VOLKSWAGEN FINANCIAL SERVICES

THE KEY TO MOBILITY

VOLKSWAGEN FINANCIAL SERVICES AG
ANNUAL REPORT

2018

Key Figures

VOLKSWAGEN FINANCIAL SERVICES AG

€ million (as of Dec. 31)	2018	2017
Total assets	80,462	68,953
Loans to and receivables from customers attributable to		
Retail financing	16,676	16,269
Dealer financing	4,062	3,584
Leasing business	19,760	18,809
Lease assets	13,083	11,571
Equity	8,016	7,624
Operating profit	844	609
Profit before tax	818	643

in percent (as of Dec. 31)	2018	2017
Cost/income ratio[1]	59	68
Equity ratio[2]	10.0	11.1
Return on equity[3]	10.5	8.4

Number (as of Dec. 31)	2018	2017
Employees	8,603	8,555
Germany	5,340	5,198
International	3,263	3,357

1 General and administrative expenses, adjusted for expenses passed on to other entities in the Volkswagen Group / interest income from lending transactions and marketable securities, net income from leasing transaction, interest expenses, net income from service contracts, net income from insurance business, provision for credit risks and net fee and commission income.

2 Equity/total assets.

3 Profit before tax / average equity. 1 Due to the reorganization of the legal entities, return on equity for 2017 is determined using only the equity as of December 31, 2017.

RATING (AS OF DEC. 31)	STANDARD & POOR'S			MOODY'S INVESTORS SERVICE		
	Short-term	Long-term	Outlook	Short-term	Long-term	Outlook
Volkswagen Financial Services AG	A–2	BBB+	Stable	P–2	A3	Stable

All figures shown in the report are rounded, so minor discrepancies may arise when amounts are added together. The comparative figures from the previous fiscal year are shown in parentheses directly after the figures for the current fiscal year.

COMBINED MANAGEMENT REPORT

Fundamental Information about the Group

Steady international growth continues to confirm 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 are:

> 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 AG 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 private, corporate and fleet customers. The close integration of marketing, sales and customer service focused on customers' needs goes a long way toward keeping the processes lean and implementing the sales strategy efficiently.

The 2016 initiated reorganization aiming a systematically separation of European lending and deposits business from the other Volkswagen Financial Services AG's activities, was continued as planned. Further project initiatives are scheduled to achieve the target structure in 2019.

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, 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.
Operating profit/loss	Interest income from lending transactions and marketable securities, net income from leasing transactions, interest expense, net income from service contracts, net income from insurance business, provision for credit risks, net fee and commission income, net gain or loss on hedges, net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income, general and administrative expenses and net other operating income/expenses
Return on equity[1]	Return on equity before tax, which is calculated by dividing profit before tax by average equity.
Cost/income ratio	General and administrative expenses, adjusted for expenses passed on to other entities in the Volkswagen Group / interest income from lending transactions and marketable securities, net income from leasing transaction, interest expenses, net income from service contracts, net income from insurance business, provision for credit risks and net fee and commission income.

1 Due to the reorganization of the legal entities, return on equity for 2017 is determined using only the equity as of December 31, 2017.

CHANGES IN EQUITY INVESTMENTS

The transfers referred below are part of the reorganization of the legal entities described in more detail in the section "Organization of the Volkswagen Financial Services AG Group".

On August 21, 2018, Volkswagen Finance Overseas B.V., Amsterdam, Netherlands, established Volkswagen Financial Services France S.A.S., Roissy-en-France, France. The company is currently not operational.

On September 28, 2018, Volkswagen Financial Services AG took over all the shares in Volkswagen Financial Services Ireland Ltd., Dublin, Ireland, from Volkswagen Bank GmbH, Braunschweig, with retroactive economic effect from January 1, 2018.

Volkswagen Financial Services AG transferred all the shares in Volkswagen Holding Financière S.A., Villers-Cotterêts, France, to Volkswagen Finance Overseas B.V., Amsterdam, Netherlands, on November 1, 2018.

