen AG, for example functions within the responsibility of the Group tax department.
- Subgroup internal auditing is a key component of Volkswagen Financial Services AG's monitoring and control system. The Internal Audit department carries out regular audits of accounting-related processes in Germany and abroad as part of its risk-oriented auditing activities and reports on these audits directly to the Board of Management of Volkswagen Financial Services AG.

In sum, the existing internal monitoring and control system of Volkswagen Financial Services AG is intended to ensure that the financial position of the individual entities and of the Volkswagen Financial Services AG Group as of the reporting date December 31, 2016 has been based on information that is reliable and has been properly recognized. No material changes were made to the internal monitoring and control system of Volkswagen Financial Services AG after the reporting date.

ORGANIZATIONAL STRUCTURE OF RISK MANAGEMENT

At Volkswagen Financial Services AG, risk is defined as the danger of loss or damage that could occur if an expected future development turns out to be less favorable than planned.

Volkswagen Financial Services AG, including its subsidiaries and equity investments (hereinafter: Volkswagen Financial Services AG), is exposed to a large number of risks typical for the financial services sector as part of its primary operating activities. The Company takes on these risks on a responsible basis so that it can specifically exploit associated market opportunities.

Volkswagen Financial Services AG, as the parent entity in the financial holding company group, has put in place a group-wide risk management system to identify, assess, manage, monitor and communicate risks. The risk management system comprises a framework of risk principles, organizational structures and processes for assessing and monitoring risks. The individual elements are tightly focused on the activities of the individual divisions. This structure makes it possible to identify at an early stage any trends that could represent a risk to the business as a going concern so that appropriate corrective action can then be initiated. No material changes were made to the risk management methodology in the reporting period.

Appropriate procedures are in place to ensure the adequacy of the risk management system. Firstly, the Group Risk Management unit continuously monitors the system. Secondly, the individual elements in the system are regularly reviewed on a risk-oriented basis by Internal Audit and as part of the audit of the annual financial statements by the independent auditors.

Within Volkswagen Financial Services AG, responsibility for risk management and credit analysis is assigned to the Chief Risk Officer. In this role, the Chief Risk Officer submits regular reports to the Supervisory Board and Board of Management of Volkswagen Financial Services AG on the overall risk position of Volkswagen Financial Services AG.

An important feature of the risk management system at Volkswagen Financial Services AG is the clear, unequivocal separation of tasks and areas of responsibility, both organizationally and in terms of personnel, between the holding company (Group Risk Management unit) and the markets (local risk management) to ensure that the system is fully functioning at all times and regardless of any particular personnel involved.

One of the functions of the Group Risk Management unit is to provide framework constraints for the organization of the risk management system. This function includes drawing up risk policy guidelines, developing and maintaining methodologies and processes relevant to risk management as well as issuing and monitoring international framework standards for the procedures to be used around the world.

In particular, these activities involve providing models for carrying out credit assessments, quantifying the types of risk relevant to Volkswagen Financial Services AG, determining risk-bearing capacity and measuring collateral. Group Risk Management is therefore responsible for identifying possible risks, analyzing, quantifying and assessing risks, and for determining the resulting measures to manage the risks. Group Risk Management is a neutral, independent unit and reports directly to the Board of Management of Volkswagen Financial Services AG.

Local risk management units ensure that the requirements specified by Group Risk Management are implemented and complied with in each market.

Local risk management is responsible for the detailed design of local structures for the models and procedures used for risk measurement and management and carries out local implementation from process and technical perspectives. There is a direct line of reporting from local risk management to Group Risk Management.

As a significant company, Volkswagen Financial Services AG continues to be supervised by the European Central Bank (ECB) under the Single Supervisory Mechanism (SSM). As a result, Volkswagen Financial Services AG continuously exchanges information with the ECB's Joint Supervisory Team. Volkswagen Financial Services AG is also subject to requirements under the Supervisory Review and Evaluation Process (SREP). In the year under review, Volkswagen Financial Services AG also participated in the bank stress test performed by the European Banking Authority (EBA) and by the ECB under the SSM. The results of this stress test confirmed the "robustness" of the business model used by Volkswagen Financial Services AG and led to an impressive overall result (see the published results for the 2016 EBA/ECB stress test).

To summarize, continuous monitoring of risks, transparent and direct communication with the Board of Management and the integration of all information obtained into the operational risk management system form a foundation for the best possible exploitation of market potential based on conscious, effective management of the overall risk faced by Volkswagen Financial Services AG.

RISK STRATEGY AND RISK MANAGEMENT

Fundamental decisions relating to strategy and the instruments of risk management are the responsibility of the Board of Management of Volkswagen Financial Services AG, the Managements of Volkswagen Bank GmbH, Volkswagen Leasing GmbH and MAN Financial Services GmbH, and the Board of Management of Volkswagen Versicherung AG.

As part of this overall responsibility, the Board of Management of Volkswagen Financial Services AG has introduced a MaRisk-compliant strategy process and drawn up a business and risk strategy. The ROUTE2025 business strategy sets out the fundamental views of the Board of Management of Volkswagen Financial Services AG on key matters relating to business policy. It includes the objectives for each major business activity and the strategic areas for action to achieve the relevant objectives. The business strategy also serves as the starting point for creating a consistent risk strategy.

The risk strategy is reviewed each year on the basis of a risk inventory, risk-bearing capacity and legal requirements. Additionally, a separate review is done if specific events make this necessary. The risk strategy is adjusted where appropriate and discussed with the Supervisory Board of Volkswagen Financial Services AG. The risk strategy describes the main risk management goals and action plans for each category of risk taking into account the business policy focus (business strategy), risk tolerance and risk appetite. A review is carried out annually to establish whether the goals have been attained. The causes of any variances are analyzed and then discussed with the Supervisory Board of Volkswagen Financial Services AG.

The group-wide risk strategy includes all material quantifiable and non-quantifiable risks. Further details and specifics for the individual risk categories are set out in risk substrategies and included in operational requirements as part of the planning round.

The Board of Management of Volkswagen Financial Services AG is responsible for implementing the group-wide risk strategy at Volkswagen Financial Services AG that was defined under its overall responsibility. After the group-wide business and risk strategy is adopted, it is communicated within the subgroup of Volkswagen Financial Services AG.

RISK INVENTORY

The objective of the risk inventory, which has to be carried out at least annually, is to identify the main categories of risk. To this end, all known categories of risk are investigated to establish whether they arise at Volkswagen Financial Services AG. In the risk inventory, the relevant categories of risk are examined in greater detail, quantified or, if they cannot be quantified, assessed by experts, and then evaluated to determine whether they are material for the Group.

The risk inventory carried out using the base data as of December 31, 2015 came to the conclusion that the following quantifiable categories of risk should be classified as material: counterparty default risk, earnings risk, direct residual value risk, market risk, liquidity risk and operational risk. It also concluded that reputational risk and strategic risk, which are not quantifiable, should also be considered material. Indirect residual risk and underwriting risk were classified as immaterial because they accounted for a low proportion of the overall risk at the Group level. Other existing subcategories of risk are taken into account within the categories specified above.

RISK-BEARING CAPACITY, RISK LIMITS AND STRESS TESTING

A system has been set up to determine the risk-bearing capacity of Volkswagen Financial Services AG. This system compares the economic risk against available financial resources referred to as the risk-taking potential. An institution has the capacity to bear its risk if, as a minimum, all material risks to which the institution is exposed are covered at all times by the institution's risk-taking potential.

The results from the risk inventory provide the basis for the level of detail in the design of the risk management process and for inclusion in risk-bearing capacity. In line with standard banking practice, risks are assessed using the net method.

The main risks are quantified as part of the risk-bearing capacity analysis using a going concern approach with a standard confidence level of 90% (exception: liquidity risk [funding risk] with a confidence level of 99%) and a time horizon of one year. Risk-bearing capacity is also analyzed using the gone concern approach in addition to the going concern approach.

In addition, Volkswagen Financial Services AG uses a system of limits derived from the risk-bearing capacity analysis to specifically manage risk cover capital in accordance with the level of risk tolerance determined by the Board of Management of Volkswagen Financial Services AG and the Managements of Volkswagen Bank GmbH and Volkswagen Leasing GmbH. Volkswagen Versicherung AG has its own system of limits.

The establishment of the risk limit system as a core component of capital allocation limits the risk at different levels, thereby safeguarding the economic risk-bearing capacity of the subgroup. Risk-taking potential is determined from the available equity and earnings components subject to various deductions. In line with the risk tolerance of the Board of Management of Volkswagen Financial Services AG, only a portion of this risk-taking potential is specified as a risk ceiling in the form of an overall risk limit.

The overall risk limit is apportioned to counterparty default risk, residual value risk, market risk, liquidity risk (funding risk) and operational risk for the purposes of operational monitoring and control. In this process, the limit allocated to counterparty default risk, itself an overarching category of risk, is subdivided into individual limits for credit risk, shareholder risk, issuer risk and counterparty risk.

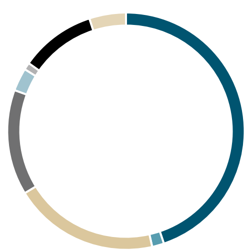
In a second step, the limits for the risk categories (with the exception of those for shareholder risk, issuer risk, counterparty risk and liquidity risk [funding risk]) are broken down and allocated to the individual companies.

The limit system provides the Management with a tool that enables it to meet its strategic and operational corporate management responsibilities in accordance with statutory requirements.

The overall economic risk of Volkswagen Financial Services AG as of September 30, 2016 amounted to €3.2 billion. The apportionment of this total risk by individual risk category was as follows:

DISTRIBUTION OF RISKS BY TYPE OF RISK

as of September 30, 2016



CHANGES IN RISK, BY RISK CATEGORY

	€ MILLION		PROPORTION (PERCENT)	
	Sept. 30, 2016	Dec. 31, 2015	**Sept. 30, 2016**	Dec. 31, 2015
Risk category				
Credit risk	1,437	1,170	45	43
Shareholder, issuer and counterparty risk	52	29	2	1
Residual value risk	635	537	20	20
Earnings risk	461	313	14	12
Market risk	100	99	3	4
Liquidity risk (funding risk)	31	29	1	1
Operational risk	330	248	10	9
Other risks[1,2]	160	265	5	10
Total	**3,206**	**2,690**	**100**	**100**

1 Aggregate figure for material non-quantifiable risks: reputational risk and strategic risk
2 Including risks of €138 million from MAN FS as of December 31, 2015

The risk-taking potential of €5.5 billion as of September 30, 2016 comprised reported equity plus the forecast result for the next twelve months (overall €16.9 billion) less regulatory minimum own funds requirements (€10.2 billion) and other adjustment items (€1.2 billion). As of September 30, 2016, 58% of risk-taking potential was utilized by the risks outlined above.

In the period January 1, 2016, to September 30, 2016, the maximum utilization of the risk-taking potential in accordance with Pillar II was 58%.

Up to December 31, 2016, there were no indications of any material changes in the utilization of the risk-taking potential.

In addition to determining the risk-bearing capacity in a normal scenario, Volkswagen Financial Services AG also conducts group-wide and cross-institutional stress tests and reports the results directly to the Board of Management. Stress tests are used to examine the potential impact from exceptional but plausible events on the risk-bearing capacity and earnings performance of Volkswagen Financial Services AG. The purpose of these scenarios is to facilitate early identification of those risks that would be particularly affected by the trends simulated in the scenarios so that any necessary corrective action can be initiated in good time. The stress tests include both historical scenarios (such as a repeat of the financial crisis in the years 2008 to 2010) and hypothetical scenarios (such as a global economic downturn or a sharp drop in sales in the Volkswagen Group). In addition, inverse stress tests are used to identify what events could represent a threat to the ability of the Group to continue as a going concern.

The calculations of risk-bearing capacity confirmed that all material risks that could adversely impact the financial position or financial performance were adequately covered by the available risk-taking potential at all times. In the reporting period, the Company managed risk such that the utilized risk-taking potential was below the overall risk limit set internally. The stress tests did not indicate any need for action.

RISK CONCENTRATIONS

Volkswagen Financial Services AG is a captive financial services provider in the automotive sector. The business model, which focuses on promoting vehicle sales for the different brands in the Volkswagen Group, causes concentrations of risk, which can take various forms.

Concentrations of risk can arise from an uneven distribution of activity in which

- just a few borrowers/contracts account for a large proportion of the loans (counterparty concentrations)
- a small number of sectors account for a large proportion of the loans (sector concentrations)
- many of the loans are to businesses within a defined geographical area (regional concentrations)
- loans/receivables are secured by just one type of collateral or by a limited range of collateral types (collateral concentrations)
- residual values subject to risk are limited to a small number of vehicle segments or models (residual value concentrations), or
- Volkswagen Financial Services AG's income is generated from just a few sources (income concentrations).

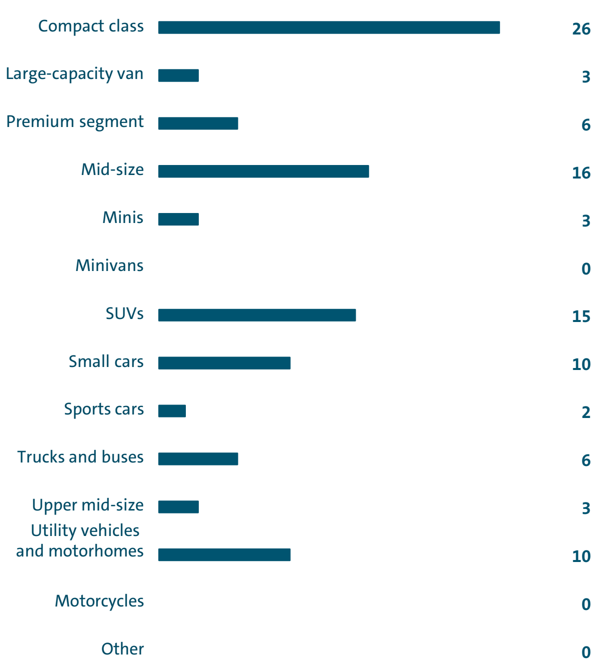
One of the objectives of Volkswagen Financial Services AG's risk policy is to reduce such concentrations by means of broad diversification.

Counterparty concentrations from customer financing are only of minor significance in Volkswagen Financial Services AG because of the large proportion of business accounted for by retail lending. From a regional perspective, Volkswagen Financial Services AG has a concentration of business in the German market, but looks to achieve broad nationwide diversification within the country.

In contrast, sector concentrations in the dealer business are part of the nature of the business for a captive provider and these concentrations are therefore individually analyzed. Overall, no particular impact has been identified, even in periods of economic downturn like the previous economic crisis.

Likewise, a captive provider cannot avoid collateral concentrations because the vehicle is the predominant collateral asset by virtue of the business model. Risks can arise from concentrations of collateral if downward pricing trends in used vehicle markets or segments lead to lower proceeds from the recovery of assets and, as a consequence, there is a fall in the value of the collateral. Nevertheless, in terms of the vehicles used as collateral, Volkswagen Financial Services AG enjoys a broad diversification across all vehicle segments (see following diagram) based on a large range of vehicles from the different brands in the Volkswagen Group.

COLLATERAL STRUCTURE AS OF SEPTEMBER 30, 2016
figures in %



This broad vehicle diversification also means that there is no residual value concentration at Volkswagen Financial Services AG.

Income concentration arises from the very nature of the business model. The Company’s particular role in which it helps to promote sales in the Volkswagen Group gives rise to certain dependencies that directly affect income growth.

RISK REPORTING

Risk reporting to the Board of Management and Supervisory Board occurs quarterly in the form of a comprehensive risk management report. The starting point for the risk management report is risk-bearing capacity because of its importance from a risk perspective for the successful continued existence of the business as a going concern. To this end, the derivation of the available risk-taking potential and the utilization of the limits for each of the risk categories is presented at both aggregated and company levels. In addition, Group Risk Management reports on counterparty default risk, direct residual value risk, market risk, liquidity risk, operational risk and underwriting risk, both at an aggregate level and – mostly for markets – in detail. These reports include quantitative information (financial data) and also qualitative elements in the form of assessments of the current situation and expected developments, including recommendations for action where appropriate. Additional reports are produced for specific risk categories. Ad hoc reports at the Group level are generated as needed to supplement the system of regular reporting.

The high quality of the information contained in the risk management reports about structures and developments in the portfolios is maintained by a process of constant refinement and ongoing adjustment in line with current circumstances.

NEW PRODUCT AND NEW MARKET PROCESS

Before launching new products or commencing activities in new markets, Volkswagen Financial Services AG first runs through its new product and new market process. All the units involved, such as Risk Management, Controlling, Accounting, Legal Affairs, Compliance, Treasury, IT, are integrated into the process. The process for every new activity involves the preparation of a written concept, which includes an analysis of the risks in connection with the new product or market and a description of the possible implications for management of the risks. Responsibility for approval or rejection lies with the relevant members of the Board of Management of Volkswagen Financial Services AG and, in the case of new markets, also with the members of the Supervisory Board of Volkswagen Financial Services AG.

OVERVIEW OF RISK CATEGORIES

Financial risks	Nonfinancial risks
Counterparty default risk	Operational risk
Market risk	Compliance and conduct risk
Liquidity risk	Outsourcing risk
Residual value risk	Model risk
Earnings risk	Strategic risk
Underwriting risk	Reputational risk

FINANCIAL RISKS

Counterparty Default Risk

Counterparty default risk refers to a potential negative variance between actual and forecast counterparty risk outcomes. The forecast outcome is exceeded if the loss incurred as a consequence of defaults or changes in credit rating is higher than the expected loss.

At Volkswagen Financial Services AG, counterparty default risk encompasses the following risk categories: credit risk, counterparty risk, issuer risk, country risk, shareholder risk and counterparty default risk according to Solvency II.

Credit risk

Credit risk is defined as the danger of incurring losses as a result of defaults in customer business, specifically the default of the borrower or lessee. Loans to and receivables from entities in the Volkswagen Group are also included in the analysis. The default is caused by the borrower's or lessee's insolvency or unwillingness to pay. This includes a situation in which the counterparty does not make interest payments or repayments of principal on time or does not pay the full amounts.

Credit risk, which also includes counterparty default risk in connection with leases, accounts for the greatest proportion of risk exposures in the counterparty default risk category by some distance.

The aim of a systematic credit risk monitoring system is to identify potential borrower or lessee insolvencies at an early stage, initiate any corrective action in respect of a potential default in good time and anticipate possible losses by recognizing appropriate write-downs or provisions.

If a loan default materializes, this represents the loss of a business asset, which has a negative impact on financial position and financial performance, depending on the amount of the loss. If, for example, an economic downturn leads to a higher number of insolvencies or greater unwillingness of borrowers or lessees to make payments, the recognition of a higher write-down expense is required. This in turn has an adverse effect on operating profit.

Risk identification and assessment

Lending or credit decisions at Volkswagen Financial Services AG are made primarily on the basis of the borrower credit check. These credit checks use rating or scoring systems, which provide the relevant departments with an objective basis for reaching a decision on a loan or a lease.

A set of procedural instructions outlines the requirements for developing and maintaining the rating systems. The Company also has a rating manual that specifies how the rating systems are to be applied as part of the loan approval process. Similarly, other written procedures specify the parameters for developing, using and validating the scoring systems in the retail business.

To quantify credit risk, an expected loss (EL) and an unexpected loss (UL) are determined at portfolio level for each entity. The UL is the value at risk (VaR) less the EL. The calculation uses an asymptotic single risk factor model (ASRF model) in accordance with the capital requirements specified by the Basel Committee on Banking Supervision (Gordy formula) taking into account the credit quality assessments from the individual rating and scoring systems used.

Rating systems for corporate customers

Volkswagen Financial Services AG uses rating systems to assess the credit quality of corporate customers. These assessments take into account both quantitative factors (mainly data from annual financial statements) and qualitative factors (such as the prospects for future business growth, quality of management, market and industry environment, and the customer's payments record). When the credit assessment has been completed, the customer is assigned to a rating class, which is linked to a probability of default. A centrally maintained, workflow-based rating application is used for the most part to support this analysis of credit quality. The rating determined for the customer serves as an important basis for decisions on whether to grant or renew a loan and for decisions on provisions.

Scoring systems in the retail business

For the purposes of determining the credit quality of retail customers, scoring systems are incorporated into the processes for credit approval and for evaluating the existing portfolio. These scoring systems provide an objective basis for credit decisions. The systems use information about the borrower available internally and externally and estimate the probability of default for the requested loan, generally with the help of statistical methods based on historical data covering a number of years. An alternative approach adopted for smaller or low-risk portfolios also uses generic, robust scorecards and expert systems to assess the risk involved in credit applications.

To classify the risk in the credit portfolio, both behavioral scorecards and straightforward estimation procedures at risk pool level are used, depending on portfolio size and the risk inherent in the portfolio.

Supervision and review of retail and corporate systems

The models and systems supervised by Group Risk Management are regularly validated and monitored using standardized procedural models for risk classification systems. The models and systems are adjusted and refined, as required. These review procedures are applied to models and systems for assessing credit quality and estimating the probability of default (such as rating and scoring systems) and to models used for estimating loss given default and estimating credit conversion factors.

In the case of the retail models and systems for credit assessment supervised by local risk management units outside Germany, Group Risk Management reviews the quality of these models and systems on the basis of the locally implemented validation processes, determines action plans in collaboration with the local risk management units if a need for action is identified and monitors the implementation of the action plans. In the validation process, particular attention is paid to a review of the discriminant power of the models and an assessment of whether the model calibration is appropriate to the risk. The models and systems for corporate customers are handled in the same way, although a centralized approach is used for their supervision and validation.

Collateral

The general rule is that credit transactions are secured by collateral to an extent that is commensurate with the risk. In addition, overarching rules specify the requirements that must be satisfied by collateral, the evaluation procedures and the evaluation bases. Further local regulations (collateral policies) set out specific values and special regional requirements that must be observed.

The values in the collateral policies are based on historical data and experience accumulated by experts over many years. As the operating activities of Volkswagen Financial Services AG are focused on retail financing, dealer financing and the leasing of vehicles, the vehicles themselves are hugely important as collateral assets. For this reason, trends in the market values of vehicles are closely monitored and analyzed. Procedures provide for adjustments to evaluation systems and vehicle remarketing processes if there are substantial changes in the market values of vehicles.

Group Risk Management also carries out regular quality assurance tests on local collateral policies. This includes a review of collateral values and implementation of any necessary adjustments.

Provisions

The calculation of provisions is based on the incurred loss model in accordance with IAS 39 and is also derived from the rating and scoring processes.

With regard to impaired loans and receivables, a distinction is also made between significant and insignificant loans and receivables. Specific provisions are recognized for significant impaired loans and receivables, whereas specific provisions evaluated on a group basis are recognized for insignificant impaired loans and receivables. Portfolio (global) provisions are recognized to cover impaired loans or receivables for which no specific provisions have been recognized.

The following average values have been determined for the aggregate active portfolio (i.e. portfolio of loans and receivables not in default) based on a time horizon of twelve months: probability of default (PD) of 2.8 % (3.2 %); loss given default (LGD) of 32.6 % (30.9 %); and total volume of loans and receivables based on the active portfolio of €103.5 billion (€95.8 billion).

Risk monitoring and control

Group Risk Management sets framework constraints for the management of credit risk. These constraints form the mandatory outer framework of the central risk management system, within which the divisions/markets can operate in terms of their business policy activities, planning, decisions, etc. in compliance with their assigned authority.

Appropriate processes are used to monitor all lending in relation to financial circumstances, collateral and compliance with limits, contractual obligations and internal and external conditions. To this end, exposures are transferred to a suitable form of supervision or support depending on risk content (normal, intensified or problem loan management). Credit risk is also managed using reporting limits determined by Volkswagen Financial Services AG and specified separately for each individual company.

A credit risk portfolio rating, together with analyses of the breakdown of expected and unexpected risks, are used to monitor risk at portfolio level. This rating brings together various risk measures into one indicator, facilitating comparability between the international portfolios of Volkswagen Financial Services AG. The Group Risk Management and Credit Analysis units also conduct risk reviews in the companies if any problems become apparent.

Development
Retail portfolio
In fiscal year 2016, further growth was achieved in the volume of loans and receivables in the retail business on the back of the established sales promotion program with the brands and continuous expansion of the fleet business. As in the previous year, the German market was instrumental in driving growth based on its stable vehicle market environment. In UK, a significant and steady portfolio growth was observable in local currency. However, the volume of loans and receivables only expanded marginally when translated into euros because of the fall in the value of the pound sterling. The challenging macroeconomic situation and the declining market for vehicles in Brazil negatively impacted the development in the Brazilian portfolio and led to a substantial portfolio decline in fiscal year 2016 when measured in local currency (real). In euro terms, the volume of loans and receivables was virtually unchanged because of currency effects.

Overall, the credit risk in the retail portfolio of Volkswagen Financial Services AG remained stable. The diesel issue in the Volkswagen Group did not have any impact on the retail portfolio of Volkswagen Financial Services AG in 2016.

Corporate portfolio
The sustained economic recovery in European markets and a corresponding stabilization of vehicle markets had a positive effect on the corporate portfolio of Volkswagen Financial Services AG in 2016. This trend is reflected in a rising volume of loans and receivables. In the UK market, the fall in the value of the pound sterling led to a sharper contraction in the volume of loans and receivables measured in euros than in the equivalent volume figure in local currency. Overall, the credit risk in the corporate portfolio of Volkswagen Financial Services AG remained stable. The diesel issue in the Volkswagen Group did not have any impact on the corporate portfolio of Volkswagen Financial Services AG in 2016.

BREAKDOWN OF CREDIT VOLUME BY REGION
in € million

1 Europe region excluding Germany.
2 The Latin America region consists of the markets of Mexico and Brazil.

Counterparty/Issuer Risk

Volkswagen Financial Services AG defines counterparty risk as the risk of financial loss that could arise from monetary investments or investments in securities or notes if the counterparty fails to make payments of interest or repayments of principal as contractually required. Similarly, issuer risk is the risk that the issuer of a financial product could become insolvent during the maturity of the product and, as a consequence, some or all of the invested capital, including the expected interest payments, has to be written off.

Counterparty risk arises in connection with interbank overnight and term deposits, derivatives and the purchase of pension fund units as part of the provision of pensions benefits for employees. Issuer risk results from the purchase of securities to optimize liquidity management and to fulfill statutory and/or regulatory requirements. The primary objective in the management of counterparty and issuer risk is to identify potential defaults in a timely manner, so that corrective action can be initiated at an early stage as far as possible. Another important objective is to ensure that the Company only takes on risks within the approved limits.

If a counterparty or issuer risk were to materialize, this would represent the potential loss of a business asset, which would have a negative impact on financial position and financial performance, depending on the amount of the loss.

Risk identification and assessment

Both counterparty risk and issuer risk are recorded as components of counterparty default risk. Both risk categories are determined by using a Monte Carlo simulation to calculate the unexpected loss (value at risk and expected shortfall) and the expected loss from a normal scenario and stress scenarios.

Risk monitoring and control

To establish effective monitoring and control, volume limits are specified in advance for each counterparty and issuer. The Treasury Backoffice unit is responsible for monitoring compliance with these limits on a day-to-day basis. The volume limit is set at an appropriate, needs-driven level and is based on the credit assessment. The Credit Analysis department is responsible for the initial classification and then regular reviews. The Group Risk Management unit assesses counterparty and issuer risk monthly. The reporting of counterparty and issuer risk to the Board of Management is included in the monthly market risk report and in the quarterly risk management report.

Country Risk

Country risk refers to risks in international transactions that are not attributable to the counterparty itself but that arise because of the counterparty's domicile in a country outside Germany. For example, political or economic trends caused by a crisis or difficulties affecting the entire financial system in the country concerned may mean that cross-border services involving the movement of capital cannot be carried out because of transfer problems attributable to action implemented by the foreign government in question. The Group would need to take into account country risk, in particular in connection with funding and equity investment activities involving foreign companies and in connection with the lending business operated by the banking and leasing branch offices. Given the focus of business activities in the Group, there is little chance that country risk (such as foreign exchange risk or legal risk) will arise.

Volkswagen Financial Services AG does not generally have any significant cross-border loans to borrowers outside the basis of consolidation.

Volkswagen Financial Services AG is not usually involved in cross-border lending business, except in the case of intercompany loans. The conventional country risk analysis is not applicable to intercompany lending because, if the difficulties described above were to occur, the funding of the Group entities through lending could be extended if necessary, thereby ensuring that the entities could continue to operate in the strategic market concerned. For these reasons, there has been no need to establish limits related to the overall level of business for countries or regions, for example, to limit transfer risk.

Shareholder Risk

Shareholder risk refers to the risk that losses with a negative impact on the carrying amount of an equity investment could be incurred after the contribution of capital or loans regarded as equity (e.g., silent contributions) for Volkswagen Financial Services AG. In principle, Volkswagen Financial Services AG only makes such equity investments to help it achieve its corporate objectives. The investments must therefore support its own operating activities and are intended to be held on a long-term basis.

If shareholder risk were to materialize in the form of a loss of fair value or even the complete loss of an equity investment, this would have a direct impact on relevant financial data. The net assets and financial performance of Volkswagen Financial Services AG would be adversely affected by write-downs recognized in profit or loss.

Risk identification and assessment

Shareholder risk is quantified on the basis of the carrying amounts of the equity investments and a probability of default and loss given default assigned to each equity investment using an ASRF model. Simulations are also carried out involving stress scenarios with rating migrations (upgrades and downgrades) or complete loss of equity investments.

Risk monitoring and control

Equity investments are integrated into the annual strategy and planning process of Volkswagen Financial Services AG. It exercises influence over the business and risk policies of the equity investments through its representation on the relevant ownership or supervisory bodies. However, responsibility for the operational use of the risk management tools lies with the business units themselves.

Counterparty Default Risk according to Solvency II

Counterparty default risk according to Solvency II refers to the possible default of counterparties such as reinsurers, insurance companies or insurance intermediaries. Counterparty default risk according to Solvency II arises in Volkswagen Financial Services AG only from the business operated by Volkswagen Versicherung AG.

At Volkswagen Versicherung AG, loans to and receivables from reinsurance partners represent the largest component of counterparty default risk according to Solvency II. The risk is monitored largely by regularly observing the ratings issued for reinsurers and retrocessionaires. Generally, transactions are only entered into with reinsurers and retrocessionaires that have been issued with an external rating equivalent to an internal Volkswagen Financial Services AG rating classified as "very good credit quality" to "good credit quality".

Appropriate safeguards must be taken whenever a reinsurer or retrocessionaire falls below the required minimum credit rating.

Risk identification and assessment

The significance of the counterparty default risk according to Solvency II is assessed through a qualitative evaluation of the risks based on the magnitude of their loss and the corresponding likelihood of their occurrence. The risk is quantified using the latest EIOPA draft technical specifications relating to the requirements under the Solvency II Directive.

Risk monitoring and control

Risk management is undertaken by the local Risk Management department of Volkswagen Versicherung AG and checked for plausibility in close consultation with the Group Risk Management unit. The results are then reported to the relevant units. The responsibility for risk monitoring lies with the Group Risk Management unit.

Market Risk

Market risk refers to the potential loss arising from adverse changes in market prices or parameters that influence prices. Volkswagen Financial Services AG is exposed to significant market risk arising from changes in market prices that trigger a change in the value of open interest rate or currency transactions.

The objective of market risk management is to keep the financial losses arising from this category of risk as low as possible. With this in mind, the Board of Management has agreed limits for this category of risk. If limits are exceeded, the situation is escalated on an ad hoc basis to the Board of Management and the Asset Liability Management Committee (ALM Committee). Action to reduce risk is discussed and initiated by the ALM Committee.

As part of risk management activities, market risk is included in the monthly risk report with a transparent analysis based on value at risk (VaR), a calculation offsetting the total market risk against the loss ceiling set for Volkswagen Financial Services AG and recommendations for targeted measures to manage the risk.

Interest Rate Risk

Interest rate risk refers to potential losses that could arise as a result of changes in market interest rates. It occurs because of interest rate mismatches between asset and liability items in a portfolio or on the balance sheet. Volkswagen Financial Services AG is exposed to interest rate risk in its banking book. Changes in interest rates that cause interest rate risk to materialize can have a negative impact on financial performance.

Risk identification and assessment

Interest rate risk for Volkswagen Financial Services AG is determined as part of the monthly monitoring process using the value at risk (VaR) method with a 40-day holding period and a confidence level of 99%. The model is based on a historical simulation and calculates potential losses taking into account 1,000 historical market fluctuations (volatilities). Negative interest rates can also be processed in the historical simulation and are factored into the risk assessment.

The VaR calculated for operational management purposes estimates potential losses under historical market conditions, but stress tests are also carried out for forward-looking situations in which interest rate exposures are subject to exceptional changes in interest rates and worst-case scenarios. The results from the simulations are analyzed to assess whether any of the situations could represent a serious potential risk. This process also includes the monthly quantification and monitoring of the changes in present value resulting from the interest rate shock scenarios of +200 basis points and −200 basis points, as specified by the German Federal Financial Supervisory Authority (BaFin).

The calculation of interest rate risk uses notional maturities to take into account early repayments under termination rights. The behavior of investors with indefinite deposits is analyzed using internal models and methods for managing and monitoring interest rate risk.

Risk monitoring and control

Treasury is responsible for the management of this risk on the basis of decisions made by the ALM Committee. Interest rate risk is managed by using interest rate derivatives. Group Risk Management is responsible for monitoring and reporting on interest rate risk.

A report on the latest position regarding interest rate risk at Volkswagen Financial Services AG is submitted to the Board of Management each month.

Currency Risk

Currency risk arises from mismatches between the amounts of asset and liability items denominated in foreign currency. However, open-ended foreign currency exposures of this nature are only permitted in individual cases.

If currency risks were to materialize, this could lead to losses in all items affected by a foreign currency.

Fund Price Risk

The risk in connection with fund investments arises from possible changes in market prices. Fund price risk describes the risk that changes in market prices will cause the value of portfolios of securities to fall, thereby giving rise to a loss.

Volkswagen Financial Services AG is exposed to fund price risk arising from its employee post-employment benefit arrangements that are funded by pension plan assets consisting of fund investments. Volkswagen Financial Services AG and Volkswagen Bank GmbH have undertaken to meet these pension obligations if the employees' guaranteed entitlements can no longer be satisfied from the pension fund.

Development

Overall, market risk remained stable during the reporting period. The quantified risk remained within the specified limits at all times.

Liquidity Risk

Liquidity risk is the risk of a negative variance between actual and expected cash inflows and outflows.

Liquidity risk is defined as the risk of not being able to meet payment obligations in full or when due, or – in the event of a liquidity crisis – the risk of only being able to raise funding at higher market rates or only being able to sell assets at a discount to market prices. This results in a distinction between illiquidity risk (day-to-day cash flow risk including deposit withdrawal/commitment drawdown risk and the risk of delayed repayment of loans on maturity), funding risk (structural liquidity risk) and market liquidity risk.

The primary objective of liquidity management at Volkswagen Financial Services AG is to safeguard the ability of the Company to meet its payment obligations at all times. To this end, Volkswagen Bank GmbH holds liquidity reserves in the form of securities deposited in its operational safe custody account with Deutsche Bundesbank. Standby lines of credit at other banks are also available to protect against unexpected fluctuations in cash flows. There are no plans to make use of these standby lines of credit; their sole purpose is to serve as backup to safeguard liquidity.

If liquidity risk were to materialize, funding risk would result in higher costs and market liquidity risk would result in lower selling prices for assets, both of which would have a negative impact on financial performance. The consequence of illiquidity risk in the worst-case scenario is insolvency caused by illiquidity. Liquidity risk management at Volkswagen Financial Services AG ensures that this situation does not arise.

Risk identification and assessment

The expected cash flows at Volkswagen Financial Services AG are brought together and evaluated by the Treasury unit.

The Group Risk Management unit is responsible for identifying and recording liquidity risk. Stress tests are applied to funding matrices using a scenario approach with scenario triggers from the Company itself or the market, or a combination of the two. Two approaches are used to determine the parameters for these stress scenarios. The first approach uses observed historical events and specifies different degrees of impact from hypothetical, but conceivable events. To quantify the funding risk, this approach takes into account the relevant aspects of illiquidity risk and changes in spreads driven by credit ratings or the market. In the second approach, to ensure there is appropriate liquidity management, Treasury also prepares four different funding matrices, carries out cash flow forecasts and uses this information to determine the relevant range of liquidity coverage.

Risk monitoring and control

To manage liquidity, the Operational Liquidity Committee (OLC) holds meetings every two weeks at which it monitors the current liquidity situation and the range of liquidity coverage. It decides on funding measures and prepares any necessary decisions for the decision-makers.

Group Risk Management communicates the main risk management information and relevant early warning indicators relating to illiquidity risk and funding risk. As far as illiquidity risk is concerned, these indicators involve appropriate threshold values for determined degrees of utilization over various time horizons, taking into account access to relevant sources of funding. The indicators relating to funding risk are based on potential funding costs, which are monitored using a system of limits.

Development

Liquidity risk has been significantly affected by the diesel issue, which has been to the fore since September 2015. However, despite volatility at the beginning of the year under review, liquidity risk at the level of Volkswagen Financial Services AG was stable overall.

Funding risk always remained within the specified limits.

Residual Value Risk

Residual value risk arises from the fact that the actual market value for a lease asset at the time of remarketing could be lower than the residual value calculated at the inception of the lease. On the other hand, there is also the opportunity that the remarketing could generate proceeds greater than the calculated residual value.

A distinction is made between direct and indirect residual value risk in relation to the bearer of this risk. Direct residual value risk refers to residual value risk borne directly by Volkswagen Financial Services AG or one of its companies (contractually determined). An indirect residual value risk arises if the residual value risk has been transferred to a third party (such as a dealer) on the basis of a residual value guarantee. In such cases, the initial risk is a counterparty default risk in respect of the residual value guarantor. If the residual value guarantor defaults, the residual value risk reverts to Volkswagen Financial Services AG.

The objective of residual value risk management is to keep the risks within the agreed limits. If a residual value risk materializes, the Company may have to recognize an exceptional write-down or a loss on disposal of the asset concerned, resulting in a negative impact on financial performance.

Risk identification and assessment

Direct residual value risks are quantified on the basis of expected loss (EL) and unexpected loss (UL). The EL equates to the difference between the latest forecast remarketing proceeds as of the measurement date and the contractual residual value specified at the inception of the lease for each vehicle. Other parameters such as remarketing costs are also taken into account in the calculation. The portfolio EL is calculated by aggregating the individual ELs for all the vehicles.

To determine the UL, the change is measured between the projected residual value one year before the end of the lease and the actual selling price achieved (adjusted for damage and mileage variances). In a first step, the change in value is determined for each individual lease for each period. However, given the size of the portfolio and the huge number of vehicles, systematic risk is significant and a second step is therefore carried out in which the average change in value compared with projected residual values is determined over several periods. The resulting markdown is calculated using the quantile function of the normal distribution with a specified confidence level.

The UL is calculated by multiplying the latest projected residual value by the markdown. This value is calculated independently of the EL and at individual lease level for each vehicle in the portfolio. As in the calculation of the EL, the portfolio UL is determined by aggregating the ULs for all the vehicles. This figure is generated quarterly. The results from the calculation of the EL and UL are fed into the assessment of the risk situation, e.g. they are one of the factors used in assessing the adequacy of the provisions for risks and are included in the calculation of risk-bearing capacity.

In the case of indirect residual value risk, the method used to quantify the risk is generally similar to that used for direct residual value risk but also takes into account further risk parameters (dealer default and other factors specific to this category of risk).

The general requirements for developing, using and validating the risk parameters for direct and indirect residual value risk are laid down in a set of procedural instructions.

Risk monitoring and control

The Group Risk Management unit monitors residual value risk within Volkswagen Financial Services AG.

As part of risk management procedures, the adequacy of provisions for risk and the potential residual value risk are regularly reviewed in respect of direct residual value risk; residual value opportunities are disregarded in the recognition of provisions for risks.

