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Ratings

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New Issue: VCL Multi-Compartment S.A., Compartment VCL 25

€1. 581 Billion Asset-Backed Floating-Rate Notes (Including €46.89 Million Subordinated Loan)

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Ratings Detail

Ratings

Class	Rating*	Amount (mil. €)	Available credit enhancement§ (%)	Interest (%)	Legal final maturity
A	AAA (sf)	1,500.00	7.2	One-month EURIBOR plus 0.40%	Sept. 21, 2023
B	AA- (sf)	34.50	5.0	One-month EURIBOR plus 0.42%	Sept. 21, 2023
Subordinated loan	NR	46.89	0.9	One-month EURIBOR plus a margin	Sept. 21, 2023

*Our ratings address timely payment of interest and ultimate principal. §Includes subordination, overcollateralization, and a cash reserve (see "Transaction Key Features"). EURIBOR--Euro Interbank Offered Rate. NR--Not rated.

Transaction Participants

Originator and servicer	Volkswagen Leasing GmbH
Arranger	UniCredit Bank AG
Joint lead managers	UniCredit Bank AG and ING Bank N.V.
Managers	Banco Santander S.A., BNP Paribas, London Branch, and Skandinaviska Enskilda Banken AB (publ)
Seller	Volkswagen Leasing GmbH (at the authority of VCL Master S.A., Compartment 1)
Security trustee, German process agent, and VCL Master security trustee	Wilmington Trust SP Services (Frankfurt) GmbH
Expectancy rights trustee	Wilmington Trust (London) Ltd.
Corporate services provider	Circumference FS (Luxembourg) S.A.
Servicer collection account bank, transaction account bank, and cash administrator	Citibank N.A., London Branch
Paying agent, calculation agent, interest determination agent, and custodian	Citibank N.A., London Branch
Subordinated lender	Volkswagen Financial Services AG
Interest rate swap counterparty	Skandinaviska Enskilda Banken AB (publ)
Data protection trustee	Wilmington Trust SP Services (Frankfurt) GmbH

Supporting Ratings

Institution/role	Rating
Citibank N.A.as parent company of the transaction bank account provider	A+/Stable/A-1
U.K. as host sovereign of the transaction bank account provider	AA/Negative/A-1+
Skandinaviska Enskilda Banken as interest rate swap counterparty	A+/Stable/A-1

Transaction Key Features

Closing date	Nov. 27, 2017
Collateral	Auto lease receivables; residual values are not securitized
Principal outstanding (€; discounted lease balance)*	1,595,750,127.45
Country of origination	Germany
Transaction structure	Static true sale
Replenishment period (years)	0
Redemption profile	Sequential at closing; switching to pro rata after additional overcollateralization builds up
Credit enhancement for the class A notes (percentage of asset volume)	Subordination: 5.1%; overcollateralization: 0.9%; cash reserve: 1.2%; and excess spread (initial percentage per year): 0.0%
Credit enhancement for the class B notes (percentage of asset volume)	Subordination: 2.9%; overcollateralization: 0.9%; cash reserve: 1.2%; and excess spread (initial percentage per year): 0.0%
Cash reserve description	1.2% of the initial discounted pool balance (€19.2 million). To cover liquidity shortfalls during the life of the transaction and redeem notes at the end of the transaction (nonamortizing).
Seller risk reserve	Seller risks are mitigated through a nonamortizing seller risk reserve sized at €17.6 million, 1.10% of the initial discounted pool balance.
Commingling risk	Mitigated through an advance cash mechanism

*As of the pool cut-off date on Oct. 31, 2017. N/A--Not applicable.

Transaction Summary

S&P Global Ratings has assigned its credit ratings to VCL Multi-Compartment S.A., Compartment VCL 25's (VCL 25) class A and B notes. At closing, VCL 25 also issued an unrated subordinated loan.

VCL 25's notes securitize a portfolio of German auto lease receivables, which Volkswagen Leasing GmbH (VW Leasing) originated to its mostly commercial retail customer base in the ordinary course of its business. The lease receivables arise from fixed-term, level payment lease contracts, with payments due monthly. The residual values of the leased vehicles corresponding to the lease receivables is not sold to VCL 25, so no additional residual value risk is present in this transaction.

The transaction is static (i.e., it has no replenishment period) and the notes start to amortize immediately after closing. Amortization begins sequentially, but switches to pro rata after further overcollateralization has built up, assuming no performance triggers are breached.

A combination of subordination, overcollateralization, and a cash reserve provides credit enhancement to the rated notes. The transaction will not have any excess spread as long as VW Leasing is not insolvent, or a principal deficiency ledger mechanism. In our opinion, a fixed-to-floating interest rate swap agreement with a counterparty rated at least 'A/A-1', in line with the transaction documents, mitigates the risk of potential interest rate mismatches between the fixed-rate assets and floating-rate liabilities. To mitigate commingling risks and following the breach of a certain rating level, the servicer advances expected collections. Finally, to mitigate tax risks, the seller funded at closing a nonamortizing seller risk reserve of 1.10% of the initial discounted pool balance (€17.6 million).

The issuer has made a material structural change to this transaction since we assigned preliminary ratings. Notably, the cash reserve can no longer amortize, and it is static at 1.2% of the initial discounted pool balance (€19.2 million). When we assigned preliminary ratings it could amortize at 1.2% of the outstanding discounted asset balance, subject to a floor of 1.0% of the initial discounted pool balance. The final outcome is a tiny increase in the available credit enhancement over the transaction's life (as the cash reserve cannot amortize), while the initial levels of credit enhancement available for the class A and B notes remain unchanged. This has affected our rating on the class B notes, which is now 'AA- (sf)'--one notch higher than our preliminary 'A+ (sf)' rating.