Further project activities are planned for 2019. It is planned to acquire the Polish company Volkswagen Serwis Ubezpieczeniowy Sp. z o.o., the Czech company ŠkoFIN s.r.o. and the Italian company Volkswagen Financial Services S.p.A. from Volkswagen Bank GmbH. If the United Kingdom leaves the European Union (EU) without an exit agreement deal ("Hard Brexit"), Volkswagen Financial Services AG intends to include Volkswagen Financial Services (UK) Ltd., its subsidiaries MAN Financial Services plc. and Volkswagen Insurance Service (Great Britain) Ltd., and Volkswagen Financial Ltd. from Volkswagen Bank GmbH. The Spanish company Volkswagen Finance 2 S.L.U. and its three subsidiaries Volkswagen Renting S.A.U., V.I.S. Correduría de Seguros S.L.U. and MAN Financial Services España S.L.U. will be merged into Volkswagen Financial Services AG.

Volkswagen Financial Services S.A., Amadora, Portugal, is currently in the set up process and will start business operations after completion of the licensing procedure with Banco de Portugal in 2019.

In addition, the following further material changes in equity investments have occurred:

As of February 1, 2018, Volkswagen Pon Financial Services B.V., Amersfoort, Netherlands, in which Volkswagen Financial Services AG holds a 60% equity investment, acquired the portfolios of the two Dutch leasing companies Lexpoint Lease B.V., Hoofddorp, and Arena Lease B.V., Venlo by means of an asset deal, thereby expanding its portfolio by approximately 2,000 contracts.

Effective March 1, 2018, Volkswagen-Versicherungsdienst GmbH, Braunschweig, sold 85% of the shares in Volkswagen-Versicherungsdienst GmbH, Vienna, Austria, to Porsche Bank AG, Salzburg, Austria.

Volkswagen Financial Services AG acquired a majority interest in Softbridge PT S.A., Lisbon, Portugal, ("Softbridge") with effect from March 22, 2018. Softbridge holds 90% of the shares in VTXRM Software Factory Lda, Lisbon, Portugal. To complement its lead product "Accipiens", a central software solution for finance and leasing companies, VTXRM offers as well services such as software development, licensing, maintenance and customizing using various technologies.

In April 2018, Volkswagen Financial Services AG transferred all the shares in Mobility Trader GmbH, Berlin, to Mobility Trader Holding GmbH, Berlin, a newly established wholly owned subsidiary of Volkswagen Financial Services AG. Mobility Trader GmbH, Berlin, operates “heycar” in Germany, a non-captive used car marketplace specializing in the online marketing of premium used cars.

On September 12, 2018, Volkswagen Financial Services AG, Braunschweig, signed a sale and purchase agreement for the sale of 20% of the shares in Mobility Trader Holding GmbH, Berlin, to LEONIE FS DVB GmbH, Stuttgart, a wholly owned subsidiary of Daimler AG, Stuttgart. The completion of the sale is subject to approval from the antitrust authorities.

Based on a purchase agreement dated May 2, 2018, Volkswagen Financial Services AG acquired 100% of the shares in the shelf company Elegant Compass Rent a Car A.E., Ilioupolis, Greece. The company was then renamed Volkswagen Financial Services Hellas A.E., Ilioupolis, Greece. The aim going forward is to use this company to sell operating lease products for retail customers.

On May 4, 2018, Volkswagen-Versicherungsdienst GmbH, Braunschweig, a wholly owned subsidiary of Volkswagen Financial Services AG, sold its 51% equity investment in Volkswagen Insurance Service (Great Britain) Ltd. (VIS UK), Milton Keynes, United Kingdom, to Volkswagen Financial Services (UK) Ltd. (VW FS UK), Milton Keynes, United Kingdom, a wholly owned subsidiary of Volkswagen Bank GmbH, Braunschweig.

As of August 1, 2018, Volkswagen Leasing B.V., Amersfoort, Netherlands, a wholly owned subsidiary of Volkswagen Pon Financial Services B.V., Amersfoort, Netherlands, acquired the two Dutch leasing companies AutoLease Beheer B.V., Apeldoorn, Netherlands, and XLEasy B.V., Apeldoorn, Netherlands, thereby expanding its portfolio by approximately 4,000 contracts.

On September 13, 2018, MAN Financial Services B.V., Amsterdam, Netherlands, was merged into Volkswagen Leasing B.V., Amersfoort, Netherlands.

With effect from September 18, 2018, Volkswagen Financial Services AG acquired 3% of the shares in Verimi GmbH, Frankfurt am Main, by way of a capital increase. Based on this equity investment in the non-industry-specific digital identity platform “Verimi”, Volkswagen Financial Services AG is pushing forward the use of digital identities for customers in the Volkswagen Group.