Because of the distribution of the risks, an analysis based on individual leases does not always fully cover the assumed risks during the term of the lease. This is because of the difference between the residual value curve (degressive) and the incoming payments curve (linear). As a result, where risks have already been identified, the risk amounts allocated to the residual maturity must still be earned in the future and added to impairment losses (in accordance with IAS 36).

Based on the resulting potential residual value risk, various measures are initiated as part of a proactive risk management approach to limit the residual value risk. Residual value recommendations for new lease originations must take into account prevailing market circumstances and future influences. There are also a number of stress tests for direct residual value risks for creating a comprehensive picture of the risk sensitivity of residual values. These stress tests are carried out by experts with the involvement of risk specialists at head office and in the local units. Indirect residual value risks faced by Volkswagen Financial Services AG or one of its companies are subject to plausibility checks and are assessed from the perspectives of risk amount and significance.

As part of its risk management activities, the Group Risk Management unit regularly reviews the potential indirect residual value risk and the adequacy of the associated provisions. Based on the potential indirect residual value risk determined by these activities, various measures are initiated in close collaboration with the brands and the dealer organization to limit the risk.

Development

Steady year-over-year growth in the number of contracts was evident in almost all markets, driven by the recovery of the vehicle markets in Europe. The most significant growth driver was the UK market. The measures previously put in place (such as intensifying the remarketing processes and initiating a confidence-building campaign) had led to further stabilization in used car prices; these measures were continued in fiscal year 2016. The diesel issue at the Volkswagen Group only had a marginal impact on the residual value portfolio at Volkswagen Financial Services AG.

Earnings Risk (Specific Profit or Loss Risk)

Earnings risk refers to the risk that actual values will vary from the budgeted values for certain items on the income statement that are not already covered by the other categories of risks described elsewhere. Earnings risk includes the following risks:

- unexpectedly low fees and commissions (fee and commission risk);
- unexpectedly high costs (cost risk);
- excessively high income targets for new and existing business volume (sales risk); and
- unexpectedly low investment income.

The objective is to regularly analyze and monitor the potential risk associated with earnings risk to ensure that variances compared with budgeted values are identified at an early stage and any necessary corrective action is initiated. If the risk were to materialize, this would reduce income or increase costs and thereby also adversely impact operating profit.

Risk identification and assessment

Volkswagen Financial Services AG quantifies earnings risk using a parametric earnings at risk (EaR) model with the confidence level specified in the calculation of risk-bearing capacity and a one-year forecast period.

The relevant income statement items provide the basis for these calculations. The estimates for earnings risk are then based on two perspectives: firstly, the observed, relative variances between target and actual values; secondly, the volatility and interdependencies between the individual items. Both components are incorporated into the EaR calculation.

Risk monitoring and control

During the course of the year, changes in the actual values at market level for the earnings risk exposures are compared against the forecast values. This comparison is included in the standard reporting procedure carried out by Controlling.

The results from the quarterly quantification of earnings risk are fed into the calculation of risk-taking potential as a deduction from risk-bearing capacity. The results are monitored by Group Risk Management.

Underwriting Risk

Underwriting risk is an inherent risk of insurance companies, which at Volkswagen Financial Services AG exists primarily as a result of the subsidiary Volkswagen Versicherung AG. It arises if the cash flows that are material to the insurance company differ from their expected value. One source of this risk is the uncertainty as to whether the total amount of actual payments for claims matches the total amount of expected payments for claims. Underwriting risk at Volkswagen Financial Services AG is broken down into the risks associated with two different classes of insurance: non-life underwriting risk and health underwriting risk.

The mission of Volkswagen Versicherung AG is to support sales of the Volkswagen Group's products. Volkswagen Versicherung AG achieves this mainly by operating its warranty insurance business as the primary insurer and actively reinsuring portfolios brokered by a company of the Volkswagen Group for other primary insurers.

The purpose of managing underwriting risk is not to avert such risk in its entirety but to manage the risk systematically in furtherance of the objectives. In principle, risks are not accepted unless they can be calculated and borne by the company.

If claims are excessive relative to the premium calculation, the risk situation of the portfolio must be reviewed.

Risk identification and assessment

The significance of the non-life and health underwriting risks is assessed through a qualitative evaluation of the risks based on the magnitude of their loss and the associated likelihood of their occurrence. The risk is quantified using the latest EIOPA draft technical specifications relating to the requirements under the Solvency II Directive.

Risk monitoring and control

Risk management is undertaken by the local Risk Management department and checked for plausibility in close consultation with the Group Risk Management unit. The results are then reported to the responsible offices. The responsibility for risk monitoring lies with the Group Risk Management unit.

NON-FINANCIAL RISKS

Operational Risk

Operational risk (OpR) is defined as the risk of loss resulting from inadequate or failed internal processes (process risk), people (HR risk) or systems (technological risk), or resulting from external events (third-party risk). This definition includes legal risk.

Other categories of risk, such as reputational or strategic risk, do not fall within the scope of operational risk because they are analyzed separately.

The objective of operational risk management is to present operational risks transparently and initiate precautionary and corrective measures with a view to preventing or, when this is not possible, mitigating the risks or losses. If an operational risk materializes, this represents an operational loss with the resulting loss of a business asset, which has a negative impact on financial position and financial performance, depending on the amount of the loss.

The operational risk strategy specifies the focus for the management of operational risk; the operational risk manual sets out the implementation process and allocates responsibilities.

Risk identification and assessment

Operational risks or losses are identified and assessed by local experts working in pairs (assessor and approver) with the help of two operational risk tools: a risk self-assessment and a loss database.

The risk self-assessment is used to determine a monetary assessment of future potential risks. A standardized risk questionnaire is provided once a year for this purpose. The local experts use these questionnaires to determine and record the details for various risk scenarios. The details include the possible amount of the risk and the probability of occurrence, in each case with typical and maximum figures.

The central loss database is used to ensure that information about monetary operational losses is collected internally on an ongoing basis and the relevant data is stored. A standardized loss form is made available to the local experts to aid this process. The experts use this form to determine and record the relevant data, including the amount and cause of the loss.

Risk monitoring and control

Operational risk is managed by the companies/divisions (operational risk units) on the basis of the guidelines in force and the requirements laid down by the special operational risk units responsible for specific risk categories. To this end, local management decides whether future risks or losses are to be ruled out (risk prevention), mitigated (risk mitigation), consciously accepted (risk acceptance) or transferred to third parties (risk transfer).

The Group Risk Management unit checks the plausibility of the information provided by the companies/divisions in the risk self-assessments, reviews the reported loss events and then initiates any necessary corrective action, reviews the operational risk system to ensure it is fully functioning and instigates appropriate modifications as required. This includes, in particular, the integration of all relevant operational risk units, a review to check compliance with the risk substrategies for operational risks and a review of the methods and procedures used for risk measurement.

Communications relating to operational risks are provided quarterly as part of the risk management reports. The quarterly details are supplemented by an annual operational risk report in which the main events in the year are presented and assessed again on a coherent basis. Ad hoc reports are issued in addition to the regular reports provided that the relevant specified criteria are satisfied.

Development

The increase in operational risk in the past was based on a number of factors, including the growth in the business of Volkswagen Financial Services AG, also after taking legal risk into account. As of November 2016, an amount of €496 million had been recognized as provisions for legal risks.

Training and briefing sessions were carried out to increase awareness of operational risk in Volkswagen Financial Services AG. These activities led to better recording of loss events. Experience and information gained about past loss events also means that potential future risks can be assessed more completely and more accurately.

Compliance and Conduct Risk

At Volkswagen Financial Services AG, compliance risk encompasses all risks that could arise from non-compliance with statutory rules and regulations or other official or regulatory requirements, or that could be caused by a breach of internal company regulations.

As opposed to conduct risk, which is defined as the risk arising from inadequate conduct by the institution toward the customer, unreasonable treatment of the customer or provision of advice using products that are not suitable for the customer.

Volkswagen Financial Services AG has set up a local compliance function to take account of both categories of risk that is aimed at identifying and implementing risk-mitigating measures.

To counter compliance and conduct risks, the compliance function is committed to ensuring compliance with laws, other legal requirements, internal rules and self-proclaimed values, and fostering an appropriate compliance culture.

As a component of the compliance function, the role of the compliance officer is to work toward implementing effective procedures to ensure compliance with key and core legal rules and regulations for the institution and toward establishing appropriate controls. This is achieved, in particular, by specifying mandatory “compliance requirements” for legal stipulations classified as material. These requirements include documenting responsibilities and processes, establishing controls to the extent required and raising employee awareness of pertinent rules so that employees comply with the rules as a matter of course, reflecting a fully functioning compliance culture.

Further regular activities are also nurturing the emergence of a compliance culture. These activities include, in particular, constantly promoting the Volkswagen Group’s code of conduct, raising employee awareness on a risk-oriented basis (e.g. tone from the top, classroom training, e-learning programs, other media-based activities), carrying out communications initiatives, including distributing guidelines and other information media, and participating in compliance programs.

The compliance function has been set up on a decentralized basis. The departments are responsible for complying with the rules and regulations in their respective areas of activity. A compliance theme coordinator is appointed for all key and core rules and regulations. The coordinator is responsible for adhering to and implementing the defined compliance requirements (such as documenting responsibilities, setting up controls, raising awareness and training employees).

Using the control plans and control documentation as a basis, the compliance function checks whether the implemented controls are appropriate. In addition, the findings from various audit activities are used to evaluate whether there are indications that the implemented compliance requirements are ineffective, or whether the audits have identified material residual risks on the basis of which further action needs to be determined.

The compliance officer is responsible for coordinating ongoing legal monitoring, the purpose of which is to ensure that new or amended legal regulations and requirements are identified promptly. For their part, the compliance theme coordinators must work in collaboration with the legal department and the various other departments to implement measures aimed at identifying at an early stage new or amended regulations and requirements relevant to their areas of responsibility and, if such relevance is established, furnishing an analysis of materiality for the Company. The identified regulations and requirements must be notified immediately to the compliance officer.

The internal Compliance Committee regularly conducts a materiality analysis on the basis of the outcomes of this legal monitoring. After taking into account the evaluated compliance risks, the Compliance Committee makes a decision on the materiality of new legal requirements applicable to the Company. Compliance risk primarily includes the risk of a loss of reputation vis-à-vis the general public or supervisory authorities and the risk of material financial loss.

Currently, the following specific legal fields have been determined as being generally material from the perspective of the Group:

- prevention of money laundering and terrorist financing,
- prevention of corruption and other criminal acts,
- data protection,
- consumer protection,
- securities trading law,
- banking supervisory law, and
- antitrust law.

The compliance requirements for the corporate group are specified centrally and must be implemented autonomously in the local companies. Any deviation from the minimum requirements or guidelines is only possible if accompanied by a description of the reasons (such as local statutory requirements) and only in consultation with, and with the consent of, the holding company compliance function.

The holding company compliance function will receive regular reports and carry out on-site visits on a risk-oriented basis to ensure that the local compliance units are meeting their responsibilities.

To meet the statutory reporting requirements of the compliance function, the compliance officer submits to the Board of Management both regular reports on the outcome of the meetings of the Compliance Committee and ad hoc reports as necessary (for example, if control plans are not prepared by the required deadline).

The Board of Management will also receive a compliance report and other comparable reports on an annually basis or if events make this necessary. The annual compliance report will contain a presentation of the appropriateness and effectiveness of the compliance requirements implemented to ensure compliance with key and core legal regulations and requirements.

Risk from Outsourcing Activities

Outsourcing describes a situation in which another entity (the outsourcee) is engaged to carry out activities and processes in connection with the provision of services that would otherwise be carried out by the outsourcing entity itself.

A distinction needs to be made between outsourcing and one-time or occasional procurement from third parties of goods or services or services that are typically obtained from a supervised entity and, because of the actual circumstances involved or legal requirements, cannot usually be supplied by the buying entity itself, either at the time of the purchase from the third party or in the future.

The objective of outsourcing risk management is to identify and minimize the risks from all outsourcing. As part of outsourcing management and detailed monitoring, measures may be initiated, where appropriate, to monitor a variance from an identified risk and ensure that the original risk position associated with an outsourced activity can be restored.

Ultimately, a variance from a determined risk may mean that the service provider has to be changed or, if possible and strategically desirable, the outsourcing arrangement ended. In this case, the activities may be performed by the Company itself or may be eliminated entirely.

Risk identification and assessment

Risks arising in connection with outsourced activities are identified by examining the circumstances and performing a risk analysis. In the first step, an examination of the circumstances is used to establish whether the planned activity constitutes procurement from a third-party supplier or an outsourcing arrangement. The risk analysis uses various criteria to determine the risk content in an outsourcing arrangement. The outcome is the classification of the outsourcing arrangement as material or immaterial. Material outsourcing arrangements are subject to more stringent levels of monitoring and control as well as special and stricter contractual provisions.

Risk monitoring and control
The risks from outsourcing activities are documented as part of operational risk. To ensure effective management of outsourcing risk, the Company has issued a framework policy specifying the constraints that outsourcing arrangements must observe. Before any activity is outsourced, a risk analysis must be prepared to determine the risk in each case. This analysis procedure is one of the components of the constraints and ensures that an adequate level of monitoring and control is applied. The framework policy also specifies that all outsourced activities must be agreed with the Group Outsourcing Coordination unit. This coordination unit is therefore informed about all outsourcing activities and the associated risks and communicates quarterly on the risks to the Board of Management.

In addition, all risks arising from outsourcing activities are subject to risk monitoring and control through the operational risk loss database and the annual risk self-assessment.

Model Risk

Model risk arises from inaccuracies in the risk values and must be taken into account, particularly in the case of the underestimation of risk and complex models.
Depending on the complexity of the model, model risk can occur in a number of areas of model development and application.

Potential model risks in the risk models are assessed by the model coordinator on a qualitative basis in an annual model risk process. The objective is to verify the coverage by own funds.

The assessment is carried out using the following criteria: “simple”, “transparent”, “conservative”. If the presence of model risk is demonstrated, the model risk drivers are identified using a further qualitative assessment. A review is then carried out to establish whether the risk drivers can be minimized with appropriate action and/or whether quantitative backing with own funds is required.

Strategic Risk

Strategic risk is the risk of a direct or indirect loss arising from strategic decisions that are flawed or based on false assumptions.

Strategic risk also includes all risks that result from the integration/reorganization of technical systems, personnel or corporate culture (integration/reorganization risk). These risks may be caused by fundamental decisions about the structure of the business made by the management in relation to the positioning of the company in the market.

The objective of Volkswagen Financial Services AG is to manage its acceptance of strategic risk enabling it to systematically leverage earnings potential in its core business. In the worst-case scenario, a materialization of strategic risk could jeopardize the continued existence of the Company as a going concern.

Strategic risk is recognized quantitatively by applying a deduction to aggregate risk cover in the calculation of risk-bearing capacity.

Reputational Risk

Reputational risk refers to the risk that an event or several successive events could cause reputational damage (in the eyes of the general public), which in turn could limit current and future business opportunities or activities (potential earnings), thereby leading to an indirect adverse financial impact (customer base, sales, funding costs, etc.) and/or direct financial losses such as penalties, litigation costs, etc.

The responsibilities of the Corporate Communications unit include avoiding negative reports in the press or similar announcements that could inflict damage on the reputation of the Company. If this is unsuccessful, the unit is then responsible for assessing the situation and initiating appropriate communications aimed at specific target groups to limit the reputational damage as far as possible. The strategic objective is therefore to prevent or reduce any negative variance between actual reputation and the level of reputation the Company expects. A loss of reputation or damage to the Company’s image could have a direct impact on financial performance.

Reputational risk is recognized quantitatively by applying a markdown in the calculation of risk-bearing capacity. This global approach is reassessed each year from a qualitative perspective.

SUMMARY

Volkswagen Financial Services AG takes on risk in a responsible manner as part of its operating activities. This approach is based on a comprehensive system for identifying, measuring, analyzing, monitoring and controlling risks, which is part of a holistic risk- and return-oriented management system. Risk-bearing capacity was maintained at all times in 2016. We do not believe that there are any risks to the continued existence of our business as a going concern.

The system was once again subject to a process of continuous refinement in 2016, for example in terms of methods, models, systems, processes and IT.

Volkswagen Financial Services AG will continue to invest in optimizing its comprehensive control system and risk management systems in order to meet the business and regulatory requirements for the management and control of risks.

Credit Risk Forecast

A stable risk position is predicted for 2017 overall. This steady position should be supported by a further stabilization in the economic environment and the continued recovery in European markets. In the Asia/Pacific region, we anticipate that the risk position will remain unchanged overall, while in Latin America we are assuming that the risk situation will be challenging. Certain markets (such as Brazil and Russia) are already being monitored; this will be continued in 2017 so that in case of need suitable measures can be implemented to reach our defined goals for the current year. We do not anticipate any impact from the diesel issue on credit risk.

Market Risk Forecast

Despite the current volatile interest rate and currency markets in Brazil, Mexico, Russia, Turkey and the UK, a constant market risk situation regarding the overall portfolio of Volkswagen Financial Services AG in fiscal year 2017 is expected.

Liquidity Risk Forecast

The future risk development very much depends on how the diesel issue evolves and on how the Company refines the management approach in connection with the funding structure. If, for example, the capital market cannot be used as currently planned, it will be necessary to switch to other, generally shorter-term, sources of funding. This could then be reflected in a higher funding cost risk and also in a higher insolvency risk.

Residual Value Risk Forecast

We expect the volume of contracts to continue to grow in fiscal year 2017. The main drivers behind this are the implemented growth program, continued economic recovery in the markets and further expansion in the fleet business. The diesel issue should not affect the residual value portfolio in 2017.

Operational Risk Forecast

Based on future business growth and the development in operational risk as described in the risk report, we anticipate a constant to moderately rising level of risk. In this context, we expect the effectiveness of fraud protection to remain stable and the high level of quality in processes and in staff skills and qualifications to be maintained.

Corporate Responsibility

Roads to the Future.

As a global financial services provider in the Volkswagen Group, we firmly believe that our business model can be successful only if we act in a sustainable, responsible manner – now and in the future. For this reason, it has become a matter of course for us to focus on and engage in activities and issues centered around our understanding of corporate responsibility (CR).

In 2016, we subjected our existing CR commitment to a review and carried out the necessary adjustments. In the future, we will ensure that our priorities are determined on a more site-oriented basis and give greater focus to specific, industry-based approaches to environmental and social issues.

For us, accepting responsibility means adjusting our decisions to align with the requirements of society, our clients, our employees and our shareholders.

We operate internationally but, at the same time, are locally based. Sustainable and responsible management is important to us. We operate reliably with a focus on the environment. As an attractive employer, we have an inherent interest in supporting a sustainable society.

Our mission is to comply with the law and our own values. Furthermore, it is our aim to return a part of our success back to society.

At Volkswagen Financial Services AG, we view it as our responsibility to go above and beyond compliance with legal requirements (corporate governance). In our core business, for example, we include environmental aspects in the development of our products and create incentives for resource-friendly, sustainable mobility.

A key aspect of our corporate responsibility is to ensure that our operating processes also protect the environment. It was therefore a logical step for us to introduce an environmental management system (EMS) in accordance with the ISO EN 14001:2009 standard for our Braunschweig site. In August 2016, this environmental management system was successfully recertified by TÜV Nord.

Outside its core business, Volkswagen Financial Services AG also takes social responsibility by getting involved in local social projects in the vicinity of its sites.

In the Braunschweig region, we support social projects, sponsor top-class sports and promote cultural events. CR is now a firmly established part of the corporate culture at Volkswagen Financial Services AG, and we will continue to breathe life into the four areas of action that we have defined: people, environment, products and dialog.

A summary of the main activities in these areas of action is provided below:

PEOPLE

Top Employer | Top Employees

We believe it is the responsibility of Volkswagen Financial Services AG to offer our employees a working environment you would expect from a top employer. The elements we think are important primarily include a wide spectrum of attractive tasks, a comprehensive range of opportunities for personal and professional development, options for international assignments and working conditions that enable employees to achieve a good work-life balance. We also offer fair remuneration commensurate with the work performed, profit-sharing and numerous social benefits.

We expect our top employees to demonstrate a high level of professional competence, deliver excellent quality of work, be prepared to embrace change and accept flexibility in their deployment, be keen to develop their skills and qualifications (especially in relation to future customer requirements, including those involving digitalization), be willing to continuously improve productivity and pursue their chosen career with commitment and passion. The long-term success of our Company will only be made possible by the outstanding performance of our employees, taking an agile approach to collaboration and using innovative methods.

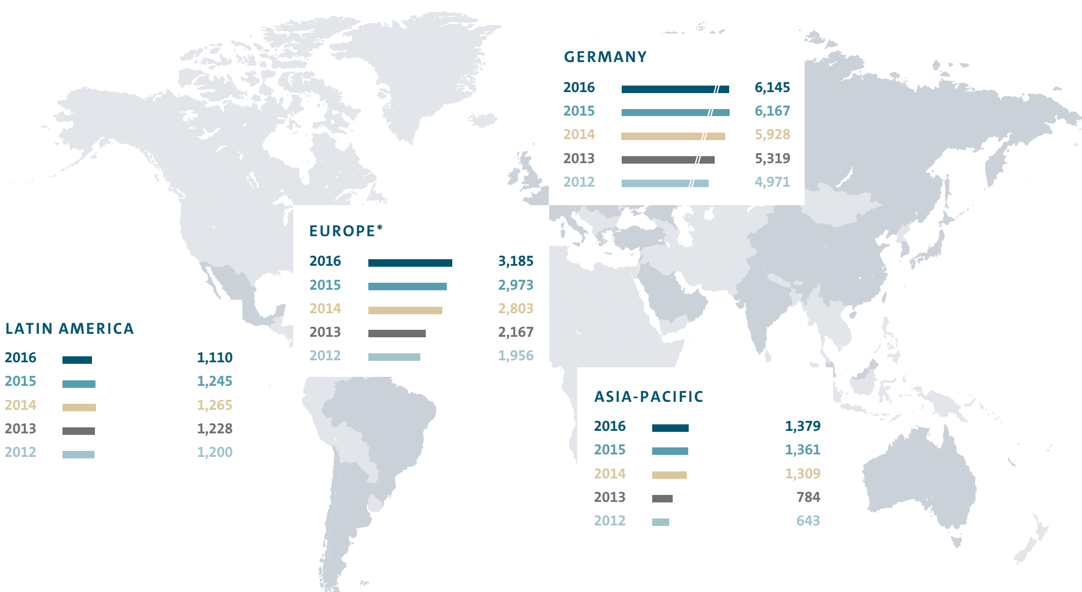
As a top employer with top employees, we aim to become not only one of the best employers in Germany and Europe, but also throughout the world by 2025.

Our Employees Worldwide

The Volkswagen Financial Services AG Group had a total workforce of 11,819 (11,746) employees on December 31, 2016. Of these, 6,145 (6,167), or 52%, were employed in Germany and 5,674 (5,579), or 48%, at our international sites. Most of the MAN financial services companies were integrated into the corresponding units of Volkswagen Financial Services AG. Their employees were given employment contracts with the respective national companies of Volkswagen Financial Services AG.

Based on economic considerations, 357 employees of Volkswagen Servicios S.A. de C.V., Puebla, Mexico, which is an unconsolidated company, are included in the overall workforce figures.

EMPLOYEES BY REGION
as of December 31



* Excluding Germany

Our HR Strategy

The ROUTE2025 program has created new areas of focus in terms of HR strategy. Six strategic areas of activity are listed under the heading “Top Employer/Top Employees”. These areas of activity are helping Volkswagen Financial Services AG to position itself as “the key to mobility”. With the support of the best employees, our objective is to continue to drive forward development around the strategic cornerstones of customers, volume, profitability and operational excellence. Based on specific activities to develop and retain personnel, coupled with profit-sharing arrangements commensurate with the work performed, we aim to encourage top performance and ensure we provide outstanding customer service with top employees, but also, as a top employer, take our excellent globally recognized reputation to yet another level. One of the factors that will help us achieve this objective is to give more attention to a culture of feedback, open discussion and appreciative cooperation.

Initially, the key priority is to promote a culture of open feedback and discussion and of customer- and service-oriented cooperation. This includes not only cooperation between departments within the Company, but equally collaboration between the head office and the branches, between the branches themselves and cooperation with the customer.

Volkswagen Financial Services AG already offers competitive, performance-related remuneration. Performance appraisals are conducted as part of the annual staff dialogs in almost all international subsidiaries.

As the parent of the financial holding company group, Volkswagen Financial Services AG is subject to direct supervision by the ECB and is required to implement the Institutsvergütungsverordnung (InstitutsVergV – German Regulation Governing Remuneration at Institutions) of December 16, 2013 throughout the Group. Under the amended provisions in this regulation, banks must satisfy the special regulatory requirements for remuneration systems as well as comply with the re-drafted and tighter general requirements. The operational implementation of the provisions of the InstitutsVergV was once again a major feature of HR activities in fiscal year 2016. Strategies and instruments already introduced, such as the works council agreement on variable remuneration, the variable remuneration ceiling, national and international risk-taker identification, the InstitutsVergV-compliant bonus process and the reporting system using a remuneration report, continued to be applied. In addition, the malus (performance adjustment) concept for risk-takers was agreed with the relevant committees and put into operation as part of the first-time use of deferral payments. The Basic Principles of the Remuneration System and the Group Remuneration Strategy are reviewed each year and adjusted if required. Furthermore, special governance functions (Remuneration Committee and Remuneration Officer) ensured that the adequacy of the remuneration systems was continuously monitored.

The Human Resources Strategy Card remained the most important steering tool for implementing our HR strategy. The objectives and definitions set out on the card provide uniform guidance for our local entities around the world from the two perspectives of top employer and top employees. The content is regularly reviewed to ensure it is up to date. The local entities hold regular meetings with the head office – at least twice a year – to report on their successes and share detailed information in this regard. Depending on the situation, support measures are agreed and/or highly positive examples are systematically made available to other branches so that synergies can also be leveraged between the different local companies.

We assess the extent to which we have achieved our objective of being a top employer by regularly taking part in external employer competitions. Twelve companies have now already been included in national lists of the best companies or have been certified as a “Great Place to Work”. These companies also include Volkswagen Financial Services AG in Germany, which took first place in Germany for the third time in succession. In 2016, it also received accolades from FOCUS magazine and the employer evaluation platform kununu as a top company and in the “Best Employers in Germany” awards.

It is also particularly encouraging that, in addition to Germany, Portugal and the UK also made it into the top 10 in their respective countries, while Italy and Poland were in the top 20. Brazil achieved an impressive 28th place, with France in 38th place. Spain, Norway, Mexico, Australia and China were also highlighted as top employers in their respective markets.

These awards make us proud, especially as we were able to make 12th place in Europe in the list of the best multinational companies. At the same time, they help us to remain an attractive employer for subsequent generations in the future.

Our successful international placings as a top employer and the findings from the studies are important strategic measures and indicators, helping us to protect and continue to build on what we have achieved already.

The satisfaction of our customers with the work of our employees is given top priority at Volkswagen Financial Services AG. For this reason, the results of external and internal customer satisfaction surveys are also used as indicators of target achievement.

Business units that have no direct contact with external customers have the opportunity to use the “Internal customer feedback on customer and service orientation” to invite all internal employees who are customers of the business unit concerned to express their satisfaction in an online survey on the basis of defined customer and service orientation criteria.

The results from the internal customer surveys and from the external customer survey data currently in development will in future provide the basis for calculating the top KPI “Customer satisfaction”.

Back in 2010, Volkswagen Financial Services Mexico introduced a tool for measuring internal customer satisfaction, enabling it to act as a pioneer for the implementation of a similar tool at Volkswagen Financial Services AG in Germany and also, from 2016, worldwide, for example in China. Based on the survey, individual departments are evaluated by their internal customers, i.e. neighboring departments and interfaces within the same organization, under headings such as availability, adherence to promises, speed of processing, commitment, friendliness and expertise. Respondents to the survey in Mexico also have the option of giving special mention to a particular employee in each department who has provided especially good service. The findings of the survey are subsequently discussed within the units and improvement measures are agreed.

The local company in the Netherlands has developed the DRIVE program. This is an intra-team and cross-team program aimed at improving customer relationships (internal and external). The basis in each team is provided by a tool known as the Stand-up Board. This tool allows internal and external customer inquiries to be processed or answered quickly within the team. It is used to present KPIs, track specific tasks on an employee basis and add new tasks. After each session, which lasts for a maximum of 30 minutes and takes place twice a week, employees reflect on the stand-up. A nominated employee subsequently takes responsibility for implementing the action agreed in the stand-up. DRIVE has already been introduced across 70% of the Amersfoort site and is run independently by each department.

Responsibility for implementing the HR strategy internationally lies with the respective local subsidiaries. The international HR department at headquarters provides support for the journey to becoming a top employer by, among other things, providing best practice examples in an HR toolbox. In 2016, the headquarters also for the first time ran a webinar aimed at HR officers in local companies. The webinar provided further training on a common understanding and possible approaches to top-class HR activities and, at the same time, also helped employees below HR manager level share their experiences with international colleagues.

The international HR managers' conference, which was held this year for the first time as a virtual conference, also represented an important information-sharing platform. The regional hubs took the lead in this conference and presented their (interim) results relating to the six areas of activity in the HR strategy.

The implementation of our corporate ROUTE2025 strategy is complemented by our "FS Way", which describes our corporate and leadership culture, i.e. the way in which the objectives of the five strategic areas for action – customers, employees, operational excellence, profitability and volume – can be met in order to live up to our strategic vision, "the key to mobility", as an automotive financial services provider. The FS Way is anchored in the five FS values, living commitment to our customers, responsibility, trust, courage and enthusiasm, combined with an attitude of continuously looking for improvement and proactively making the changes this requires.

Our leadership principles underscore the critical responsibility of managers in implementing the corporate strategy and the binding principles of the FS Way.

A key factor in improving the corporate and leadership culture, customer focus, working atmosphere and performance is a frank and active feedback culture. The standardized, regularly used feedback tools, "Internal customer feedback on customer and service orientation" and "Employee feedback on management behavior" are key elements for meeting the strategic corporate objectives of the employee dimension of ROUTE2025. In this context, the "Employee feedback on management behavior" tool helps managers determine where they currently stand from their employees' perspective. They can also use it as a basis to reflect on their own management behavior in relation to the FS values.

At an international level, the local subsidiaries are also working on the further development of the culture at Volkswagen Financial Services AG to optimize cooperation both internally and with our customers with the assistance of open, constructive feedback. To send a clear signal in this regard, the international Group Management Conference attended by all international senior managers and holding company managers, for example, was held using modified methods, and specified the issues of feedback culture and customer focus as key HR strategy priorities for 2016/2017. Working groups from the regions developed pragmatic concepts in this regard and presented these concepts to international HR colleagues in this year's virtual HR conference.

Human Resources Planning and Development

In 2016, the training team at Volkswagen Financial Services AG in Germany selected and recruited a total of 44 new vocational trainees/dual vocational training students from a total of approximately 1,700 applicants. Training is provided in banking (for professional banking qualifications), insurance (for professional insurance and finance qualifications) and in IT (for specialist professional IT qualifications in application development). The dual approach combines vocational training with study for a university degree. The Bachelor of Arts in Business Administration is offered in collaboration with WelfenAkademie e.V; the Bachelor of Science in Business Informatics is offered in collaboration with Leibniz University of Applied Sciences. In addition, two vocational trainees are taken on each year at EURO-Leasing GmbH, Sittensen. In 2016, one of them was training for professional qualifications in fleet and international business, the other for professional IT qualifications in system integration. As of December 31, 2016, a total of 133 vocational trainees and dual vocational training students were employed in Germany across all levels and professions. Our companies in Brazil and Austria also offer young people the opportunity to receive vocational training.

In 2016, one vocational trainee was honored by the Braunschweig Chamber of Industry and Commerce as the best graduate in her vocational training program. A dual vocational training student also graduated as top of his year on the BSc. in Business Informatics course at Leibniz University of Applied Sciences. Vocational trainees/dual vocational training students in their second year of training had the opportunity to spend a week at our international subsidiary in Poland to give them insight into international cooperation within Volkswagen Financial Services AG. Immediately after the completion of their training in 2016, four vocational trainees and dual vocational training students were again given the opportunity to broaden their horizons with a twelve-month assignment abroad in one of our international companies. An IT marketing campaign was initiated with a view to designing vocational training on a forward-looking basis and incorporating the issue of digitalization. The aim was to recruit IT vocational trainees/dual vocational training students and improve the profile of Volkswagen Financial Services AG as an IT training organization. The vocational training project took the wishes of young drivers into account by addressing the topics of connectivity and digitalization. The add-on automotive competence qualification, which was included in the business training program to ensure that vocational training meets the needs of sales, dealers and the brands, continued at Volkswagen Leasing GmbH in 2016. In Germany, a total of 47 vocational trainees were offered permanent positions in the reporting period.

In order to continue to attract qualified, committed employees for our Company, Volkswagen Financial Services AG has a rigorous concept for recruiting and retaining young university graduates. Partnerships with selected universities provide a fixed framework for these efforts. For example, existing partnerships with Harz University of Applied Sciences, Ostfalia University of Applied Sciences, Braunschweig University of Technology, the Institute of Insurance Science at Leipzig University, the University of Applied Sciences and Arts in Hanover and Martin Luther University in Halle-Wittenberg were supplemented with a first international partnership agreement with Alpen-Adria Universität Klagenfurt, which was signed in 2016. Volkswagen Financial Services AG has been providing support to students at an individual level for five years now with "Deutschlandstipendium" scholarships that are funded jointly by the German federal government and the private sector. A total of 14 such scholarships were once again awarded in 2016.

These activities aim to enable students to participate in an internship or work-study program that encourages them to join the Company directly or start the trainee program at Volkswagen Financial Services AG. The twelve-month trainee program, which takes place both in Germany and abroad, is another element in the Company's strategy to ensure its future viability. The trainee program was restructured in 2016 and now has a stronger focus on the issue of digitalization. The development program for young graduates is complemented by a three-year doctoral program aimed at ensuring Volkswagen Financial Services AG's future demand for expert and management staff can be met by identifying academic talent at an early stage, offering specific development opportunities and recruiting and retaining this talent as part of a forward-looking student talent management program.

Each year since 2012, Volkswagen Financial Services has also recruited the best graduates from the renowned Wharton Business School at the University of Pennsylvania in the USA. These recruits are initially employed at the headquarters in Braunschweig and put through the general management program to prepare them for an international career at senior management level.

International subsidiaries also engage in partnerships with universities to improve the way vacancies for experts are filled. The subsidiary in Spain maintains partnerships with the Universities of Madrid and Barcelona for this purpose. As part of the alliance with Comillas Pontifical University in Madrid, an international recruitment initiative for the holding company of Volkswagen Financial Services AG resulted in three Spanish job entrants being offered jobs in Germany.

Moreover, Volkswagen Bank GmbH, Portugal, has partnered with Católice Lisbon and the Inete Institute of Technical Education in Lisbon. The partnerships focus on recruiting interns with the potential to join the subsidiary after they have completed their studies. This program has already led to the recruitment of young talent.

In 2016, Volkswagen Bank GmbH, Italy expanded its partnership with Bocconi University in Milan and participated in a job fair at the university. Volkswagen Financial Services AG participated in the event with 104 other Italian companies as part of its employer branding strategy and to promote itself to potential new employees. Our international subsidiary is looking here primarily for university graduates and postgraduates who can demonstrate some affinity with international mobility. Volkswagen Bank GmbH, Italy managed to hold around 130 interviews on its stand on this day alone.

Volkswagen Financial Services UK runs a student program offering university students the opportunity to acquire valuable work experience between the second and third years of study. In the year under review, the company received a total of 1,253 applications, from which they selected 18 students at seven assessment centers. The students are assigned to various departments, such as HR, Finance, Risk Management, Fleet Business, Customer Service and IT.

The students support their teams with day-to-day tasks and also carry out their own independent projects. Life skills modules and internal development activities are also provided to complement the work carried out by the students.

A critical element determining the successful implementation of ROUTE2025 is to identify talent in the existing workforce and to nurture this talent with professional development in the Company. In Germany, over 200 talented individuals have already taken part in the young talent, experts and management talent groups since the talent program was launched in 2010. The objectives of the programs – which run over 24 or 36 months – are to provide individual personal and professional development and to enhance the participant's profile in the Company. At the heart of the programs is the individual development of each person identified as talent. This development comprises a specifically focused combination of on-the-job, near-the-job and off-the-job training and development activities. These activities are incorporated into a central program for the whole of the talent group. Key components of the programs include processing a project task, moderating a continuous improvement process (CIP) workshop and participating in information and dialog events.

In 2016, the management talent group comprised a total of 130 individuals across all countries, of which 28% were women.

Our subsidiary in the UK operates a talent management program in collaboration with an external service provider, a new company that has been selected as a partner in the last year; the responsibilities of the service partner are to provide the formal components. The objective of the program is to develop high-caliber executives. In addition to completing the demanding application process for managers, 9 out of 12 candidates also successfully came through the assessment center. A three-day external kick-off event was held in the New Forest, with activities focusing on the theme of team leadership. The aims of the workshop were to improve self-awareness, understand an individual leadership style, create the foundations for teamwork and set out the economic context for the program.

Under the banner "success needs competence", Volkswagen Financial Services AG established the FS Academy for the financial services job family in 2013. The FS Academy aims to provide structured and professional training for all automotive financial services in the Group: banking, leasing, insurance, mobile services and FS-specific risk management. In 2016 training reviews were held with around 2,400 employees to discuss individual training measures. A subsequent survey found that over 85 % of employees and managers were satisfied with the skills profile tool. Skills development conferences are also held at regular yearly intervals. At these conferences, carefully chosen managers from the various units address the issue of skills development with a forward-looking approach in collaboration with employees of the FS Academy; they discuss the future areas for action and the resulting strategic requirements in terms of skills and qualifications. In 2016, the FS Academy came third in the Volkswagen Group Academy Award in the category "Excellence in Education & Training Needs Analysis" for the development and successful implementation of its skills development conferences concept. The year under review was the first year in which this award and category were open to units throughout the Group and internationally.

In an effort to devise new learning formats, various internal expert forums and presentations were held in different departments. These events provide an opportunity to share knowledge with a high degree of practical relevance, allowing participants to discuss particular problems from their daily working environment with a trainer provided by the Company's inhouse training center and an expert from among the workforce. By the end of 2016, 76 events attended by around 450 employees were held in this format. One of the main purposes of the FS Academy is to improve the automotive and sales skills of employees. To this end, successive offerings have been developed throughout the Automotive Competence program, and this approach has now become well established.

To tap into the wealth of expert knowledge in the Volkswagen Group, the "internal teacher" concept has been developed. This concept structures internal knowledge management and knowledge transfer for the financial services job family and makes greater use of the know-how of internal employees. As part of this setup, the internal teachers network across their areas of expertise, thus creating mutual understanding of interfacing processes and improving collaboration.

Technical training was offered for employees requiring technical skills. Because of the growing significance of environmentally compatible and digital mobility concepts in the Volkswagen Group, a wide variety of lecture series on e-mobility were launched in cooperation with the Volkswagen Sales Academy and Volkswagen Group AutoUni. The e-up! and e-Golf were used as examples to explain the strategic goals and concepts of the Volkswagen brand and the special technical aspects of e-mobility. Around 150 internal teachers were working for the FS Academy by the end of 2016.

FS Academy International also continued to grow in 2016. Seven new countries were added to the fleet management section. From 2017, these countries will work with the three skills profiles, enabling them to provide even better training for their employees. The seven countries involved are Australia, South Africa, Italy, Poland, Slovakia, Russia and Turkey. For the markets, this is a tool that facilitates training for fleet employees but that also highlights completely new development and career opportunities.

To continue to make the most of the impetus provided by the positive trend, the rollout of the risk manager profile was also initiated in 2016 in the original pilot markets for fleet management. A skills profile has been drawn up in collaboration with the Group Risk Management unit at Volkswagen Financial Services AG and the plan is to apply this profile worldwide. A skills profile for a head of IT is also being developed with the assistance of FS Academy International with a view to establishing uniformly high standards of skills and qualifications in IT, especially at a time of considerable advances in digitalization. Finally, FS Academy International intends to make the "project manager" skills profile available in all countries in 2016. An increasing number of projects are being carried out on a cross-border basis so that the same methodologies and similar skills and qualifications can create even more synergies.