We believe that Volkswagen AG's (VW) admission on Sept. 22, 2015, that it installed software designed to manipulate diesel engine exhaust emissions in relation to nitrogen oxides (NOx) in 11 million passenger cars and commercial vehicles could ultimately affect the transaction in a number of areas: potential declines in the realization proceeds if lessees default, potential dilution of the lease receivables backing the transaction as a result of vehicle owner claims against VW, and potential increase in the operational risk associated with VW.

On Feb. 2, 2016, VW announced its schedule for the first wave of remediation actions to repair the affected vehicles in Europe. The recall started with the VW Amarok fitted with the EA 189 2.0 liter diesel engine and should continue over the course of the year. On April 28, 2016, VW disclosed the start of the technical modification of the Golf Blue Motion Technology with a 2.0 liter diesel engine following the German authority confirmation that the proposed solution does not result in any changes to the fuel consumption levels, performance data, or noise emissions of the vehicles concerned. Later, on June 8, 2016, VW announced that the technical solutions for several affected 2.0 liter diesel engine variants used in the high-volume Golf, Passat, and Tiguan ranges had been confirmed by the German authorities. More recently, in Aug. 14, 2016, VW stated they have received approval from German authorities for the technical solutions for the Volkswagen Polo and SEAT Ibiza models with 1.2 liter diesel affected engines.

As of the cut-off date, just 0.02% of VCL 25's discounted pool balance related to vehicles equipped with diesel engines affected by the manipulation of NOx exhaust emissions. The exposure is minimal and it has reduced compared with VCL Multi-Compartment S.A., Compartment VCL 24 (VCL 24), where about 1.7% of the pool related to vehicles fitted with affected engines.

We understand from the transaction's legal counsel that if VW does not successfully fix the affected vehicles or if the engines parameters are negatively affected following the repair, borrowers may have a right to reduce payments, rescind the contract, or be entitled to a purchase price reduction, if the customer can demonstrate that excessive NOx emissions result in a material defect of the leased vehicle. In this transaction, Volkswagen Leasing GmbH (VW Leasing) has made certain representations and warranties in respect of the securitized lease receivables. We understand from the transaction counsel that, if the borrower takes any of the above actions, it may be regarded as a misrepresentation by seller, and the seller would have to cure or remedy such breach or repurchase the receivable. Based on VW's public announcements, we assume that the proposed remediation actions will not result in a change to the fuel economy figures, performance figures, or CO_2 or noise emissions, and that the vehicles will remain roadworthy until and after the recall. Hence, based on the currently available information, we do not assume potential dilution of the lease receivables backing the transaction as a result of vehicle owner claims against the seller. On top of that the exposure to affected engines in this transaction is quite minimal (0.02%).

On Nov. 3, 2015, VW also announced that internal investigations had identified irregularities related to CO2 levels and fuel consumption levels in certain vehicles, at that time estimated to affect about 800,000 vehicles globally. At closing, VCL Multi-Compartment S.A., Compartment VCL 22 (VCL 22) transaction VW Leasing funded a dedicated market risk reserve to mitigate the risk from leased vehicles that could be subject to irregularities related to CO2 emissions. Since that time, VW announced on Dec. 9, 2015 that significantly fewer vehicles, about 36,000, remain potentially affected by fuel consumptions levels of about 0.1 to 0.2 liters per 100 kilometers higher than originally determined. As a result, we believe CO2 related risks have significantly diminished. Similarly to VCL Multi-Compartment S.A., Compartment VCL 23 (VCL 23) and VCL 24, we have not separately sized for this risk in our credit analysis. No dedicated market risk reserve is present in VCL 25 to address CO2 related risks, as was also the case in VCL 23 and VCL 24.

As part of our ongoing monitoring of VW's VCL transactions, we will seek further information regarding the extent to which vehicle owners may be entitled to compensation claims or similar remedies against VW, as any such claims could reduce the amount of their securitized lease receivables, even though in VCL 25 the exposure is quite minimal at 0.02%.

Notable Features

All of the securitized receivables have previously been refinanced through the existing warehousing facility, VCL Master S.A., Compartment 1.

The transaction's capital structure is similar to that of its rated predecessor, VCL 24, showing lower credit enhancement for the class A and B notes by 0.20% and 0.10%, respectively. Credit enhancement for the class A notes (including the cash reserve) is 7.2% for VCL 25, compared with 7.4% for VCL 24. Credit enhancement for the class B notes is 5.0% for VCL 25, compared with 5.1% for VCL 24 as in VCL 23.

The cash reserve cannot amortize and it is static at 1.2% of the initial discounted pool balance, while in VCL 24 the cash reserve could amortize to 1.2% of the outstanding discounted asset balance, subject to a floor of 1.0% of the initial discounted pool balance.

Similar to VCL 24, seller-related risks (German trade tax risks, and VAT risks) are mitigated by a nonamortizing seller risk reserve (1.10% of the initial discounted pool balance, being €17.6 million), which VW Leasing funded at closing. In our view, the seller risk reserve partially mitigates the potential German trade tax risk and VAT risks. We have therefore considered the uncovered portion (0.80% of the initial discounted pool balance) as an extra senior cost in our cash flow analysis.

As in VCL 24, an advance mechanism is applied to address the servicer commingling risk if (i) our short-term issuer credit rating (ICR) on Volkswagen Financial Services AG falls below 'A-2' and our long-term ICR falls below 'BBB'; (ii) our long-term ICR on Volkswagen Financial Services falls below 'BBB+' if there is no short-term rating; or (iii) we consider that the servicer is no longer deemed eligible. We consider that the advance mechanism fully mitigates commingling risk.