Volkswagen Losch Financial Services S.A., based in Howald, Luxembourg, was established on October 2, 2018. This company is a joint venture in which Volkswagen Financial Services AG holds 60% and Losch Services S.à.r.l. 40% of the shares. It will offer leasing products mainly for retail customers and small fleets in the Luxembourg market. It is scheduled to commence operations on January 2, 2019.

Effective October 18, 2018, Volkswagen Financial Services AG increased its majority share in the mobility service provider sunhill technologies GmbH, Bubenreuth, to approximately 96%.

Effective October 8, 2018, Porsche Volkswagen Servicios Financieros SpA, Santiago, Chile, (a company in which Volkswagen Financial Services AG, Braunschweig, holds a 50% equity investment) established the insurance broker Porsche Volkswagen Corredores De Seguros Chile SPA, Santiago, Chile.

Volkswagen Versicherungsdienst GmbH, Braunschweig, sold its shares in VVS Verzekerings-Service N.V., Amersfoort, Netherlands, to Volkswagen Leasing B.V., Amersfoort, Netherlands, a wholly owned subsidiary of Volkswagen Pon Financial Services B.V., Amersfoort, Netherlands, with effect from November 6, 2018.

At the same date, VVS Verzekerings-Service N.V., Amersfoort, Netherlands, was merged into its wholly owned subsidiary VVS Assuradeuren B.V., Amersfoort, Netherlands.

Effective December 14, 2018, XLEasy B.V., Apeldoorn, Netherlands, was merged into AutoLease Beheer B.V., Apeldoorn, Netherlands.

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

- Volkswagen Finance (China) Co., Ltd., Beijing, by around €532 million;
- Volkswagen Payments S.A., Strassen, by around €22 million;
- Volkswagen Møller Bilfinans A/S, Oslo, by around €21 million;
- Mobility Trader GmbH, Berlin, by around €20 million;
- Mobility Trader Holding GmbH, Berlin, by around €15 million;
- PayPoint Technologies Canada Inc., Vancouver, British Columbia, by around €12 million;
- sunhill technologies GmbH, Bubenreuth, by around €10 million;
- Volkswagen New Mobility Services Investment Co., Ltd., Beijing, by around €9 million;
- Volkswagen Financial Services Holding Argentina S.R.L., Buenos Aires, by around €9 million;
- Rent-X GmbH, Braunschweig, by around €8 million.

These measures serve to expand the business and support the growth strategy pursued 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/listofholdings2018.

SEPARATE NONFINANCIAL REPORT FOR THE GROUP

The Volkswagen Financial Services AG has made use of the option under section 289b(2) HGB and section 315b(2) HGB exempting it from submission of a nonfinancial statement and nonfinancial group statement and refers to the combined separate nonfinancial report of Volkswagen AG for fiscal year 2018, which will be available on the website www.volkswagenag.com/presence/ /nachhaltigkeit/documents/sustainability-report/2018/ Nichtfinanzieller_Bericht_2018_d.pdf in German and at www.volkswagenag.com/presence/nachhaltigkeit/ documents/sustainability-report/2018/Nonfinancial_Report _2018_e.pdf in English by no later than April 30, 2019.

Report on Economic Position

The robust growth of the global economy continued in fiscal year 2018 with a slight decrease in momentum. Global demand for vehicles was somewhat lower than in the previous year. Profit before tax at Volkswagen Financial Services AG was up significantly compared to the previous year.

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

Profit before tax was up significantly on the previous year. New business worldwide recorded positive growth over the reporting period.

Volkswagen Financial Services AG lifted its business volume year-on-year, particularly in Germany.

The share of financed and leased vehicles among worldwide Group deliveries to customers (penetration) stood at 22.3 (23.8)% at the end of 2018.

Funding costs were slightly higher than the prior-year level, although the volume of business was also higher.

The provision for credit risks was lower in the reporting period than in the previous year; the margins remained stable.

Risks in the year under review remained on a level with the previous year. In fiscal year 2018, further growth was achieved in the volume of loans and receivables and the residual value portfolio on the back of the established sales promotion program with the brands and continuous expansion of the fleet business. These trends were supported by the global economic environment, which continued to be stable. The credit risk in the overall portfolio of Volkswagen Financial Services AG remained stable.