In addition, cooperation is gradually being expanded with other job family academies and the AutoUni of the Volkswagen Group Academy, especially the Institute for Sales and Marketing. Networking among the different parts of the Group not only improves the quality of the training options on offer, it can also – and is intended to – lead to synergies across the job families.

A special field that has undergone a rethink since the middle of 2015 is the megatrend of digitalization. At the FS Academy, this field is approached from two perspectives:

Firstly, from the perspective of training all employees in preparation for the digitalized workplace. To this end, a three-stage model has been implemented since 2015 as part of the "knowledge initiative on digitalization". The first and second stages of this model deal with building knowledge about digitalization. In the third stage, which has been available since 2016, the departments' training needs resulting from digitalization are ascertained and their employees are prepared and trained accordingly.

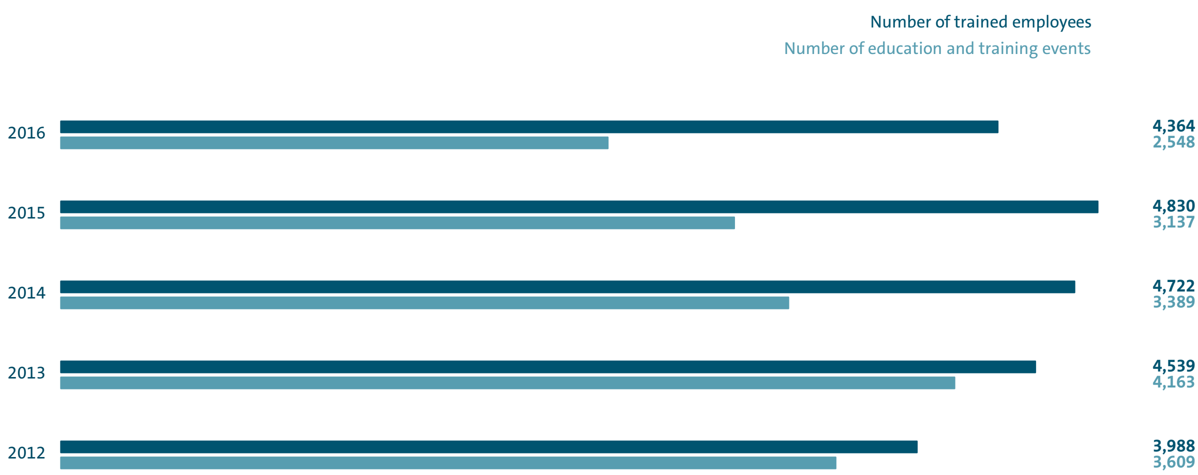
The “knowledge initiative on digitalization” has also included a detailed examination of agile methodologies, such as SCRUM. In this regard, large-scale series of training and development sessions have been initiated and implemented to serve all target groups and hierarchy levels: a broad and in-depth range of knowledge is being delivered throughout the organization, from the Board of Management to the individual employee.

The second perspective is that of digitalized training: the focus is increasingly switching to digital learning formats over and above the conventional approaches in which knowledge is delivered in person. One of the main priorities of future training provision is to continue to expand these digital methodologies and strengthen the vision of digital, decentralized learning for all, based on PCs, tablets, smartphones and blended learning (combination of e-learning and traditional classroom teaching requiring a physical presence). Learning in the digital age should be fun; it is becoming interactive, with collaboration platforms that facilitate the interdisciplinary transfer of knowledge across sites becoming increasingly important.

At an international level, employees are also being prepared for imminent changes as the march of digitalization continues. For example, all employees who are being assigned to the new digital unit in Berlin are undergoing an induction program that prepares them for agile cooperation from cultural, professional and methodological perspectives.

EDUCATIONAL PROGRAMS*

as of December 31



* Due to changes in reporting in 2014, the prior-year figures have been restated.

The strategic approaches of FS values and the resulting leadership principles have also been adopted and implemented at Volkswagen Financial Services in Germany as part of the holistic training program for new and experienced managers; the program is aimed at developing effective leadership and management skills.

In addition to the modular “Erfolgreich durchstarten” (hit the ground running) program for new managers, there are advanced modules (“Führungskompetenz Advanced”) for enhancing the management know-how of experienced managers as well as regular individual assessments of leadership skills. Volkswagen Financial Services thus ensures consistent quality standards of management know-how as well as a shared understanding of the leadership culture and principles as set out by the FS Way for more than 400 employees with line management responsibilities.

The compulsory “Erfolgreich durchstarten” training program develops the technical, business and social skills as well as the personality of newly promoted or recently recruited managers as a basis for effective management performance, because this is key to success in everyday working life.

The program is complemented by the “Boxenstopp Führung” (management pitstop), which gives all managers the time and the opportunity to get information on current issues. Here they can obtain support for specific management situations; internal and external facilitators help them analyze their own leadership and in this way enhance their skills.

The international subsidiaries also attach great importance to continuously enhancing management skills. For example, the subsidiary in the Netherlands launched a systematic program to strengthen management skills at all levels of management. The focus was on teamwork, especially with regard to the aspects of trust, conflict handling, involvement, commitment and goal setting. This resulted in, among other outcomes, significantly improved cooperation among teams and departments to achieve common objectives. Improved management skills are a critical component of the strategic focus at Volkswagen Financial Services: the ability to manage oneself and others as well as the business is a key management skill aimed at meeting corporate objectives.

Volkswagen Financial Services UK operates a management talent group program as part of its management training approach. The objective of the program is to develop individuals who may potentially become managers in the future. In 2016, 16 participants who had successfully negotiated a demanding application process were invited to the assessment center. Of this total, ten were successful at the assessment center and now form the third management talent group.

The external kick-off event took place over two-and-a-half days in Shropshire and focused on self-reflection, an understanding of individual strengths and weaknesses, group dynamics and the preparation of development plans prior to the three seminars.

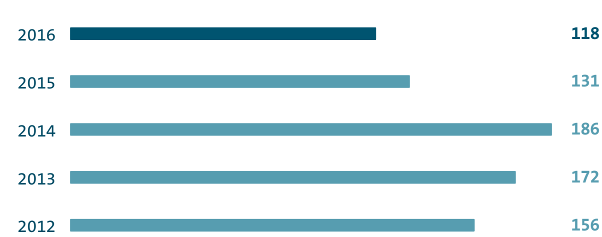
The three mandatory seminars, covering topics such as self-management, leadership of employees and coaching, followed by a group project, will take place in January, April and July of next year. The international subsidiary of Volkswagen Financial Services AG in Slovakia supports its managers with various modules. For example, it offers a "Management without fear" training option, which comprises customized management training over five seminars. In addition, all managers regularly take part in 360° feedback with the aim of identifying possible improvements and drawing up individual development plans. Finally, managers have the option of participating in the "Balance management" program, which enables them to enhance their team development skills. The training involves evaluating behavioral stereotypes within the management team, identifying imbalances and stress factors in the group, supporting individuals and carrying out team development.

For all managers worldwide, we have implemented the standardized process of target-setting dialogs based on the practice at our parent company, Volkswagen AG. These dialogs are not only used to set targets for the next fiscal year, but also to assess the degree to which the previous year's targets have been met as well as the manager's performance in terms of expertise, leadership, cooperation and entrepreneurship. The performance assessment and the degree to which targets set in the target agreement have been met form the basis for determining the personal performance bonus. At the same time, the assessment of the manager's potential is incorporated into our succession and management planning.

In line with Group-wide standards, international efforts continued in 2016 to roll out the basic leadership qualification (BLQ), at the end of which a "leadership license" is granted. BLQ and the "leadership license" are aimed at giving young talent the best possible preparation for taking on a leadership position. The Company also continued to press ahead with the certification of international subsidiaries' own assessment center facilitators. For example, the UK has been certified and can run its own management assessment centers (MACs). The assessment centers can also take candidates from other English-speaking countries. Once again in 2016, there was one transnational MAC in English for non-native speakers. Successful completion of the MAC is required worldwide for the individual to take on complex management responsibilities. In total, 99 employees worldwide passed their leadership license exams and 51 employees successfully completed the MAC.

As of the end of 2016, Volkswagen Financial Services AG had sent 118 employees on assignment to other international subsidiaries. Of this total, 62% related to assignments from Germany to other host countries and 19% to assignments to Germany. Assignments between countries without a German involvement – referred to as third-country assignments – also accounted for 19% in 2016. Overall, the number of international assignments worldwide remained at a steady level.

ASSIGNMENTS
as of December 31



Increase in the Proportion of Women

Women account for 49.8% of the workforce of Volkswagen Financial Services AG in Germany, but this is not yet reflected in the percentage of women in management positions. We have set ourselves the target of permanently increasing the proportion of women in management positions to 30%. We are working to meet the targets we set ourselves for the first time in 2010 for the proportion of women in management by giving special consideration to female candidates in recruitment and succession planning, in combination with measures to improve work-life balance as well as systematic succession planning and the development of HR tools. The agreed trajectory was revised in 2016 and approved by the Board of Management and senior management, with a resolution passed at the highest level. The targets for the proportion of women on the Supervisory Board and the Board of Management of Volkswagen Financial Services AG were also updated and approved.

When offering jobs to female university graduates, for example, our decisions are guided by the proportion of female students on the respective course. The increased proportion of highly qualified women joining the Company will enable us to continuously raise the proportion of female managers at the various management levels in the coming years.

On this basis, Volkswagen Financial Services had set itself the target of increasing the proportion of women at the first management level to 10.7% by the end of 2016. The target for the second management level was 22.0%. The Supervisory Board had decided on a target of 16.7% for both the Supervisory Board and the Board of Management to be reached by the end of 2016. At Volkswagen Financial Services AG in Germany, women accounted for 9.8% of first-level managers and 22.0% of second-level managers at the end of 2016. Therefore, the target for the first level of management in 2016 was not attained because of unplanned staff changes in the Group/subsidiaries and outside Germany. At the end of 2016, the proportion of women on the Supervisory Board was 33%, while the equivalent proportion for the Board of Management was 16.7%.

Under the Gesetz zur gleichberechtigten Teilhabe von Frauen und Männern an Führungspositionen (FührposGleichberG – German Act on the Equal Representation of Women and Men in Management Positions), Volkswagen Financial Services had to set new targets by the end of 2016 for the first two management levels to be achieved by 2021. These targets were once again approved by the Board of Management and senior management. The target to be achieved by 2021 for the first management level is 12%, and for the second management level 22.8%. The target ratios for the Supervisory Board and the Board of Management were also restated. The target ratio for the Supervisory Board of Volkswagen Financial Services AG is 25.0%, while the equivalent target for the Board of Management is 16.7%. Both of these targets are also to be met by the end of 2021.

Volkswagen Financial Services AG also pays attention to diversity at international level and therefore also to the proportion of women. In 2016, women accounted for 23.3% of employees at management level worldwide. The proportion of women at the upper management level was 13.3%, equating to an increase of 3.6 percentage points compared with 2015. Overall, the proportion of women in Volkswagen Financial Services AG at international level is 48.6%. The Board of Management receives regular reports on ongoing developments, giving it the necessary transparency.

Eight female participants once again successfully completed the Group-wide mentoring program in 2016. The aim of the twelve-month program is for suitably qualified female employees to receive advice, support and coaching from managers in the Group.

The mentoring program comprises three core components. The first component is the mentor-mentee information-sharing relationship between the participant and an experienced manager. The second component involves the completion of a project task with a subsequent presentation. The final component comprises a program of seminars together with information and dialog events.

For the second time since the redesign of the program, the mentees had the opportunity to attend an internal FS closing event for the mentoring program and present their project tasks to the sponsors from the Board of Management and senior management as well as to their mentors and line managers, HR managers and representatives of the works council. The event raised the mentees' profile within the Company significantly. It is planned to keep to the same procedure for the next group of mentees in 2016/2017. The group in this next round of the program once again consists of eight participants.

The "Frauen in Karriere" (careers for women) project receives support from the German Federal Ministry of Education and Research and the EU's European Social Fund as part of the priority issue of "Frauen an die Spitze" (women to the top) under the funding area for "Strategien zur Durchsetzung von Chancengleichheit für Frauen in Bildung und Forschung" (strategies for enforcing equal opportunities for women in education and research). The third project phase, focusing on the issue of research and development, was launched at the end of 2015, and Volkswagen Financial Services AG is once again one of the project partners. An internal workshop was organized in which discussions were held with experts from within the Company from a practical perspective about the opportunities and challenges presented by the current transformation processes in the business and the associated options for business organization. The aim of the workshop was to develop long-term structural concepts aimed at improving the development and career opportunities for women in IT arising from digital transformation.

Diversity

In addition to the specific advancement of women, diversity has been an important part of corporate culture since 2002. This is reflected in a number of ways, notably in the Great Place to Work employer benchmark study. Volkswagen Financial Services AG sent a clear signal with its corporate initiative around the Diversity Charter, which was signed in 2007.

Volkswagen Financial Services AG operates for very diverse customer groups in different markets. In this context, we aim to maintain a working environment characterized by openness, a sense of community, respect and appreciation, as well as a global organization where the workplace is defined by effective and focused cooperation of all the people who work together.

In 2016, Volkswagen Financial Services AG celebrated its 15th anniversary as the principal sponsor of Braunschweig's gay pride Sommerlochfestival, once again making a powerful statement in support of equality and acceptance. The festival consists of a program of art and other cultural events aimed at countering anti-gay discrimination and highlighting problems and needs associated with alternative gender identity.

Health and Family

To promote the health of our employees, we continually enhance our holistic healthcare concept with its different areas of action in line with demand. All healthcare management activities are already aligned with demographic developments. We raise awareness of healthcare and healthy living among vocational trainees, tailored to specific needs and target groups, while also implementing the concept together with HR officers in the individual departments.

One of our most important tools in the area of occupational health and safety is the FS checkup, which is available on request to all employees free of charge and during working hours. This program is based on state-of-the-art medical diagnostic procedures: first, the checkup determines the employee's current state of health and, second, it focuses on promoting and maintaining good health by giving personal advice.

Our wide range of services in connection with the promotion of healthcare and healthy living also includes presentations, seminars and preventive activities covering current health issues, such as presentations on emotional strain and nutrition when under stress.

The promotion of healthcare and healthy living for employees is also of key importance at Volkswagen Financial Services AG's international subsidiaries. The options provided by Volkswagen Bank GmbH in Italy, for example, include a Qigong relaxation class, which employees can attend during their lunch break. This class complements a comprehensive range of checkups and other healthcare initiatives offered in this country.

The subsidiary in India has launched the "Stepathlon" initiative as part of its range of healthcare services to promote healthy living among its employees while at the same time strengthening teamwork at the subsidiary. In this initiative, groups of employees compete with each other in trying to reach a particular health target, for example a reduction in body weight.

Volkswagen Financial Services Australia operates a "fruit-at-work" initiative to create a healthy workplace environment and encourage good employee health. Twice a week, fresh seasonal fruit is delivered to the office in Chullora for employees to enjoy. In exactly the same way as Volkswagen Financial Services AG in Germany, the international subsidiary in Greece offers an annual health checkup free of charge to further promote the health and fitness of employees.

We provide regular information and training to our management staff on health-related topics to enable them to recognize health situations among their employees at an early stage so that action for the benefit of the employees can be taken as soon as possible. In this way, we encourage health-oriented management behavior.

Since 2015, we have offered a social coach function, an impartial first port of call for our employees and managers at sites in Germany. The aim is to provide confidential, competent and relevant support to help employees deal with challenges at work or personal problems.

At Volkswagen Financial Services AG, great importance is attached to both work and family. This is why the Company promotes a family-friendly environment and offers a diverse range of initiatives and programs aimed at achieving the right work-life balance.

"Frech Daxe", the inhouse childcare facility of Volkswagen Financial Services AG, which is operated by Impuls Soziales Management GmbH & Co. KG, is located very close to the Company's offices. It has capacity for 180 children and offers flexible hours of care, making it unrivaled in Germany. The childcare facility is very popular and occupancy levels are high. It can accommodate children aged from a few months up to school-starting age in a total of ten groups between 7.00 a.m. and 8.30 p.m. In 2016, holiday care was again provided for school children for the entire duration of the Easter, summer and fall vacations.

The childcare facility has received several awards for its work in promoting musical talent, science and technology, and exercise.

Our Brazilian subsidiary runs two initiatives that stand out in the Brazilian labor market. The local subsidiary grants maternity leave of six months rather than the statutory maternity leave of four months. And after that, the company pays for some of the childcare costs.

A system of flexible working hours known as flexi-work time has also been introduced in India. This enables employees to divide up their 42.5 weekly working hours on a more flexible basis. There are just core working hours of 10.00 a.m. to 4.00 p.m. The system gives employees at this international subsidiary the flexibility to arrange convenient private appointments and the variable start and finish times mean employees do not necessarily have to travel in the Mumbai rush-hour traffic.

Education and Mobility

Up to the summer of 2016, Volkswagen Financial Services AG gave support to My Finance Coach Stiftung GmbH. The initiative aims to kindle a basic interest in economic matters in children and adolescents and to impart basic practical skills for dealing with money. Around 280 employees of Volkswagen Financial Services AG underwent voluntary finance coach training as part of this scheme. In teams of two, they then visited school classes at lower secondary level on an unpaid basis and partnered with the teacher, using illustrative materials, to explain complex matters and teach how to deal with money and financial matters independently and responsibly.

Volkswagen Financial Services AG has also been involved as one of the judges in the “Bundeswettbewerb Finanzen”, a national finance competition for school children, which represents a key component of the My Finance Coach educational offering. Young people from a range of different schools participate in the competition throughout an entire school year.

For over ten years now, Volkswagen Financial Services AG has supported free travel for children, young people and senior citizens with its “Bus Project”. In this project run jointly with the Kunstmuseum Wolfsburg, participants can enjoy free travel for a period of 16 weeks each year to enable them to experience contemporary works of art at the museum. Since the project was launched in 2002, over 60,000 school students and around 7,500 senior citizens have visited the exhibitions.

Social and Regional Responsibility

The non-profit “Unsere Kinder in Braunschweig” (our children in Braunschweig) foundation established by Volkswagen Financial Services AG in December 2008 focuses on socially disadvantaged children. Activities are aimed at providing assistance in the socially deprived districts of Braunschweig. We continued to support the foundation in the reporting period by making another large donation. Under the banner “Gemeinsam machen wir Braunschweigs Kinder löwenstark. Löwenstark für eine hoffnungsvolle Zukunft!” (together we make Braunschweig’s children strong for a promising future), the employees of Volkswagen Financial Services AG are also encouraged to contribute money, time and their own ideas. For example, regular donations are collected in voluntary fundraising efforts at sporting events, service anniversary celebrations and Christmas parties, as well as through the monthly “1er für Alle” (1 for all) salary donation campaign.

Nine institutions – four daycare centers, three primary schools and two lower secondary schools – currently receive permanent needs-based sponsorship in education, healthy eating, physical education and early music training, while other institutions, such as sports and youth clubs, get support from ad hoc initiatives. The focus is on long-term projects established a number of years ago, including the varied, healthy daily breakfast, the acquisition of the “nutrition license”, or lunch for secondary school students. These projects raise awareness of the importance of healthy eating. The swimming classes offered during the school holidays, which are aimed at getting children to swim in and under water without fear, are very popular and successful. In addition, the foundation contributes substantially to financing existing early childhood music education projects, for example by purchasing the necessary musical instruments and remunerating the required teachers. The “Gewaltfrei Lernen” (nonviolent learning), “Klasse 2000” (class of 2000) and “Vorbereiten auf das Berufsleben” (preparing for working life) projects, in which students learn how to handle aggression, practice social behavior and build self-esteem, continued in 2016. Initiatives such as a language development project using theater educational resources and an adventure day in the countryside for primary school children were added to the supported programs in 2016.

Volkswagen Financial Services AG also runs donation campaigns at regular intervals. The “Belegschaftsspende Mai” (May workforce donation) benefited a social institution in the region. The monthly “Restcentspende” (cent-to-spare donation) goes to Terre des Hommes. The workforce’s third initiative to collect donations in kind for Fairkauf, a thrift store run as a social enterprise, was again a great success.

The Christmas tree wishlist campaign, organized by the Works Council in cooperation with various social institutions, has also become a fixed item on the schedule of voluntary initiatives. In 2016, employees fulfilled a Christmas wish for 547 socially disadvantaged children.

Volkswagen Financial Services AG focuses its sponsorship activities on long-term involvement in sporting, arts and social activities in the Braunschweig region. In the area of sports, for example, the Company is a premium and payment partner of the VfL Wolfsburg football club, an exclusive partner of the Eintracht Braunschweig football club as well as a main and jersey sponsor of Löwen Braunschweig, a basketball team in Germany’s national league. The arts involvement also benefits the region. In Braunschweig, agreements are in place for, among other things, the well-known “Classics in the Park”, a daytime event at which the State Orchestra of Braunschweig’s State Theater gives a free open-air concert, and the Braunschweig International Film Festival. In Wolfsburg, an alliance with the Kunstmuseum Wolfsburg forms part of the commitment of Volkswagen Financial Services AG to the arts. In addition to the above-mentioned foundation, social support is also provided for projects such as Braunschweiger Zeitung’s “Gemeinsam-Preis” (Together Prize) for civic engagement.

As in the previous year, we are continuing to make appropriate contributions to support refugees. A website has been specially created and is permanently available at www.fsag-hilft.de to encourage people to volunteer their time and effort. The workforce donations collected in 2015, which were doubled by the Company to an amount of €68,490, are still being used by a refugee aid association in Braunschweig, Verein Refugium Flüchtlingshilfe e.V., to fund projects that provide assistance to refugees. The association works in regional and national networks and publicly campaigns for the interests of refugees. Irrespective of their nationality or residence status, the refugees are given support in all matters of concern to them, such as the asylum procedure, residence permits, social benefits and language courses.

As part of a support project, five refugees from Syria, Sudan and Ivory Coast also worked as interns at EURO-Leasing GmbH for one week to learn more about becoming a professional driver. Volkswagen Financial Services AG is financing driver training for the refugees to enable them first to obtain a passenger car license; this will then enable them to move on to obtaining a commercial vehicle driver's license. The objective is to offer the refugees job prospects and support them in finding a suitable occupation. As part of this process, employees also support the refugees as sponsors.

ENVIRONMENT

Our Contribution to Preservation

Based on a systematic management approach, we are reducing the impact of our operating activities on the environment. We therefore operate sustainably and make an active contribution to environmental protection.

Introduction of an Environmental Management System

In fiscal year 2016, we subjected the environmental management system certified in the previous year by TÜV Nord to a recertification process in accordance with the DIN EN ISO 14001:2009 standard. This took place in August 2016. During the recertification process, the available options to monitor energy consumption were rated very positively.

A key component of our environmental management system is sustainable facility management. Sustainability is therefore a prime concern in both new construction and renovation projects. This is supported to a significant extent by an integrated planning process, which helps reduce building costs even further compared to the benchmark. The process also takes follow-up costs into account, and in particular operating costs. This approach enables us to comply with the standards set by the DGNB (German Sustainable Building Council) – a requirement to obtain the necessary certificates. In the refurbishment of buildings, further progress was made with upgrading the ventilation and air-conditioning systems, focusing on energy efficiency and noise protection in particular. TÜV Nord's audit report specifically highlighted the excellent implementation of current construction projects in terms of corporate responsibility and current environmental and legal requirements.

In 2015, a pilot project was initiated at the Braunschweig site to replace the plastic cups used at the meeting points with glasses. The implementation of this change was completed in 2016 at all the sites in Braunschweig.

Resource-Conserving Paper Consumption

Our Company has launched several projects to implement measures to reduce paper consumption. Choosing the right kind of paper is an important step toward protecting the environment. During the year under review, stickers were placed on all the paper towel dispensers in the Company to make employees aware of their paper consumption each time they take a paper towel. A project carried out jointly with students at the Braunschweig University of Technology demonstrated that 30% of the paper towel consumption could be saved.

By implementing the "Digitales Autohaus" (digital car dealership) project launched in 2015, we will now significantly reduce the amount of mail sent between car dealerships and Volkswagen Financial Services AG. In addition, documents relevant to dealers will be stored electronically, thus eliminating the need for printouts for dealer files. Digitalization will generate considerable optimization potential throughout the entire process between the car dealership and Volkswagen Financial Services AG. The ecological potential of this project is measured on an ongoing basis.

PRODUCTS

Offering Intelligent Mobility Solutions

Our customers expect us to deliver intelligent and environmentally compatible mobility solutions. To this end, we develop attractive financing offerings and services.

Environmental Programs

When developing new products, we consider not only economic factors, but also the impact on the environment.

This aspect is particularly evident in the partnership between Volkswagen Financial Services and the German Nature And Biodiversity Conservation Union (NABU). The objective is to help NABU implement wetlands protection projects.

The two partners in this initiative have in the past received several awards for their commitment. For example, in addition to being recognized as a project of the UN Decade of Education for Sustainable Development in 2014 and 2016, they received the EcoGlobe in 2010 and the "Ausgewählter Ort im Land der Ideen" (Selected Landmark in the Land of Ideas) award in 2012. This documents once again that ecology and economy are inextricably linked in the environmental program. Volkswagen Financial Services and NABU are also involved in wetlands protection projects at an international level. To finance these international nature conservation and climate protection activities, for example in the Slowinski National Park in Poland, NABU and Volkswagen Financial Services have established the International Wetlands Protection Fund. We will be providing a total of €1 million for this fund in the period up to 2019. The fund complements the

German Wetlands Protection Fund established in 2012, for which we have made available a total sum of €2 million.

Electromobility

Volkswagen Financial Services AG is supporting the increasing electrification of the product portfolio of the Volkswagen Group's brands by selectively expanding its e-mobility services. The Charge&Fuel card and app developed in conjunction with the Volkswagen Passenger Cars and Audi brands in 2014 for recharging and refueling anywhere in Germany has established itself among e-vehicle customers. In 2015, enhancements were made to the app in particular, and the network of connected charging stations was extended significantly. The service provided to customers still includes standardized electricity tariffs and monthly billing. At the Retail Banking Conference forming part of the Euro Finance Week in Frankfurt am Main, the Charge&Fuel card was awarded the "Innovationspreis 2016 Privatkundengeschäft" (2016 innovation prize, retail business) in the "Payments" category.

The charging infrastructure for electric vehicles is being expanded at the Braunschweig site: by 2018, there will be a total of 90 charging points for electric vehicles – currently there are ten. The expansion is being carried out in two stages: in 2017, 30 new charging points will be installed at our sites, followed by a further 25 at each of the sites in 2018. This will create more opportunities for employees to commute using electric vehicles. The option of charging a vehicle at work will extend the potential commuting radius to include, for example, the Gifhorn, Wolfsburg and Salzgitter regions.

Electric vehicles are also available immediately from the company vehicle center to be used as departmental vehicles, function vehicles or personal company cars. The aim of providing a greater number of charging points is to increase the use of electric vehicles and hybrid models.

Mobility Concepts

Global trends and changing social and political conditions are permanently changing the mobility needs of a large number of people. The megatrends toward urbanization, digitalization and sustainability are giving rise to a need for mobility on demand.

In response to these developments, Volkswagen Financial Services AG has made the issue of mobility a fixed component of its corporate strategy. For this reason, in the year under review, Volkswagen Financial Services AG significantly stepped up the development of new mobility services in close consultation with the Volkswagen Group brands. In this regard, a new area of focus in the range of mobility services for the customers of the brands and Volkswagen Financial Services AG is a smartphone app providing a parking payment service. The service provides users with an easy-to-use cashless method of paying for parking spaces, either on the street in urban areas or in parking facilities that offer this method of payment. The further development of specific mobility services will enable us to continue to safeguard the future viability of the existing business model and to meet the future needs of our customers to the greatest possible extent.

Responsible Lending

Volkswagen Bank GmbH is aware of its responsibility as a lender. For this reason, it signed up to the voluntary "Responsible Lending to Consumers" Code of Conduct in 2010.

This Code, which sets standards for lending, applies to all installments and revolving credit facilities. It is in Volkswagen Bank GmbH's fundamental interest to grant loans responsibly, since ultimately it wants its customers to be able to pay back what they have borrowed. For this reason, high standards apply to issuing loans to consumers.

The Code provides an overview of these standards and contains a number of consumer-friendly regulations that go beyond the requirements of the law. It covers a total of ten points based on the lending process, from advertising to handling payment difficulties. In addition, by signing the Code, the member institutions commit their companies to assuming social responsibility and to promoting general financial education.

During the reporting period, Volkswagen Bank GmbH contributed to a new publication by the signatories of the Code of Conduct. This document uses specific practical examples to document how the participating institutions guarantee quality in retail financing. In it, Volkswagen Bank GmbH explains its newly launched "adviser for financial products" certification, which involves an exam and offers dealership sales staff comprehensive training in financial products and the underlying processes. This ensures that high-quality advice is provided when financial services are arranged at the car dealership.

DIALOG

Embracing Transparency

We embrace dialog and create transparency through our actions. Social acceptance and ongoing communication with our stakeholders are the basis of our success.

In 2016, further efforts were focused on raising employee awareness in relation to the Company's environmental management system, thereby ensuring, among other things, that the system was successfully recertified.

To improve the exchange of views and information, there is ongoing participation in and networking with a number of committees of the Volkswagen Group, which involves, for example, attending meetings of the Group Environmental & Energy and CSR & Sustainability Steering Committees as well as working groups at association level.

COMPLIANCE

Volkswagen Financial Services AG is bound not only by legal and internal requirements. Commitments that the Company has made voluntarily as well as ethical standards are likewise an integral part of our corporate culture and serve at the same time as guiding principles for our decision-making.

The Board of Management of Volkswagen Financial Services AG therefore ensures that both legal requirements and internal guidelines within the Volkswagen Financial Services AG subgroup are complied with. This is monitored by the Supervisory Board.

Our compliance activities are based on a Group-wide compliance strategy, which follows a preventive approach. This means that we make our employees and business partners aware of the relevant topics, train them and, where necessary, make them give contractual undertakings.

The Volkswagen Group's Code of Conduct, which also applies throughout the Volkswagen Financial Services subgroup, is a key document in this context. Employees receive the relevant training by attending events or completing online training programs; printed and digital copies of the Code of Conduct are distributed to them. Suppliers are placed under an obligation to meet the Volkswagen Group's sustainability requirements in their relationships with business partners (Code of Conduct for Business Partners).

To ensure compliance with legal requirements, there is a regular process to identify new or amended legal rules and regulations that are relevant for Volkswagen Financial Services AG. The implementation of and compliance with material rules and regulations are also continuously monitored.

The Volkswagen Group has a worldwide anti-corruption system with independent attorneys acting as ombudsmen and an internal anti-corruption officer. Volkswagen Financial Services AG has joined this system. The ombudsman system is a worldwide platform through which employees and third parties can report breaches of legal provisions – in particular corruption and other criminal activities. Two external lawyers ensure that any reported case is investigated further and guarantee the anonymity of the whistleblower.

In order to combat corruption risks, Volkswagen Financial Services AG also has a set of framework instructions to guide employees. Articles are published on the intranet and special information events are held on a regular basis to raise awareness.

To minimize compliance risks, clear rules are provided in the form of written instructions – for example on the issue of antitrust law. The departments concerned have an obligation to raise awareness among their employees, specifically about the provisions of antitrust law. If employees have any doubts or questions, they can obtain advice on compliance issues. The Compliance unit and its employees can be contacted by telephone or by email for this purpose.

Within the subgroup, regular exchanges with the local compliance officers in the foreign branches and subsidiaries are becoming an increasingly important aspect of compliance work. Risk-based checks support local colleagues in the implementation of Group-wide standards (especially on the prevention of money laundering and other criminal activities as well as in relation to the compliance function).

Report on Expected - Developments

The momentum of the global economy is expected to be somewhat stronger in 2017 than in the previous year. We assume that global demand for vehicles will be mixed and increase at a slightly slower rate than in the reporting period.

The main opportunities and risks arising from the operating activities and their forecasts having been set out in the report on opportunities and risks, the section below now outlines the expected future developments. These developments give rise to opportunities and potential benefits that are included in our planning process on an ongoing basis so that we can exploit them as soon as possible.

Our assumptions are based on current estimates by third-party institutions. These include economic research institutes, banks, multinational organizations and consulting firms.

GLOBAL ECONOMIC DEVELOPMENT

In our forecasts, we assume that global economic growth in 2017 will be slightly above the previous year's level. We believe risks will arise from protectionist tendencies, turbulence in the financial markets and structural deficits in individual countries. In addition, growth prospects will continue to be hurt by geopolitical tensions and conflicts. We expect the economic upturn to continue in the large majority of industrialized nations, with stable rates of expansion overall. Most emerging markets will probably see faster growth than in the previous year. We expect the strongest rates of expansion in Asia's emerging economies.

Furthermore, we anticipate that the global economy will also continue to grow in the period 2018 to 2021.

Europe/Other Markets

In Western Europe, the economic recovery is expected to decelerate to some extent in 2017 compared with the reporting period. Resolving structural problems and the uncertain outcome of the Brexit negotiations between the EU and the United Kingdom represent major challenges.

For Central Europe, we estimate that growth rates in 2017 will be similar to those of the past fiscal year. In Eastern Europe, the economic situation should stabilize further, providing the smoldering conflict between Russia and Ukraine does not worsen. Following its decline in recent years, Russia's economic output is likely to increase slightly.

Political uncertainty and social tensions resulting primarily from high unemployment levels will probably continue to weigh on the South African economy in 2017 and keep growth down.

Germany

In Germany, GDP is slated to rise in 2017 at a similar pace as in the reporting period. The situation in the labor market is expected to remain stable, bolstering consumer spending.

North America

For North America, we expect that the economy will expand in 2017 at a faster rate than in the previous year. Growth in the USA and in Canada is forecast to rise year-on-year,

Latin America

Brazil is very likely to come out of recession in 2017, showing a modest growth trend. In spite of persistently high inflation, the Argentinian economy should pick up speed again. The rate of growth in the Mexican economy is projected to decrease.

Asia-Pacific

In 2017, the Chinese economy is expected to continue growing on a high level, but year-on-year this growth will lose momentum. For India, we anticipate an expansion rate at around the prior-year level. The economic situation in Japan is likely to remain essentially unchanged compared to the reporting period.

FINANCIAL MARKETS

We predict that economic growth in 2017 will be slightly higher than in the previous year. Geopolitical tensions, uncertainty in financial markets and structural deficits in individual countries will have an adverse impact. Trends in capital markets will continue to maintain downward pressure on returns because of the loose monetary policy that is being sustained in the eurozone and in Japan. The ECB will continue its bond-buying program because core inflation is still rising too slowly and the structural deficits in southern European countries have not yet been eliminated. Interest rate rises by the Federal Reserve in the USA could have a negative impact on a weakening global economy.

Europe/Other Markets

Further economic recovery is anticipated in Europe. Challenges will be presented by the negotiations for the UK's exit from the EU and by structural problems in some European countries. Despite the conflict with Ukraine, the Russian economy is likely to grow slightly. The ECB's decision in December to maintain its loose monetary policy will continue to exacerbate the problems caused by the scarcity of available bonds.

Germany

Economic growth in Germany is expected to remain at the level of the previous year overall. Although there is likely to be a slowdown in export growth in 2017, the rise in the statutory minimum wage will give a clear boost to macroeconomic wage growth during the year.

North America

Both the USA and Canada are projected to generate economic growth, although it is not yet possible to assess the effects of the change in policy in the USA.

Latin America

Brazil will probably see the first signs of recovery and the Argentinian economy should begin to pick up momentum again. Economic growth in Mexico is expected to be at the same level as in the previous year.

Asia-Pacific

Economic growth in China is forecast to remain at a high level in 2017, but with a further slackening in pace compared with previous years. We anticipate that the rate of expansion in India will be around the level of the previous year. In Japan, the economic situation will probably only improve slightly compared with the reporting year. We expect economic growth across the ASEAN region to remain at the level of the previous year.

TRENDS IN THE PASSENGER CAR MARKETS

We expect trends in the passenger car markets in the individual regions to be mixed in 2017. Overall, growth in global demand for new vehicles will probably be slower than in the reporting period.

The Volkswagen Group is well positioned to deal with the mixed developments in automotive markets around the world. Our broad, selectively expanded product range featuring the latest generation of engines as well as a variety of alternative drives puts us in a good position globally compared with our competitors. Our goal is to offer all customers the mobility and innovations they need, sustainably strengthening our competitive position in the process.

We estimate that demand for passenger cars worldwide will continue to increase in the period 2018 to 2021.

Europe/Other Markets

For 2017, we anticipate that unit sales volumes in Western Europe will fall somewhat short of the level seen in the reporting period. Pre-crisis levels are not expected to be reached, even in the medium term. The continuing uncertainty among consumers precipitated by the debt crisis is likely to be exacerbated by the uncertain outcome of the Brexit negotiations between the EU and the UK, putting a damper on demand. In Italy and Spain, the recovery will probably continue in 2017 but at a much slower pace; for France, we expect growth to be only slightly positive. We anticipate that the market volume in the United Kingdom will be considerably lower than the high level seen in the previous year.

In the Central and Eastern European markets, demand for passenger cars in 2017 should exceed the weak prior-year figure. Following significant declines in some of the previous years, the volume of demand in Russia is estimated to increase moderately. We expect to see further growth in demand in the Central European markets.

We are projecting that the volume of demand in the South African passenger car market in 2017 will be up slightly year-on-year.

Germany

Following the positive trend of recent years, we forecast that the volume of the German passenger car market in 2017 will be slightly lower than in the previous year.

North America

We expect that the market volume for passenger cars and light commercial vehicles (up to 6.35 tonnes) in North America as a whole and in the USA will be a little lower in 2017 than in the prior year. Demand will probably remain highest for models in the SUV, pickup and van segments. In the Canadian market, the number of new registrations is likely to be slightly below the previous year's high level as well.

Latin America

Owing to their dependence on demand for raw materials, the South American markets for passenger cars and light commercial vehicles are heavily influenced by developments in the global economy. Protectionist tendencies are adversely affecting the performance of the region's vehicle markets, especially in Brazil and Argentina, which have imposed restrictions on vehicle imports. Nevertheless, compared with the previous year, demand in the South American markets as a whole will probably edge up in 2017. In Brazil, the largest market in South America, the volume is expected to rise moderately following substantial losses in the previous years. We anticipate that volumes in the Argentinian market in 2017 will be up slightly year-on-year. In Mexico, we anticipate that demand will be noticeably higher than in the reporting period.

Asia-Pacific

The passenger car markets in the Asia-Pacific region look set to continue their growth trajectory in 2017, however at a weaker pace. In China, the steady increase in individual mobility requirements will push up demand, though the rate of growth is likely to be slower than in the previous year because the tax break for vehicles with engine sizes of up to 1.6 l was reduced by half at the end of 2016. Strong demand is still forecast for attractively priced entry-level models in the SUV segment in particular. In India, we expect demand for passenger cars to slightly exceed the previous year. We believe that demand in the Japanese passenger car market will continue to taper off in 2017.

TRENDS IN THE MARKETS FOR COMMERCIAL VEHICLES

We expect trends in the markets for light commercial vehicles in the individual regions to be mixed again in 2017. Overall, we envisage modest growth in demand, a trend that is likely to continue in the period 2018 to 2021.

Due to the uncertainty caused by the United Kingdom's European Union membership referendum in June 2016, we estimate that demand for light commercial vehicles in Western Europe in 2017 will be slightly below the previous year's level. The United Kingdom is expected to register the biggest decline in the region. We anticipate that registrations in Germany will be around the previous year's level.

In the Central and Eastern European markets, registrations of light commercial vehicles in 2017 will probably be higher than in the previous year. Also in Russia we expect the market volume to rise compared with 2016.

In North and South America, the light vehicle market is reported as part of the passenger car market, which includes both passenger cars and light commercial vehicles.

The market volume in the Asia-Pacific region in 2017 will probably record a slight increase year-on-year. We are expecting demand in the Chinese market to match the prior-year level. For India we are forecasting a considerably higher volume in 2017 than in the reporting period. In the Japanese market, the downward trend is likely to continue in 2017 at a slower pace.