Rating Rationale

Operational risk

VW Leasing has underwritten auto leasing contracts in Germany since 1966. In our view, the company's track record of stable, strong quality asset origination is among the best of all European auto asset-backed securities (ABS) issuers. Our ratings on the class A and B notes reflect our assessment of the company's origination policies, as well as our evaluation of VW Leasing's ability to fulfill its role as servicer under the transaction documents. At this time, we do not believe the NOx or CO2 announcements have materially affected VW Leasing's operations. Our structured finance operational risk criteria do not impose any cap on the maximum achievable rating due to operational risks (see "Global Framework For Assessing Operational Risk In Structured Finance Transactions," published on Oct. 9, 2014).

Economic outlook

In our base-case scenario, we forecast that Germany will record GDP growth of 2.1% in 2017, 1.7% in 2018, and 1.6% in 2019, compared with 1.9% in 2016. At the same time, we expect unemployment rates to stabilize at historically low levels. We forecast unemployment to be 3.8% in 2017, 3.5% in 2018, and 3.4% in 2019, compared with 4.2% in 2016 (see "This Time Is Different: The Eurozone Recovery Is Alive And Kicking," published on Oct. 2, 2017). In our view, changes in GDP growth and the unemployment rate largely determine portfolio performance. We set our credit assumptions to reflect our economic outlook. Our near- to medium-term view is that the German economy will remain resilient and record positive growth.

Credit risk

Our net loss base-case scenario for the securitized pool is 1.0%, unchanged from the base-case scenario that we applied to the preceding transaction that we rated (VCL 24). The net loss base-case scenario reflects our assumption of the German economy's continued growth. Unlike VCL 23 and VCL 24, we have reduced our base-case multiples to the levels of predecessor transactions like VCL Multi-Compartment S.A., Compartment VCL 21 (VCL 21; e.g., to 4.1x from 4.2x at 'AAA'), to account for minimal exposure to vehicles equipped with diesel engines affected by the manipulation of NOx exhaust emissions (just 2 basis points [bps]), the historical performance provided, and the overall good performance of previous VCL deals that we have rated.

We have analyzed credit risk by applying our criteria for European auto ABS, using historical loss data for VW Leasing's book and performance data from previous VCL Leasing transactions (see "Methodology And Assumptions For European Auto ABS," published on Oct. 15, 2015).

Just 0.02% of the pool (by volume) relates to cars equipped with diesel engines affected by the manipulation of exhaust emissions. At this stage, we consider that the stressed recovery rate assumptions in VCL 25 also cover the potential for recoveries to deteriorate due to any reduction in resale values, also considering the minimal exposure of 0.02%.

VCL 25 is not exposed to residual values, hence, in our view, there is no additional residual value risk in this transaction.

Cash flow analysis

Our ratings on the class A and class B notes reflect our assessment of the credit and cash flow characteristics of the underlying asset pool. Our analysis indicates that the available credit enhancement for the rated notes is sufficient to withstand the credit and cash flow stresses that we apply at a 'AAA' rating level for the class A notes and at a 'AA-' rating level for the class B notes. We have analyzed the transaction's structural features and performed our cash flow analysis by applying our global cash flow criteria (see "Global Framework For Cash Flow Analysis Of Structured Finance Securities," published on Oct. 9, 2014).

Counterparty risk

Our ratings on the class A and B notes also consider that the replacement mechanisms implemented in the transaction documents adequately mitigate the counterparty risks to which the transaction is exposed. We have analyzed these counterparty risks by applying our current counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, and "Global Derivative Agreement Criteria," published on June 24, 2013). Our ratings on the notes reflect our anticipation that the transaction documents and swap agreements are line with our current counterparty criteria.

Legal risk

We consider the issuer to be a bankruptcy remote entity, in line with our legal criteria (see "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). Our ratings on the notes reflect the legal opinion has provided comfort that the sale of the assets would survive the insolvency of the seller (VW Leasing).

Rating stability

We have analyzed the effect of a moderate stress on the credit variables and their ultimate effect on the ratings on the notes (see "Scenario Analysis: Gross Default Rates And Excess Spread Hold The Answer To Future European Auto ABS Performance," published on May 12, 2009). We have run two scenarios and the results are in line with our credit stability criteria (see "Methodology: Credit Stability Criteria," published on May 3, 2010).

Strengths, Concerns, And Mitigating Factors

Strengths

- We consider that defaults under transactions backed by leases to commercial retail customers are sensitive to the economy. The German economy is performing relatively well and our baseline forecast of unemployment levels is at 3.8% in 2017 and 3.5% in 2018. Further, we expect German economy to record positive GDP growth of 2.1% in 2017 and 1.7% in 2018.
- In our view, VW Leasing has a strong market position as one of the largest leasing companies in Europe, with more than 49 years' business experience.
- The pool is granular and diversified. As of Oct. 31, 2017, it comprised 165,743 lease contracts. The largest single lessee concentration is 0.02% and the top 20 lessees comprise just 0.42% of the pool's discounted principal balance.
- As of the pool cut date, the pool did not contain any contracts with overdue payments.
- The portfolio does not revolve, so a shift in pool quality due to substitution cannot occur.
- The pool does not include leasing contracts with mileage settlements (Kilometerabrechnung) entered into before Oct. 1, 2013 by private customers. The potential exposure to additional risk related to a ruling of a German Higher Regional Court (Oberlandesgericht) has been reduced to zero because all these contracts are excluded via the

transactions' eligibility criteria (see "S&P Comments On Possible Effect Of A Higher Court's Ruling On Certain German Auto Leasing Contracts," published on Sept. 2, 2013).
- The structure benefits from a nonamortizing liquidity reserve, sized at 1.2% of the initial discounted pool balance, which was fully funded at closing. The liquidity reserve serves primarily as liquidity support to mitigate any cash strains. Ultimately, it is available to repay the notes at the end of the life of the transaction.

Concerns and mitigating factors

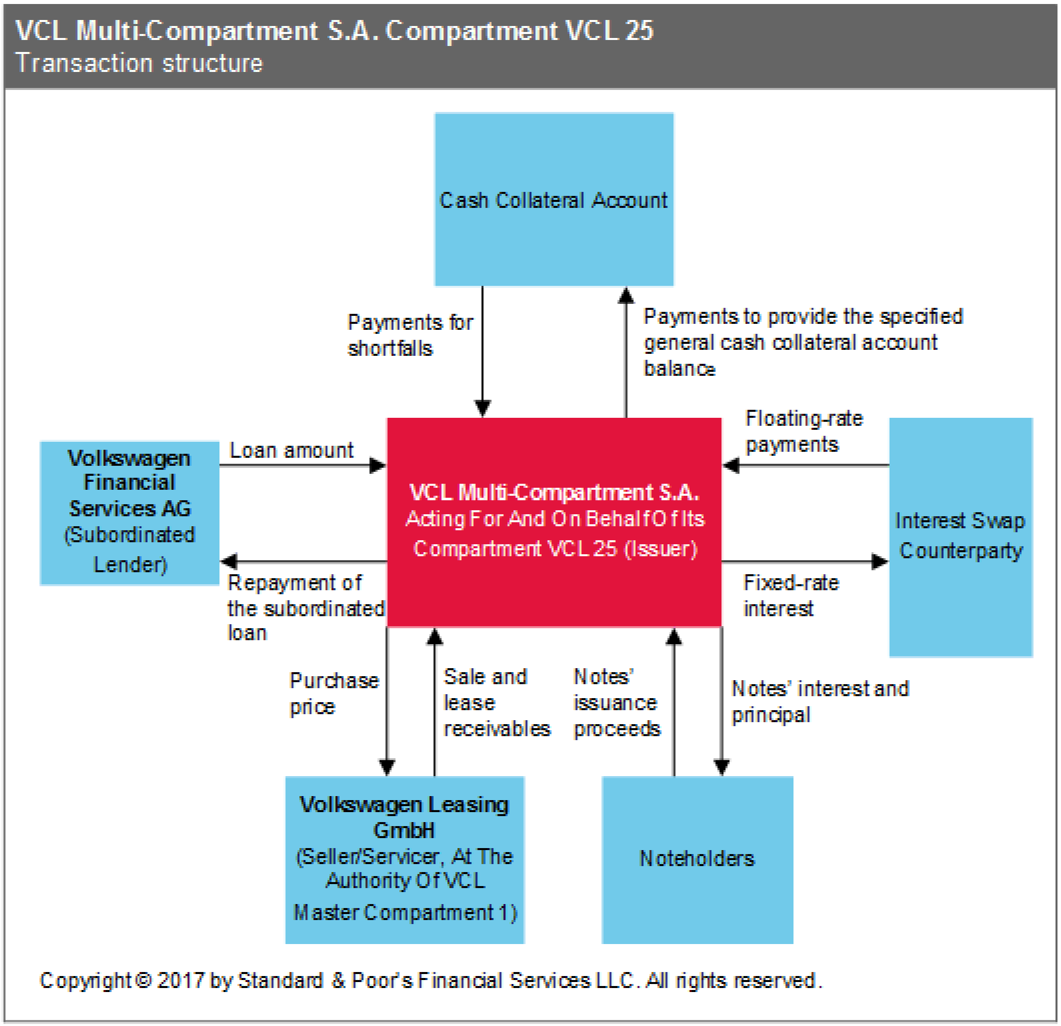
- The transaction's payment structure is not fully sequential. Once certain target overcollateralization levels have been reached (and as long as they are maintained), the issuer will pay pro rata principal on the class A and B notes. We have stress-tested appropriate cash flows for each rating level, which included modeling the potential effect of the pro rata payment structure with a back-loaded loss curve.
- Similar to prior VCL transactions, but unlike most other European auto ABS transactions, there is no excess spread in the structure. VW Leasing matches the transaction's interest receipts and expenses through the discounting mechanism, and any remaining amounts are paid back to VW Leasing as long as VW Leasing is not insolvent through the buffer released amount subtracted from the issuer available distribution amount, before being applied into the combined waterfall. We have modelled our cash-flows accordingly, assuming no excess spread available in the transaction.
- The transaction is exposed to commingling risk (as the servicer collects the collections), VAT risk (in accordance with section 13c of the German VAT Act), and German trade tax risk. A specific advance mechanism mitigates commingling risk. To mitigate the other listed risks, the seller funded at closing a nonamortizing seller risk reserve of 1.10% of the initial discounted pool balance (€17.6 million). In our view, the seller risk reserve partially mitigates potential tax risks. Therefore, we stressed the uncovered portion (0.80% of the initial discounted pool balance) as an additional senior cost in our cash flows.

Transaction Structure

At closing, the issuer bought a pool of auto lease receivables with a net present value of €1,595,750,127.45 (see chart 1). The lease receivables were discounted at a fixed rate of 5.7016%. However, the effective interest available to the issuer is reduced (unless VW Leasing becomes insolvent) in a way to leave no excess spread in the transaction. Therefore, interest receipts are equal to the sum of:

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

Chart 1



Priority of payments

The class A and B notes pay interest in arrears on a designated date each month, at a rate of EURIBOR (Euro interbank offered rate) plus a margin of 0.40% and 0.42% per annum, respectively. The first interest payment date (IPD) is on Dec. 21, 2017 and the legal final maturity of the notes is on Sept. 21, 2023.

On each monthly IPD, the issuer applies to the priority of payments any asset collections (less the buffer release amount described above), net swap receipts, and amounts drawn from the cash reserve from the previous month, in the order outlined in table 1.