In the markets for mid-sized and heavy trucks that are relevant for the Volkswagen Group, new registrations in 2017 are set to be somewhat up on the level in 2016. For the period 2018 to 2021 we anticipate a positive trend.

We expect to see demand in Western Europe and Germany decrease slightly year-on-year in 2017.

Central and Eastern European markets should record a significant increase in demand. For Russia we anticipate a substantial recovery in demand in 2017, in contrast to the low level recorded in 2016.

Owing to a cyclical decline in the truck market, registrations in North America will probably be down substantially in 2017 on the figure for 2016.

Demand in the Brazilian market will recover in 2017 from the low level of the previous year, as the first signs of an economic recovery suggest.

Registrations in China, the world's largest truck market, are projected to be moderately higher in 2017 than in 2016. In India, we expect significant growth in the market on the strength of the positive economic climate and the implementation of numerous infrastructure measures.

In the bus markets that are relevant for the Volkswagen Group, we expect to see a moderate increase in demand in 2017. We anticipate that demand in Western Europe in 2017 will be below the 2016 level. For Central and Eastern Europe, we are forecasting higher demand than in the previous year. In South America, new registrations will probably be noticeably higher than the prior-year level.

For the period 2018 to 2021, we expect moderate growth overall in the demand for buses in the markets that are relevant for the Volkswagen Group.

INTEREST RATE TRENDS

In 2016 and also into the beginning of the current fiscal year, central banks continued to support the global economy and the financial system with an expansionary monetary policy. This is reflected in the sustained period of historically low interest rates. Uncertainty about the growth in the global economy is gradually dissipating and this could mean that the central banks decide to scale back their monetary policy stimulus. However, the ECB will certainly maintain its policy of low interest rates throughout the whole of 2017. There is now greater uncertainty – mainly caused by Brexit – about when the Bank of England will bring the period of low interest rates in the UK to an end. In the US, the key interest rate was raised by 25 basis points in December 2016 and further rate rises are anticipated during the course of 2017.

MOBILITY CONCEPTS

Social and political factors are increasingly having an impact on many people's individual mobility behavior. New challenges in connection with the design of an intelligent mobility mix comprising public transport combined with motorized and non-motorized personal transport are appearing, primarily in large metropolitan areas. Mobility is being redefined in many respects.

In collaboration with the automotive brands in the Volkswagen Group, Volkswagen Financial Services AG is extensively working on the development of new mobility concepts, as has been the case in the conventional automotive business for many years.

New mobility solutions will enhance the traditional idea of owning a vehicle. Based on leasing, long-term and short-term rentals, car and truck hire as well as car sharing, Volkswagen Financial Services AG – through its subsidiaries – can now cover an even greater proportion of the mobility needs of its customers.

Simple, transparent, safe, reliable, affordable and flexible – these are the key requirements that our business must satisfy in the future. Volkswagen Financial Services AG continues to closely monitor developments in the mobility market and is already working on new models to support alternative concepts of marketing and establish new mobility concepts that will safeguard and expand on its existing business model.

In this way, we will continue to make good on the essence of our brand promise in the future and remain "The Key to Mobility" over the long term.

NEW MARKETS/INTERNATIONALIZATION/NEW SEGMENTS

The financing, leasing, insurance and mobility services businesses are key to attracting customers and to developing loyal, long-term customer relationships globally. Volkswagen Financial Services AG, as financial services provider and strategic partner for the Volkswagen Group brands, specifically reviews the implementation of these business areas in new markets through developing targeted entry concepts in order to lay the foundations for profitable growth in the business volume in these markets.

SUMMARY OF EXPECTED DEVELOPMENTS

Volkswagen Financial Services AG expects its growth in the next fiscal year to be linked to the growth in unit sales of Volkswagen Group vehicles. The Company aims to boost its business volume and expand its international orientation by increasing the penetration rate, expanding the product range in existing markets and developing new markets. Please refer to the statements in the opportunities and risks report for information on the trends in credit risk, liquidity risk, market risk, residual value risk and operational risk.

Sales activities related to the Volkswagen Group brands will be further intensified, particularly through joint strategic projects.

Furthermore, Volkswagen Financial Services AG intends to continue enhancing the leveraging of potential along the automotive value chain.

Our aim is to satisfy the wishes and needs of our customers in the most efficient manner in cooperation with the Group brands. Our end customers are looking, in particular, for mobility with predictable fixed costs. In addition, we intend to further expand the digitalization of our business.

The product packages and mobility solutions successfully launched in the last few years will be refined in line with customer needs.

In parallel with the company's market-based activities, the position of Volkswagen Financial Services AG vis-à-vis its global competitors will be further strengthened through strategic investment in structural projects as well as through process optimization and productivity gains.

OUTLOOK FOR 2017

Volkswagen Financial Services AG's Board of Management expects the global economy to record slightly stronger growth in 2017 than in the previous year, despite some uncertainties. The financial markets continue be the source of some risk, primarily because of the challenging level of indebtedness in many countries. In addition, growth prospects will be hurt by geopolitical tensions and conflicts. The emerging economies of Asia will probably record the highest rates of growth. While we expect to see an economic upturn in the major industrialized nations, the rates of expansion will remain moderate.

When the above factors and the market trends are considered, the following overall picture emerges: our earnings expectations assume stable funding costs, greater levels of cooperation with the individual Group brands, increased investment in digitalization for the future and a continued high degree of uncertainty about macroeconomic conditions in the real economy and the impact of this uncertainty on factors such as risk costs. Assuming that margins remain stable in the coming year, the operating profit in fiscal year 2017 would be at the level achieved in fiscal year 2015. The diesel issue is not expected to result in any additional effects that would have a negative impact on operating profit for fiscal year 2017.

We are projecting a slight increase in new contracts and a marginal rise in current contracts. In addition, we assume that in 2017 we will again be able to boost our penetration rate slightly in an overall growing vehicle market. We expect the business volume to increase slightly in 2017. Regarding the volume of deposits at Volkswagen Bank GmbH, we anticipate a moderate contraction in the level of these deposits in 2017 compared with the year under review. The tighter capital requirements and the resulting greater capital adequacy will probably lead to a slight decline in return on equity in 2017 compared with the previous year. Based on the forecast profit for the year, we expect the cost/income ratio in 2017 to be at or slightly below the level of the previous year.

FORECAST CHANGES IN KEY PERFORMANCE INDICATORS FOR FISCAL YEAR 2017 COMPARED WITH PRIOR-YEAR FIGURES

	Actual 2015	Actual 2016		Forecast for 2017
Nonfinancial performance indicators				
Penetration (percent)	28.3	30.0	> 30.0	Slight increase
Current contracts (thousands)	12,081	13,244	> 13,244	Slight increase
New contracts (thousands)	4,886	5,603	> 5,603	Slight increase
Financial performance indicators				
Volume of business (€ million)	97,318	105,303	> 105,303	Slight increase
Volume of deposits (€ million)	28,109	36,149	< 36,149	Moderate decrease
Operating profit (€ million)	1,416	1,641	= 1,416	At 2015 level
Return on equity (percent)	11.3	10.4	< 10.4	Slightly lower
Cost/income ratio (percent)	63	64	≤ 64	Slightly below/at prior-year level

Braunschweig, February 14, 2017
The Board of Management

Lars Henner Santelmann

Dr. Mario Daberkow

Dr. Christian Dahlheim

Frank Fiedler

Christiane Hesse

Dr. Michael Reinhart

This report contains forward-looking statements on the future business development of Volkswagen Financial Services AG. These statements are based on assumptions relating to the development of the economic and legal environment in individual countries and economic regions in terms of the global economy and of the financial and automotive markets, which we have made on the basis of the information available to us and which we consider to be realistic at the time of going to press. The estimates given entail a degree of risk, and the actual developments may differ from those forecast. Consequently, any unexpected fall in demand or economic stagnation in the key sales markets of the Volkswagen Group will have a corresponding impact on the development of our business. The same applies in the event of material changes in exchange rates against the euro. In addition, expected business development may vary if the assessments of the key performance indicators and of risks and opportunities presented in the 2016 Annual Report develop in a way other than we are currently expecting, or additional risks and opportunities or other factors emerge that affect the development of our business.

Income Statement

of the Volkswagen Financial Services AG Group

€ million	Notes	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015	Change in percent
Interest income from lending transactions		3,848	3,909	−1.6
Net income from leasing transactions before provision for credit risks		1,260	1,333	−5.5
Interest expense		−1,363	−1,461	−6.7
Net income from insurance business		79	56	41.1
Net income from lending, leasing and insurance transactions before provision for credit risks	22	3,824	3,836	−0.3
Provision for credit risks from lending and leasing business	9, 23, 33	−672	−672	0.0
Net income from lending, leasing and insurance transactions after provision for credit risks		3,152	3,165	−0.4
Net fee and commission income	24	13	96	−86.5
Net gain/loss on the measurement of derivative financial instruments and hedged items	10, 25	−85	53	X
Share of profits and losses of equity-accounted joint ventures		77	24	X
Net gain/loss on marketable securities and miscellaneous financial assets[1]	26	20	25	−20.0
General and administrative expenses	27	−2,040	−2,062	−1.1
Net other operating income/expenses	28	512	212	X
Profit before tax		**1,650**	**1,513**	**9.1**
Income tax expense	6, 29	−509	−304	67.4
Profit after tax		1,141	1,209	−5.6
Profit after tax attributable to Volkswagen AG		1,141	1,209	−5.6

1 This item includes income of €14 million from the disposal of noncurrent assets in the reporting period that had been classified as held for sale in the previous year.

Statement of Comprehensive Income

of the Volkswagen Financial Services AG Group

€ million	Notes	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
Profit after tax		**1,141**	**1,209**
Pension plan remeasurements recognized in other comprehensive income	46		
Pension plan remeasurements recognized in other comprehensive income, before tax		−112	41
Deferred taxes relating to pension plan remeasurements recognized in other comprehensive income	6, 29	31	−10
Pension plan remeasurements recognized in other comprehensive income, net of tax		−81	31
Share of other comprehensive income of equity-accounted investments that will not be reclassified to profit or loss, net of tax		1	−4
Items that will not be reclassified to profit or loss		**−80**	**27**
Exchange differences on translating foreign operations	4		
Gains/losses on currency translation recognized in other comprehensive income		−54	−193
Reclassified to profit or loss		–	–
Exchange differences on translating foreign operations, before tax		−54	−193
Deferred taxes relating to exchange differences on translating foreign operations		–	–
Exchange differences on translating foreign operations, net of tax		−54	−193
Cash flow hedges	10		
Fair value changes recognized in other comprehensive income		18	7
Reclassified to profit or loss		7	0
Cash flow hedges, before tax		25	7
Deferred taxes relating to cash flow hedges	6, 29	−7	−2
Cash flow hedges, net of tax		18	4
Available-for-sale financial assets			
Fair value changes recognized in other comprehensive income		37	5
Reclassified to profit or loss		−13	0
Available-for-sale financial assets, before tax		23	5
Deferred taxes relating to available-for-sale financial assets	6, 29	−9	1
Available-for-sale financial assets, net of tax		14	6
Share of other comprehensive income of equity-accounted investments that may be reclassified subsequently to profit or loss, net of tax		6	−19
Items that may be reclassified subsequently to profit or loss		**−16**	**−202**
Other comprehensive income, before tax		−111	−164
Deferred taxes relating to other comprehensive income		15	−11
Other comprehensive income, net of tax		**−96**	**−175**
Total comprehensive income		**1,045**	**1,034**
Total comprehensive income attributable to Volkswagen AG		1,045	1,034

Balance Sheet

of the Volkswagen Financial Services AG Group

€ million	Notes	Dec. 31, 2016	Dec. 31, 2015	Change in percent
Assets				
Cash reserve	7, 31	1,478	1,416	4.4
Loans to and receivables from banks	8	2,236	2,940	−23.9
Loans to and receivables from customers attributable to				
Retail financing		53,973	50,665	6.5
Dealer financing		14,638	13,967	4.8
Leasing business		21,997	19,704	11.6
Other loans and receivables		9,957	8,435	18.0
Total loans to and receivables from customers	8, 32	100,564	92,771	8.4
Derivative financial instruments	10, 34	1,297	1,178	10.1
Marketable securities	11	2,993	2,936	1.9
Equity-accounted joint ventures	35	633	538	17.7
Miscellaneous financial assets	12, 35	288	206	39.8
Intangible assets	13, 36	150	149	0.7
Property and equipment	14, 37	314	317	−0.9
Lease assets	16, 38	14,696	12,982	13.2
Investment property	16, 38	14	15	−6.7
Deferred tax assets	6, 39	1,834	1,703	7.7
Current tax assets	6	156	320	−51.3
Other assets	40	3,495	3,780	−7.5
Total		**130,148**	**121,251**	**7.3**

€ million	Notes	Dec. 31, 2016	Dec. 31, 2015	Change in percent
Equity and liabilities				
Liabilities to banks	17, 42	17,034	15,721	8.4
Liabilities to customers	17, 42	49,454	43,764	13.0
Notes, commercial paper issued	43, 44	37,849	39,913	−5.2
Derivative financial instruments	10, 45	413	249	65.9
Provisions for pensions and other post-employment benefits	18, 46	478	357	33.9
Underwriting provisions and other provisions	19, 20, 47	1,212	1,092	11.0
Deferred tax liabilities	6, 48	1,151	1,072	7.4
Current tax liabilities	6	494	329	50.2
Other liabilities	49	1,929	1,599	20.6
Subordinated capital	44, 50	3,183	2,344	35.8
Equity	52	16,951	14,811	14.4
Subscribed capital		441	441	–
Capital reserves		10,449	9,224	13.3
Retained earnings		6,564	5,634	16.5
Other reserves		−503	−488	3.1
Total		**130,148**	**121,251**	**7.3**

Statement of Changes in Equity

of the Volkswagen Financial Services AG Group

€ million	Subscribed capital	Capital reserves	Retained earnings	OTHER RESERVES Currency translation	Cash flow hedges	Available-for-sale financial assets	Equity-accounted investments	Total equity
Balance as of Jan. 1, 2015	**441**	**6,964**	**4,807**	**–266**	**–12**	**16**	**–19**	**11,931**
Profit after tax	–	–	1,209	–	–	–	–	1,209
Other comprehensive income, net of tax	–	–	31	–193	4	6	–23	–175
Total comprehensive income	**–**	**–**	**1,240**	**–193**	**4**	**6**	**–23**	**1,034**
Capital increases	–	2,260	–	–	–	–	–	2,260
Distribution/profit transfer to Volkswagen AG	–	–	–420	–	–	–	–	–420
Other changes	–	–	6	0	–	–	–	6
Balance as of Dec. 31, 2015	**441**	**9,224**	**5,634**	**–460**	**–7**	**21**	**–42**	**14,811**
Balance as of Jan. 1, 2016	**441**	**9,224**	**5,634**	**–460**	**–7**	**21**	**–42**	**14,811**
Profit after tax	–	–	1,141	–	–	–	–	1,141
Other comprehensive income, net of tax	–	–	–81	–54	18	14	7	–96
Total comprehensive income	**–**	**–**	**1,060**	**–54**	**18**	**14**	**7**	**1,045**
Capital increases	–	1,225	–	–	–	–	–	1,225
Distribution/profit transfer to Volkswagen AG	–	–	–130	–	–	–	–	–130
Other changes	–	–	–	–	–	–	–	–
Balance as of Dec. 31, 2016	**441**	**10,449**	**6,564**	**–514**	**10**	**36**	**–35**	**16,951**

See note (52) for further disclosures on equity.

Cash Flow Statement

of the Volkswagen Financial Services AG Group

€ million	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
Profit after tax	**1,141**	**1,209**
Depreciation, amortization, impairment losses and reversals of impairment losses	3,152	3,291
Change in provisions	222	−1
Change in other noncash items	1,607	−390
Gain/loss on disposal of financial assets and items of property and equipment	1	−6
Net interest income and dividend income	−3,326	−3,297
Other adjustments	−3	7
Change in loans to and receivables from banks	740	−1,071
Change in loans to and receivables from customers	−9,817	−7,874
Change in lease assets	−4,700	−4,728
Change in other assets related to operating activities	257	−1,231
Change in liabilities to banks	879	3,444
Change in liabilities to customers	6,116	4,846
Change in notes, commercial paper issued	−1,255	2,408
Change in other liabilities related to operating activities	379	177
Interest received	4,692	4,736
Dividends received	−2	23
Interest paid	−1,363	−1,461
Income taxes paid	−196	−295
Cash flows from operating activities	**−1,478**	**−213**
Proceeds from disposal of investment property	0	2
Acquisition of investment property	0	–
Proceeds from disposal of subsidiaries and joint ventures	0	8
Acquisition of subsidiaries and joint ventures	−92	−158
Proceeds from disposal of other assets	6	22
Acquisition of other assets	−75	−103
Change in investments in securities	−75	−912
Cash flows from investing activities	**−236**	**−1,141**
Proceeds from changes in capital	1,225	2,260
Distribution/profit transfer to Volkswagen AG	−420	−147
Change in cash funds attributable to subordinated capital	969	210
Cash flows from financing activities	**1,774**	**2,323**
Cash and cash equivalents at end of prior period	**1,416**	**451**
Cash flows from operating activities	−1,478	−213
Cash flows from investing activities	−236	−1,141
Cash flows from financing activities	1,774	2,323
Effect of exchange rate changes	1	−4
Cash and cash equivalents at end of period	**1,478**	**1,416**

See note (65) for disclosures on the cash flow statement.

Notes to the Consolidated Financial Statements

of the Volkswagen Financial Services AG Group
for the Year Ended December 31, 2016

General Information

Volkswagen Financial Services Aktiengesellschaft (VW FS AG) has the legal structure of a stock corporation. It has its registered office at Gifhorner Strasse, Braunschweig, Germany, and is registered in the Braunschweig commercial register (HRB 3790).

The object of the Company is to develop, sell and process its own and third-party financial services both in Germany and abroad, the purpose of such financial services being to support the business of Volkswagen AG and of Volkswagen AG's affiliated companies.

Volkswagen AG, Wolfsburg, is the sole shareholder of the parent company, VW FS AG. Volkswagen AG and VW FS AG have entered into a control and profit-and-loss transfer agreement.

The annual financial statements of the companies in the VW FS AG Group are included in the consolidated financial statements of Volkswagen AG, Wolfsburg, which are published in the electronic German Federal Gazette and Company Register.

Basis of Presentation

VW FS AG has prepared its consolidated financial statements for the year ended December 31, 2016 in accordance with International Financial Reporting Standards (IFRSs), as adopted by the European Union (EU), and the interpretations issued by the International Financial Reporting Standards Interpretations Committee (IFRS IC) as well as in accordance with the additional disclosures required by German commercial law under section 315a(1) of the Handelsgesetzbuch (HGB – German Commercial Code). All IFRSs issued by the International Accounting Standards Board (IASB) up to December 31, 2016 for which mandatory application was required in fiscal year 2016 in the EU have been taken into account in these consolidated financial statements.

In addition to the income statement, the statement of comprehensive income and the balance sheet, the IFRS consolidated financial statements also include the statement of changes in equity, the cash flow statement and the notes. The separate report on the risks associated with future development (risk report in accordance with section 315(1) of the HGB) can be found in the management report on pages 23 – 40. This includes the qualitative disclosures on the nature and scope of risk from financial instruments required under IFRS 7.

All the estimates and assumptions necessary as part of recognition and measurement in accordance with IFRS comply with the relevant standard, are continuously updated and are based on past experience and other factors, including expectations regarding future events that appear to be reasonable in the given circumstances. Where significant estimates have been necessary, the assumptions made by the Company are explained in detail in the disclosures on management's estimates and assumptions.

The Board of Management completed the preparation of these consolidated financial statements on February 14, 2017. This date marked the end of the period in which adjusting events after the reporting period were recognized.

Significant Events

In 2016, Volkswagen Financial Services AG initiated a reorganization of its structures under company law. The aim of the restructuring is to pool the European lending and deposits business separately from the other financial services activities under Volkswagen Bank GmbH, structured in the future as a direct subsidiary of Volkswagen AG. A new company, Volkswagen Financial Services Digital Solutions GmbH, will in the future also develop and make available selected, innovative services for the benefit of its parent company Volkswagen Bank GmbH and for Volkswagen Financial Services AG. The other activities will remain in Volkswagen Financial Services AG, which will still be a direct subsidiary of Volkswagen AG. During the course of 2017, further work will be carried out on the details of the restructuring and preparations will be made for its implementation.

Effects of New and Revised IFRSs

VW FS AG has applied all financial reporting standards adopted by the EU and subject to mandatory application from fiscal year 2016.

A number of amendments to International Financial Reporting Standards resulting from the Annual Improvements Project 2012 and Annual Improvements Project 2014 have come into force since January 1, 2016. These amendments include changes to IFRS 3, IFRS 7, IFRS 8, IFRS 13 and IAS 24. Following the amendments to IFRS 8 “Operating Segments”, the criteria used to aggregate operating segments must now also be disclosed. These changes do not have any effect on the VW FS AG Group’s segment reporting. Additional disclosure requirements regarding the derecognition of financial instruments have been added to IFRS 7. These mainly concern clarifications relating to ABS transactions.

There has also been a requirement since January 1, 2016 to apply amendments to IAS 19. The amendments concern the accounting treatment of employee contributions to pensions. As a result of these amendments, the VW FS AG Group will change its procedures so that employee contributions in which the amount is independent of the number of years of service (fixed percentage of salary) will be deducted from the service cost in the respective year.

As a result of the amendments to IAS 16 and IAS 38, it has been clarified with effect from January 1, 2016 that revenue-based methods of measuring depreciation and amortization will generally not be permitted.

In IAS 1, clarifications and new requirements in relation to reporting were introduced with effect from January 1, 2016. The changes also specified that disclosures are only required in the consolidated financial statements if the content is material.

The amended provisions do not materially affect the VW FS AG Group’s financial position and financial performance.

New and Revised IFRSs Not Applied

VW FS AG has not applied in its 2016 consolidated financial statements the following financial reporting standards that have already been issued by the IASB but were not yet subject to mandatory application in fiscal year 2016.

Standard/ interpretation		Published by the IASB	Application requirement[1]	Adopted by EU	Expected impact
IFRS 2	Classification and Measurement of Share-based Payment Transactions	June 20, 2016	January 1, 2018	No	None
IFRS 4	Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	September 12, 2016	January 1, 2018	No	None
IFRS 9	Financial Instruments	July 24, 2014	January 1, 2018	Yes	Detailed description following the table overview
IFRS 10 and IAS 28	Consolidated Financial Statements and Investments in Associates and Joint Ventures: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	September 11, 2014	Postponed[2]	–	None
IFRS 15	Revenue from Contracts with Customers	May 28, 2014	January 1, 2018[3]	Yes	No material impact on revenue recognition, additional disclosure requirements in the notes
	Clarifications to IFRS 15 – Revenue from Contracts with Customers	April 12, 2016	January 1, 2018	No	Additional transitional exemptions, otherwise no material impact
IFRS 16	Leases	January 13, 2016	January 1, 2019	No	Detailed description following the table overview
IAS 7	Statement of Cash Flows: Disclosures	January 29, 2016	January 1, 2017	No	Preparation of a reconciliation for liabilities from financing activities.
IAS 12	Income Taxes: Recognition of Deferred Tax Assets for Unrealized Losses	January 19, 2016	January 1, 2017	No	No material impact
IAS 40	Transfers of Investment Property	December 8, 2016	January 1, 2018	No	No material impact
	Improvements to International Financial Reporting Standards 2016[4]	December 8, 2016	January 1, 2018	No	No material impact
IFRIC 22	Foreign Currency Transactions and Advance Consideration	December 8, 2016	January 1, 2018	No	Translation of foreign currency advances into the functional currency using the spot rate on the date of payment

1 Requirement for initial application from the VW FS AG perspective
2 On December 15, 2015, the IASB decided to postpone the date of initial application indefinitely.
3 Postponed until January 1, 2018 (IASB decision on September 11, 2015)
4 Minor changes to a number of IFRSs (IFRS 1, IFRS 12, IAS 28)

IFRS 9 FINANCIAL INSTRUMENTS

IFRS 9 Financial Instruments revises the financial reporting provisions governing the classification and measurement of financial assets, impairment of financial assets and hedge accounting. A project is currently under way to evaluate the expected impact of the changes arising from IFRS 9 on the VW FS AG Group and to implement the requirements. The necessary IT modifications are being carried out and are expected to be completed during the course of 2017.

Financial assets are classified and measured on the basis of the business model operated by an entity and the structure of its cash flows. On initial recognition, a financial asset is classified as “at amortized cost”, “at fair value through other comprehensive income” or “at fair value through profit or loss”. The VW FS AG Group is not anticipating any material impact from the classification of financial assets under IFRS 9 because our assessments show that the main financial assets are currently measured at amortized cost under IAS 39 and will remain so under IFRS 9 in the future. At present, it is not yet possible to arrive at a definitive evaluation of the impact from the classification of financial assets because the classification will have to be carried out on the changeover date of January 1, 2018. Under IFRS 9, the classification of financial liabilities will be largely unchanged compared with the classification under the previous financial reporting requirements in accordance with IAS 39.

The model for determining impairment and recognizing the provision for credit risks is changing from an incurred loss model to an expected loss model. The expected loss model breaks down the provision for credit risks into three stages. Financial assets that are newly acquired or issued and that are not deemed to be underperforming or non-performing on the date of initial recognition are allocated to stage 1. Stage 1 includes expected defaults that could arise from potential default events within the subsequent twelve months. In the case of financial assets in which the credit risk has increased significantly since acquisition or issue but in which the financial asset is not underperforming (stage 2) and non-performing financial assets (stage 3), the provision for credit risks is recognized on the basis of the remaining maturity of the financial asset (lifetime expected loss). In addition, interest income on financial assets classified as stage 3 is recognized on the basis of the net carrying amount, i.e. amortized cost less recognized impairment losses, in contrast to the rules applicable to stages 1 and 2. It is anticipated that these changes to the rules will cause an upward trend in the level of the provision for credit risks. This forecast is based firstly on the requirement to recognize a provision for credit risks on the basis of expected credit losses for the first twelve months for performing financial assets that have not been affected by a significant increase in credit risk since initial recognition. Secondly, it is a result of an assessment that the portfolio of financial assets for which the provision for credit risks must be recognized on the basis of lifetime expected losses will tend to be greater than the portfolio of financial assets for which the provision for credit risks has been recognized on the basis of incurred losses (IAS 39).

As regards hedge accounting, IFRS 9 introduces wider designation options and the need to implement more complex measurement logic. IFRS 9 also removes the quantitative limits for the effectiveness test. In particular, there will be changes to the method of reclassification under IFRS 9. Depending on market trends, hedges will be assumed to have a greater impact on operating profit. The IFRS 9 hedge accounting requirements will be applied by the VW FS AG Group prospectively from the changeover date.

Overall, IFRS 9 will also give rise to significantly more extensive disclosures in the notes.

IFRS 16 LEASES

IFRS 16 amends the requirements for the accounting treatment of leases. The core objective of IFRS 16 is to ensure that all leases are recognized in the balance sheet. Accordingly, the previous requirement for lessees to classify a lease as either a finance lease or operating lease has been eliminated. Instead, for all leases, lessees will have to recognize both a right-of-use asset and a lease liability in their balance sheet in the future. There are only exemptions for short-term leases or those of low value. During the term of the lease, the right-of-use asset must be depreciated and the lease liability measured using the effective interest method, taking into account the lease payments. The new accounting treatment for lessees will therefore tend to increase assets and financial liabilities. It is also expected to reduce general and administrative expenses and increase interest expenses in the income statement. Moreover, there will be significantly more extensive disclosures in the notes. The required accounting treatment for leases by lessors will be largely the same as under the current provisions in IAS 17. In the future, lessors will still have to classify a lease as either a finance lease or an operating lease based on the allocation of opportunities and risks from the asset.

Accounting Policies

1. Basic Principles

All entities included in the basis of consolidation have prepared their annual financial statements to the reporting date of December 31, 2016.

Financial reporting in the VW FS AG Group complies with IFRS 10 and is on the basis of standard Group-wide accounting policies.

Unless otherwise stated, amounts are shown in millions of euros (€ million). All amounts shown are rounded, so minor discrepancies may arise from addition of these amounts. Negligible discrepancies could also arise in the comparison with the prior year owing to adjustments in the rounding methodology.

Assets and liabilities are presented broadly in order of liquidity in accordance with IAS 1.60.

2. Basis of Consolidation

In addition to VW FS AG, the consolidated financial statements cover all significant German and non-German subsidiaries, including all structured entities, controlled directly or indirectly by VW FS AG. This is the case if VW FS AG has power over potential subsidiaries directly or indirectly from voting rights or similar rights, is exposed, or has rights to, positive or negative variable returns from its involvement with the potential subsidiaries, and has the ability to use its power to influence those returns. The purpose of the structured entities is to facilitate asset-backed-securities transactions to fund the financial services business. In the case of the structured entities consolidated in the VW FS AG Group, VW FS AG holds no equity investment but nevertheless determines the main relevant activities remaining after the structure is created and thereby influences its own variable returns.

Subsidiaries are included in the consolidation from the date on which control comes into existence; they cease to be consolidated when control no longer exists. Subsidiaries in which activities are dormant or of low volume and that, individually and jointly, are of minor significance in the presentation of a true and fair view of the financial position, financial performance and cash flows of the VW FS AG Group are not consolidated. They are recognized in the consolidated financial statements under financial assets at cost, taking into account any necessary impairment losses. The equity method is used to account for material entities in which VW FS AG has the opportunity, directly or indirectly, to exercise significant influence over financial and operating policy decisions (associates) or in which VW FS AG directly or indirectly shares control (joint ventures). Joint ventures also include entities in which the VW FS AG Group controls a majority of the voting rights but whose partnership agreements or articles of association specify that key decisions may only be resolved unanimously. Associates and joint ventures of minor significance are not accounted for using the equity method but are reported under financial assets at cost, taking into account any necessary impairment losses.

The composition of the VW FS AG Group is shown in the following table:

	2016	2015
VW FS AG and consolidated subsidiaries		
Germany	24	31
International	49	52
Subsidiaries recognized at cost		
Germany	7	7
International	36	28
Associates, equity-accounted joint ventures		
Germany	2	2
International	22	20
Associates, joint ventures and equity investments recognized at cost		
Germany	2	3
International	9	9
Total	**151**	**152**

The list of all shareholdings in accordance with section 313(2) of the HGB and in accordance with IFRS 12.10 and IFRS 12.21 can be accessed at www.vwfsag.com/listofholdings2016.

The following consolidated German subsidiaries with the legal form of a corporation have satisfied the criteria in section 264(3) of the HGB and have elected not to publish annual financial statements:

- Volim GmbH, Braunschweig
- Volkswagen-Versicherungsdienst GmbH, Braunschweig
- Volkswagen Insurance Brokers GmbH, Braunschweig
- MAN Financial Services GmbH, Munich
- EURO-Leasing GmbH, Sittensen

SUBSIDIARIES

The changes in consolidated subsidiaries in the period under review are described below. As part of the continuing integration of the MAN financial services business, the subsidiaries MAN Financial Services S.p.A., Dossobuono di Villafranca, Italy, and MAN Financial Services S.A.S., Evry Cedex, France, were merged into the subsidiary Volkswagen Bank GmbH. The subsidiary MAN Financial Services GmbH, Munich, was also merged into the subsidiary MAN Finance International GmbH, Munich. MAN Finance International GmbH was then renamed MAN Financial Services GmbH.

The following changes were implemented in the period under review to simplify the investment structure of the holding companies in the Netherlands. The subsidiary Global Automotive Finance C.V., Amsterdam, Netherlands, and the subsidiary Volkswagen Financial Services Beteiligungsgesellschaft mbH, Braunschweig, were merged into the holding company Volkswagen Financial Services AG, Braunschweig. In addition, the subsidiaries Volkswagen Finance Cooperation B.V., Amsterdam, Netherlands, and Volkswagen Global Finance Holding B.V., Amsterdam, Netherlands, were merged into the subsidiary Volkswagen Finance Overseas B.V., Amsterdam, Netherlands.

The operating activities of the subsidiary MAN Financial Services plc., Swindon, UK, were transferred to the subsidiary Volkswagen Financial Services UK Ltd., Milton Keynes, UK, in an asset deal. As a consequence, the subsidiary MAN Financial Services plc., Swindon, UK, was removed from the basis of consolidation because it is now of minor significance for the VW FS AG Group.

The subsidiaries Volkswagen Financial Services UK March Ltd., Milton Keynes, UK, Volkswagen Financial Services UK June Ltd., Milton Keynes, UK, and Volkswagen Financial Services UK September Ltd., Milton Keynes, UK, were liquidated in the reporting period because these entities were dormant.

In May 2016, Fleetzil Locação e Serviços Ltda., Curitiba, was established in Brazil as a wholly owned subsidiary. In Mexico, Volkswagen Insurance Brokers, Agente de Seguros y de Fianzas S.A. de C.V., Puebla, was also established in July 2016 as a wholly owned subsidiary. Both companies are included in the consolidation at cost for reasons of materiality.

In December 2016, Volkswagen Financial Services AG acquired all the shares in the five companies of the PayByPhone Group, which provides cashless parking services in Australia, Canada, France, Switzerland, the UK and the US. The subsidiaries are not fully consolidated for reasons of materiality.

The changes described above did not have any impact on the financial position and financial performance of the VW FS AG Group.

JOINT VENTURES

From a Group perspective, the following three entities among the equity-accounted joint ventures require separate presentation because they were deemed material at the reporting date on the basis of the size of the entity concerned. These three joint ventures are strategically important to the VW FS AG Group. They operate the financial services business in the respective countries and thus help to promote vehicle sales in the Volkswagen Group.

Volkswagen Pon Financial Services B.V.

The Volkswagen Pon Financial Services B.V. Group, whose registered office is situated in Amersfoort in the Netherlands, is a financial services provider offering financing and leasing products for Volkswagen Group vehicles to business and private customers in the Netherlands. Volkswagen Financial Services AG and its partner in this joint venture, Pon Holdings B.V., have entered into an agreement for a long-term strategic partnership.

Volkswagen D'Ieteren Finance S.A.

Volkswagen D'Ieteren Finance S.A. and its subsidiary D'Ieteren Lease S.A., whose registered offices are situated in Brussels, Belgium, are financial services providers offering financing and leasing products for Volkswagen Group vehicles to business and private customers in Belgium. The Group and joint venture partner D'Ieteren S.A. have a long-term strategic partnership agreement.

Volkswagen Møller Bilfinans A.S.

Volkswagen Møller Bilfinans A.S., whose registered office is situated in Oslo, Norway, is a financial services provider offering financing and leasing products for Volkswagen Group vehicles to business and private customers, predominantly in Norway. The Group and joint venture partner, Møllergruppen A.S., have entered into a long-term strategic partnership agreement.

Summarized financial information for the material joint ventures on a 100% basis:

€ million	VOLKSWAGEN PON FINANCIAL SERVICES B.V. (NETHERLANDS)		VOLKSWAGEN D'IETEREN FINANCE S.A. (BELGIUM)		VOLKSWAGEN MØLLER BILFINANS AS (NORWAY)	
	2016	2015	2016	2015	2016	2015
Shareholding (percent)	60 %	60 %	50 %	50 %	51 %	51 %
Loans to and receivables from banks	2	1	0	20	1	0
Loans to and receivables from customers	1,747	1,666	1,150	776	1,581	1,203
Lease assets	1,108	986	438	404	–	–
Other assets	236	218	49	41	17	9
Total	**3,093**	**2,871**	**1,638**	**1,241**	**1,599**	**1,213**
of which: noncurrent assets	1,469	1,274	982	815	1,319	1,019
of which: current assets	1,624	1,597	656	426	279	193
of which: cash	2	1	0	20	1	0
Liabilities to banks	737	2,006	1,412	1,051	1,299	981
Liabilities to customers	1,156	3	89	66	34	20
Notes, commercial paper issued	556	438	–	–	–	–
Other liabilities	351	175	11	9	47	32
Equity	292	249	126	115	218	180
Total	**3,093**	**2,871**	**1,638**	**1,241**	**1,599**	**1,213**
of which: noncurrent liabilities	1,292	982	649	447	519	350
of which: current liabilities	1,509	1,640	863	680	861	682
of which: noncurrent financial liabilities	1,287	976	643	441	457	312
of which: current financial liabilities	1,362	1,491	769	610	842	528
Revenue	699	632	344	322	80	68
of which: interest income	87	65	24	22	70	67
Expenses	645	581	327	318	43	43
of which: interest expense	19	21	8	7	19	18
of which: depreciation and amortization	251	222	88	96	1	1
Profit/loss from continuing operations, before tax	**54**	**50**	**17**	**4**	**37**	**26**
Income tax expense or income	14	12	5	1	9	5
Profit/loss from continuing operations, net of tax	**41**	**38**	**11**	**3**	**28**	**20**
Profit/loss from discontinued operations, net of tax	–	–	–	–	–	–
Other comprehensive income, net of tax	2	–7	–	–	–	–
Total comprehensive income	**43**	**32**	**11**	**3**	**28**	**20**
Dividends received	–	12	–	–	–	–

Reconciliation from the financial information to the carrying amount of the equity-accounted investments:

€ million	VOLKSWAGEN PON FINANCIAL SERVICES B.V. (NETHERLANDS)	VOLKSWAGEN D'IETEREN FINANCE S.A. (BELGIUM)	VOLKSWAGEN MØLLER BILFINANS A.S. (NORWAY)
2015			
Equity of the joint venture as of Jan. 1, 2015	237	112	143
Profit/loss	38	3	20
Other comprehensive income	–7	–	–
Change in share capital	–	–	28
Exchange differences on translating foreign operations	–	–	–12
Dividends	–20	–	–
Equity of the joint venture as of Dec. 31, 2015	**249**	**115**	**180**
Share of equity	149	57	92
Goodwill	61	–	–
Carrying amount of the share of equity as of Dec. 31, 2015	**210**	**57**	**92**
2016			
Equity of the joint venture as of Jan. 1, 2016	249	115	180
Profit/loss	41	11	28
Other comprehensive income	2	–	–
Change in share capital	–	–	–
Exchange differences on translating foreign operations	–	–	11
Dividends	–	–	–
Equity of the joint venture as of Dec. 31, 2016	**292**	**126**	**218**
Share of equity	175	63	111
Goodwill	61	–	–
Carrying amount of the share of equity as of Dec. 31, 2016	**236**	**63**	**111**

Summarized financial information for the individually immaterial joint ventures on the basis of the Volkswagen Group's proportionate interest:

€ million	2016	2015
Carrying amount of the share of equity as of Dec. 31	**222**	**178**
Profit/loss from continuing operations, net of tax	34	–8
Profit/loss from discontinued operations, net of tax	–	–
Other comprehensive income, net of tax	1	0
Total comprehensive income	**35**	**–8**

VDF Filo Kiralama A.Ş., Istanbul, which was established in Turkey in March 2016, is included in the consolidated financial statements using the equity method.

The 49% equity investment in Volkswagen Financial Services Compañia Financiera S.A., Buenos Aires, acquired in September 2016 is included as a joint venture at cost for reasons of materiality.

There were no unrecognized losses relating to interests in joint ventures.

Cash attributable to joint ventures amounting to €173 million (previous year: €72 million) was pledged as collateral in connection with ABS transactions and was therefore not available to the VW FS AG Group.

There were no contingent liabilities to joint ventures in the year under review (previous year: €14 million).

3. Consolidation Methods

The assets and liabilities of the German and international entities included in the consolidated financial statements are reported in accordance with the uniform accounting policies applicable throughout the VW FS AG Group. In the case of the equity-accounted investments, we determine the pro rata equity on the basis of the same accounting policies. The relevant figures are taken from the most recently audited annual financial statements of the entity concerned.

Acquisitions are accounted for by offsetting the carrying amounts of the equity investments with the proportionate amount of the remeasured equity of the subsidiaries on the date of acquisition or initial inclusion in the consolidated financial statements and in subsequent periods.