Table 1

Priority Of Payments (Simplified)	
1	Taxes and payments to the trustee
2	Senior fees, including payments to the corporate services provider, data protection trustee, and servicer
3	Payments to the account bank
4	Payments to the swap counterparty (except termination payments if the swap counterparty is the defaulting party)
5	Interest on the class A notes

Table 1

Priority Of Payments (Simplified) (cont.)	
6	Interest on the class B notes
7	Top-up cash reserve (only if drawn upon previously)
8	Class A notes principal (sequential or pro rata)
9	Class B notes principal (sequential or pro rata)
10	Payments to the swap counterparty not paid above
11	Interest on the subordinated loan
12	Principal on the subordinated loan
13	Final success fee to VW Leasing

If interest on the most senior notes outstanding is not paid timely or principal is not fully paid by the legal maturity, the noteholders or the trustee can call an event of default. This could lead to multiple events, such as the swap terminating (with the issuer needing to make termination payments), and the post-enforcement priority of payments being applied. However, we consider these events as ratings remote, and as such, we do not model the post-enforcement priority of payments in our analysis. If the trustee were to call an event of default, it could have an impact on the transaction cash flows. Note that our ratings address the timely payment of interest and principal on both the class A and B notes, even though an event of default is called for nonpayment of interest on the most senior notes outstanding.

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

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

- Trigger level 1: The cumulative net loss ratio exceeds 0.50% before or during February 2019 or 1.15% between February 2019 (excluding) and November 2019; or
- Trigger level 2: The cumulative net loss ratio exceeds 1.6% at any time.

Table 2

Overcollateralization Levels

	Actual overcollateralization (%)	**Target overcollateralization levels (%)**		
	At closing	**No trigger breach**	**Trigger level 1 breached**	**Trigger level 2 breached**
Class A	6.0	12.25	14.00	100.00
Class B	3.8	7.50	8.25	100.00

Cash reserve

The issuer deposited 1.2% of the initial discounted asset balance as a general cash reserve at closing. Amounts deposited in the general cash reserve account are available to bridge any liquidity shortfalls in the payment of senior costs and expenses, and interest on the class A and B notes. On the scheduled maturity date, the issuer can also use the cash reserve to redeem the class A and B notes. The cash cannot amortize.

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

Collateral Description

As of Oct. 31, 2017, based on the pool, the collateral pool backing the notes comprises approximately lease contracts entered into with 165,743 lessees (see the breakdown in table 3). The largest single lessee concentration is 0.02%, and the top 20 lessees comprise about 0.42% of the pool by discounted principal balance. There are no residual values contained in the contracts sold. About 0.02% of the pool (by volume) relates to cars equipped with diesel engines affected by the manipulation of exhaust emissions.

Table 3

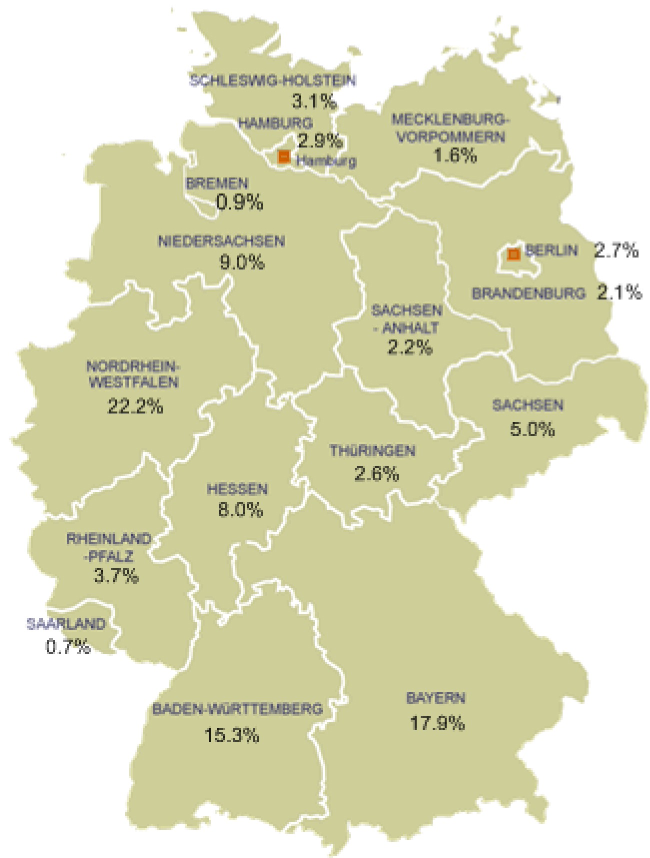
Collateral Distribution Of The Pool	
Pool characteristics	
Principal outstanding (mil. €)*	1,596
Discount rate (%)	5.70
Buffer release rate (%)	4,53
Discount rate minus buffer release rate (%)	1.17
Average remaining discounted lease principal balance*	9,628
Weighted-average life (months)*	15.9
Weighted-average original term (months)*	39.2
Weighted-average remaining term (months)*	30.0
Weighted-average seasoning (months)*	9.2
Percentage of pool discounted principal balance (%)*	
Share of new vehicles	95.17
Share of retail customers	71.86
Share of corporate customers	28.14
Contracts (volume) with EA 189 EU5 engines	0.02
Manufacturer distribution (%)	
Audi	36.1
VW	33.1
VW Nutzfahrzeuge (light commercial vehicles)	16.0
Skoda	11.4
Seat	3.2
Other	0.2

*Based on the pool as of Oct. 31, 2017..

The geographical distribution shows a diversified pool, reflecting the residential distribution in Germany. The highest geographical concentration by discounted principal balance is 22.23% for lessees resident in Nordrhein-Westfalen (see chart 2).

Chart 2

Geographic Distribution Of The Portfolio



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

- Contracts are legally valid and binding agreements and enforceability is not impaired;
- Receivables are denominated and payable in euro;
- The leased vehicles are situated in Germany;
- The seller may freely dispose of the receivables;
- Receivables are free of defenses and from the rights of third parties. Lessees have no set-off claim;
- No receivable was overdue at the cut-off date;
- None of the lessees is an affiliate of Volkswagen AG, Family Porsche Stuttgart, or Family Piech Salzburg Group;
- Contracts are governed by the laws of Germany;
- Lessees have their registered office/place of residence in Germany;
- At least two lease installments have been paid;
- At least 95% of the leased vehicles are VW, Audi, SEAT, Skoda or VW Nutzfahrzeuge;
- Lease contracts require monthly payments to be made within 12 to 60 months after origination;
- Lease contracts do not include lease contracts with mileage settlements (Kilometerabrechnung) entered into before Oct. 1, 2013;

- The total amount of purchased lease receivables due from one and the same lessee does not exceed 0.2% of the initial discounted pool balance;
- Where applicable, contracts comply with the requirements of the German Civil Code (Bürgerliches Gesetzbuch) on consumer financing; and
- Acquisition of the leased vehicles by VW Leasing is financed in compliance with the requirements of section 108 (I) sentence 2 of the German Insolvency Code (Insolvenzordnung).

Nature of the leases

A lease contract comprises two elements. The first, typically the regular lease installments, relates to the payments from the lessee covering the vehicle's value deprecation for the contract's duration. The second relates to the vehicle's residual value when the lease contract expires. VCL 25 only purchased the regular lease installments, and not the residual value. Furthermore, it also purchased rights associated with the premature termination of a lease receivable or with the transfer of the lease receivable, plus rights to payments from the realization of vehicles. It did not buy rights to insurance premiums, any VAT payments, and the residual value element.

Commercial retail lessees have no contractual right to prepay the lease contract. If VW Leasing allows prepayment, it will pay the outstanding net present value of the future lease payments due to VCL 25, discounted at the rate at which the issuer initially purchased the receivables.

VCL 25 purchased the lease receivables in this transaction from the VCL Master Compartment 1 securitization, where they have been warehoused. Furthermore, all of the corresponding residual values can be refinanced via the VCL Master Residual Value S.A., Compartment 1 and VCL Master Residual Value S.A., Compartment 2 securitizations. The legal title over the leased vehicles is held by the trustee of VCL 25.

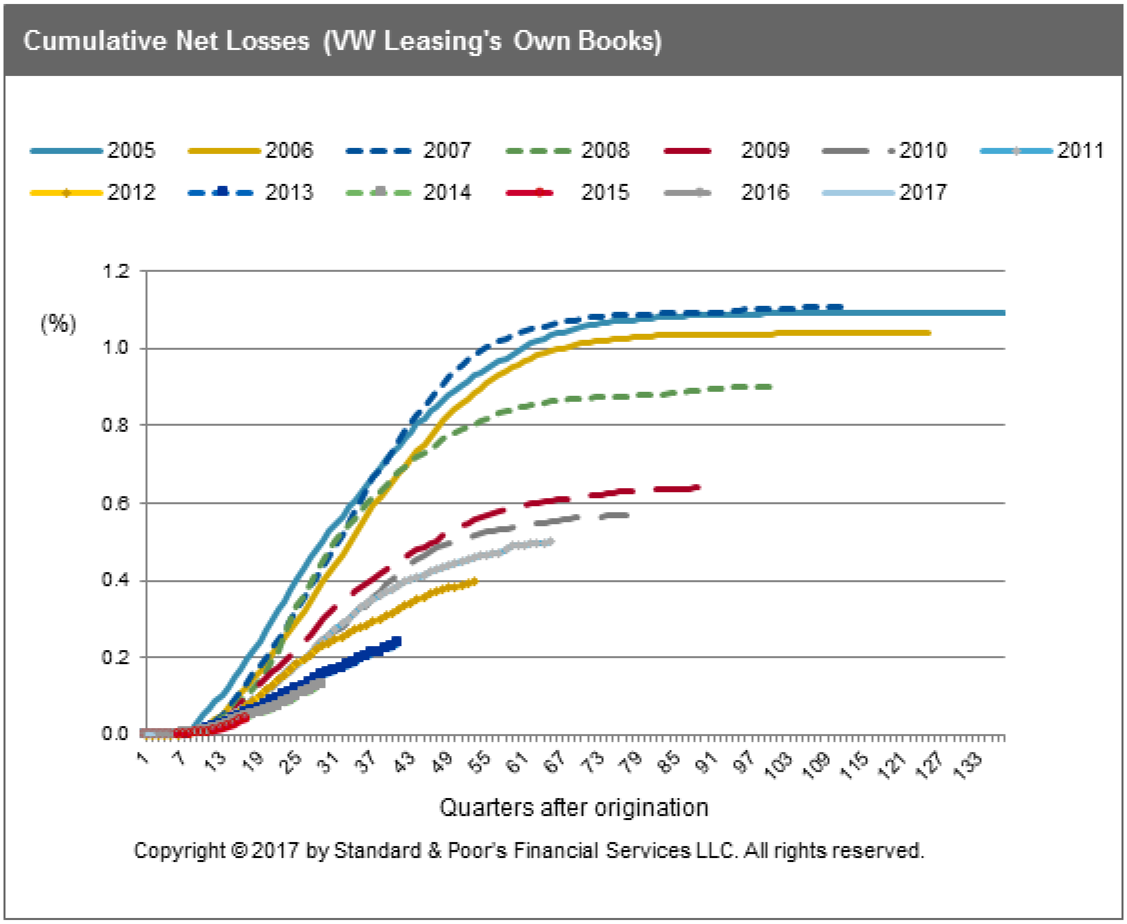
Credit And Cash Flow Analysis

Our rating analysis includes an assessment of the credit risk inherent in the transaction. We analyzed various stress scenarios and their effects on the notes' cash flows by applying our methodology and assumptions for European auto ABS criteria.