When subsidiaries are consolidated for the first time, the assets and liabilities, together with contingent consideration, are recognized at fair value on the date of acquisition or on the date of inclusion (for newly established subsidiaries). Subsequent changes in the fair value of contingent consideration do not generally result in an adjustment of the acquisition-date measurement. Acquisition-related costs that are not equity transaction costs are not added to the purchase price, but instead recognized as expenses. Goodwill arises when the purchase price of the investment exceeds the fair value of the identifiable assets and liabilities. Goodwill is tested for impairment at least once a year and additionally if relevant events or changes in circumstances occur (impairment-only approach) to determine whether its carrying amount is recoverable. If the carrying amount of goodwill is higher than the recoverable amount, an impairment loss is recognized. If this is not the case, there is no change in the carrying amount of goodwill compared with the previous year. If the purchase price of the investment is less than the identifiable assets and liabilities, the difference is recognized in profit or loss in the year of acquisition. Goodwill is accounted for at the subsidiaries in the functional currency of those subsidiaries.

The net assets recognized at fair value as part of an acquisition transaction are depreciated or amortized over their relevant useful lives. If the useful life is indefinite, any requirement for the recognition of an impairment loss is determined at individual asset level using a procedure similar to that used for goodwill. Where hidden reserves and charges in the recognized assets and liabilities are uncovered during the course of purchase price allocation, these items are amortized over their remaining maturities.

The acquisition method described above is not applied when subsidiaries are newly established; no goodwill or negative goodwill can arise when newly established subsidiaries are included in the consolidation.

Loans/receivables, liabilities, income and expenses relating to business relationships between consolidated entities are eliminated in the consolidation.

Consolidation transactions recognized in profit or loss are subject to the recognition of deferred taxes. Investments in subsidiaries that are not consolidated because they are of minor significance are reported, together with other equity investments, under miscellaneous financial assets.

Intragroup transactions are conducted on an arm’s-length basis. Any resulting intercompany profits or losses are eliminated.

4. Currency Translation

Transactions in foreign currencies are translated in the single-entity financial statements of VW FS AG and its consolidated subsidiaries at the rates prevailing at the transaction date. Foreign currency monetary items are reported in the balance sheet using the middle rate at the closing date and the resulting gains or losses are recognized in profit or loss. The foreign companies forming part of the VW FS AG Group are independent subunits whose financial statements are translated using the functional currency principle. Under this principle, assets and liabilities, but not equity, are translated at the closing rate. With the exception of income and expense items recognized in other comprehensive income, equity is translated at historical rates. Until the disposal of the subsidiary concerned, the resulting exchange differences on translating foreign operations are recognized in other comprehensive income and are presented as a separate item in equity.

The transaction data in the statement of changes in noncurrent assets is translated into euros using weighted average rates. A separate “Foreign exchange differences” line is reported to reconcile the carryforwards translated at the middle spot rate on the prior-year reporting date and the transaction data translated at average rates with the final balances translated at the middle spot rate on the reporting date.

We translate the income statement items into euros using weighted average rates.

The following table shows the rates applied in currency translation:

		BALANCE SHEET, MIDDLE SPOT RATE ON DEC. 31		INCOME STATEMENT, AVERAGE RATE	
	€1 =	**2016**	2015	**2016**	2015
Australia	AUD	1.46150	1.48970	1.48880	1.47648
Brazil	BRL	3.43720	4.31170	3.86217	3.69160
Denmark	DKK	7.43500	7.46260	7.44537	7.45864
United Kingdom	GBP	0.85850	0.73395	0.81897	0.72600
India	INR	71.65500	72.02150	74.37058	71.17522
Japan	JPY	123.50000	131.07000	120.31663	134.28651
Mexico	MXN	21.84800	18.91450	20.66535	17.59984
Poland	PLN	4.41530	4.26390	4.36416	4.18278
Republic of Korea	KRW	1,269.11000	1,280.78000	1,284.79543	1,255.74059
Russia	RUB	64.67550	80.67360	74.23443	68.00684
Sweden	SEK	9.56720	9.18950	9.46712	9.35448
Czech Republic	CZK	27.02400	27.02300	27.03433	27.28500
People’s Republic of China	CNY	7.33320	7.06080	7.35067	6.97300

5. Recognition of Revenue and Expenses

Revenue and expenses are recognized in accordance with the accrual basis of accounting and are reported in profit or loss in the period in which the substance of the related transaction occurs.

Interest income is recognized in the income statement using the effective interest method. Income from financing and leasing transactions, together with expenses for the funding of this business, is included in net income from lending, leasing and insurance transactions. Leasing revenue from operating leases is recognized on a straight-line basis over the lease term and includes both the interest portion and the repayment of the principal.

Contingent payments under finance leases and operating leases are recognized when the conditions for the contingent payments are satisfied.

Net fee and commission income includes income and expenses from insurance broking as well as fees and commissions from the financing and financial services businesses. Fee and commission income derived from insurance broking is recognized when the fee or commission payment is actually received.

Dividends are reported on the date on which the legal entitlement is established, i.e. generally the date on which a dividend distribution resolution is approved.

General and administrative expenses comprise personnel expenses, non-staff operating expenses, depreciation of and impairment losses on property and equipment, amortization of and impairment losses on intangible assets, and other taxes.

The main components of net other operating income/expenses are income from cost allocations to other entities in the Volkswagen Group and income from the reversal of provisions.

6. Income Taxes

Current income tax assets and liabilities are measured using the tax rates expected to apply in respect of the refund from or payment to the tax authorities concerned. Current income taxes are generally reported on an unnetted basis. Provisions are recognized for potential tax risks.

Deferred tax assets and liabilities are recognized in respect of temporary differences between the carrying amounts of assets and liabilities in the consolidated balance sheet and those in the tax base and in respect of tax loss carryforwards. This gives rise to expected income tax income or expense effects in the future (temporary differences). Deferred taxes are measured using the domicile-specific income tax rates expected to apply in the period in which the tax benefit is recovered or liability paid.

Deferred tax assets are recognized if it is probable that in the future sufficient taxable profits will be generated in the same tax unit against which the deferred tax assets can be utilized. If it is no longer likely that it will be possible to recover deferred tax assets within a reasonable period, valuation allowances are applied. Deferred tax assets and liabilities with the same maturities and relating to the same tax authorities are netted.

The tax expense attributable to the profit before tax is reported in the Group's income statement under the "Income tax expense" item and a breakdown into current and deferred taxes for the fiscal year is disclosed in the notes. Other non-income-related taxes are reported as a component of general and administrative expenses.

7. Cash Reserve

The cash reserve is carried at the nominal amount.

8. Loans and receivables

Loans to and receivables from banks, and loans to and receivables from customers, originated by the VW FS AG Group are generally recognized at amortized cost using the effective interest method. Gains or losses arising from the changes in amortized cost are recognized in profit or loss, including the effects from changes in exchange rates. For reasons of materiality, current loans and receivables (due within one year) are not discounted and no unwinding of discount is therefore recognized. Some of the loans to and receivables from customers are included in portfolio hedges. Loans to and receivables from customers assigned to portfolio hedges are measured at hedged fair value.

Loans and receivables are derecognized when they are repaid or settled. There are no indications of derecognition for loans/receivables from ABS transactions carried out by the Group.

9. Provision for Credit Risks

The VW FS AG Group takes full account of the default risk arising in connection with loans and receivables by recognizing specific and portfolio-based valuation allowances in accordance with IAS 39. These allowances are posted to valuation allowance accounts. Provisions are also recognized to take into account indirect residual value risks.

In the case of credit risk present in significant individual loans to or receivables from customers or banks (e.g. dealer financing loans/receivables and fleet customer business loans/receivables), specific valuation allowances are recognized in accordance with Group-wide standards in the amount of losses already incurred.

Potential impairment is assumed in a number of situations, such as delayed payment over a certain period, the initiation of enforcement measures, the threat of insolvency or overindebtedness, application for or the initiation of insolvency proceedings, or the failure of restructuring measures.

Insignificant loans/receivables and significant individual loans/receivables with no indication of impairment are grouped together into homogeneous portfolios using comparable credit risk features and broken down by risk category. As long as no definite information is available as to which loans or receivables are in default, average historical default probabilities for the portfolio concerned are used to calculate the amount of the valuation allowances. Regular backtesting is carried out to ensure that the valuation allowances are appropriate.

Loans and receivables are reported in the balance sheet at the net carrying amount. Disclosures relating to the provision for credit risks are presented separately in note (33).

Uncollectible loans or receivables that are already subject to a workout process and for which all collateral has been recovered and all further options for recovering the loan or receivable have been exhausted are written off directly. Any specific valuation allowances previously recognized are utilized. Income subsequently collected in connection with loans or receivables already written off is recognized in profit or loss.

10. Derivative Financial Instruments

Derivative financial instruments comprise derivatives in effective hedges and derivatives not designated as hedging instruments. All derivatives are measured at fair value and are presented separately in notes (34) and (45).

The fair value is determined with the help of measurement software in IT systems using the discounted cash flow method and taking into account credit value adjustments and debt value adjustments.

Derivatives are used as hedging instruments in fair value hedges or cash flow hedges. Hedge accounting in accordance with IAS 39 is only applied in the case of highly effective hedges.

When fair value hedges are applied, changes in the fair value of the derivative designated as the instrument used to hedge the fair value of a recognized asset or liability (hedged item) are recognized in profit or loss under net gain/loss on the measurement of derivative financial instruments and hedged items. Changes in the fair value of the hedged item in connection with which the risk is being minimized are also reported in profit or loss under the same item. The effects in profit or loss from the changes in the fair value of the hedging instrument and the hedged item balance each other out depending on the extent of hedge effectiveness.

IAS 39 permits the use of fair value hedging not only for individual hedged items, but also for a group of similar hedged items. In the reporting period, the VW FS AG Group used portfolio-based fair value hedges to hedge interest-rate risks. In portfolio-based hedging, the accounting treatment of changes in fair value is the same as in fair value hedging at micro level.

In the case of derivatives that are designated as hedges of future cash flows and that satisfy the relevant criteria, the effective portion of changes in the fair value of the derivative is recognized in the cash flow hedge reserve via other comprehensive income. Any effect on profit or loss arises solely from the ineffective portion of the change in fair value. The measurement of the hedged item remains unchanged.

Changes in the fair value of derivatives that do not satisfy the hedge accounting criteria in IAS 39 are recognized in profit or loss under net gain/loss on the measurement of derivative financial instruments and hedged items.

The VW FS AG Group documents all relationships between hedging instruments and hedged items. Hedge effectiveness is kept under constant review. In the VW FS AG Group, hedging transactions are used solely as part of asset/liability management activities.

With the exception of derivatives not designated as hedging instruments, no financial instruments are classified as financial assets or financial liabilities at fair value through profit or loss.

11. Marketable Securities

Marketable securities largely comprise fixed-income bonds issued by the public sector, investments of resources within the framework specified by the investment policy issued by VW Versicherung AG (mainly fixed-income securities and equities) and acquired bonds issued by a special purpose entity of another entity in the Volkswagen Group (see note 69). Marketable securities are categorized as available-for-sale financial assets. Changes from remeasurement are recognized in other comprehensive income. Permanent impairment losses are recognized in profit or loss.

Available-for-sale financial assets are subject to the recognition of impairment losses if there is objective evidence of permanent impairment. In the case of equity instruments, indicators of impairment include a significant (more than 20%) or long-term (more than 10% of the average market price over one year) fall in fair value below cost. If such an asset is found to be impaired, the cumulative loss is posted to other reserves and recognized in profit or loss. Reversals of impairment losses on equity instruments are reported in other comprehensive income.

In the case of debt instruments, impairment losses are recognized in the event of a forecast decline in future cash flows from the financial asset. On the other hand, a rise in the risk-free interest rate or an increase in credit risk premiums does not, by itself, generally represent objective evidence of impairment. Reversals of impairment losses on debt instruments are recognized in profit or loss.

In the prior year, an investment in Visa Europe Ltd. had been reported under marketable securities. Following the announcement of Visa Inc.'s acquisition of Visa Europe Ltd. in the second quarter of 2016, the investment was measured at fair value using an offer to buy as the basis, taking into account appropriate discounts for liquidity and the risk of potential changes in the offer to buy. The fair value was based on input factors under Level 3 of the fair value hierarchy specified in IFRS 13. The measurement of the investment at fair value in the previous year had given rise to a gain of €12 million, which had been recognized in other comprehensive income, taking into account deferred taxes. Visa Inc. completed its acquisition of Visa Europe Ltd. in the reporting period. As a consequence, the investment in Visa Europe Ltd. was sold, the associated reserves in equity for available-for-sale financial assets were reversed and a gain of €14 million was reported under net gain/loss on marketable securities and miscellaneous financial assets. As a noncurrent asset within the meaning of IFRS 5, the investment had been classified as held for sale and allocated to the Germany segment. For reasons of materiality, this asset is not presented separately in the balance sheet, nor are the related income and expenses shown separately in the income statement. The preferred shares in Visa Inc. acquired as part of the deal will be converted into ordinary shares in Visa Inc. using a predetermined ratio within a specified period. The preferred shares were measured using the market price of shares in Visa Inc. on the reporting date taking into account a liquidity markdown. Because the markdown included in the measurement was not material, the fair value of the shares was classified as Level 2.

Fixed-income bonds and bonds acquired from other entities in the Volkswagen Group amounting to a total of €2,053 million (previous year: €2,013 million) have been pledged as collateral for the VW FS AG Group's own liabilities. Most of these securities are deposited at Deutsche Bundesbank and are furnished as collateral in connection with open market operations.

12. Miscellaneous Financial Assets

Investments in subsidiaries that are not consolidated and other equity investments are reported as miscellaneous financial assets. The equity investments are measured at cost because there is no active market for these entities and fair values could not be reliably determined without disproportionate time, effort and expense. Investments in unconsolidated subsidiaries are recognized at cost taking into account any necessary impairment losses. Impairment losses are recognized in profit or loss if there are country-specific indications of significant or permanent impairment (e.g. imminent payment difficulties or economic crisis). Subsidiaries not consolidated for reasons of materiality do not fall within the scope of IAS 39 and are therefore not included in the disclosures required by IFRS 7.

13. Intangible Assets

Purchased intangible assets with finite useful lives (largely software) are recognized at cost and amortized on a straight-line basis over a useful life of three to five years. Subject to the conditions specified in IAS 38, internally developed software and all the direct and indirect costs that are directly attributable to the development process are capitalized. When assessing whether the development costs associated with internally generated software are to be capitalized or not, we take into account not only the probability of a future inflow of economic benefits but also the extent to which the costs can be reliably determined. Research costs are not capitalized. Amortization is on a straight-line basis over the useful life of three to five years and is reported under general and administrative expenses.

At every reporting date, intangible assets with finite useful lives are tested to establish whether there are any indications of impairment. An appropriate impairment loss is recognized if a comparison shows that the recoverable amount for the asset is lower than its carrying amount.

Intangible assets with indefinite useful lives are not amortized. An annual review is carried out to establish whether an asset has an indefinite useful life. In accordance with IAS 36, these assets are tested for impairment by comparing the carrying amount and recoverable amount at least once a year and additionally if relevant events or changes in circumstances should occur. If required, an impairment loss is recognized to reduce the carrying amount to a lower recoverable amount (see note 15).

Goodwill is tested for impairment once a year and also if relevant events or changes in circumstances occur. If the carrying amount of goodwill is higher than the recoverable amount, an impairment loss is recognized. There can be no subsequent reversal of such impairment losses.

The recoverable amount of goodwill is derived from the value in use for the relevant cash-generating unit, which is determined using the discounted cash flow method. The basis is the latest planning data prepared by management for a planning period of five years, with growth in subsequent years estimated using a flat rate percentage. This planning is based on expectations regarding future global economic trends, trends in the overall markets for passenger cars and commercial vehicles and on assumptions derived from these trends about financial services, taking into account market penetration, risk costs, margins and regulatory requirements. Planning assumptions are adjusted in line with the latest available information. The interest rate used is based on the long-term market interest rate relevant to each cash-generating unit (regions or markets). The calculations use a standard Group cost of equity of 7.5 % (previous year: 8.5 %). If necessary, the cost of equity rate is also adjusted for factors specific to the country and business concerned. The calculation of cash flows is based on the forecast growth rates for the relevant markets. Cash flows after the end of the planning period are generally estimated using a growth rate of 1 % p.a. (previous year: 1 % p.a.).

14. Property and Equipment

Property and equipment (land and buildings plus operating and office equipment) is carried at cost less depreciation and, if necessary, any impairment losses. Depreciation is applied on a straight-line basis over the estimated useful life. Useful lives are reviewed at every reporting date and adjusted where appropriate.
Depreciation is based mainly on the following useful lives:

Property and equipment	Useful lives
Buildings and property facilities	10 to 50 years
Operating and office equipment	3 to 10 years

An impairment loss is recognized in accordance with IAS 36 if the recoverable amount of the asset concerned has fallen below its carrying amount (see note 15).

The depreciation expense and impairment losses are reported within general and administrative expenses. Income from the reversal of impairment losses is recognized in net other operating income/expenses.

15. Impairment of Non-Financial Assets

Assets with an indefinite useful life are not depreciated or amortized; they are tested for impairment once a year and additionally if relevant events or changes in circumstances occur. Assets subject to depreciation and amortization are tested for impairment if relevant events or changes in circumstances indicate that the recoverable amount for the asset concerned is lower than its carrying amount.

An impairment loss is recognized in the amount by which the carrying amount exceeds the recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties. The value in use is defined as the net present value of future cash flows expected to be derived from the asset.

If the reasons for the recognition of an impairment loss in prior years now no longer apply, an appropriate reversal of the impairment loss is recognized. This does not apply to impairment losses recognized in respect of goodwill.

16. Leasing Business

GROUP AS LESSOR

The VW FS AG Group operates both finance lease business and operating lease business. The leases are mainly vehicle leases, but to a lesser extent also involve land, buildings and dealer equipment.

A finance lease is a lease that transfers substantially all the risks and rewards to the lessee. In the consolidated balance sheet, receivables from finance leases are therefore reported within loans to and receivables from customers and the net investment in the lease generally equates to the cost of the lease asset. Interest income from these transactions is reported under leasing income in the income statement. The interest paid by the customer is allocated so as to produce a constant periodic rate of interest on the remaining balance of the lease receivable.

In the case of operating leases, substantially all the risks and rewards related to the lease asset remain with the lessor. In this case, the assets involved are reported in a separate “Lease assets” item in the consolidated balance sheet, measured at cost and reduced by straight-line depreciation over the lease term to the calculated residual carrying amount. Any impairment identified as a result of an impairment test in accordance with IAS 36 in which the recoverable amount is found to have fallen below the carrying amount is taken into account by recognizing an impairment loss and adjusting the future depreciation rate. If the reasons for the recognition of an impairment loss in prior years no longer apply, a reversal of the impairment loss is recognized. Impairment losses and reversals of impairment losses are included in the net income from leasing transactions before provision for credit risks. The leasing revenue is recognized on a straight-line basis over the lease term.

Land and buildings held to earn rentals are reported under the “Investment property” item in the balance sheet and measured at amortized cost. The land and buildings involved are generally leased out to dealer businesses. The fair values disclosed in the notes are determined by the relevant entity by discounting the estimated future cash flows using the relevant long-term market discount rate. Depreciation is applied on a straight-line basis over useful lives of ten to 33 years. Any impairment identified as a result of an impairment test in accordance with IAS 36 is taken into account by recognizing an impairment loss.

GROUP AS LESSEE

Lease payments made under operating leases are recognized under general and administrative expenses.

In the case of finance leases, the leased assets are recognized at the lower of cost or present value of minimum lease payments and depreciated on a straight-line basis over the shorter of the asset’s useful life or lease term. The payment obligations in respect of the future lease installments are discounted and recognized as a liability.

BUYBACK TRANSACTIONS

Leases in which the VW FS AG Group has a firm agreement with the lessor regarding the return of the leased asset are recognized under other loans and receivables within loans to and receivables from customers at the amount of the resale value agreed at the inception of the lease and are also recognized under other assets in the amount equating to the right of use. In the case of noncurrent leases (maturity of more than one year), the agreed resale value is discounted at the inception of the lease. The unwinding of the discount during the term of the lease is recognized in interest income. The value of the right of use recognized under other assets is depreciated on a straight-line basis over the term of the lease. This depreciation is reported under expenses from the leasing business. Lease payments received under subleases are reported as income from leasing business.

17. Liabilities

Liabilities to banks and customers, notes and commercial paper issued, and subordinated capital liabilities are recognized at amortized cost using the effective interest method. Gains or losses arising from the changes in amortized cost are recognized in profit or loss, including the effects from changes in exchange rates. For reasons of materiality, current liabilities (due within one year) are not discounted and no unwinding of discount is therefore recognized.

18. Provisions for Pensions and Other Post-Employment Benefits

Provisions are recognized for commitments in the form of retirement, invalidity and surviving dependants' benefits payable under pension plans. The benefits provided by the Group vary according to the legal, tax and economic circumstances of the country concerned, and usually depend on the length of service and remuneration of the employees.

The VW FS AG Group provides occupational pensions in the form of both defined contribution and defined benefit plans. In the case of defined contribution plans, the Company makes contributions to state or private pension schemes based on statutory or contractual requirements, or on a voluntary basis. Once the contributions have been paid, the VW FS AG Group has no further obligations. Current contributions are recognized as expenses in the period concerned. In 2016, the total contributions made by the VW FS AG Group came to €45 million (previous year: €42 million). Contributions to the compulsory state pension system in Germany amounted to €37 million (previous year: €34 million).

Pension schemes in the VW FS AG Group are predominantly defined benefit plans in which there is a distinction between pensions funded by provisions (without plan assets) and externally funded plans (with plan assets). The pension provisions for defined benefit commitments are measured by independent actuaries using the internationally accepted projected unit credit method in accordance with IAS 19, under which the future obligations are measured on the basis of the proportionate benefit entitlements earned as of the reporting date. The measurement of pension provisions takes into account actuarial assumptions as to discount rates, salary and pension trends, and employee turnover rates, which are determined for each Group company depending on the economic environment. Actuarial gains or losses arise from differences between actual trends and prior-year assumptions as well as from changes in assumptions. These gains and losses are recognized in the period in which they arise in other comprehensive income (taking into account deferred taxes) and have no impact on profit or loss. Detailed disclosures on provisions for pensions and other post-employment benefits are set out in note (46).

19. Insurance Business Provisions

Inward reinsurance and direct insurance operations are accounted for in the period in which the reinsurance or insurance arises without any time delay.

Insurance contracts are accounted for in accordance with IFRS 4 and, to the extent permitted by local accounting regulations, also in accordance with sections 341ff. of the HGB and the Verordnung über die Rechnungslegung von Versicherungsunternehmen (RechVersV – German Accounting Regulation for Insurance Companies).

Unearned premiums for direct insurance business are generally determined on the basis of each individual contract using the 1/act method.

Provisions for claims outstanding in direct insurance operations are normally determined and measured on the basis of each claim in accordance with the estimated requirement. The chain ladder method or modified chain ladder method is generally used to determine the provision for incurred but not reported (IBNR) losses.. The partial loss provision for claims settlement expenses is calculated in accordance with the requirements set out in the coordinated regulations issued by the German federal states on February 2, 1973.

The provision for with-profits and no claims premium refunds includes solely obligations in connection with no claims premium refunds and is estimated on the basis of contract-specific claims experience.

The other underwriting provisions include the cancellation provision for direct insurance business, which is based on historical cancellation rates.

No equalization provision is recognized because this is prohibited under IFRS 4.

The reinsurers' share of provisions is calculated in accordance with the contractual agreements with the retrocessionaires and reported under other assets.

Provisions for claims outstanding in inward reinsurance business are generally recognized on the basis of the information provided by the cedants.

Actuarial methods and systems that guarantee ongoing monitoring and control of all key insurance risks are used to ensure that the level of underwriting provisions is adequate. One of the main features of the insurance business is underwriting risk, which comprises in particular premium/loss risk, reserve risk, cancellation risk and catastrophe risk. We counter these risks by constantly monitoring the bases of computations, making appropriate additions to provisions and applying a restrictive underwriting policy.

20. Other Provisions

Under IAS 37, provisions are recognized if a present legal or constructive obligation to third parties has arisen as a result of a past event, it is probable that settlement in the future will result in an outflow of resources and the amount of the obligation can be estimated reliably. If an outflow of resources is neither probable nor improbable, the amount concerned is deemed to be a contingent liability. In accordance with IAS 37, this contingent liability is not recognized but disclosed in note (66).

Provisions for litigation and legal risks are recognized and measured using assumptions about the probability of an unfavorable outcome and the amount of possible utilization.

The reversal of other provisions is recognized as other operating income whereas the expense from the recognition of new provisions is allocated to the relevant expense items.

Provisions that are not related to an outflow of resources likely to take place in the subsequent year are recognized at their settlement amount discounted to the reporting date using market discount rates. An average discount rate of 0.04% (previous year: 0.45%) has been used for the eurozone. The settlement amount also includes expected cost increases. Any rights of recourse are not offset against provisions.

21. Estimates and Assumptions by Management

The preparation of the consolidated financial statements requires management to make certain estimates and assumptions that affect the recognition and measurement of assets, liabilities, income and expenses, and the disclosures relating to contingent assets and liabilities for the reporting period.

Assumptions and estimates are based on the latest available information. The circumstances prevailing at the time the consolidated financial statements are prepared and future trends in the global and sector environment considered to be realistic are taken into account in the projected future performance of the business. The estimates and assumptions used by management have been made, in particular, on the basis of assumptions relating to macroeconomic trends as well as trends in automotive markets, financial markets and the legal framework. These and other assumptions are explained in detail in the report on expected developments, which forms an integral part of the management report.

As future business performance is subject to unknown factors that, in part, lie outside the control of the Group, our assumptions and estimates continue to be subject to considerable uncertainty. If changes in parameters are different from the assumptions and beyond any influence that can be exercised by management, the amounts actually arising could differ from the estimated values originally forecast. If actual performance is at variance with the forecasts, the assumptions and, where necessary, the carrying amounts of the assets and liabilities concerned are adjusted accordingly.

The assumptions and estimates largely relate to the items set out below.

RECOVERABLE AMOUNT OF LEASE ASSETS

The recoverable amount of the lease assets in the Group mainly depends on the residual value of the lease vehicles when the leases expire because this value represents a considerable proportion of the expected cash inflows. Continuously updated internal and external information on trends in residual values – based on particular local circumstances and empirical values from the marketing of used vehicles – is factored into the forecasts of residual values for lease vehicles. These forecasts require the Group to make assumptions, primarily in relation to future supply and demand for vehicles and in relation to trends in vehicle prices. These assumptions are based on either professional estimates or information published by third-party experts. The professional estimates are based on external data (where available), taking into account any additional information available internally, such as values from past experience and current sales data. Forecasts and assumptions are regularly verified by a process of backtesting.

FINANCIAL INSTRUMENTS

The procedure for determining the recoverability of financial assets requires estimates about the extent and probability of occurrence of future events. As far as possible, these estimates take into account the latest market data as well as rating classes and scoring information based on past experience. Further details on specific and portfolio-based valuation allowances can be found in the disclosures on the provision for credit risks (note 9).

Management estimates are necessary to determine the fair value of financial instruments. This relates to both fair value as a measurement standard in the balance sheet and fair value in the context of disclosures in the notes. Fair value measurements are categorized into a three-level hierarchy depending on the type of inputs to the valuation techniques used and each level requires different management estimates. Fair values in Level 1 are based on prices quoted in active markets. Management assessments in this case relate to determining the primary or most advantageous market. Level 2 fair values are measured on the basis of observable market data using market-based valuation techniques. Management decisions for this level relate to selecting generally accepted, standard industry models and specifying the market in which the relevant input factors are observable. Level 3 fair values are determined with recognized valuation techniques relying on some inputs that cannot be observed in an active market. Management judgment is required in this case when selecting the valuation techniques and determining the inputs to be used. These inputs are developed using the best available information. If the Company uses its own data, it applies appropriate adjustments to best reflect market conditions.

COSTS UNDER SERVICE CONTRACTS

Estimated costs arising from contracts for servicing and wear-and-tear repairs, which are included in other liabilities, are measured using past experience of the actual use of such service contracts. The measurement parameters for costs arising under service contracts are regularly reviewed.

PROVISIONS

The recognition and measurement of provisions is also based on assumptions about the probability that future events will occur and the amounts involved, together with an estimation of the discount rate. Again, past experience or reports from external experts are used as far as possible.

The measurement of pension provisions is based on actuarial assumptions as to discount rates, salary and pension trends, employee turnover rates and increases in healthcare costs, which are determined for each Group company depending on the economic environment. In the case of other provisions, expected values are used as the basis for measurement, which means that changes are made on a regular basis, involving either additions to the provisions or the reversal of unused provisions. Changes in the estimates of the amounts for other provisions are always recognized in profit or loss. The recognition and measurement of provisions for litigation and legal risks included within other provisions requires predictions with regard to decisions to be made by the courts and the outcome of legal proceedings. Each case is individually assessed on its merits based on developments in the proceedings, the Company's past experience in comparable situations and evaluations made by experts and lawyers.

RECOVERABLE AMOUNT OF NON-FINANCIAL ASSETS, JOINT VENTURES AND EQUITY INVESTMENTS

The impairment tests applied to non-financial assets (particularly goodwill and brand names), equity-accounted joint ventures and equity investments measured at cost require assumptions related to the future cash flows in the planning period and, where applicable, beyond. The assumptions about the future cash flows factor in expectations regarding future global economic trends, trends in the overall markets for passenger cars and commercial vehicles and expectations derived from these trends about financial services, taking into account market penetration, risk costs, margins and regulatory requirements. For further information on the assumptions relating to the detailed planning period, please refer to the report on expected developments, which forms part of the management report. The discount rates used in the discounted cash flow method applied when testing goodwill for impairment are based on specified cost of equity rates, taking into account historical experience and appropriate assumptions regarding macroeconomic trends. In particular the forecasts for short- and medium-term cash flows, and the discount rates used, are subject to uncertainty outside the control of the Group.

DEFERRED TAX ASSETS AND UNCERTAIN INCOME TAX ITEMS

When determining deferred tax assets, there is a need to make assumptions about future taxable income and the timings for any recovery of the deferred tax assets. The measurement of deferred tax assets for tax loss carryforwards is generally based on future taxable income within a planning horizon of five fiscal years. In the recognition of uncertain income tax items, the expected tax payment is used as the basis for the best estimate.

Income Statement Disclosures

22. Net Income from Lending, Leasing and Insurance Transactions before Provision for Credit Risks

The breakdown of net income from lending, leasing and insurance transactions before provision for credit risks is as follows:

€ million	2016	2015
Interest income from lending and money market transactions	3,848	3,909
Income from leasing transactions and service contracts	14,507	13,568
Expenses from leasing transactions and service contracts	−10,536	−9,603
Depreciation of and impairment losses on lease assets and investment property	−2,710	−2,631
Interest expense	−1,363	−1,461
Total	**3,744**	**3,780**

Interest income from lending and money market transactions and the income from leasing transactions and service contracts include interest income on impaired loans and receivables amounting to a total of €30 million (previous year: €37 million).

Income from leasing transactions and service contracts includes rental income on investment property amounting to €2 million (previous year: €2 million). The following amounts have also been recognized under income from leasing transactions and service contracts: contingent payments under finance leases of €27 million (previous year: €27 million) and under operating leases of €17 million (previous year: €11 million).

In connection with assets leased in as part of buyback transactions, payments of €461 million (previous year: €458 million) were recognized as an expense in the reporting period.

The impairment losses recognized as a result of the impairment test on lease assets amounted to €188 million (previous year: €353 million) and are included in the depreciation of and impairment losses on lease assets. Impairment losses are based on continuously updated internal and external information, which is then fed into the forecasts of residual values for vehicles. Impairment losses on lease assets in the reporting year were not impacted by the diesel issue, although this had been the case in the previous year. In the previous year, some of the impairment losses were offset by support payments from the Volkswagen Group.

Income from reversals of impairment losses on lease assets applied in prior years amounted to €67 million (previous year: €2 million) and is included in income from leasing business. The year-on-year rise in income from such reversals is attributable to the fact that, in the year under review, it was possible to reduce the risk provisioning that had been recognized in 2015.

The interest income included here that relates to financial instruments not allocated to the category of financial assets or financial liabilities measured at fair value through profit or loss amounted to €3,884 million (previous year: €3,936 million).

The following table shows the net income from insurance business:

€ million	2016	2015
Insurance premiums earned	197	165
Insurance claims expenses	–115	–108
Reinsurance commissions and with-profits expenses	–2	0
Other underwriting expenses	–1	–1
Total	**79**	**56**

The interest expenses include funding expenses for lending and leasing business, and an amount of €1,346 million (previous year: €1,418 million) relates to financial instruments not measured at fair value through profit or loss. The net expense arising from interest income and expenses in the reporting period on derivatives not designated as hedging instruments amounts to €75 million (previous year: €91 million).

23. Provision for Credit Risks from Lending and Leasing Business

The provision for credit risks relates to the balance sheet items “Loans to and receivables from customers” and “Provisions for lending business”. The breakdown of the amount recognized in the consolidated income statement is as follows:

€ million	2016	2015
Additions to provision for credit risks	–1,094	–1,075
Reversals of provision for credit risks	533	468
Direct write-offs	–169	–126
Income from loans and receivables previously written off	58	62
Total	**–672**	**–672**

Additional credit risks to which the Volkswagen Financial Services AG Group is exposed as a result of the crises (economic crises, Brexit impact, block on sales) in some eurozone countries and in the United Kingdom, Russia, Brazil, India and the Republic of Korea were accounted for in the reporting period by recognizing valuation allowances of €224 million (previous year: €224 million).

24. Net Fee and Commission Income

Net fee and commission income largely comprises income and expenses from insurance broking, together with fees and commissions from the financing business and financial services business.

The breakdown is as follows:

€ million	2016	2015
Fee and commission income	594	593
of which commissions from insurance broking	452	451
Fee and commission expenses	−581	−497
of which sales commission in the financing business	−497	−398
Total	**13**	**96**

The higher level of sales commission expenses in the financing business resulted from commissions paid as part of the confidence-building campaign with the brands and dealers.

25. Net Gain/Loss on the Measurement of Derivative Financial Instruments and Hedged Items

This item includes the net gains or losses on hedges, on derivatives not designated as hedging instruments and on the measurement of foreign currency loans/receivables and liabilities.

The net gain or loss on hedges comprises gains and losses arising from the fair value measurement of hedging instruments and hedged items. Gains and losses arising from changes in the fair value of derivatives that do not satisfy the IAS 39 requirements for hedge accounting are recognized under gains and losses on other derivatives not designated as hedging instruments.

The detailed breakdown of the gains and losses is as follows:

€ million	2016	2015
Gains/losses on hedging instruments in fair value hedges and cash flow hedges	634	376
Gains/losses on hedged items in fair value hedges	−669	−387
Ineffective portion of hedging instruments in cash flow hedges	0	0
Gains/losses on the measurement of foreign currency loans/receivables and liabilities	−4	−121
Gains/losses on derivatives not designated as hedging instruments	−45	186
Total	**−85**	**53**

There were no other gains or losses from changes in the fair value of financial instruments.

26. Net Gain/Loss on Marketable Securities and Miscellaneous Financial Assets

The net gain/loss on marketable securities and miscellaneous financial assets includes income and expenses arising from marketable securities, dividend income, and income and expenses arising from profit or loss transfers.

27. General and Administrative Expenses

The breakdown of general and administrative expenses is shown in the following table:

€ million	2016	2015
Personnel expenses	−954	−935
Non-staff operating expenses	−924	−948
Advertising, public relations and sales promotion expenses	−60	−73
Depreciation of and impairment losses on property and equipment, amortization of and impairment losses on intangible assets	−74	−95
Other taxes	−27	−11
Total	**−2,040**	**−2,062**

The non-staff operating expenses include expenses of €43 million (previous year: €43 million) for leased-in assets under operating leases related in particular to land and buildings as well as office and operating equipment.

In the previous year, the amortization of and impairment losses on intangible assets included an impairment loss on internally generated software amounting to €18 million.

In accordance with the requirements specified in section 314(1) no. 9 of the HGB, the general and administrative expenses for fiscal year 2016 include the fees charged by the independent auditors as shown in the following table.

€ million	2016	2015
Financial statements audit services	3	3
Other attestation services	2	2
Tax consulting services	0	0
Other services	1	3
Total	**6**	**8**

28. Net Other Operating Income/Expenses

The breakdown of the net other operating income/expenses is as follows:

€ million	2016	2015
Income from cost allocations to other entities in the Volkswagen Group	74	59
Income from the reversal of provisions and deferred income	252	294
Income from claims for damages	16	11
Income from the disposal of vehicles under financing agreements	135	74
Miscellaneous operating income	550	261
Litigation and legal risk expenses	−180	−200
Expenses from the disposal of vehicles under financing agreements	−169	−90
Other operating expenses	−165	−197
Net other operating income/expenses	**512**	**212**

The rise in other operating income includes support payments from the Volkswagen Group.

29. Income Tax Expense

Income tax expense includes the taxes charged in respect of the Volkswagen AG tax group, taxes for which VW FS AG and its consolidated subsidiaries are the taxpayers, and deferred taxes. The components of the income tax expense are as follows:

€ million	2016	2015
Current tax expense, Germany	−43	155
Current tax expense, foreign	−471	−321
Current income tax expense	**−514**	**−166**
of which income (+)/expense (–) related to prior periods	(−34)	(−13)
Deferred tax income (+)/expense (–), Germany	−246	−288
Deferred tax income (+)/expense (–), foreign	251	150
Deferred tax income (+)/expense (–)	**5**	**−137**
Income tax expense	**−509**	**−304**

The reported tax expense in 2016 of €509 million (previous year: €304 million) is €16 million higher (previous year: €147 million lower) than the expected tax expense of €493 million (previous year: €451 million) calculated by applying the tax rate of 29.9 % (previous year: 29.8 %) to the consolidated profit before tax.

The following reconciliation shows the relationship between the income tax expense and the profit before tax for the reporting period:

€ million	2016	2015
Profit before tax	**1,650**	**1,513**
multiplied by the domestic income tax rate of 29.9 % (previous year: 29.8 %)		
= Imputed income tax expense in the reporting period at the domestic income tax rate	**−493**	**−451**
+ Effects from tax credits	1	2
+ Effects from domestic/foreign tax rates	56	36
+ Effects from changes in tax rates	0	−3
+ Effects from permanent differences	−39	102
+ Effects from tax-exempt income	120	112
+ Effects from loss carryforwards	2	2
+ Effects from non-deductible operating expenses	−123	−126
+ Taxes attributable to prior periods	−34	12
+ Other variances	0	10
= Current income tax expense	**−509**	**−304**

The statutory corporation tax rate in Germany for the 2016 assessment period was 15 %. Including trade tax and the solidarity surcharge, this resulted in an aggregate tax rate of 29.9 %.

In the German tax group, a tax rate of 29.9 % (previous year: 29.8 %) was used to measure deferred taxes.

The effects from different income tax rates outside Germany arise because of the different income tax rates in the individual countries in which the Group companies are domiciled compared with the rates in Germany. These rates outside Germany vary between 12.5 % and 45.0 % (previous year: 12.5 % and 45.0 %).

As of December 31, 2016, there were unused tax loss carryforwards of €133 million (previous year: €166 million) for which deferred tax assets of €17 million (previous year: €25 million) had been recognized. Of these unused tax loss carryforwards, €80 million (previous year: €90 million) can be used without any time restriction, while €9 million (previous year: €22 million) must be used within the next five years, €12 million (previous year: €20 million) within five to ten years and €31 million (previous year: €34 million) within a period longer than ten years but subject to limitations.

No deferred tax assets have been recognized in respect of certain tax loss carryforwards deemed to be unusable and amounting to €71 million (previous year: €75 million). Of these tax loss carryforwards that the Group is unable to use, €12 million (previous year: €14 million) could have been used subject to limitations within a period of up to ten years and €58 million (previous year: €61 million) without any time restriction.