We received monthly static net loss data, showing cumulative net losses (i.e., actual write-offs after recoveries) as a percentage of its origination volume in VW Leasing's entire lease book. The data range from January 2007 to June 2017. The originator did not provide us with separate recovery or prepayment data. To arrive at a gross loss proxy, we "gross up" the net loss data, using a recovery rate assumption of 60%, which we derived from the historical recoveries of other VCL transactions.

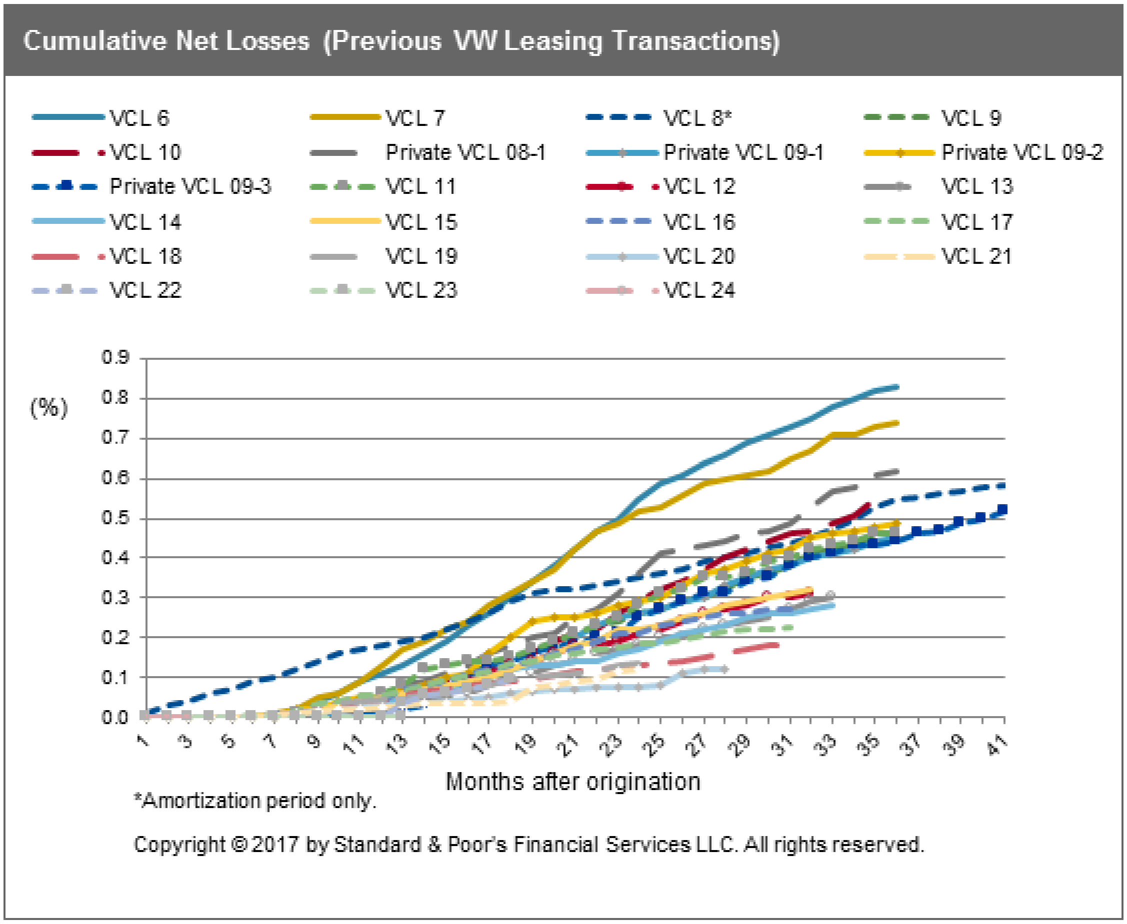
Performance in the originators' books has significantly improved from 2007 to 2017 and has stabilized at low levels since then. Performance also remained stable during the economic downturn in 2008 and 2009.

Chart 3



We also analyzed performance data from existing and matured securitization transactions of the same originator. VW Leasing has already exercised its clean-up call option for transactions originated in 2012 and before, so that no performance data are available for the tail of those transactions.

Chart 4



Similar to the loss data from the originators' books, the transaction performance shows a positive trend (improving performance from 2002 to 2007, and stabilization since then) but at lower absolute loss levels. In our view, this difference in absolute levels between performance in the originators' books and the transactions can be explained by the positive selection bias introduced through the eligibility criteria.

Also, the exercise of the clean-up call option effectively provides some implicit support to the transaction, as VW Leasing also repurchases delinquent and terminated receivables, which would, absent the call, eventually translate into additional losses. We do not incorporate such call options or their effect on asset performance in our analysis because the call may not be exercised in the future.

Based on the stable performance of the receivables and of the outstanding VCL transactions throughout the economic downturn, we sized an average net loss pool of 1.00% for the whole pool. Tables 4 and 5 summarize our credit assumptions.

We had increased our gross loss base-case multiples in our analytical approach for the previous three VCL transactions (VCL 22, VCL 23, and VCL 24). For VCL 25, however, we reduced our gross loss base-case multiples at all ratings to levels we used before VW's manipulation of engines started, to account for minimal exposure in this static deal to vehicles equipped with diesel engines affected by the manipulation of NOx exhaust emissions (just 2 bps), the long historical performance provided, and the overall good performance of previous VCL deals that we rate.

At this stage, we consider that our 40% stressed recovery rate assumptions in VCL 25 covers the potential for recoveries to deteriorate due to any reduction in resale values, even though the exposure to affected engines is limited to 0.2%. VCL 25 is not exposed to residual values, hence there is, in our view, no additional residual value risk in this transaction.