The tax credits granted by various countries led to the recognition of a tax benefit in an amount of €0.2 million (previous year: €6 million).

The deferred tax expense decreased in the reporting period by €0.3 million (previous year: €3 million) as a result of previously unrecognized tax losses in an earlier period. In the reporting period, deferred tax income from the reversal of an impairment loss on a deferred tax asset amounted to €1 million (previous year: €0.6 million). Changes in tax rates have given rise to deferred tax income throughout the Group of €0.3 million (previous year: deferred tax expenses of €3 million).

There were no notable deductible temporary differences for 2016 for which no deferred tax asset was recognized in the balance sheet (previous year: €10 million).

The Group has recognized deferred tax assets of €108 million (previous year: €96 million) against which there are no deferred tax liabilities in an equivalent amount. The companies involved are expecting to generate profits in the future following losses in the reporting and in the prior period.

In accordance with IAS 12.39, deferred tax liabilities of €45 million (previous year: €37 million) have not been recognized for temporary differences and undistributed profits of subsidiaries because Volkswagen Financial Services AG has the relevant control.

Of the deferred taxes recognized in the balance sheet, an amount of €74 million (previous year: €59 million) relates to transactions reported in other comprehensive income. Within this figure, an amount of €92 million (previous year: €61 million) relates to actuarial gains or losses (IAS 19), €–4 million (previous year: €3 million) to derivative financial instruments and €–14 million (previous year: €–4 million) to the fair value measurement of marketable securities.

30. Further Income Statement Disclosures

Fee and commission income and expenses related to fiduciary activities and to financial assets or financial liabilities not measured at fair value and not measured using the effective interest method:

€ million	2016	2015
Income from fees and commissions	66	51
Expenses from fees and commissions	0	0
Total	**66**	**51**

Balance Sheet Disclosures

31. Cash Reserve

The cash reserve includes credit balances of €1,363 million (previous year: €1,264 million) held with Deutsche Bundesbank.

32. Loans to and Receivables from Customers

The loans to and receivables from customers item includes deductions arising from the recognized provision for credit risks from lending and leasing business. The provision for credit risks from lending and leasing business is presented in note (33).

Loans to and receivables from customers arising from retail financing generally comprise loans to private and commercial customers for the financing of vehicles. The vehicle itself is normally pledged to us as collateral for the financing of vehicles. Dealer financing encompasses floor plan financing as well as loans to the dealer organization for operating equipment and investment. Again, assets are pledged as collateral, but guarantees and charges on real estate are also used as security. Receivables from leasing transactions include receivables from finance leases and receivables due in connection with lease assets. The other loans and receivables largely consist of loan and receivables from entities in the Volkswagen Group, receivables from leasing transactions with a buyback agreement, together with credit lines and overdraft facilities drawn down by customers. Other loans and receivables include subordinated assets in the amount of €217 million (previous year: €195 million).

Some of the fixed-income exposures under loans and receivables from retail financing and finance lease receivables have been hedged against fluctuations in the risk-free base interest rate using a portfolio hedge. Receivables from operating leases are excluded from this hedging strategy because they do not satisfy the definition of a financial instrument within the meaning of IAS 39 in conjunction with IAS 32.

The reconciliation to the balance sheet values is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Loans to and Receivables from Customers	**100,564**	**92,771**
Fair value adjustment from portfolio hedging	–8	–18
Loans to and receivables from customers, net of fair value adjustment from portfolio hedging	100,572	92,789

Receivables from leasing transactions include due receivables amounting to €312 million (previous year: €247 million).

As of the reporting date, receivables from operating leases amounted to €111 million (previous year: €78 million).

The breakdown of receivables from finance leases as of December 31, 2015 and December 31, 2016 was as follows:

€ million	2016	2017 – 2020	from 2021	Total
Future payments from finance lease receivables[1]	7,669	12,962	61	20,692
Unearned finance income from finance leases (discounting)[1]	–397	–668	–3	–1,068
Present value of minimum lease payments outstanding at the reporting date	7,272	12,294	57	19,624

1 The presentation of prior year figures has been amended.

€ million	2017	2018 – 2021	from 2022	Total
Future payments from finance lease receivables	8,438	14,499	53	22,989
Unearned finance income from finance leases (discounting)	–420	–682	–3	–1,105
Present value of minimum lease payments outstanding at the reporting date	8,018	13,817	50	21,884

In the VW FS AG Group, the present value of the minimum lease payments outstanding as of the reporting date equates to the net receivables from finance leases disclosed above.

A provision for credit risks in connection with outstanding minimum lease payments has been recognized in the amount of €36 million (previous year: €36 million).

33. Provision for Credit Risks from Lending and Leasing Business

The provision for credit risks from lending and leasing business is recognized in accordance with standard rules applicable throughout the Group and covers all identifiable credit risks.

€ million	Specific valuation allowances	Portfolio-based valuation allowances	2016	Specific valuation allowances	Portfolio-based valuation allowances	2015
Balance as of Jan. 1	**1,108**	**1,583**	**2,692**	**1,112**	**1,339**	**2,452**
Exchange rate and other changes	74	–19	55	–77	–18	–95
Changes in basis of consolidation	–	–	–	–21	–5	–26
Additions	492	571	1,063	558	501	1,059
Utilization	184	–	184	201	–	201
Reversals	179	350	530	218	241	460
Interest income on impaired loans and receivables	30	–	30	37	–	37
Reclassification	–2	2	–	–7	7	–
Balance as of Dec. 31	**1,280**	**1,787**	**3,066**	**1,108**	**1,583**	**2,692**

The provision for credit risks has been recognized in respect of loans to and receivables from customers. At the end of the reporting period, valuation allowances of €876 million (previous year: €652 million) had been recognized in relation to loans to and receivables from individual countries in the eurozone, the United Kingdom, Russia, Brazil, India and the Republic of Korea, which are affected by various crises (economic crises, Brexit impact, block on sales).

34. Derivative Financial Instruments

This item comprises the positive fair values from hedges and from derivatives not designated as a hedging instrument. The breakdown is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Transactions to hedge against		
currency risk on assets using fair value hedges	235	120
currency risk on liabilities using fair value hedges	398	454
interest-rate risk using fair value hedges	492	455
of which hedges against interest-rate risk using portfolio fair value hedges	1	1
interest-rate risk using cash flow hedges	15	0
currency and pricing risk on future cash flows using cash flow hedges	15	18
Hedging transactions	**1,156**	**1,047**
Assets arising from derivatives not designated as hedges	142	131
Total	**1,297**	**1,178**

35. Equity-Accounted Joint Ventures and Miscellaneous Financial Assets

€ million	Equity-accounted investments	Miscellaneous financial assets	Total
Gross carrying amount as of Jan. 1, 2015	**470**	**157**	**627**
Foreign exchange differences	–	0	0
Changes in basis of consolidation	–	–	–
Additions	72	95	167
Reclassifications	44	–44	–
Disposals	10	0	10
Changes recognized in profit or loss	24	–	24
Dividends	–12	–	–12
Other changes recognized in other comprehensive income	–23	–	–23
Balance as of Dec. 31, 2015	**564**	**207**	**772**
Impairment losses Balance as of Jan. 1, 2015	**26**	**1**	**28**
Foreign exchange differences	–	–	–
Changes in basis of consolidation	–	–	–
Additions	–	–	–
Reclassifications	–	–	–
Disposals	–	–	–
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2015	**26**	**1**	**28**
Net carrying amount as of Dec. 31, 2015	**538**	**206**	**744**
Net carrying amount as of Jan. 1, 2015	**443**	**156**	**599**

The reclassifications in the previous year of €44 million included the investment in Volkswagen Financial Services South Africa (Pty) Ltd., which had been accounted for using the equity method for the first time in 2015.

€ million	Equity-accounted investments	Miscellaneous financial assets	Total
Gross carrying amount as of Jan. 1, 2016	**564**	**207**	**772**
Foreign exchange differences	–	0	0
Changes in basis of consolidation	–	–	–
Additions	10	82	92
Reclassifications	–	–	–
Disposals	–	0	0
Changes recognized in profit or loss	77	–	77
Dividends	–	–	–
Other changes recognized in other comprehensive income	7	–	7
Balance as of Dec. 31, 2016	**659**	**289**	**948**
Impairment losses Balance as of Jan. 1, 2016	**26**	**1**	**28**
Foreign exchange differences	–	–	–
Changes in basis of consolidation	–	–	–
Additions	–	–	–
Reclassifications	–	–	–
Disposals	–	0	0
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2016	**26**	**1**	**28**
Net carrying amount as of Dec. 31, 2016	**633**	**288**	**920**
Net carrying amount as of Jan. 1, 2016	**538**	**206**	**744**

36. Intangible Assets

€ million	Internally generated software	Brand names, customer base	Goodwill	Other intangible assets	Total
Cost					
Balance as of Jan. 1, 2015	**114**	**56**	**41**	**197**	**408**
Foreign exchange differences	−3	−4	−1	−1	−9
Changes in basis of consolidation	–	–	–	0	0
Additions	6	–	–	23	29
Reclassifications	–	–	–	–	–
Disposals	0	–	–	6	6
Balance as of Dec. 31, 2015	**117**	**53**	**40**	**213**	**422**
Amortization and impairment losses					
Balance as of Jan. 1, 2015	**79**	**8**	**–**	**137**	**224**
Foreign exchange differences	−1	0	–	0	−1
Changes in basis of consolidation	–	–	–	0	0
Additions to cumulative amortization	6	2	–	29	37
Additions to cumulative impairment losses	18	–	–	–	18
Reclassifications	–	–	–	–	–
Disposals	–	–	–	5	5
Reversal of impairment losses	–	–	–	–	–
Balance as of Dec. 31, 2015	**101**	**10**	**–**	**162**	**273**
Net carrying amount as of Dec. 31, 2015	**16**	**43**	**40**	**51**	**149**
Net carrying amount as of Jan. 1, 2015	**35**	**48**	**41**	**60**	**184**

€ million	Internally generated software	Brand names, customer base	Goodwill	Other intangible assets	Total
Cost					
Balance as of Jan. 1, 2016	**117**	**53**	**40**	**213**	**422**
Foreign exchange differences	2	2	0	3	7
Changes in basis of consolidation	–	–	–	–	–
Additions	3	–	–	28	32
Reclassifications	–	–	–	0	0
Disposals	4	–	–	1	5
Balance as of Dec. 31, 2016	**118**	**54**	**40**	**243**	**456**
Amortization and impairment losses					
Balance as of Jan. 1, 2016	**101**	**10**	**–**	**162**	**273**
Foreign exchange differences	0	0	–	2	2
Changes in basis of consolidation	–	–	–	–	–
Additions to cumulative amortization	3	2	–	29	33
Additions to cumulative impairment losses	–	–	–	0	0
Reclassifications	–	–	–	–	–
Disposals	2	–	–	1	3
Reversal of impairment losses	–	–	–	–	–
Balance as of Dec. 31, 2016	**102**	**12**	**–**	**192**	**306**
Net carrying amount as of Dec. 31, 2016	**17**	**43**	**40**	**51**	**150**
Net carrying amount as of Jan. 1, 2016	**16**	**43**	**40**	**51**	**149**

The goodwill of €40 million (previous year: €40 million) and brand names of €35 million (previous year: €32 million) in Brazil, Poland and Germany on the balance sheet as of the reporting date have an indefinite useful life. The indefinite useful life arises because goodwill and brand names are linked to the relevant cash-generating unit and will therefore remain in existence for as long as this unit also remains in existence. The customer base in Poland is being amortized over a period of ten years.

Of the total recognized goodwill, €29 million (previous year: €30 million) was attributable to Poland and €11 million (previous year: €10 million) to Brazil. The discount rates used for the impairment tests are as follows: 11.8 % (previous year: 12.8 %) for Poland and 12.7 % (previous year: 12.2 %) for Brazil.

The impairment tests for the reported goodwill are based on the value in use. The values in use determined for the reported goodwill in the impairment tests exceeded the corresponding carrying amounts, so no impairment loss requirement was identified for any of the reported goodwill. The VW FS AG Group also carried out sensitivity analyses as part of the impairment tests. No possible change in a material assumption would lead to the recognition of an impairment loss for goodwill.

37. Property and Equipment

€ million	Land and buildings	Operating and office equipment	Total
Cost			
Balance as of Jan. 1, 2015	**315**	**238**	**553**
Foreign exchange differences	2	−2	1
Changes in basis of consolidation	−5	0	−5
Additions	12	62	73
Reclassifications	−8	12	5
Disposals	13	27	40
Balance as of Dec. 31, 2015	**303**	**283**	**586**
Depreciation and impairment losses			
Balance as of Jan. 1, 2015	**95**	**151**	**246**
Foreign exchange differences	1	0	0
Changes in basis of consolidation	0	0	0
Additions to cumulative depreciation	10	30	40
Additions to cumulative impairment losses	–	0	0
Reclassifications	0	0	0
Disposals	9	7	17
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2015	**96**	**173**	**269**
Net carrying amount as of Dec. 31, 2015	**207**	**110**	**317**
Net carrying amount as of Jan. 1, 2015	**220**	**87**	**307**

€ million	Land and buildings	Operating and office equipment	Total
Cost			
Balance as of Jan. 1, 2016	**303**	**283**	**586**
Foreign exchange differences	0	0	0
Changes in basis of consolidation	–	–	–
Additions	12	31	43
Reclassifications	–1	1	0
Disposals	0	64	65
Balance as of Dec. 31, 2016	**313**	**251**	**564**
Depreciation and impairment losses			
Balance as of Jan. 1, 2016	**96**	**173**	**269**
Foreign exchange differences	0	0	0
Changes in basis of consolidation	–	–	–
Additions to cumulative depreciation	10	31	41
Additions to cumulative impairment losses	–	–	–
Reclassifications	–	0	0
Disposals	0	60	61
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2016	**105**	**144**	**250**
Net carrying amount as of Dec. 31, 2016	**208**	**106**	**314**
Net carrying amount as of Jan. 1, 2016	**207**	**110**	**317**

In connection with land and buildings, land charges of €13 million (previous year: €13 million) serve as collateral for financial liabilities.

Assets under construction with a carrying amount of €9 million (previous year: €2 million) are included in land and buildings.

38. Lease Assets and Investment Property

€ million	Movable lease assets	Investment property	Total
Cost			
Balance as of Jan. 1, 2015	**13,946**	**29**	**13,975**
Foreign exchange differences	151	0	151
Changes in basis of consolidation	0	–	0
Additions	11,941	–	11,941
Reclassifications	0	–4	–5
Disposals	9,076	3	9,079
Balance as of Dec. 31, 2015	**16,961**	**22**	**16,983**
Depreciation and impairment losses			
Balance as of Jan. 1, 2015	**3,180**	**8**	**3,188**
Foreign exchange differences	33	0	33
Changes in basis of consolidation	0	–	0
Additions to cumulative depreciation	2,278	1	2,278
Additions to cumulative impairment losses	353	–	353
Reclassifications	0	0	0
Disposals	1,863	1	1,864
Reversal of impairment losses	2	–	2
Balance as of Dec. 31, 2015	**3,978**	**7**	**3,986**
Net carrying amount as of Dec. 31, 2015	**12,982**	**15**	**12,997**
Net carrying amount as of Jan. 1, 2015	**10,766**	**22**	**10,788**

In the prior year, we expected the following payments over the next few years from noncancelable leases:

€ million	2016	2017 – 2020	Total
Lease payments	156	162	318

The following table shows the present values in the prior year of future lease payments arising from buildings leased under finance leases:

€ million	2016	2017 – 2020	From 2021	Total
Lease payments	2	6	4	12
Interest component	0	1	0	2
Carrying amount of liabilities	**2**	**5**	**4**	**10**

€ million	Movable lease assets	Investment property	Total
Cost			
Balance as of Jan. 1, 2016	**16,961**	**22**	**16,983**
Foreign exchange differences	−442	0	−442
Changes in basis of consolidation	–	–	–
Additions	12,486	0	12,486
Reclassifications	–	–	–
Disposals	10,036	2	10,039
Balance as of Dec. 31, 2016	**18,968**	**21**	**18,988**
Depreciation and impairment losses			
Balance as of Jan. 1, 2016	**3,978**	**7**	**3,986**
Foreign exchange differences	−98	0	−98
Changes in basis of consolidation	–	–	–
Additions to cumulative depreciation	2,522	1	2,523
Additions to cumulative impairment losses	188	–	188
Reclassifications	0	–	0
Disposals	2,251	2	2,253
Reversal of impairment losses	67	–	67
Balance as of Dec. 31, 2016	**4,272**	**7**	**4,279**
Net carrying amount as of Dec. 31, 2016	**14,696**	**14**	**14,710**
Net carrying amount as of Jan. 1, 2016	**12,982**	**15**	**12,997**

The fair value of investment property amounts to €16 million (previous year: €16 million). The fair value is determined using an income approach based on internal calculations (Level 3 of the fair value hierarchy). Operating expenses of €1 million (previous year: €2 million) were incurred in the reporting period for the maintenance of investment property.

In the reporting period, we expected the following payments over the next few years from noncancelable leases:

€ million	2017	2018 – 2021	Total
Lease payments	223	245	468

The following table shows the present values in the reporting period of future lease payments arising from buildings leased under finance leases:

€ million	2017	2018 – 2021	From 2022	Total
Lease payments	2	6	3	11
Interest component	0	1	0	2
Carrying amount of liabilities	**1**	**5**	**3**	**9**

39. Deferred Tax Assets

The deferred tax assets comprise exclusively deferred income tax assets, the breakdown of which is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Deferred tax assets	9,183	8,589
of which noncurrent	4,252	3,812
Recognized benefit from unused tax loss carryforwards, net of valuation allowances	17	25
of which noncurrent	17	25
Offset (with deferred tax liabilities)	–7,366	–6,911
Total	**1,834**	**1,703**

Deferred tax assets are recognized in connection with the following balance sheet items:

€ million	Dec. 31, 2016	Dec. 31, 2015
Loans, receivables and other assets	668	325
Marketable securities and cash	2,545	2,755
Intangible assets/property and equipment	19	14
Lease assets	5,255	4,738
Liabilities and provisions	696	755
Valuation allowances for deferred tax assets on temporary differences	–	–
Total	**9,183**	**8,589**

40. Other Assets

The details of other assets are as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Vehicles returned for disposal	767	746
Restricted cash	1,018	1,380
Prepaid expenses	327	304
Other tax assets	161	167
Reinsurers’ share of underwriting provisions	71	76
Miscellaneous	1,149	1,106
Total	**3,495**	**3,780**

Minimum lease payments of €798 million (previous year: €797 million) are expected from noncancelable subleases in connection with buyback transactions.

The breakdown of the reinsurers' share of underwriting provisions is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Reinsurers' share of provision for claims outstanding	52	56
Reinsurers' share of provision for unearned premiums	19	19
Reinsurers' share of other underwriting provisions	1	1
Total	**71**	**76**

41. Noncurrent Assets

€ million	Dec. 31, 2016	of which noncurrent	Dec. 31, 2015	of which noncurrent
Cash reserve	1,478	–	1,416	–
Loans to and receivables from banks	2,236	46	2,940	42
Loans to and receivables from customers	100,564	55,621	92,771	51,463
Derivative financial instruments	1,297	822	1,178	836
Marketable securities	2,993	–	2,936	–
Equity-accounted joint ventures	633	633	538	538
Miscellaneous financial assets	288	288	206	206
Intangible assets	150	150	149	149
Property and equipment	314	314	317	317
Lease assets	14,696	12,502	12,982	10,714
Investment property	14	14	15	15
Current tax assets	156	16	320	5
Other assets	3,495	873	3,780	782
Total	**128,314**	**71,278**	**119,549**	**65,067**

42. Liabilities to Banks and Customers

To cover the capital requirements for the leasing and financing activities, the entities in the VW FS AG Group make use of, among other things, the funds provided by the entities in the Volkswagen Group.

The liabilities to banks include significant liabilities to Deutsche Bundesbank arising from targeted longer-term refinancing operations.

The liabilities to customers include customer deposits of €36,149 million (previous year: €28,109 million). These deposits predominantly comprise overnight money and time deposits, as well as various savings bonds and savings plans, held with Volkswagen Bank GmbH. In terms of maturity, the "Direkt-Sparplan" and "Plus Sparbrief" savings products currently offer the longest investment horizon. The maximum maturity is ten years.

43. Notes, Commercial Paper Issued

This item comprises bonds and commercial paper.

€ million	Dec. 31, 2016	Dec. 31, 2015
Bonds issued	33,482	36,695
Commercial paper issued	4,367	3,218
Total	**37,849**	**39,913**

In the reporting year, customer and dealer financing loans and receivables amounting to €251 million were furnished as collateral for issued bonds not related to ABS transactions.

44. ABS Transactions

The VW FS AG Group uses ABS transactions for funding purposes. The related liabilities are recognized in the following balance sheet items:

€ million	Dec. 31, 2016	Dec. 31, 2015
Bonds issued[1]	18,773	17,061
Subordinated liabilities	1,830	1,587
Total[1]	**20,603**	**18,648**

1 The prior year has been adjusted for the accrued interest on issued bonds in the amount of €4 million.

Of the total amount of liabilities arising in connection with ABS transactions, an amount of €18,536 million (previous year: €16,930 million) is accounted for by ABS transactions with financial assets. The corresponding carrying amount of loans/receivables from retail financing and leasing business is €19,115 million (previous year: €17,218 million). As of December 31, 2016, the fair value of the liabilities amounted to €18,890 million (previous year: €16,988 million). The fair value of the assigned loans/receivables, which continued to be recognized, amounted to €19,888 million (previous year: €17,565 million) as of December 31, 2016.

In these arrangements, the expected payments are assigned to special purpose entities and the ownership of the collateral in the financed vehicles is transferred. The assigned loans/receivables cannot be assigned again to anyone else or used in any other way as collateral. The rights of the bond holders are limited to the assigned loans/receivables and the payment receipts arising from these loans/receivables are used to repay the corresponding liability.

These asset-backed securities transactions did not lead to a derecognition of the loans or receivables from the financial services business because the credit risk and timing risk were retained in the Group. The difference between the amount of the assigned loans/receivables and the associated liabilities results from the different terms and conditions and from the proportion of the ABSs held by the VW FS AG Group itself.

Collateral totaling €22,061 million (previous year: €20,138 million) has been furnished in connection with ABS transactions.

The VW FS AG Group is under a contractual obligation to transfer funds in certain circumstances to the structured entities included in its consolidated financial statements. As the transfer of the loans/receivables to the special purpose entity is carried out as an undisclosed assignment, it is possible that the originator's loan/receivable could already have been legally reduced, for example if the debtor has an effective right of set-off against amounts it is owed by the VW FS AG Group. Collateral must be furnished for the resulting compensation claim in respect of the special purpose entity if, for example, the rating of the relevant Group company falls to a contractually specified reference value.

The bulk of the public and private ABS transactions in the Volkswagen Financial Services AG Group can be repaid early (with a clean-up call) when less than 9% or 10% of the original transaction volume remains outstanding.

45. Derivative Financial Instruments

This item comprises the negative fair values from hedges and from derivatives not designated as a hedging instrument. The breakdown is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Transactions to hedge against		
currency risk on assets using fair value hedges	27	0
currency risk on liabilities using fair value hedges	109	54
interest-rate risk using fair value hedges	143	63
of which hedges against interest-rate risk using portfolio fair value hedges	85	42
interest-rate risk using cash flow hedges	2	4
currency and pricing risk on future cash flows using cash flow hedges	12	22
Hedging transactions	**293**	**143**
Liabilities arising from derivatives not designated as hedges	120	105
Total	**413**	**249**

46. Provisions for Pensions and Other Post-Employment Benefits

The following amounts have been recognized in the balance sheet for benefit commitments:

€ million	Dec. 31, 2016	Dec. 31, 2015
Present value of funded obligations	323	233
Fair value of plan assets	227	196
Funded status (net)	**96**	**36**
Present value of unfunded obligations	379	318
Amount not recognized as an asset because of the ceiling in IAS 19	1	1
Net liability recognized in the balance sheet	**477**	**355**
of which provisions for pensions	478	357
of which other assets	1	3

Key pension arrangements in the VW FS AG Group:
For the period after the active working life of employees, the VW FS AG Group offers its employees benefits under attractive, state-of-the-art occupational pension arrangements. Most of the arrangements in the VW FS AG Group are pension plans for employees in Germany classified as defined benefit plans under IAS 19. The majority of these obligations are funded by provisions recognized in the balance sheet. These plans are now closed for new members. To reduce the risks associated with defined benefit plans, in particular longevity, salary increases and inflation, the VW FS AG Group has introduced new defined benefit plans in recent years in which the benefits are funded by appropriate external plan assets. The risks referred to above have been significantly reduced in these pension plans. The proportion of the total defined benefit obligation attributable to pension obligations funded by plan assets will continue to rise in the future. The main pension commitments are described below.

German pension plans funded solely by recognized provisions
The pension plans funded solely by recognized provisions comprise both defined contribution plans with guarantees and final salary plans. For defined contribution plans, an annual pension expense dependent on income and status is converted into a lifelong pension entitlement using annuity factors (guaranteed modular pension entitlements). The annuity factors include a guaranteed rate of interest. The modular pension entitlements earned annually are added together at retirement. For final salary plans, the underlying salary is multiplied at retirement by a percentage that depends on the years of service up to the retirement date. The present value of the guaranteed obligation rises as interest rates fall and is therefore exposed to interest rate risk. The pension system provides for lifelong pension payments. The companies therefore bear the longevity risk. This is accounted for by calculating the annuity factors and the present value of the guaranteed obligation using the latest generational mortality tables – the "Heubeck 2005 G" mortality tables – which already reflect future increases in life expectancy. To reduce the inflation risk from adjusting the regular pension payments by the rate of inflation, a pension adjustment that is not indexed to inflation was introduced for pension plans where this is permitted by law.

German pension plans funded by external plan assets
The pension plans funded by external plan assets are defined contribution plans with guarantees. In this case, an annual pension expense dependent on income and status is either converted into a lifelong pension entitlement using annuity factors (guaranteed modular pension entitlement) or paid out in a single lump sum or in installments. In some cases, employees also have the opportunity to provide for their own retirement through deferred compensation. The annuity factors include a guaranteed rate of interest. The modular pension entitlements earned annually are added together at retirement. The pension expense is contributed on an ongoing basis to a separate pool of assets that is administered independently of the Company in trust and invested in the capital markets. If the plan assets exceed the present value of the obligations calculated using

the guaranteed rate of interest, surpluses are allocated (modular pension bonuses). As the assets administered in trust meet the IAS 19 criteria for classification as plan assets, they are offset against the obligations.

The amount of the plan assets is exposed to general market risk. The investment strategy and its implementation are therefore continuously monitored by the trusts' governing bodies, on which the companies are also represented. For example, investment policies are stipulated in investment guidelines with the aim of limiting market risk and its impact on plan assets. In addition, asset-liability management analyses are conducted at regular intervals so as to ensure that investments are in line with the obligations that need to be covered. The pension assets are currently invested primarily in fixed-income or equity funds. The main risks are therefore interest rate and equity price risk. To mitigate market risk, the pension system also provides for funds to be set aside in an equalization reserve before any surplus is allocated.

The present value of the obligation is reported as the maximum of the present value of the guaranteed obligation and of the plan assets. If the value of the plan assets falls below the present value of the guaranteed obligation, a provision must be recognized for the difference. The present value of the guaranteed obligation rises as interest rates fall and is therefore exposed to interest rate risk.

In the case of lifelong pension payments, the VW FS AG Group bears the longevity risk. This is accounted for by calculating the annuity factors and the present value of the guaranteed obligation using the latest generational mortality tables – the "Heubeck 2005 G" mortality tables – which already reflect future increases in life expectancy. In addition, the independent actuaries carry out annual risk monitoring as part of the review of the assets administered by the trusts.

To reduce the inflation risk from adjusting the regular pension payments by the rate of inflation, a pension adjustment that is not indexed to inflation was introduced for pension plans where this is permitted by law.

The calculation of the present value of the defined benefit obligations was based on the following actuarial assumptions:

	GERMANY		INTERNATIONAL	
Percent	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Discount rate	1.80	2.70	4.91	5.73
Pay trend	3.60	3.40	5.44	5.30
Pension trend	1.50	1.70	3.61	3.45
Staff turnover rate	0.98	0.82	2.68	2.50

These assumptions are averages that were weighted using the present value of the defined benefit obligation.

With regard to life expectancy, the latest mortality tables in every country are taken into account. For example, in Germany calculations are based on the "2005 G" mortality tables developed by Professor Dr. Klaus Heubeck. The discount rates are generally determined to reflect the yields on prime-rated corporate bonds with matching maturities and currencies. The iBoxx AA 10+ Corporates index was taken as the basis for the obligations of German Group companies. Similar indices were used for foreign pension obligations.

The pay trends cover expected wage and salary trends, which also include increases attributable to career development. The pension trends either reflect the contractually guaranteed pension adjustments or are based on the rules on pension adjustments in force in each country. The employee turnover rates are based on past experience and future expectations.

The following table shows changes in the net defined benefit liability recognized in the balance sheet:

€ million	2016	2015
Net liability recognized in the balance sheet as of January 1	**355**	**383**
Current service cost	26	29
Net interest expense	9	9
Actuarial gains (–)/losses (+) arising from changes in demographic assumptions	2	0
Actuarial gains (–)/losses (+) arising from changes in financial assumptions	120	–49
Actuarial gains (–)/losses (+) arising from experience adjustments	–2	5
Income/expenses from plan assets not included in interest income	6	–3
Change in amount not recognized as an asset because of the ceiling in IAS 19	0	0
Employer contributions to plan assets	17	17
Employee contributions to plan assets	–	0
Pension payments from company assets	6	5
Past service cost (including plan curtailments)	0	0
Gains (–) or losses (+) arising from plan settlements	–	–
Changes in basis of consolidation	–	–
Other changes	–4	–3
Foreign exchange differences from foreign plans	0	0
Net liability recognized in the balance sheet as of December 31	**477**	**355**

The change in the amount not recognized as an asset because of the ceiling in IAS 19 includes an interest component, some of which is recognized in profit or loss under general and administrative expenses and some of which is recognized in other comprehensive income.

The change in the present value of the defined benefit obligation is attributable to the following factors:

€ million	2016	2015
Present value of obligations as of January 1	**551**	**563**
Current service cost	26	29
Interest cost (unwinding of discount on obligations)	17	16
Actuarial gains (–)/losses (+) arising from changes in demographic assumptions	2	0
Actuarial gains (–)/losses (+) arising from changes in financial assumptions	120	–49
Actuarial gains (–)/losses (+) arising from experience adjustments	–2	5
Employee contributions to plan assets	2	2
Pension payments from company assets	6	5
Pension payments from plan assets	3	2
Past service cost (including plan curtailments)	0	0
Gains (–) or losses (+) arising from plan settlements	–	–
Changes in basis of consolidation	–	–
Other changes	–2	–3
Foreign exchange differences from foreign plans	–1	–3
Present value of obligations as of December 31	**702**	**551**

Changes in the relevant actuarial assumptions would have had the following effects on the defined benefit obligation:

		DEC. 31, 2016		DEC. 31, 2015	
Present value of defined benefit obligation if		€ million	Change in percent	€ million	Change in percent
Discount rate	is 0.5 percentage points higher	629	–10.42	495	–10.03
	is 0.5 percentage points lower	788	12.21	612	11.09
Pension trend	is 0.5 percentage points higher	734	4.47	574	4.30
	is 0.5 percentage points lower	674	–4.08	526	–4.43
Pay trend	is 0.5 percentage points higher	710	1.10	556	0.97
	is 0.5 percentage points lower	698	–0.58	545	–0.93
Longevity	increases by one year	721	2.64	562	2.09

The sensitivity analysis shown above considers the change in one assumption at a time, leaving the other assumptions unchanged versus the original calculation. In other words, any correlation effects between the individual assumptions are ignored.

To examine the sensitivity of the present value of the defined benefit obligation to a change in assumed longevity, the estimates of mortality were reduced as part of a comparative calculation by a measure that was roughly equivalent to an increase in life expectancy of one year.

The average duration of the defined benefit obligation weighted by the present value of the defined benefit obligation (Macaulay duration) is 23 years (previous year: 22 years).

The following table shows a breakdown of the present value of the defined benefit obligation by category of plan member:

€ million	2016	2015
Active members with pension entitlements	512	401
Members with vested entitlements who have left the Company	61	46
Retirees	129	104
Total	**702**	**551**

The maturity profile of payments attributable to the defined benefit obligation is presented in the following table, which classifies the present value of the obligation by the maturity of the underlying payments:

€ million	2016	2015
Payments due within the next fiscal year	7	5
Payments due between two and five years	39	25
Payments due in more than five years	655	520
Total	**702**	**551**

Changes in plan assets are shown in the following table:

€ million	2016	2015
Fair value of plan assets as of January 1	**196**	**180**
Interest income on plan assets determined using the discount rate	8	7
Income/expenses from plan assets not included in interest income	6	–3
Employer contributions to plan assets	17	17
Employee contributions to plan assets	2	1
Pension payments from plan assets	3	2
Gains (+) or losses (–) arising from plan settlements	–	–
Changes in basis of consolidation	–	–
Other changes	2	0
Foreign exchange differences from foreign plans	–1	–4
Fair value of plan assets as of December 31	**227**	**196**

The investment of the plan assets to cover future pension obligations resulted in income in the amount of €14 million (previous year: €4 million).

Employer contributions to plan assets are expected to amount to €22 million (previous year: €22 million) in the next fiscal year.

Plan assets are invested in the following asset classes:

€ million	DEC. 31, 2016 Quoted prices in active markets	DEC. 31, 2016 No quoted prices in active markets	DEC. 31, 2016 Total	DEC. 31, 2015 Quoted prices in active markets	DEC. 31, 2015 No quoted prices in active markets	DEC. 31, 2015 Total
Cash and cash equivalents	5	–	5	6	–	6
Equity instruments	7	–	7	7	–	7
Debt instruments	52	–	52	44	–	44
Direct investments in real estate	–	–	–	–	–	–
Derivatives	3	–	3	3	–	3
Equity funds	26	–	26	20	1	21
Bond funds	127	–	127	106	–	106
Real estate funds	1	–	1	2	–	2
Other funds	4	–	4	6	–	6
Asset-backed securities	–	–	–	–	–	–
Structured debt securities	–	–	–	–	–	–
Other	0	1	1	0	1	1

Of the total plan assets, 57% (previous year: 56%) are invested in German assets, 21% (previous year: 24%) in other European assets and 22% (previous year: 20%) in assets in other regions. Investments of plan assets in debt instruments issued by the Volkswagen Group are of minor significance.

The following amounts have been recognized in the income statement:

€ million	2016	2015
Current service cost	26	29
Net interest on the net defined benefit liability	9	9
Past service cost (including plan curtailments)	0	0
Gains (–) or losses (+) arising from plan settlements	–	–
Net income (–) and expenses (+) recognized in profit or loss	**35**	**38**

47. Underwriting Provisions and Other Provisions

€ million	Dec. 31, 2016	Dec. 31, 2015
Underwriting provisions	365	337
Other provisions	847	755
Total	**1,212**	**1,092**

The following table shows the changes in underwriting provisions:

€ million	UNDERWRITING PROVISIONS Provision for claims outstanding	Provision for unearned premiums	Other underwriting provisions	Total
Balance as of Jan. 1, 2015	**93**	**214**	**1**	**308**
Changes to basis of consolidation	–	–	–	–
Utilization	36	95	0	130
Additions	27	131	1	159
Balance as of Dec. 31, 2015	**85**	**250**	**2**	**337**

€ million	UNDERWRITING PROVISIONS Provision for claims outstanding	Provision for unearned premiums	Other underwriting provisions	Total
Balance as of Jan. 1, 2016	**85**	**250**	**2**	**337**
Changes to basis of consolidation	–	–	–	–
Utilization	38	29	2	69
Additions	41	55	3	98
Balance as of Dec. 31, 2016	**87**	**275**	**3**	**365**

Maturity profile of underwriting provisions:

€ million	DEC. 31, 2016		DEC. 31, 2015	
	Remaining maturity of more than one year	Total	Remaining maturity of more than one year	Total
Provision for claims outstanding	44	87	56	85
Provision for unearned premiums	144	275	136	250
Other underwriting provisions	–	3	–	2
Total	**188**	**365**	**192**	**337**

Underwriting provisions for direct insurance business:

€ million	2016 Remaining maturity of more than one year	2016 Total	2015 Remaining maturity of more than one year	2015 Total
Balance as of Jan. 1	**78**	**166**	**69**	**147**
Utilization	10	26	33	70
Additions	1	4	42	89
Balance as of Dec. 31	**69**	**144**	**78**	**166**

The underwriting provisions for direct insurance business were recognized in respect of warranty insurance and repair costs insurance.

Changes in the underwriting provisions for reinsurance business, by class of insurance:

€ million	2015 Vehicle insurance	2015 Credit protection insurance	2015 Other	2015 Total
Balance as of Jan. 1	**66**	**82**	**13**	**161**
Utilization	9	16	35	60
Additions	0	25	44	69
Balance as of Dec. 31	**57**	**91**	**22**	**170**

€ million	2016 Vehicle insurance	2016 Credit protection insurance	2016 Other	2016 Total
Balance as of Jan. 1	**57**	**91**	**22**	**170**
Utilization	6	17	20	43
Additions	0	16	78	94
Balance as of Dec. 31	**51**	**90**	**80**	**221**

In the reporting period, other provisions were broken down into provisions for employee expenses, provisions for litigation and legal risks, and miscellaneous provisions.

The following table shows the changes in other provisions, including maturities:

€ million	Employee expenses	Litigation and legal risks	Miscellaneous provisions	Total
Balance as of Jan. 1, 2015	**102**	**509**	**188**	**799**
Foreign exchange differences	1	–42	–2	–43
Changes in basis of consolidation	0	–	–	0
Utilization	44	82	38	165
Additions/new provisions	60	197	72	328
Unwinding of discount/effect of change in discount rate	–	5	–	5
Reversals	10	108	51	169
Balance as of Dec. 31, 2015	**108**	**480**	**167**	**755**
of which current	58	225	149	432
of which noncurrent	50	255	18	324
Balance as of Jan. 1, 2016	**108**	**480**	**167**	**755**
Foreign exchange differences	–1	19	0	18
Changes in basis of consolidation	–	–	–	–
Utilization	46	27	31	104
Additions/new provisions	69	178	90	337
Unwinding of discount/effect of change in discount rate	–	6	–	6
Reversals	11	111	43	165
Balance as of Dec. 31, 2016	**119**	**545**	**183**	**847**
of which current	61	227	159	446
of which noncurrent	58	318	24	401

Provisions for employee expenses are recognized primarily for annually recurring bonuses such as holiday or Christmas bonuses, long service awards and other employee expenses. The provisions for litigation and legal risks reflect the risks identified as of the reporting date in relation to utilization and legal expenses arising from the latest decisions by the courts and from ongoing civil proceedings involving dealers and other customers. Based on analysis of the individual matters covered by the provisions, we believe that the disclosure of further detailed information on individual proceedings, legal disputes or legal risks could seriously prejudice the course or initiation of proceedings.

The miscellaneous provisions also include provisions for indirect credit risks amounting to €40 million (previous year: €38 million). The timing of the cash outflows in connection with other provisions is expected to be as follows: 53% in the next year, 42% in the years 2018 to 2021 and 5% thereafter.

48. Deferred Tax Liabilities

The breakdown of the deferred tax liabilities is as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Deferred tax liabilities	8,517	7,983
of which noncurrent	4,536	4,331
Offset (with deferred tax assets)	–7,366	–6,911
Total	**1,151**	**1,072**

The deferred tax liabilities include taxes arising on temporary differences between amounts in the IFRS financial statements and those determined in the calculation of taxable profits in the Group entities.