Table 4

Base-Case Assumptions

	(%)
Net loss	1.00
Recovery rate (for gross up)	60.00
Gross loss (grossed up)	2.50

Table 5

Stress Assumptions

Rating	Gross loss (%)	Recovery (%)	Prepayment (%)
AAA	10.25	40.0	0.5 to 20.0
AA-	6.92	40.0	0.5 to 20.0

In our cash flow modeling of this transaction, we applied stressed losses equally for a period of 16 months. The model incorporates the potential pro rata amortization of the notes and we also ran a back-loaded loss curve to test the impact of the pro-rata pay down mechanism on the available credit enhancement. We stressed the prepayment rates, and ran interest rate scenarios at current levels (with a 0% floor), down to 0%, and up to 12%. We did not model commingling losses as we consider the advance mechanism fully mitigates these losses. We also modelled potential tax payments for 0.80% of the initial discounted value of the portfolio as we consider the seller risk reserve only partially mitigates the related risk. In addition, we modelled the erosion of the cash credit enhancement due to negative interest rate scenarios.

The ratings scenarios address not only the availability of funds for full payment of interest and principal, but also the timeliness of these payments in accordance with the terms of the rated securities.

Scenario Analysis

When rating European auto and consumer ABS transactions, we have developed a scenario analysis and sensitivity-testing model framework. This demonstrates the likely effect of scenario stresses on the ratings in a transaction over a one-year outlook horizon. For this asset class, we consider scenario stresses over a one-year horizon to be appropriate, given the relatively short weighted-average life of the assets backing the notes. For these types of securities, there are many factors that could cause the downgrade and default of a rated note, including asset performance and structural features. However, for the purposes of this analysis, we focused on the three fundamental drivers of collateral performance, namely:

- Gross loss rate,
- Recovery rate, and
- Prepayment rate.

Given current economic conditions, the proposed stress scenarios reflect negative events for each of these variables. Increases in gross default rates could arise from a number of factors, including rises in unemployment and company insolvencies, together with falls in house prices and a reduction in the availability of credit. In addition, these effects would most likely cause collateral recovery rates to fall as the structural imbalance between supply and demand leads to reductions in asset prices. In this environment, we also expect prepayment rates to fall as fewer refinancing options leave obligors unable to prepay finance agreements and demand for replacement vehicles falls.

For this analysis, we have included two stress scenarios to demonstrate the transition of a rating on a note (see table 6).

Table 6

Scenario Stresses

Rating variable	Scenario 1 (relative stress to base case)	Scenario 2 (relative stress to base case)
Gross loss rate (%)	30.0	50.0
Recovery rate (%)	(30.0)	(50.0)
Constant prepayment rate (%)	(20.0)	(33.3)

Our base-case assumptions for each transaction are intended to be best estimates of future performance for the asset portfolio. Our approach in determining these base cases would take account of historically observed performance and an expectation of potential changes in these variables during the life of the transaction. The sensitivity of rated notes in each transaction will differ depending on these factors, in addition to structural features of the transaction including its reliance on excess spread, payment waterfalls, and levels of credit enhancement at closing.

For each proposed scenario stress, we separate the applied methodology into three distinct stages. In the first stage, we stress our expected base-case assumptions over a one-year period to replicate deviations away from our expected performance over the stress horizon. We assume that the stresses that we apply occur at closing, and apply gross losses based on our expectation of a cumulative default curve for the pool.

The second stage applies our usual rating methodology, including revising our base-case assumptions at the one-year horizon to reflect the assumed deviations as a result of the stressed environment.

In the final stage of the analysis, we re-rate the transaction at the one-year horizon, after revising our base-case assumptions and applying our standard credit and cash flow stresses at each rating level. The output of the analysis shows the likely rating transition of the rated notes, given the applied stresses and the value and timing of any forecasted principal and interest shortfalls under the most stressful scenario.

Scenario stress and sensitivity analysis

When applying scenario stresses in the manner described above, we intend the results of this modeling to be a simulation of what could happen to the ratings on the notes for the given transaction. For the purposes of our analysis for this transaction, we applied the two scenarios described above in our cash flow modeling. Tables 7 to 8 show the implied stresses and scenario stress results.

Table 7

Scenario Stresses

12-Month stress horizon

Rating variable	Base case	Scenario 1	Scenario 2
Gross loss rate (%)	2.50	2.50	2.50
Stressed recovery rate (%)	40.00	30.66	24.44
Constant prepayment rate (%)	10.00	8.0	6.7

Table 8

Scenario Stress Analysis: Rating Transition Results

Scenario stress	Class	Initial rating	Scenario stress rating
Scenario 1	A	AAA (sf)	AA (sf)
	B	AA- (sf)	A (sf)
Scenario 2	A	AAA (sf)	A (sf)
	B	AA- (sf)	BBB (sf)

Given the transaction's structure, the more stressful scenario for our cash flow analysis is a high collateral prepayment rate in a falling interest rate environment. Given the stresses we applied under scenario 1, we would most likely lower our ratings on the class A and B notes to 'AA (sf)' from 'AAA (sf)' and to 'A (sf)' from 'AA- (sf)', respectively. Under scenario 2, we would most likely lower our ratings on the class A and B notes to 'A (sf)' from 'AAA (sf)' and to 'BBB (sf)' from 'AA- (sf)', respectively.

Because of the short weighted-average life of the securitized assets, scenario 2 (impact of moderate stress on the transaction's ratings over a three year horizon) is not applicable.

A number of features of this transaction, including triggers that lead to a temporary and finally permanent sequential repayment mechanism, the initial overcollateralization, and the nonamortizing cash reserve enhance the stability of the ratings under each scenario.

Monitoring And Surveillance

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

- The performance of the underlying pool, including defaults, delinquencies, and prepayments;
- Progress on the NOx recalls, including any change to the fuel economy figures, performance figures, or CO2 or noise emissions, and any effect on resale values;
- The supporting ratings in the transaction; and
- The servicer's operations and its ability to maintain minimum servicing standards.

Related Criteria

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