Deferred tax liabilities have been recognized in connection with the following balance sheet items:

€ million	Dec. 31, 2016	Dec. 31, 2015
Loans, receivables and other assets	5,550	5,336
Marketable securities and cash	89	147
Intangible assets/property and equipment	17	17
Lease assets	528	571
Liabilities and provisions	2,333	1,912
Total	**8,517**	**7,983**

49. Other Liabilities

The details of other liabilities are as follows:

€ million	Dec. 31, 2016	Dec. 31, 2015
Deferred income	864	656
Other tax liabilities	200	193
Social security and payroll liabilities	174	170
Miscellaneous	692	581
Total	**1,929**	**1,599**

50. Subordinated Capital

The subordinated capital of €3,183 (previous year: €2,344) has been issued by or raised from Volkswagen Bank GmbH, Volkswagen Leasing GmbH, Volkswagen Financial Services (UK) Ltd., Banco Volkswagen S.A., Volkswagen Financial Services Australia Limited, Volkswagen Finans Sverige AB and VW FS AG.

51. Noncurrent Liabilities

€ million	Dec. 31, 2016	of which noncurrent	Dec. 31, 2015	of which noncurrent
Liabilities to banks	17,034	7,367	15,721	6,309
Liabilities to customers	49,454	7,579	43,764	8,678
Notes, commercial paper issued	37,849	22,634	39,913	25,282
Derivative financial instruments	413	143	249	132
Current tax liabilities	494	215	329	165
Other liabilities	1,929	766	1,599	625
Subordinated capital	3,183	2,689	2,344	1,461
Total	**110,356**	**41,394**	**103,919**	**42,652**

52. Equity

The subscribed capital of VW FS AG is divided into 441,280,000 fully paid up no-par-value bearer shares, each with a notional value of €1, which are all held by Volkswagen AG, Wolfsburg. There are no preferential rights or restrictions in connection with the subscribed capital.

The capital contributions made by the sole shareholder, Volkswagen AG, are reported under the capital reserves of VW FS AG.

The retained earnings comprise the profits from previous fiscal years that have not been distributed. The retained earnings include a legal reserve of €44 million (previous year: €44 million).

On the basis of the control and profit-and-loss transfer agreement with the sole shareholder, Volkswagen AG, the profits of €130 million (previous year: €420 million) in accordance with the HGB generated by VW FS AG have been reported as a reduction of equity.

53. Capital Management

In this context, “capital” is generally defined as the equity in accordance with IFRS. The aims of capital management in the VW FS AG Group are to support the Company’s credit rating by ensuring that the Group has adequate capital backing, obtain capital for the planned growth over the next few years and satisfy the capital requirements imposed by the banking supervisory authorities.

Regulatory capital is different from equity in accordance with IFRS (for the components, see note 52).

Regulatory capital consists of capital components referred to as Common Equity Tier (CET) 1 capital, Additional Tier 1 capital and Tier 2 capital net of certain deductions and adjustments and must meet specific requirements defined by law.

Corporate action implemented by the parent company of VW FS AG has an impact on both IFRS equity and regulatory capital.

Under the legislative provisions governing banking supervision – Capital Requirements Regulation (CRR), Kreditwesengesetz (KWG – German Banking Act), Solvabilitätsverordnung (SolvV– German Solvency Regulation) – the banking supervisor generally assumes that capital adequacy requirements are satisfied if the entity subject to supervision has a CET 1 capital ratio of at least 4.5%, a Tier 1 capital ratio of at least 6.0% and a total capital ratio of at least 8.0%. In calculating these ratios, capital is measured against the own funds requirements determined in accordance with statutory provisions for counterparty risk, operational risk, market risk and credit value adjustments (CVAs). To ensure compliance with these requirements at all times, the Group has established a planning procedure integrated into the internal reporting system. In this procedure, the capital requirement is continuously determined based on actual and forecast business trends. This approach once again ensured in the reporting period that both the Group and the individual companies subject to particular capital requirements complied with the minimum regulatory capital requirements at all times.

The following amounts and key figures were determined for the financial holding group as of the reporting date:

	Dec. 31, 2016	Dec. 31, 2015
Total risk exposure amount[1] (€ million)	119,709	108,343
of which risk-weighted exposure amounts for credit risk	104,414	94,824
of which own funds requirements for market risk *12.5	6,982	6,158
of which own funds requirements for operational risk *12.5	7,894	6,906
of which own funds requirements for credit valuation adjustments *12.5	419	455
Eligible own funds (€ million)	15,121	13,109
Own funds (€ million)	15,121	13,109
of which Common Equity Tier 1 capital	13,989	12,966
of which Additional Tier 1 capital	0	0
of which Tier 2 capital	1,132	143
Common Equity Tier 1 capital ratio (percent)[2]	11.7	12.0
Tier 1 capital ratio (percent)[2]	11.7	12.0
Total capital ratio (percent)[2]	12.6	12.1

1 According to Article 92(3) of the CRR
2 According to Article 92(1) of the CRR

Financial Instrument Disclosures

54. Carrying Amounts of Financial Instruments by IAS 39 Measurement Category

The IAS 39 measurement categories are defined in the VW FS AG Group, as follows:

Loans and receivables are non-derivative financial instruments that are not traded in an active market and that are subject to fixed-payment agreements. The cash reserve also forms part of this category.

Financial assets and financial liabilities measured at fair value through profit or loss include derivative financial instruments. The VW FS AG Group has no plans to specially allocate other financial instruments to this category.

Available-for-sale financial assets are either assets specifically allocated to this category as such or financial assets that cannot be allocated to any other category. In the VW FS AG Group, marketable securities and miscellaneous financial assets are allocated to this category.

All non-derivative financial instruments are accounted for on the basis of the settlement date. Derivative financial instruments are accounted for on the basis of the trade date.

The carrying amounts of financial instruments (excluding hedge derivatives) by measurement category are as follows:

	LOANS AND RECEIVABLES		AVAILABLE-FOR-SALE FINANCIAL ASSETS		FINANCIAL LIABILITIES MEASURED AT AMORTIZED COST		FINANCIAL ASSETS AND FINANCIAL LIABILITIES MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Assets								
Cash reserve	1,478	1,416	–	–	–	–	–	–
Loans to and receivables from banks	2,236	2,940	–	–	–	–	–	–
Loans to and receivables from customers	78,552	73,054	–	–	–	–	–	–
Derivative financial instruments	–	–	–	–	–	–	142	131
Marketable securities	–	–	2,993	2,936	–	–	–	–
Miscellaneous financial assets	–	–	0	0	–	–	–	–
Other assets	1,242	1,618	–	–	–	–	–	–
Total	**83,508**	**79,028**	**2,993**	**2,936**	**–**	**–**	**142**	**131**
Liabilities								
Liabilities to banks	–	–	–	–	17,034	15,721	–	–
Liabilities to customers	–	–	–	–	49,445	43,753	–	–
Notes, commercial paper issued	–	–	–	–	37,849	39,913	–	–
Derivative financial instruments	–	–	–	–	–	–	120	105
Other liabilities	–	–	–	–	690	579	–	–
Subordinated capital	–	–	–	–	3,183	2,344	–	–
Total	**–**	**–**	**–**	**–**	**108,200**	**102,310**	**120**	**105**

Receivables from leasing business of €21,997 million (previous year: €19,704 million) do not have to be allocated to any of these categories.

The net income/expense for each of the categories is as follows:

€ million	2016	2015
Loans and receivables	3,439	3,441
Available-for-sale financial assets	29	17
Financial liabilities measured at amortized cost	−1,445	−1,566
Financial assets and financial liabilities measured at fair value through profit or loss	−85	115

The net income/expense is determined as follows:

Measurement category	Measurement method
Loans and receivables	Interest income using the effective interest method in accordance with IAS 39 and expenses/income from the recognition of valuation allowances in accordance with IAS 39, including effects from currency translation
Available-for-sale financial assets	Fair value in accordance with IAS 39 in conjunction with IFRS 13, including interest and effects from currency translation and impairment
Financial liabilities measured at amortized cost	Interest expense using the effective interest method in accordance with IAS 39, including effects from currency translation
Financial assets and financial liabilities measured at fair value through profit or loss	Fair value in accordance with IAS 39 in conjunction with IFRS 13, including interest and effects from currency translation and impairment

55. Classes of Financial Instruments

Financial instruments are divided into the following classes in the VW FS AG Group:
- Measured at fair value
- Financial assets measured at amortized cost
- Derivative financial instruments designated as hedges
- Financial liabilities measured at amortized cost
- Credit commitments and financial guarantees
- Not within the scope of IFRS 7

Loans/receivables and liabilities designated as hedges with derivative financial instruments are included in the "Financial assets measured at amortized cost" and Financial liabilities measured at amortized cost" classes.

Within miscellaneous financial assets, subsidiaries and joint ventures that are not consolidated for reasons of materiality are not deemed financial instruments in accordance with IAS 39 and therefore do not fall within the scope of IFRS 7. Equity investments forming part of miscellaneous financial assets are reported as financial instruments in accordance with IAS 39 in the class "Measured at fair value".

The following table shows a reconciliation of the relevant balance sheet items to the classes of financial instruments:

€ million	BALANCE SHEET ITEM		MEASURED AT FAIR VALUE		MEASURED AT AMORTIZED COST[1]		DERIVATIVE FINANCIAL INSTRUMENTS DESIGNATED AS HEDGES		NOT WITHIN THE SCOPE OF IFRS 7	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Assets										
Cash reserve	1,478	1,416	–	–	1,478	1,416	–	–	–	–
Loans to and receivables from banks	2,236	2,940	–	–	2,236	2,940	–	–	–	–
Loans to and receivables from customers	100,564	92,771	–	–	100,564	92,771	–	–	–	–
Derivative financial instruments	1,297	1,178	142	131	–	–	1,156	1,047	–	–
Marketable securities	2,993	2,936	2,993	2,936	–	–	–	–	–	–
Equity-accounted joint ventures	633	538	–	–	–	–	–	–	633	538
Miscellaneous financial assets	288	206	0	0	–	–	–	–	287	206
Other assets	3,495	3,780	–	–	1,242	1,618	–	–	2,253	2,162
Total	**112,984**	**105,765**	**3,135**	**3,067**	**105,520**	**98,745**	**1,156**	**1,047**	**3,173**	**2,905**
Liabilities										
Liabilities to banks	17,034	15,721	–	–	17,034	15,721	–	–	–	–
Liabilities to customers	49,454	43,764	–	–	49,454	43,764	–	–	–	–
Notes, commercial paper issued	37,849	39,913	–	–	37,849	39,913	–	–	–	–
Derivative financial instruments	413	249	120	105	–	–	293	143	–	–
Other liabilities	1,929	1,599	–	–	690	579	–	–	1,239	1,020
Subordinated capital	3,183	2,344	–	–	3,183	2,344	–	–	–	–
Total	**109,861**	**103,590**	**120**	**105**	**108,210**	**102,321**	**293**	**143**	**1,239**	**1,020**

1 Some of the loans to and receivables from customers and liabilities to customers have been designated as hedged items in fair value hedges and are therefore subject to fair value adjustments. The loans to and receivables from customers and liabilities to customers in the class "Measured at amortized cost" are therefore measured neither entirely at fair value nor entirely at amortized cost.

The "Credit commitments and financial guarantees" class contains obligations under irrevocable credit commitments and financial guarantees amounting to €2,721 million (previous year: €2,862 million).

56. Measurement Hierarchy for Financial Instruments Measured at Fair Value and at Amortized Cost

For the purposes of fair value measurement and the associated disclosures, fair values are classified using a three-level measurement hierarchy. Classification to the individual levels is dictated by the extent to which the main inputs used in determining the fair value are observable in the market or not.

Level 1 is used to report the fair value of financial instruments such as marketable securities or notes and commercial paper issued for which a quoted price is directly observable in an active market.

Level 2 fair values are measured on the basis of inputs observable in the markets, such as exchange rates or yield curves, using market-based valuation techniques. Fair values measured in this way include those for derivatives and liabilities to customers.

Level 3 fair values are measured using valuation techniques incorporating at least one input that is not directly observable in an active market. Most of the loans to and receivables from customers are allocated to Level 3 because their fair value is measured using inputs that are not observable in active markets (see note 57).

The following table shows the allocation of financial instruments to this three-level fair value hierarchy by class:

	LEVEL 1		LEVEL 2		LEVEL 3	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Assets						
Measured at fair value						
Derivative financial instruments	–	–	142	131	–	–
Marketable securities	2,708	2,701	285	223	–	12
Miscellaneous financial assets	–	–	–	–	0	0
Measured at amortized cost						
Cash reserve	1,478	1,416	–	–	–	–
Loans to and receivables from banks	2,178	2,884	59	56	–	–
Loans to and receivables from customers	–	–	915	853	101,228	92,972
Other assets	–	–	1,242	1,618	–	–
Derivative financial instruments designated as hedges	–	–	1,156	1,047	–	–
Total	**6,364**	**7,001**	**3,798**	**3,929**	**101,228**	**92,985**
Liabilities						
Measured at fair value						
Derivative financial instruments	–	–	120	105	–	–
Measured at amortized cost						
Liabilities to banks	–	–	16,949	15,572	–	–
Liabilities to customers	–	–	49,525	43,742	–	–
Notes, commercial paper issued	20,963	21,529	16,910	18,543	–	–
Other liabilities	–	–	693	581	–	–
Subordinated capital	–	–	2,930	2,357	–	–
Derivative financial instruments designated as hedges	–	–	293	143	–	–
Total	**20,963**	**21,529**	**87,420**	**81,044**	**–**	**–**

57. Fair Value of Financial Instruments in the Classes "Assets and Liabilities Measured at Amortized Cost", "Measured at Fair Value", "Derivative Financial Instruments Designated As Hedges"

The table below shows the fair values of the financial instruments. The fair value is the amount at which financial instruments could be sold on fair terms as of the reporting date. Where market prices (e.g. for marketable securities) were available, we have used these prices without modification for measuring fair value. If no market prices were available, the fair values for loans/receivables and liabilities were calculated by discounting using a maturity-matched discount rate appropriate to the risk. The discount rate was determined by adjusting risk-free yield curves, where appropriate, by relevant risk factors and to take into account capital and administrative costs. For reasons of materiality, the fair values of loans/receivables and liabilities due within one year were deemed to be the same as the carrying amount.

Likewise, no fair value was determined for miscellaneous financial assets because there is no active market for the unlisted equity investments in the miscellaneous financial assets and fair values could not be reliably determined without disproportionate time, effort and expense. The fair value of irrevocable credit commitments equates to the nominal value of the obligations because of the short maturity and the variable interest rate linked to the market interest rate. There are also no differences between the fair value and the nominal value of the obligation in the case of financial guarantees.

	FAIR VALUE		CARRYING AMOUNT		DIFFERENCE	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Assets						
Measured at fair value						
Derivative financial instruments	142	131	142	131	–	–
Marketable securities	2,993	2,936	2,993	2,936	–	–
Miscellaneous financial assets	0	0	0	0	–	–
Measured at amortized cost						
Cash reserve	1,478	1,416	1,478	1,416	–	–
Loans to and receivables from banks	2,236	2,940	2,236	2,940	0	1
Loans to and receivables from customers	102,143	93,826	100,564	92,771	1,579	1,055
Other assets	1,242	1,618	1,242	1,618	–	–
Derivative financial instruments designated as hedges	1,156	1,047	1,156	1,047	–	–
Liabilities						
Measured at fair value						
Derivative financial instruments	120	105	120	105	–	–
Measured at amortized cost						
Liabilities to banks	16,949	15,572	17,034	15,721	−85	−149
Liabilities to customers	49,525	43,742	49,454	43,764	71	−22
Notes, commercial paper issued	37,873	40,072	37,849	39,913	24	159
Other liabilities	693	581	690	579	4	2
Subordinated capital	2,930	2,357	3,183	2,344	−253	13
Derivative financial instruments designated as hedges	293	143	293	143	–	–

The fair values of financial instruments were determined on the basis of the following risk-free yield curves:

Percent	EUR	USD	GBP	JPY	BRL	MXN	SEK	CZK	AUD	CNY	PLN	INR	RUB	KRW	DKK
Interest rate for six months	−0.251	0.996	0.375	0.024	12.429	6.869	−0.445	0.152	1.821	3.531	1.739	5.936	10.178	1.509	−0.251
Interest rate for one year	−0.214	1.169	0.401	0.023	11.520	7.298	−0.431	0.152	1.876	3.780	1.762	6.166	10.073	1.506	−0.107
Interest rate for five years	0.074	1.972	0.866	0.059	11.483	7.210	0.258	0.505	2.630	4.405	2.340	6.715	8.850	1.675	0.318
Interest rate for ten years	0.652	2.346	1.233	0.210	–	7.480	1.098	0.965	2.995	4.555	2.865	6.790	8.370	1.835	0.926

58. Offsetting of Financial Assets and Liabilities

The table below contains information about the effects of offsetting in the consolidated balance sheet and the financial effects of offsetting in the case of instruments that are subject to a legally enforceable master netting agreement or a similar arrangement.

Financial assets and financial liabilities are generally reported with their gross values. Offsetting is only then applied if, at the present time, the offsetting of the amounts is legally enforceable by the VW FS AG Group and there is an intention to settle on a net basis in practice.

The “Financial instruments” column shows the amounts that are subject to a master netting agreement but have not been netted because the relevant criteria have not been satisfied. Most of the amounts involved are positive and negative fair values of derivatives entered into with the same counterparty.

The “Collateral received/pledged” column shows the cash collateral amounts and collateral in the form of financial instruments received or pledged in connection with the total sum of assets and liabilities. It includes such collateral relating to assets and liabilities that have not been offset against each other. The collateral amounts primarily consist of pledged cash collateral in connection with ABS transactions, marketable securities pledged as collateral and collateral received in the form of cash deposits.

€ million	Gross amount of recognized financial assets/liabilities		Gross amount of recognized financial liabilities/assets offset in the balance sheet		Net amount of financial assets/liabilities reported in the balance sheet		AMOUNTS NOT OFFSET IN THE BALANCE SHEET: Financial instruments		AMOUNTS NOT OFFSET IN THE BALANCE SHEET: Collateral received/pledged		Net amount	
	Dec. 31, 2016	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015
Assets												
Cash reserve	1,478	1,416	–	–	1,478	1,416	–	–	–	–	1,478	1,416
Loans to and receivables from banks	2,236	2,940	–	–	2,236	2,940	–	–	–	–	2,236	2,940
Loans to and receivables from customers	100,646	92,934	−82	−163	100,564	92,771	–	–	−65	−84	100,499	92,687
Derivative financial instruments	1,297	1,178	–	–	1,297	1,178	−123	−124	−175	−123	999	931
Marketable securities	2,993	2,936	–	–	2,993	2,936	–	–	–	–	2,993	2,936
Miscellaneous financial assets	0	0	–	–	0	0	–	–	–	–	0	0
Other assets	1,255	1,629	−14	−11	1,242	1,618	–	–	–	–	1,242	1,618
Total	**109,907**	**103,033**	**−96**	**−174**	**109,811**	**102,859**	**−123**	**−124**	**−240**	**−207**	**109,447**	**102,528**
Liabilities												
Liabilities to banks	17,034	15,721	–	–	17,034	15,721	–	–	−2,051	−1,836	14,983	13,885
Liabilities to customers	49,536	43,927	−82	−163	49,454	43,764	–	–	–	–	49,454	43,764
Notes, commercial paper issued	37,849	39,913	–	–	37,849	39,913	–	–	−904	−1,415	36,945	38,498
Derivative financial instruments	413	249	–	–	413	249	−123	−124	−24	−12	266	113
Other liabilities	704	590	−14	−11	690	579	–	–	–	–	690	579
Subordinated capital	3,183	2,344	–	–	3,183	2,344	–	–	–	–	3,183	2,344
Total	**108,719**	**102,744**	**−96**	**−174**	**108,623**	**102,570**	**−123**	**−124**	**−2,978**	**−3,263**	**105,521**	**99,183**

59. Counterparty Default Risk

For qualitative information, please refer to the risk report (Credit Risk section, pages 29 to 32), which forms part of the management report.

The credit and default risk arising from financial assets is essentially the risk that a counterparty will default. The maximum amount of the risk is therefore the amount of the claims against the counterparty concerned arising from recognized carrying amounts and irrevocable credit commitments. The maximum credit and default risk is reduced by collateral and other credit enhancements amounting to €56,593 million (previous year: €54,658 million). The collateral held is in respect of loans to and receivables from banks and customers in the class "Assets measured at amortized cost". The types of collateral held include vehicles, other assets pledged as collateral, financial guarantees, marketable securities and charges on real estate. Cash deposits are also used as collateral in connection with derivatives.

The following table shows the credit quality of financial assets:

	GROSS CARRYING AMOUNT		NEITHER PAST DUE NOR IMPAIRED		PAST DUE BUT NOT IMPAIRED		IMPAIRED	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Measured at fair value	3,135	3,067	3,135	3,067	–	–	–	–
Measured at amortized cost								
Cash reserve	1,478	1,416	1,478	1,416	–	–	–	–
Loans to and receivables from banks	2,236	2,940	2,236	2,940	–	–	–	–
Loans to and receivables from customers	103,630	95,462	99,020	91,571	2,089	1,621	2,521	2,270
Other assets	1,242	1,619	1,242	1,618	–	–	–	1
Derivative financial instruments designated as hedges	1,156	1,047	1,156	1,047	–	–	–	–
Total	**112,877**	**105,551**	**108,267**	**101,659**	**2,089**	**1,621**	**2,521**	**2,271**

The maximum default risk from irrevocable credit commitments and financial guarantees is €2,721 million (previous year: €2,862 million).

These assets are measured in accordance with IAS 39, as already described in notes (8) and (9).

The breakdown of neither past due nor impaired financial assets by risk class is as follows:

€ million	NEITHER PAST DUE NOR IMPAIRED		RISK CLASS 1		RISK CLASS 2	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Measured at fair value	3,135	3,067	3,135	3,067	–	–
Measured at amortized cost						
Cash reserve	1,478	1,416	1,478	1,416	–	–
Loans to and receivables from banks	2,236	2,940	2,236	2,940	–	–
Loans to and receivables from customers	99,020	91,571	84,924	77,191	14,096	14,380
Other assets	1,242	1,618	1,145	1,524	96	94
Derivative financial instruments designated as hedges	1,156	1,047	1,156	1,047	–	–
Total	**108,267**	**101,659**	**94,075**	**87,185**	**14,192**	**14,474**

In the financial services business, the group evaluates the credit quality of the borrower before entering into any lending contract or lease. In the retail business, this evaluation is carried out by using scoring systems, whereas rating systems are used for fleet customers and dealer financing transactions. Lending evaluated as “good” is included in risk class 1. Loans to and receivables from customers whose credit quality has not been classified as “good” but who have not yet defaulted are included under risk class 2.

Age analysis of financial assets past due but not impaired, by class:

	Past due but not impaired		IN THE FOLLOWING AGED PAST DUE CATEGORIES: Up to 1 month		1 to 3 months		More than 3 months	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Measured at fair value	–	–	–	–	–	–	–	–
Measured at amortized cost								
Cash reserve	–	–	–	–	–	–	–	–
Loans to and receivables from banks	–	–	–	–	–	–	–	–
Loans to and receivables from customers	2,089	1,621	1,451	1,093	637	515	1	13
Other assets	–	–	–	–	–	–	–	–
Derivative financial instruments designated as hedges	–	–	–	–	–	–	–	–
Total	**2,089**	**1,621**	**1,451**	**1,093**	**637**	**515**	**1**	**13**

The VW FS AG Group intends to recover the following collateral accepted in the reporting period for financial assets:

€ million	Dec. 31, 2016	Dec. 31, 2015
Vehicles	87	68
Real estate	–	–
Other movable assets	–	–
Total	**87**	**68**

The vehicles are remarketed to Volkswagen Group dealers through direct sales and auctions.

60. Liquidity Risk

Please refer to the management report for information on the funding and hedging strategy.

The maturity profile of assets held to manage liquidity risk is as follows:

€ million	ASSETS		REPAYABLE ON DEMAND		UP TO 3 MONTHS		3 MONTHS TO 1 YEAR		1 TO 5 YEARS	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Cash reserve	1,478	1,416	1,478	1,416	–	–	–	–	–	–
Loans to and receivables from banks	2,236	2,940	1,652	2,018	509	850	29	30	46	42
Marketable securities	2,444	2,507	–	–	2,444	2,507	–	–	–	–
Total	**6,158**	**6,864**	**3,130**	**3,435**	**2,953**	**3,358**	**29**	**30**	**46**	**42**

The following table shows the maturity profile of undiscounted cash outflows from financial liabilities:

€ million	Cash outflows		REMAINING CONTRACTUAL MATURITIES: Up to 3 months		3 months to 1 year		1 to 5 years		More than 5 years	
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Liabilities to banks	17,543	16,260	5,067	5,284	4,868	4,416	7,498	6,481	110	78
Liabilities to customers	50,000	44,246	35,307	30,400	6,735	4,814	7,121	8,212	836	819
Notes, commercial paper issued	38,704	40,990	3,766	4,142	11,802	10,844	19,988	22,038	3,148	3,966
Derivative financial instruments	13,393	9,463	4,817	3,602	4,917	2,565	3,544	3,296	116	–
Other liabilities	690	579	190	139	254	200	243	236	2	3
Subordinated capital	3,754	2,845	55	455	491	484	1,507	1,262	1,701	644
Irrevocable credit commitments	2,648	4,642	1,201	2,953	1,447	1,689	0	0	–	0
Total	**126,732**	**119,024**	**50,404**	**46,975**	**30,514**	**25,013**	**39,901**	**41,525**	**5,914**	**5,512**

Financial guarantees with a maximum possible drawdown of €73 million (previous year: €95 million) are assumed to be payable on demand at all times.

61. Market Risk

For qualitative information, please refer to the risk report within the management report.

For quantitative risk measurement, interest rate and foreign currency risk are measured using a value-at-risk (VaR) model on the basis of a historical simulation. The value-at-risk calculation indicates the size of the maximum potential loss on the portfolio as a whole within a time horizon of 40 days, measured at a confidence level of 99%. To provide the basis for this calculation, all cash flows from non-derivative and derivative financial instruments are aggregated into an interest rate gap analysis. The historical market data used in determining the value-at-risk covers a period of 1,000 trading days.

This approach has produced the following values:

€ million	Dec. 31, 2016	Dec. 31, 2015
Interest-rate risk	110	90
Currency translation risk	141	119
Total market risk	**155**	**153**

62. Foreign Currency Exposures

The following table shows a breakdown of the foreign currency amounts included in the assets and liabilities of the VW FS AG Group as of December 31, 2016:

€ million	AUD	BRL	CNY	CZK	GBP	JPY	KRW	MXN	PLN	SEK	Other	Total
Loans to and receivables from banks	102	288	260	1	23	62	67	52	6	74	85	1,018
Loans to and receivables from customers	2,983	4,279	6,408	1,160	14,528	2,453	673	2,112	1,209	2,958	4,437	43,200
Assets	**3,085**	**4,568**	**6,668**	**1,160**	**14,551**	**2,514**	**740**	**2,164**	**1,215**	**3,031**	**4,522**	**44,218**
Liabilities to banks	1,075	1,969	3,324	479	857	1,118	277	1,078	794	–	721	11,691
Liabilities to customers	60	822	1,362	454	565	83	252	191	337	642	2,570	7,338
Notes, commercial paper issued	1,287	129	1,214	139	5,660	1,211	316	654	105	1,205	634	12,552
Subordinated capital	46	317	–	–	1,463	–	–	–	–	56	–	1,881
Liabilities	**2,467**	**3,236**	**5,900**	**1,071**	**8,545**	**2,412**	**845**	**1,923**	**1,236**	**1,902**	**3,925**	**33,462**

63. Hedging Policy Disclosures

HEDGING POLICY AND FINANCIAL DERIVATIVES

Given its international financial activities, the VW FS AG Group is exposed to fluctuations in interest rates and foreign exchange rates on international money and capital markets. The general rules governing the Group-wide currency and interest rate hedging policy are specified in internal Group guidelines and satisfy the Minimum Requirements for Risk Management (MaRisk – Mindestanforderungen an das Risikomanagement) issued by the German Federal Financial Supervisory Authority (BaFin). The partners used by the Group when entering into appropriate financial transactions are national and international banks with strong credit ratings whose credit quality is continuously monitored by leading rating agencies. The Group enters into suitable hedging transactions to limit currency and interest rate risks. Regular derivative financial instruments are used for this purpose.

MARKET RISK

Market risk arises when changes in prices on financial markets (interest rates and exchange rates) have a positive or negative effect on the value of traded products. The fair values listed in the tables in the notes were determined using the market information available on the reporting date and represent the present values of the financial derivatives. They were determined on the basis of standardized techniques or quoted prices.

Interest Rate Risk

Changes in the level of interest rates in the money and capital markets represent an interest rate risk in the case of any funding that is not maturity-matched. Interest rate risk is managed on the basis of recommendations made by the Asset-Liability Management Committee (ALM Committee). Interest rate risk is quantified using interest rate gap analyses to which various scenarios involving changes in interest rates are applied. The calculations take into account uniform risk ceilings applicable throughout the Group.

The hedging contracts entered into by the Group mainly comprise interest rate swaps and cross-currency swaps. Microhedges and portfolio hedges are used for interest rate hedging. Fixed-income assets and liabilities included in this hedging strategy are recognized at fair value rather than at amortized cost, the method used in their original subsequent measurement. The resulting effects in the income statement are generally offset by the opposite effects from the corresponding gains and losses on the interest rate hedging instruments (swaps).

Currency Risk

The VW FS AG Group avoids currency risk by entering into currency hedging contracts, which may be currency forwards or cross-currency swaps. Generally speaking, all cash flows in foreign currency are hedged.

LIQUIDITY RISK, FUNDING RISK

The VW FS AG Group takes precautions to minimize the risk from any potential liquidity squeeze by holding confirmed credit lines and by using debt issuance programs with multicurrency capability. It also holds marketable securities from public-sector issuers that are readily marketable and can be deposited in its operational safe custody account with Deutsche Bundesbank, and can thus be used to help safeguard liquidity.

DEFAULT RISK

The default risk arising from financial assets is essentially the risk that a counterparty will default. The maximum amount of the risk is therefore the balance due from the counterparty concerned.

Given that only counterparties with strong credit ratings are used for transactions and limits are set for each counterparty as part of the risk management system, the actual default risk is deemed to be low. Furthermore, the default risk in the Group’s transactions is also minimized in accordance with regulatory requirements by the use of collateral to be furnished by the counterparty.

Risk concentrations arise in the VW FS AG Group in a variety of forms. A detailed description can be found in the report on opportunities and risks within the combined management report.

The breakdown of the notional volume of the derivative financial instruments is as follows:

	REMAINING CONTRACTUAL MATURITIES					
	Up to 1 year		1 to 5 years		More than 5 years	
€ million	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Cash flow hedges						
Interest rate swaps	1,297	670	1,778	1,155	–	–
Cross-currency interest rate swaps	376	167	500	521	–	–
Currency forward contracts	7	3	–	–	–	–
Currency swaps	–	–	–	–	–	–
Other						
Interest rate swaps	16,679	14,410	29,884	34,529	17,270	16,229
Cross-currency interest rate swaps	1,949	1,130	1,959	2,500	–	–
Currency forward contracts	3,527	2,962	–	2	–	–
Currency swaps	4,051	3,879	1,003	198	–	–
Total	**27,886**	**23,222**	**35,124**	**38,904**	**17,270**	**16,229**

The timings of the future payments for the hedged items in the cash flow hedges match the maturities of the hedging instruments.

As of the reporting date, none of the recognized cash flow hedges involved a hedged item in which the transaction was no longer expected to occur in the future.

Segment Reporting

64. Breakdown by Geographical Market

The reportable segments in accordance with IFRS 8 and on the basis of the internal reporting structure of the VW FS AG Group are the geographical markets Germany, Europe, Latin America and Asia-Pacific.

In contrast to the presentation in the 2015 consolidated financial statements, the MAN FS segment is no longer included into the geographical markets of the VW FS AG Group following the final integration of the MAN Financial Services Group. The companies in the previous MAN FS segment have been allocated to the following geographical markets: Germany, Europe and Other Companies. The prior-year figures for these segments have therefore been restated accordingly. The amended presentation reflects the current internal reporting structure in the VW FS AG Group.

The 2015 consolidated financial statements included a separate reconciliation statement showing a breakdown of the reconciliation effects between non-allocated units and consolidation. The reconciliation statement has now been integrated in the tables showing the breakdown by geographical markets by means of the new Other Companies and Consolidation columns. There is thus no longer a need for a separate reconciliation statement.

Foreign branches of German subsidiaries are allocated to the Europe segment. The Europe segment comprises the subsidiaries and branches in the United Kingdom, Italy, France, the Czech Republic, Austria, the Netherlands, Spain, Sweden, Ireland, Greece, Portugal, Poland and Russia. The Latin America segment consists of the subsidiaries in Mexico and Brazil. The Asia-Pacific segment consists of the subsidiaries in Australia, Japan, China, India and the Republic of Korea.

The Other Companies segment comprises the holding company VW FS AG, the holding and financing companies in the Netherlands, France and Belgium, EURO Leasing companies in Germany, Denmark and Poland, VW Insurance Brokers GmbH and Volkswagen Versicherung AG. In the internal reporting structure, this presentation ensures that there is a separation between market activities on one side and typical holding company or financing functions, industry business, primary insurance business and reinsurance business on the other side.

The information made available to management for management purposes is based on the same accounting policies as those used for external financial reporting.

The profit or loss for each individual segment is measured on the basis of the operating profit or loss and profit or loss before tax.

Operating profit or loss includes net income from lending, leasing and insurance transactions after provision for credit risks, net fee and commission income, general and administrative expenses, and other operating income and expenses. The interest expenses, general and administrative expenses and net other operating income/expenses that are not components of operating profit or loss largely comprise interest income and expenses from tax audits, interest costs from unwinding the discount on other provisions, interest expenses for pension provisions and the expected return on plan assets for externally funded pension obligations. Interest income not classified as revenue is interest income that is not attributable to the financial services business. This interest income is not a component of operating profit or loss.

BREAKDOWN BY GEOGRAPHICAL MARKET 2015:

€ million	Germany[1]	Europe[1]	Latin America	Asia-Pacific	Segments total[1]	Other companies[1]	Consolidation[1]	Group
	JAN. 1 – DEC. 31, 2015							
Revenue from lending transactions with third parties	907	1,203	957	871	3,938	37	−4	3,971
Intersegment revenue from lending transactions	78	0	–	0	78	104	−182	–
Total segment revenue from lending transactions	985	1,203	957	871	4,016	141	−186	3,971
Revenue from leasing and service transactions	7,624	4,991	105	398	13,118	176	−14	13,280
Insurance premiums earned	–	–	–	–	–	165	–	165
Fee and commission income	296	160	124	7	587	39	−33	593
Revenue	**8,905**	**6,354**	**1,186**	**1,276**	**17,721**	**521**	**−233**	**18,009**
Cost of sales attributable to lending, leasing and service transactions	−5,556	−3,853	−23	−115	−9,547	−149	2	−9,694
Reversals of impairment losses on lease assets and investment property	2	0	–	–	2	–	–	2
Depreciation of and impairment losses on lease assets and investment property	−1,527	−826	−8	−253	−2,614	−17	–	−2,631
of which impairment losses in accordance with IAS 36	−196	−152	−3	−2	−353	–	–	−353
Expenses from insurance business	–	–	–	–	–	−136	27	−109
Interest expense (component of operating profit or loss)	−337	−317	−493	−368	−1,515	−123	187	−1,451
Provision for credit risks from lending and leasing business	−51	−321	−246	−52	−670	−2	–	−672
Fee and commission expenses	−195	−188	−63	−55	−501	−2	6	−497
Net gain/loss on the measurement of derivative financial instruments and hedged items (component of operating profit or loss)	−4	–	–	–	−4	–	–	−4
General and administrative expenses (component of operating profit or loss)	−893	−487	−201	−225	−1,806	−954	707	−2,053
Net other operating income/expenses (component of operating profit or loss)	252	91	33	19	395	830	−710	515
Segment profit or loss (operating profit or loss)	**596**	**453**	**185**	**227**	**1,461**	**−32**	**−14**	**1,416**
Interest income not classified as revenue	11	0	0	–	11	1	0	12
Interest expense (not a component of operating profit or loss)	−3	0	−5	0	−8	−2	–	−10
Net gain/loss on the measurement of derivative financial instruments and hedged items (not a component of operating profit or loss)	57	−5	2	0	54	–	3	57
Share of profits and losses of equity-accounted joint ventures	0	–	–	–	0	12	12	24
Net gain/loss on marketable securities and miscellaneous financial assets	21	4	–	–	25	416	−416	25
General and administrative expenses (not a component of operating profit or loss)	−1	−1	0	0	−2	−7	–	−9
Net other operating income/expenses (not a component of operating profit or loss)	0	0	−1	–	−1	–	–	−1
Profit before tax	**681**	**451**	**181**	**227**	**1,540**	**388**	**−415**	**1,513**
Income tax expense	−172	−147	−13	−66	−398	150	−56	−304
Profit after tax	**509**	**304**	**168**	**161**	**1,142**	**538**	**−471**	**1,209**
Segment assets	**45,741**	**32,828**	**6,301**	**12,157**	**97,027**	**505**	**–**	**97,532**
of which noncurrent	**29,152**	**19,336**	**3,086**	**7,801**	**59,375**	**127**	**–**	**59,502**
Segment liabilities	**61,573**	**31,555**	**5,704**	**11,121**	**109,953**	**14,096**	**−25,981**	**98,068**

1 Presentation amended as described in note 64 “Breakdown by Geographical Market”.

BREAKDOWN BY GEOGRAPHICAL MARKET 2016:

	JAN. 1 – DEC. 31, 2016							
€ million	Germany	Europe	Latin America	Asia-Pacific	Segments total	Other companies	Conso-lidation	Group
Revenue from lending transactions with third parties	896	1,301	874	873	3,944	32	–	3,975
Intersegment revenue from lending transactions	100	0	–	0	100	96	−197	–
Total segment revenue from lending transactions	996	1,301	874	873	4,044	128	−197	3,975
Revenue from leasing and service transactions	8,001	5,542	167	442	14,151	229	−19	14,361
Insurance premiums earned	–	–	–	–	–	197	–	197
Fee and commission income	290	167	119	8	584	42	−32	594
Revenue	**9,287**	**7,010**	**1,159**	**1,323**	**18,778**	**596**	**−248**	**19,127**
Cost of sales attributable to lending, leasing and service transactions	−5,725	−4,350	−78	−150	−10,304	−409	9	−10,705
Reversals of impairment losses on lease assets and investment property	3	62	–	1	67	–	–	67
Depreciation of and impairment losses on lease assets and investment property	−1,553	−861	−14	−256	−2,684	−27	–	−2,710
of which impairment losses in accordance with IAS 36	−110	−73	−3	−2	−188	–	–	−188
Expenses from insurance business	–	–	–	–	–	−143	26	−118
Interest expense (component of operating profit or loss)	−310	−355	−464	−343	−1,472	−79	197	−1,354
Provision for credit risks from lending and leasing business	−29	−238	−311	−91	−670	−1	–	−672
Fee and commission expenses	−226	−226	−63	−70	−585	−2	7	−581
Net gain/loss on the measurement of derivative financial instruments and hedged items (component of operating profit or loss)	−11	–	–	–	−11	–	–	−11
General and administrative expenses (component of operating profit or loss)	−873	−490	−178	−209	−1,750	−986	705	−2,031
Net other operating income/expenses (component of operating profit or loss)	121	23	−1	22	164	1,159	−695	628
Segment profit or loss (operating profit or loss)	**684**	**574**	**48**	**227**	**1,533**	**108**	**–**	**1,641**
Interest income not classified as revenue	7	0	1	–	7	0	0	7
Interest expense (not a component of operating profit or loss)	−1	–	0	0	−1	−8	–	−9
Net gain/loss on the measurement of derivative financial instruments and hedged items (not a component of operating profit or loss)	−18	−30	0	−1	−49	−25	0	−74
Share of profits and losses of equity-accounted joint ventures	–	–	–	–	–	–	77	77
Net gain/loss on marketable securities and miscellaneous financial assets	−7	11	–	–	4	117	−101	20
General and administrative expenses (not a component of operating profit or loss)	−1	0	0	0	−2	−8	–	−9
Net other operating income/expenses (not a component of operating profit or loss)	−4	−1	1	0	−3	–	–	−3
Profit before tax	**659**	**554**	**51**	**226**	**1,490**	**184**	**−24**	**1,650**
Income tax expense	−254	−130	−12	−73	−469	−38	−2	−509
Profit after tax	**405**	**424**	**39**	**153**	**1,021**	**146**	**−26**	**1,141**
Segment assets	**49,545**	**35,175**	**6,299**	**13,838**	**104,857**	**703**	**–**	**105,560**
of which noncurrent	**32,034**	**21,093**	**2,990**	**9,117**	**65,234**	**137**	**–**	**65,371**
Segment liabilities	**67,479**	**33,246**	**5,191**	**12,613**	**118,529**	**13,187**	**−27,881**	**103,835**

All business transactions between the segments are conducted on an arm's-length basis.

The consolidation in revenue from lending transactions and interest expenses resulted from the provision of intragroup funding between geographical markets. Information on the main products (lending and leasing business) can be taken directly from the income statement (see note 22).

The additions to noncurrent lease assets amounted to €3,442 million (previous year: €3,161 million) in Germany, €2,963 million (previous year: €2,303 million) in the Europe segment, €145 million (previous year: €77 million) in the Latin America segment and €203 million (previous year: €538 million) in the Asia-Pacific segment. Investment recognized under other assets was of minor significance.

Individual line items in the financial statements are aggregated for the purposes of internal reporting. The following table shows the reconciliation of these line items in the financial statements to the segment reporting disclosures.

€ million	Dec. 31, 2016	Dec. 31, 2015
Interest income from lending transactions	3,848	3,909
minus interest income not classified as revenue	7	12
Net income from leasing transactions before provision for credit risks	1,260	1,333
minus expenses from leasing transactions and service contracts	–10,536	–9,603
minus depreciation of and impairment losses on lease assets and investment property	–2,710	–2,631
minus reversals of impairment losses on lease assets and investment property	67	2
minus leasing income not classified as revenue	79	–286
Net income from insurance business	79	56
minus expenses from insurance business	–118	–109
Fee and commission income	594	593
Revenue included in net other operating income/expenses	135	74
Consolidated revenue	**19,127**	**18,009**
Net income from leasing transactions before provision for credit risks	1,260	1,333
minus income from leasing transactions and service contracts	14,507	13,568
minus depreciation of and impairment losses on lease assets and investment property	–2,710	–2,631
Cost of sales included in net other operating income/expenses[1]	–169	–90
Consolidated cost of sales attributable to lending, leasing and service transactions	**–10,705**	**–9,694**
Loans to and receivables from customers attributable to		
Retail financing	53,973	50,665
Dealer financing	14,638	13,967
Leasing business	21,997	19,704
Other loans and receivables	9,957	8,435
of which not included in segment assets	–9,701	–8,221
Lease assets	14,696	12,982
Consolidated assets in accordance with segment reporting	**105,560**	**97,532**
Liabilities to banks	17,034	15,721
of which not included in segment liabilities	–74	–92
Liabilities to customers	49,454	43,764
of which not included in segment liabilities	–3,468	–3,416
Notes, commercial paper issued	37,849	39,913
of which not included in segment liabilities	–142	–165
Subordinated capital	3,183	2,344
Consolidated liabilities in accordance with segment reporting	**103,835**	**98,068**

1 The prior year has been restated.

Other Disclosures

65. Cash Flow Statement

VW FS AG Group's cash flow statement documents changes in cash and cash equivalents attributable to cash flows from operating, investing and financing activities. Cash flows from investing activities comprise purchase payments and disposal proceeds relating to investment property, subsidiaries, joint ventures and other assets. Cash flows from financing activities reflect all cash flows arising from transactions involving equity, subordinated capital and other financing activities. All other cash flows are classified as cash flows from operating activities in accordance with standard international practice for financial services companies.

The narrow definition of cash and cash equivalents comprises only the cash reserve, which consists of cash-in-hand and central bank balances.

The changes in the balance sheet items used to determine the changes in the cash flow statement cannot be derived directly from the balance sheet because effects from the changes in the basis of consolidation have no impact on cash and are eliminated.

66. Off-Balance-Sheet Liabilities

CONTINGENT LIABILITIES

The contingent liabilities of €364 million (previous year: €272 million) largely relate to legal disputes concerning tax matters in which the criteria for the recognition of a provision in accordance with IAS 37 are not satisfied. Based on analysis of the individual matters covered by the contingent liabilities, we believe that the disclosure of further detailed information on individual proceedings, legal disputes or legal risks could seriously prejudice the course or initiation of proceedings.

The trust assets and liabilities of the savings and trust entity belonging to the Latin American subsidiaries are not included in the consolidated balance sheet and amounted to €944 million (previous year: €702 million).

OTHER FINANCIAL OBLIGATIONS

	DUE	DUE	DUE	TOTAL
€ million	2016	2017 – 2020	From 2021	Dec. 31, 2015
Purchase commitments in respect of				
property and equipment	10	–	–	10
intangible assets	1	–	–	1
investment property	–	–	–	–
Obligations from[1]				
irrevocable credit and leasing commitments to customers	4,642	0	0	4,642
long-term leasing and rental contracts	29	56	77	161
Miscellaneous financial obligations[1]	66	0	–	66

1 Presentation changed compared with previous year. In contrast to the previous year, the obligations under loan commitments to unconsolidated subsidiaries are reported under miscellaneous financial obligations because they are not material.

€ million	DUE 2017	DUE 2018 – 2021	DUE From 2022	TOTAL Dec. 31, 2016
Purchase commitments in respect of				
property and equipment	56	–	–	56
intangible assets	1	–	–	1
investment property	–	–	–	–
Obligations from				
irrevocable credit and leasing commitments to customers	4,699	0	–	4,700
long-term leasing and rental contracts	27	48	48	123
Miscellaneous financial obligations	80	3	–	83

In the case of irrevocable credit commitments, we expect the customers to draw down the facilities concerned.

67. Average Number of Employees during the Reporting Period

	2016	2015
Salaried employees	11,554	11,506
Vocational trainees	149	142
Total	**11,703**	**11,648**

68. Related Party Disclosures

Related parties within the meaning of IAS 24 are deemed to be individuals or entities who can be influenced by VW FS AG, who can exercise an influence over VW FS AG, or who are under the influence of another related party of VW FS AG.

Volkswagen AG, Wolfsburg, is the sole shareholder in VW FS AG. In addition, Porsche Automobil Holding SE, Stuttgart, controlled 52.2 % of the voting rights in Volkswagen AG as of the reporting date and therefore held a majority. The Extraordinary General Meeting of Volkswagen AG held on December 3, 2009 approved the creation of rights of appointment for the State of Lower Saxony. As a result of these rights, Porsche SE can no longer appoint a majority of the members of Volkswagen AG's Supervisory Board for as long as the State of Lower Saxony holds at least 15 % of Volkswagen AG's ordinary shares. However, Porsche SE has the power to participate in the operating policy decisions of the Volkswagen Group and is therefore deemed to be a related party within the meaning of IAS 24. According to a notification submitted on January 5, 2016, the State of Lower Saxony and Hannoversche Beteiligungsgesellschaft mbH, Hanover, held 20.00 % of the voting rights in Volkswagen AG as of December 31, 2016. In addition, as referred to above, the Extraordinary General Meeting of Volkswagen AG held on December 3, 2009 approved a resolution under which the State of Lower Saxony could appoint two members of the Supervisory Board (right of appointment).

Volkswagen AG as the sole shareholder and VW FS AG have entered into a control and profit-and-loss transfer agreement. All business transactions between the two companies are conducted on an arm's-length basis.

Volkswagen AG and its subsidiaries provide the entities in the VW FS AG Group with funding on an arm's-length basis. Volkswagen AG and its subsidiaries have also furnished collateral in our favor as part of the operating business.

The production and importer companies in the Volkswagen Group provide the entities in the VW FS AG Group with financial subsidies to support sales promotion campaigns.

All business transactions with unconsolidated subsidiaries and joint ventures of VW FS AG as well as with other related parties in Volkswagen AG's group of consolidated entities are processed at arm's length.

The two tables below show the transactions with related parties. In these tables, the exchange rates used in connection with the figures are the closing rate for asset and liability items, and the average rates for the year for income statement items.

FISCAL YEAR 2015

€ million	Supervisory Board	Board of Management	Volkswagen AG	Porsche SE	Other related parties in the consolidated entities	Non-consolidated subsidiaries	Joint ventures
Loans and receivables	0	0	289	–	3,501	80	5,360
Valuation allowances on loans and receivables	–	–	–	–	–	–	–
of which additions in current year	–	–	–	–	–	–	–
Obligations	3	5	4,885	100	13,051	261	25
Interest income	0	0	4	–	107	3	103
Interest expense	0	0	–10	0	–215	–2	0
Goods and services provided	–	–	736	0	3,300	45	63
Goods and services received	–	–	7,924	–	6,923	28	12

In the previous year, the obligations to Porsche SE resulted from time deposits made by Porsche SE with Volkswagen Bank GmbH.

FISCAL YEAR 2016

€ million	Supervisory Board	Board of Management	Volkswagen AG	Porsche SE	Other related parties in the consolidated entities	Non-consolidated subsidiaries	Joint ventures
Loans and receivables	0	0	329	0	4,138	64	5,984
Valuation allowances on loans and receivables	–	–	–	–	–	–	–
of which additions in current year	–	–	–	–	–	–	–
Obligations	3	10	6,226	–	11,532	208	2
Interest income	0	0	4	–	120	6	129
Interest expense	0	0	–12	0	–225	–3	0
Goods and services provided	0	–	1,056	0	3,530	79	51
Goods and services received	–	–	7,984	–	7,193	34	12

The “Other related parties in the group of consolidated entities” column includes, in addition to sister entities, joint ventures and associates that are related parties in Volkswagen AG’s group of consolidated entities. The relationships with the Supervisory Board and the Board of Management comprise relationships with the relevant groups of people at VW FS AG and the Group parent company Volkswagen AG. As in the prior year, relationships with pension plans and the State of Lower Saxony were of lesser significance. The goods and services shown in the “Volkswagen AG” column include support payments from the Volkswagen Group.

Members of the Board of Management and Supervisory Board of VW FS AG are members of management and supervisory boards of other entities in the Volkswagen Group with which we sometimes conduct transactions in the normal course of business. All transactions with these related parties are on an arm’s-length basis.

During the course of the reporting period, standard short-term bank loans amounting to an average total of €563 million (previous year: €488 million) were granted to related parties as part of dealer financing.

BOARD OF MANAGEMENT REMUNERATION

BOARD OF MANAGEMENT REMUNERATION

€ million	2016	2015
Short-term benefits	5	5
Long-term benefits	3	3
Termination benefits	–	–
Post-employment benefits	9	1

In accordance with a resolution passed by the Annual General Meeting, the members of the Supervisory Board are entitled to annual remuneration. This remuneration is independent of the performance of the Company and the Supervisory Board role undertaken by the person concerned. Various members of the Supervisory Board are also members of the supervisory boards of other Volkswagen AG subsidiaries. The remuneration received for these functions is deducted from the entitlement to remuneration from VW FS AG. As a result, a total amount of less than €0.05 million was paid out to the members of the Supervisory Board in the reporting period.

The employee representatives on the Supervisory Board of VW FS AG also receive their regular salaries under the terms of their employment contracts. This salary is based on the provisions in the Betriebsverfassungsgesetz (BetrVG – German Works Constitution Act) and is an appropriate remuneration for the relevant function or activity in the Company. The same also applies to the representative of the senior executives on the Supervisory Board.

The total payments made to former members of the Board of Management and their surviving dependants amounted to €0.5 million (previous year: €0.4 million); the provisions recognized for this group of people to cover current pensions and pension entitlements amounted to €15 million (previous year: €13 million).

69. Disclosures Relating to Unconsolidated Structured Entities

A structured entity is normally designed so that voting rights or similar rights are not the deciding factor in determining control over the entity.

Typical features of a structured entity are as follows:
- limited scope of activities;
- narrowly defined business purpose;
- inadequate equity to finance the business activities;
- financing through a number of instruments that contractually bind investors and that give rise to a concentration of credit risk and other risks.

VW FS AG maintains business relationships with structured entities. These are ABS special purpose entities within Volkswagen AG's group of consolidated entities. The entities carry out a process of securitization by taking assets from lending agreements and leases for vehicles and transforming them into securities (asset-backed securities) on a maturity-matched basis. VW FS AG has purchased some or all of these securities and classified them as available-for-sale financial assets. Under the principles specified in IFRS 10, these entities are not controlled by VW FS AG and are therefore not included in the consolidated financial statements. The acquisition of the securities issued by ABS special purpose entities in the Volkswagen AG group of consolidated entities means that the financial services business of the associated entities is funded within the Volkswagen AG group of consolidated entities. Some of the purchased securities are deposited at Deutsche Bundesbank and are furnished as collateral in connection with open market operations.

The purchase of the securities gives rise to counterparty default risk on the part of the issuer and interest rate risk. The maximum risk exposure of VW FS AG arising from its interests in unconsolidated structured entities is limited to the fair value of the acquired bonds reported in the balance sheet and the carrying amount of any subordinated loans granted to the entities concerned. The following table contains disclosures on VW FS AG's assets reported in the balance sheet that are related to unconsolidated structured entities and the maximum risk exposure of the VW FS AG Group (disregarding collateral). The nominal volume of the securitized assets is also disclosed.

	ABS SPECIAL PURPOSE ENTITIES	
€ million	2016	2015
Reported in the balance sheet as of December 31		
Marketable securities	285	223
Loans to and receivables from customers[1]	116	64
Maximum loss risk	401	286
Nominal volume of securitized assets	1,187	916

1 Subordinated loans granted

VW FS AG did not provide unconsolidated structured entities with any noncontractual support during the reporting period.

70. Executive Bodies of Volkswagen Financial Services AG

The members of the Board of Management are as follows:

LARS HENNER SANTELMANN
Chairman of the Board of Management
Corporate Management
Insurance
China/India/ASEAN and Latin America regions
Truck & Bus Division (until December 31, 2016)

DR. MARIO DABERKOW
Information Technology and Processes

DR. CHRISTIAN DAHLHEIM
Sales and Marketing
Germany, Europe, International regions
Truck & Bus Division (from January 1, 2017)

FRANK FIEDLER
Finance and Purchasing

CHRISTIANE HESSE
Human Resources and Organization

DR. MICHAEL REINHART
Risk Management and Credit Analysis

THE MEMBERS OF THE SUPERVISORY BOARD ARE AS FOLLOWS:

FRANK WITTER
Chairman
Member of the Board of Management of Volkswagen AG
Finance and Controlling

DR. JÖRG BOCHE
Deputy Chairman (from November 1, 2016)
Executive Vice President of Volkswagen AG
Head of Group Treasury

STEPHAN WOLF
Deputy Chairman
Deputy Chairman of the Joint and Group Works Council of Volkswagen AG

DR. ARNO ANTLITZ
Member of the Board of Management
Volkswagen Brand
Controlling and Accounting

WALDEMAR DROSDZIOK
Chairman of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

PROF. DR. SUSANNE HOMÖLLE (FROM OCTOBER 6, 2016)
Chair of Banking and Finance
University of Rostock

FRED KAPPLER (FROM OCTOBER 6, 2016)
Head of Group Sales
Volkswagen AG

DETLEF KUNKEL (UNTIL APRIL 30, 2016)
General Secretary/Principal Representative of IG Metall Braunschweig

SIMONE MAHLER
Deputy Chairman of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

JAMES MORYS MUIR (UNTIL OCTOBER 5, 2016)
Head of Volkswagen Group National Sales Companies (NSC) Steering

GABOR POLONYI
Head of Fleet Customer Management for Volkswagen Leasing GmbH

PETRA REINHEIMER
General Secretary of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

EVA STASSEK (FROM DECEMBER 8, 2016)
General Secretary/Principal Representative of IG Metall Braunschweig

AXEL STROTBEK
Member of the Board of Management
AUDI AG
Finance and IT

COMMITTEES OF THE SUPERVISORY BOARD
As of December 31, 2016

Members of the Remuneration Committee
Frank Witter (Chairman)
Waldemar Drosdziok (Deputy Chairman)
Dr. Arno Antlitz (until February 24, 2016)
Axel Strotbek (from February 25, 2016)

Members of the Nomination Committee
Frank Witter (Chairman)
Waldemar Drosdziok (Deputy Chairman)
Dr. Arno Antlitz
Fred Kappler (from November 1, 2016)

Members of the Joint Risk and Audit Committee
Dr. Jörg Boche (Chairman)
Waldemar Drosdziok (Deputy Chairman)
Dr. Arno Antlitz
Prof. Dr. Susanne Homölle (from November 1, 2016)
Gabor Polonyi

71. Letter of Comfort for Our Affiliated Companies

With the exception of political risks, Volkswagen Financial Services AG hereby declares that, as the shareholder of its affiliated companies, over which it has managerial control and/or in which it holds a direct or indirect majority share of the share capital, it will exert its influence to ensure that the latter meet their liabilities to lenders in the agreed manner. Moreover, Volkswagen Financial Services AG confirms that, for the term of the loans, it will make no changes to the share structures of these companies which would adversely affect the letter of comfort without informing the lenders.

This comfort also applies to holders of unguaranteed bonds issued by the following affiliated companies: Banco Volkswagen S.A., São Paulo, Brazil; Volkswagen Finance (China) Co., Ltd., Beijing, China; Volkswagen Finance Pvt. Ltd., Mumbai, India; Volkswagen Doğuş Finansman A.Ş., Kağıthane-Istanbul, Turkey.

72. Events After the Balance Sheet Date

Effective January 1, 2017, Volkswagen Financial Services AG acquired around 51% of the shares in LogPay Transport Services GmbH, Eschborn, Germany, a subsidiary of the DVB Bank Group. This majority equity investment will enable Volkswagen Financial Services AG to integrate the Europe-wide processing of truck and passenger car tolls into its service offering for commercial customers and to further develop its fuel card portfolio. The aim is to become one of the largest fuel suppliers in Europe by 2020. The acquisition is still subject to approval by the antitrust authorities.

On January 16, 2017, Volkswagen AG increased the capital in Volkswagen Financial Services AG by €1.0 billion.

Volkswagen AG and Volkswagen Financial Services AG entered into an agreement for a subordinated loan of €500 million for a term beginning on January 16, 2017.

On January 18, 2017, Volkswagen Financial Services AG added €400 million to the capital reserves of Volkswagen Bank GmbH.

Dr. Christian Dahlheim took over responsibility for the Truck & Bus Division of Volkswagen Financial Services AG on January 1, 2017 in addition to his existing responsibilities. This division had previously fallen within the remit of the Chairman of the Board of Management, Lars Henner Santelmann.

The Standard & Poor's (S&P) senior unsecured ratings for unsecured bonds issued by Volkswagen Financial Services AG and Volkswagen Bank GmbH were downgraded by one notch on February 9, 2017 to BBB (Volkswagen Financial Services AG) and BBB+ (Volkswagen Bank GmbH) because of a regulatory amendment.

There were no other significant developments after the end of fiscal year 2016.

73. Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the management report of the Group includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Braunschweig, February 14, 2017
The Board of Management

Lars Henner Santelmann	Dr. Mario Daberkow
Dr. Christian Dahlheim	Frank Fiedler
Christiane Hesse	Dr. Michael Reinhart

Country-by-Country Reporting of Volkswagen Financial Services AG

The country-by-country reporting requirements specified in Article 89 of Directive 2013/36/EU (Capital Requirements Directive, CRD IV) have been transposed into German law in section 26a(1) sentence 2 of the Kreditwesengesetz (KWG – German Banking Act).

In this country-by-country reporting section, the Volkswagen Financial Services AG Group provides the following disclosures as of December 31, 2016 in accordance with section 26a(1) nos. 1 to 6 of the KWG:
- name of entity, nature of activities and geographical location of the branch
- revenue
- number of employees on a full-time equivalent basis
- profit or loss before tax
- tax on profit or loss
- public subsidies received

The report includes the necessary disclosures for all entities fully consolidated in the consolidated financial statements in accordance with IFRS. Branch is defined as the individual subsidiaries, together with any branch offices maintained by subsidiaries in the individual countries. The figures contained in this report have generally been determined on an unconsolidated basis. Revenue figures have been adjusted for intragroup transactions within a country.

Revenue is defined as the total of the following components in the income statement in accordance with IFRS:
- interest income from lending transactions less interest expense
- income from leasing transactions and service contracts
- net fee and commission income
- net gain/loss on the measurement of derivative financial instruments and hedged items
- net gain/loss on marketable securities and miscellaneous financial assets
- other operating income

The number of employees is disclosed as an average figure on a full-time equivalent basis.

The effective income tax is reported for the tax on profit or loss. For further information on the procedure, please refer to the consolidated financial statements of Volkswagen Financial Services AG for the year ended December 31, 2016, notes to the consolidated financial statements, income tax expense.

Public subsidies received are defined as direct EU subsidies.

Country	Revenue (€ million)	Employees	Profit or loss before tax (€ million)	Tax on profit or loss (€ million)	Public subsidies received (€ million)
EU countries					
Germany	9,740	5,207	777	43	–
Belgium	17	–	7	1	–
Denmark	43	15	0	0	–
France	618	359	56	2	–
Greece	11	42	5	–	–
United Kingdom	1,733	899	461	93	–
Ireland	42	61	24	4	–
Italy	549	361	84	44	–
Luxembourg	–	–	–	–	–
The Netherlands	40	2	27	7	–
Austria	49	112	5	2	–
Poland	167	321	12	36	–
Portugal	38	67	3	0	–
Sweden	3,031	144	25	0	–
Spain	10	16	15	4	–
Czech Republic	254	215	30	2	–
Non-EU countries					
Australia	45	127	8	5	–
Brazil	386	798	112	52	–
China	334	758	190	156	–
India	35	292	15	5	–
Japan	66	92	26	10	–
Mexico	304	346	97	27	–
Republic of Korea	453	75	32	14	–
Russia	63	264	10	7	–
Turkey	–	–	–	–	–

Name of company	Nature of activity	Location of registered office	Country
EU countries			
Volkswagen Bank GmbH	Bank	Braunschweig	Germany
MAN Financial Services GmbH	Financial institution	Munich	Germany
VOLKSWAGEN FINANCIAL SERVICES AG	Financial institution	Braunschweig	Germany
Volkswagen Leasing GmbH	Financial institution	Braunschweig	Germany
Volkswagen Versicherung AG	Insurer	Braunschweig	Germany
Volim Volkswagen Immobilien Vermietgesellschaft für VW-/Audi-Händlerbetriebe mbH	Provider of ancillary services	Braunschweig	Germany
EURO-Leasing GmbH	Other	Sittensen	Germany
Volkswagen Insurance Brokers GmbH	Other	Braunschweig	Germany
Volkswagen-Versicherungsdienst GmbH	Other	Braunschweig	Germany
Driver Ten GmbH	Special purpose entity	Frankfurt am Main	Germany
Driver Eleven GmbH	Special purpose entity	Frankfurt am Main	Germany
Driver Twelve GmbH	Special purpose entity	Frankfurt am Main	Germany
Driver thirteen UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2011-3 GmbH i.L.	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2012-1 GmbH i.L.	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2012-2 GmbH i.L.	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2012-3 GmbH	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2013-1 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2013-2 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2014-1 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2014-2 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2014-3 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2014-4 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Private Driver 2015-1 UG (haftungsbeschränkt)	Special purpose entity	Frankfurt am Main	Germany
Volkswagen Finance Belgium S.A.	Financial institution	Brussels	Belgium
Euro-Leasing A/S	Other	Padborg	Denmark
Volkswagen Bank GmbH, France Branch	Bank	Roissy en France	France
Volkswagen Holding Financière s.a.	Financial institution	Villers-Cotterêts	France
Volkswagen Versicherung AG, France Branch	Insurer	Roissy en France	France
MAN Location & Services S.A.S.	Other	Evry	France
Driver France FCT	Special purpose entity	Pantin	France
Volkswagen Bank GmbH, Greece Branch	Bank	Glyfada, Athens	Greece
Volkswagen Bank GmbH, United Kingdom Branch	Bank	Milton Keynes	United Kingdom
Volkswagen Financial Services (UK) Ltd.	Financial institution	Milton Keynes	United Kingdom
Volkswagen Bank GmbH, Ireland Branch	Bank	Dublin	Ireland
Volkswagen Bank GmbH, Italy Branch	Bank	Milan	Italy
Volkswagen Bank GmbH, Italy Branch	Bank	Verona	Italy
Volkswagen Bank GmbH, Italy Branch	Bank	Bolzano	Italy
Volkswagen Leasing GmbH, Italy Branch	Financial institution	Milan	Italy
Volkswagen Leasing GmbH, Italy Branch	Financial institution	Verona	Italy
Volkswagen Leasing GmbH, Italy Branch	Financial institution	Bolzano	Italy
Driver Master S.A.	Special purpose entity	Luxembourg	Luxembourg
Driver UK Master S.A.	Special purpose entity	Luxembourg	Luxembourg
Driver UK Multi-Compartment S.A.	Special purpose entity	Luxembourg	Luxembourg
VCL Master S.A.	Special purpose entity	Luxembourg	Luxembourg
VCL Master Residual Value S.A.	Special purpose entity	Luxembourg	Luxembourg
VCL Multi-Compartment S.A.	Special purpose entity	Luxembourg	Luxembourg
Trucknology S.A.	Special purpose entity	Luxembourg	Luxembourg

Name of company	Nature of activity	Location of registered office	Country
Volkswagen Bank GmbH, Netherlands Branch	Bank	Amersfoort	The Netherlands
Volkswagen Finance Overseas B.V.	Financial institution	Amsterdam	The Netherlands
Volkswagen Financial Services N.V.	Financial institution	Amsterdam	The Netherlands
MAN Financial Services GesmbH	Financial institution	Eugendorf	Austria
Volkswagen-Versicherungsdienst GmbH	Other	Vienna	Austria
Volkswagen Bank Polska S.A.	Bank	Warsaw	Poland
MAN Financial Services Poland Sp. z o.o.	Financial institution	Nadarzyn	Poland
Volkswagen Leasing GmbH, Poland Branch	Financial institution	Warsaw	Poland
Euro-Leasing Sp. z o.o.	Other	Kolbaskowo	Poland
Volkswagen Bank GmbH, Portugal Branch	Bank	Amadora	Portugal
Volkswagen Renting, Unipessoal, Lda.	Financial institution	Amadora	Portugal
Volkswagen Finans Sverige AB	Bank	Södertälje	Sweden
Volkswagen Bank GmbH, Spain Branch	Bank	Alcobendas, Madrid	Spain
ŠkoFIN s.r.o.	Financial institution	Prague	Czech Republic
Non-EU countries			
Volkswagen Financial Services Australia Pty. Ltd.	Financial institution	Chullora	Australia
Driver Australia One Pty. Ltd.	Special purpose entity	Ashfield	Australia
Driver Australia Two Pty. Ltd.	Special purpose entity	Ashfield	Australia
Driver Australia Three Pty. Ltd.	Special purpose entity	Ashfield	Australia
Driver Australia Master Trust Pty. Ltd.	Special purpose entity	Ashfield	Australia
Banco Volkswagen S.A.	Bank	São Paulo	Brazil
Volkswagen Participações Ltda.	Financial institution	São Paulo	Brazil
Consórcio Nacional Volkswagen - Administradora de Consórcio Ltda.	Provider of ancillary services	São Paulo	Brazil
Volkswagen Serviços Ltda.	Provider of ancillary services	São Paulo	Brazil
Volkswagen Corretora de Seguros Ltda.	Other	São Paulo	Brazil
Driver Brasil One Banco Volkswagen Fundo de Investimento em Direitos Creditórios Financiamento de Veículos	Special purpose entity	Osasco	Brazil
Driver Brasil Two Banco Volkswagen Fundo de Investimento em Direitos Creditórios Financiamento de Veículos	Special purpose entity	Osasco	Brazil
Driver Brasil Three Banco Volkswagen Fundo de Investimento em Direitos Creditórios Financiamento de Veículos	Special purpose entity	Osasco	Brazil
Volkswagen Finance (China) Co., Ltd.	Financial institution	Beijing	China
Driver China Two Auto Loan Securitization Trust	Special purpose entity	Beijing	China
Driver China Three Auto Loan Securitization Trust	Special purpose entity	Beijing	China
Driver China Four Auto Loan Securitization Trust	Special purpose entity	Beijing	China
Driver China Five Auto Loan Securitization Trust	Special purpose entity	Beijing	China
Volkswagen Finance Pvt. Ltd.	Financial institution	Mumbai	India
Volkswagen Financial Services Japan Ltd.	Financial institution	Tokyo	Japan
Volkswagen Bank S.A., Institución de Banca Múltiple	Bank	Puebla	Mexico
Volkswagen Leasing S.A. de C.V.	Financial institution	Puebla	Mexico
OOO Volkswagen Bank RUS	Financial institution	Moscow	Russia
OOO MAN Financial Services	Financial institution	Moscow	Russia
OOO Volkswagen Group Finanz	Financial institution	Moscow	Russia
Volkswagen Financial Services Korea Co., Ltd.	Financial institution	Seoul	Republic of Korea

Auditor's Report

We have audited the consolidated financial statements prepared by VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig, comprising the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity, the cash flow statement and the notes to the consolidated financial statements, together with the group management report, which is combined with the management report of VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig, for the fiscal year from January 1 to December 31, 2016. The preparation of the consolidated financial statements and the combined management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law required to be applied under section 315a(1) of the Handelsgesetzbuch (HGB – German Commercial Code) are the responsibility of the Company's Board of Management. Our responsibility is to express an opinion on the consolidated financial statements and the combined management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with section 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW – Institute of Public Auditors in Germany). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the combined management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the combined management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in the consolidated financial statements, the determination of the entities to be included in the consolidation, the accounting and consolidation principles used and significant estimates made by the Company's Board of Management, as well as evaluating the overall presentation of the consolidated financial statements and the combined management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law required to be applied under section 315a(1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these provisions. The combined management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Hanover, February 14, 2017

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Frank Hübner	Burkhard Eckes
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Report of the Supervisory Board

of Volkswagen Financial Services AG

In fiscal year 2016, the Supervisory Board gave regular and thorough consideration to the position and development of Volkswagen Financial Services AG and the Volkswagen Financial Services AG Group.

During the reporting period, the Board of Management informed the Supervisory Board promptly and comprehensively at all times, in writing or verbally, regarding material aspects of the Company's planning and position, including the risk situation and the risk management system, and also regarding business development and any deviations from planning and targets. Based on these reports of the Board of Management, the Supervisory Board constantly monitored the management of the Company's and the Group's business and was thus able to carry out without limitation the functions assigned to it by law and under the articles of association. All decisions of fundamental importance for the Company and other transactions requiring the approval of the Supervisory Board under the rules of procedure were reviewed and discussed with the Board of Management before the relevant resolution was adopted.

The Supervisory Board generally comprises twelve members. Changes in the reporting period are disclosed in the information on governing bodies.

The Supervisory Board held four regular meetings in the reporting period; there were no extraordinary meetings. The average attendance rate was 93%. One member of the Supervisory Board attended half of the meetings; all other members of the Supervisory Board were present at more than half of the meetings. Decisions were made on five urgent matters by means of a written resolution circulated to each of the members for approval.

COMMITTEE ACTIVITIES

The Supervisory Board has set up various committees to enable it to fulfill its responsibilities, namely the Joint Risk and Audit Committee, the Nomination Committee, the Remuneration Committee and the Credit Committee.

The Joint Risk and Audit Committee focused on the business and risk strategy, the refinancing and liquidity position, and on internal and external audit activities, together with the related findings. The committee also addressed risk management in the Volkswagen Financial Services AG Group. The committee received detailed reports from the Board of Management on IT issues of current importance and from the compliance officer. In addition, it held discussions with the external auditor regarding audit planning, key points of the audit and the auditor's information requirements. The committee consists of five members. It held two meetings in the reporting period.

The Nomination Committee dealt with the annual evaluation of the Board of Management and of the Supervisory Board in accordance with section 25d of the Kreditwesengesetz (KWG – German Banking Act), based on the structure, size, composition and performance of the respective board, as well as on the knowledge, skills and experience of the individual board members and of the respective board as a whole. The committee also addressed the succession planning strategy and the requirements profile for members of the Board of Management and Supervisory Board. In addition, it dealt with the gender quota for the Supervisory Board and Board of Management of Volkswagen Financial Services AG to be achieved by 2021 and on the lifelong learning program for the Supervisory Board. Appointments to the Supervisory Board and its committees were a further key topic of discussion. The committee consists of three members. It held four meetings in the reporting period.

The Remuneration Committee's main focus was to review the remuneration of the Board of Management of Volkswagen Financial Services AG, taking into account the requirements of the Institutsvergütungsverordnung (InstitutsVergV – German Remuneration Regulation for Institutions), which include a malus review, a sustainability component and ascertaining whether ancillary conditions have been met. The remuneration officer also submitted the remuneration report and reported on the implementation of the new InstitutsVergV from January 1, 2017. The committee consists of four members. It held four meetings in the reporting period. It approved the issue of powers of attorney (“Prokura”) by written resolution.

The Credit Committee is responsible for approving issues the Supervisory Board must deal with under statutory provisions and the rules of procedure regarding loan commitments, the assumption of sureties, guarantees and similar liabilities, company borrowings, the purchasing of receivables (factoring) and for general agreements related to the assumption of receivables. The Credit Committee comprises three members of the Supervisory Board and makes its decisions by means of written resolutions.

The members of the committees also consulted each other on numerous occasions and were in constant contact with the Board of Management outside committee meetings. The activities of the committees were reported at the plenary meetings of the Supervisory Board.

MATTERS DISCUSSED BY THE SUPERVISORY BOARD

At its meeting on February 24, 2016, the Supervisory Board examined in detail and then approved both the consolidated financial statements of the Volkswagen Financial Services AG Group and the annual financial statements of Volkswagen Financial Services AG for 2015 prepared by the Board of Management. We also discussed the status and further development of compliance activities, the refinancing strategy – specifically higher thresholds in the existing frameworks – and the review of malus required by the InstitutsVergV. Finally, the Supervisory Board approved a capital increase for Volkswagen Bank GmbH, which was necessary because of the greater volume of business.

In this meeting and also in the meetings held on April 29, 2016, September 2, 2016 and November 1, 2016, the Board of Management provided us with comprehensive reports on the economic and financial position of the Company and the Group.

At the meeting of the Supervisory Board on April 29, 2016, the Board of Management presented us with a detailed report on the rental strategy, the digitalization strategy and the status of VWFS IT. We also addressed the optimization of the funding structure in Europe. In addition, the Supervisory Board approved the planned partnerships in China, the transfer of Volkswagen Finance S.A. (Spain) from SEAT S.A. to Volkswagen Financial Services AG, the liquidation of inactive companies in the United Kingdom and the consolidation of the holding company structure in the Netherlands.

At the meeting on September 2, 2016, the Supervisory Board mainly discussed risk analyses and regulatory issues as well as the activities to safeguard and expand the international fleet business. Other topics included the development of project performance in IT, the appropriateness of remuneration, and the discussion and feedback culture within Volkswagen Financial Services AG. Finally, the Supervisory Board approved an investment in a fuel and toll card operator and the establishment of branches in Brazil.

At the meeting of the Supervisory Board on November 1, 2016, we discussed in detail and then approved the medium-term financial and capital investment planning for Volkswagen Financial Services AG and the Volkswagen Financial Services AG Group. We also held in-depth discussions on the reorganization of the Volkswagen Financial Services Group and, after comprehensive deliberations, approved the separation of the credit business supervised by the European Central Bank from the other areas of business operated by Volkswagen Financial Services AG. In addition, the Board of Management reported on HR development and submitted the remuneration report. Finally, we approved the merger of Volkswagen Holding Financière S.A., France, into MAN Location & Services S.A.S., the simplification of the organizational structure in the Netherlands, the acquisition of a Dutch leasing company and the establishment of regional offices in Brazil.

AUDIT OF THE ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hanover, was appointed to audit both the consolidated financial statements of the Volkswagen Financial Services AG Group in accordance with IFRS and the annual financial statements of Volkswagen Financial Services AG in accordance with HGB for the year ended December 31, 2016, including the bookkeeping system and management reports.

The consolidated financial statements of the Volkswagen Financial Services AG Group in accordance with IFRS and the annual financial statements of Volkswagen Financial Services AG in accordance with HGB for the year ended December 31, 2016, together with the management reports, were submitted to the Supervisory Board. The auditor, PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hanover, audited these financial statements, including the bookkeeping system and the management reports, and issued an unqualified auditor's opinion in each case.

The Supervisory Board agrees with the findings of these audits. The Supervisory Board had no reservations after its review of the consolidated financial statements and the annual financial statements, including the management reports. The independent auditors were present when this agenda item was addressed at the Supervisory Board meeting and they reported on the main findings of their audit.

At its meeting on March 6, 2017, the Supervisory Board approved both the consolidated financial statements and annual financial statements of Volkswagen Financial Services AG prepared by the Board of Management. The consolidated financial statements and annual financial statements have thus been adopted.

In accordance with the existing control and profit-and-loss transfer agreement, the profits reported in the financial statements of Volkswagen Financial Services AG for the year ended December 31, 2016 have been transferred to Volkswagen AG.

The Supervisory Board would like to take this opportunity to express its gratitude and appreciation for the work of the members of the Board of Management, the works council, the managerial staff and all employees of Volkswagen Financial Services AG and its affiliated companies. The high level of commitment from all of you has helped to sustain the ongoing growth of Volkswagen Financial Services AG.

Braunschweig, March 6, 2017

Frank Witter
Chairman of the Supervisory Board

Supervisory Board

of Volkswagen Financial Services AG

FRANK WITTER
Chairman
Member of the Board of Management of Volkswagen AG
Finance and Controlling

DR. JÖRG BOCHE
Deputy Chairman (from November 1, 2016)
Executive Vice President of Volkswagen AG
Head of Group Treasury

STEPHAN WOLF
Deputy Chairman
Deputy Chairman of the Joint and Group Works Council of Volkswagen AG

DR. ARNO ANTLITZ
Member of the Board of Management Volkswagen Brand
Controlling and Accounting

WALDEMAR DROSDZIOK
Chairman of the Joint Works Council of Volkswagen Financial Services AG,
Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

PROF. DR. SUSANNE HOMÖLLE (FROM OCTOBER 6, 2016)
Chair of Banking and Finance
University of Rostock

FRED KAPPLER (FROM OCTOBER 6, 2016)
Head of Group Sales
Volkswagen AG

DETLEF KUNKEL (UNTIL APRIL 30, 2016)
General Secretary/Principal Representative of
IG Metall Braunschweig

SIMONE MAHLER
Deputy Chairman of the Joint Works Council of Volkswagen Financial Services AG,
Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

JAMES MORYS MUIR (UNTIL OCTOBER 5, 2016)
Head of Volkswagen Group National Sales Companies (NSC) Steering

GABOR POLONYI
Head of Fleet Customer Management for
Volkswagen Leasing GmbH

PETRA REINHEIMER
General Secretary of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

EVA STASSEK (FROM DECEMBER 8, 2016)
General Secretary/Principal Representative of IG Metall Braunschweig

AXEL STROTBEK
Member of the Board of Management
AUDI AG
Finance and IT

NOTE ON FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements on the future business development of Volkswagen Financial Services AG. These statements are based on assumptions relating to the development of the global economy and of the financial and automotive markets, which Volkswagen Financial Services AG has made on the basis of the information available to it and which it considers to be realistic at the time of going to press. The estimates given entail a degree of risk, and the actual developments may differ from those forecast.

Should actual developments turn out to be different, contrary to expectations and assumptions, or unforeseen events occur that have an impact on the business of Volkswagen Financial Services AG, this will have a corresponding effect on the business development of the Company.

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TYPESETTING

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