The downward trend in the share of the market accounted for by diesel vehicles in Europe initially continued in 2018. The end of the year saw a trend reversal for the Volkswagen Group, particularly in Germany. Here, in particular the market share of Volkswagen Passenger Cars diesel vehicles grew year-on-year for the first time since the emergence of the emissions issue. The public debate about the use of diesel vehicles being prohibited in major European cities and changes in customer needs continued to have an impact on used vehicle markets and the residual value portfolio in 2018. Changes in residual value risk are closely monitored on an ongoing basis, leading to any necessary action as required.

No significant fall in the residual values of diesel vehicles was identified in 2018.

If delays in the delivery of new vehicle orders arose because of the Worldwide Harmonized Light Vehicle Test Procedure (WLTP), customers could be offered two options: an extension of the existing lease or a new lease for a used vehicle. No impact from the WLTP issue has been identified in respect of residual value risk.

At Group level, liquidity risk remained stable overall, despite some volatility, and was kept within the limit. As of December 31, 2018, utilization of the liquidity risk limit at Volkswagen Financial Services AG was 53 (44)%.

A new global cross-company efficiency program was launched in the year under review. The name of this program is Operational Excellence (OPEX).

It is focused on achieving further cost savings by 2025 in addition to the requirements under current planning. The main components are action plans to enhance productivity (among other things by streamlining processes), IT measures (including the global introduction of standardized systems) and the optimization of selling costs.

Events after the balance sheet date are reported in the notes to the consolidated financial statements of Volkswagen Financial Services AG in note 73 (page 153).

The Board of Management of Volkswagen Financial ServicesAG still considers the course of business in 2018 to have been positive.

CHANGES IN KEY PERFORMANCE INDICATORS FOR FISCAL YEAR 2018 COMPARED WITH PRIOR-YEAR FORECASTS

	Actual 2017		Forecast for 2018	Actual 2018
Nonfinancial performance indicators[1]				
Penetration (percent)	23.8	= 23.8	At prior-year level	22.3
Current contracts (thousands)	9,931	= 9,931	At prior-year level	10,164
New contracts (thousands)	4,099	= 4,099	At prior-year level	4,019
Financial performance indicators				
Volume of business (€ million)	50,233	> 50,233	Slight increase	53,581
Operating profit (€ million)	609	= 609	At prior-year level	844
Return on equity (percent)	8.4	= 8.4	At prior-year level	10.5
Cost/income ratio (percent)	68	= 68	At prior-year level	59

1 Adjustment of prior-year figures due to inclusion of contracts entered into by international joint ventures.

DEVELOPMENTS IN THE GLOBAL ECONOMY

The global economy sustained its robust growth in 2018 with a slight decrease in momentum: global gross do¬mestic prod¬uct (GDP) rose by 3.2 (3.3)%. Economic momentum nearly matched the prior-year level both in advanced economies and emerging markets. With interest rates remaining com¬paratively low and prices for energy and other commodities rising year-on-year on the whole, consumer prices continued to increase worldwide. Growing upheaval in trade policy at international level and geopolitical tensions led to much greater uncertainty.

Europe/Other Markets

The solid GDP growth in Western Europe slowed to 1.8 (2.3)% as the year went on. The rate of change in the majority of countries in this region decreased compared with the previous year. The Brexit negotiations between the United Kingdom and the Euro¬pean Union (EU), which continued for the entire year, generated uncertainty, as did the related question of what form this relationship would take in the future. The unemployment rate in the eurozone continued to decrease, falling to an average of 8.1 (9.0)%, though rates remained considerably higher in Greece and Spain.

At 2.9 (4.0)%, the Central and Eastern Europe region also recorded a slower growth rate in the re¬porting period than in the previous year. While the comparatively high level of GDP growth in Central Europe slowed down on the whole, economic growth in Eastern Europe remained unchanged. Higher prices for energy and other commodities led to further stabilization of the economic situation in the countries from this region that export raw materials. Russia's economy improved somewhat with a growth rate of 1.6 (1.5)%.

Growth in the Turkish economy slumped substantially to 2.5 (7.3)% after the first half of 2018. South Africa's GDP rose by just 0.7 (1.3)% in the reporting period, down on the already low figure for the previous year. Ongoing structural deficits, social unrest and political challenges weighed on the economy.

Germany

Germany's GDP continued to grow in 2018 on the back of the good labor market, however, momentum diminished year-on-year to 1.5 (2.5)%. Both company and consumer sentiment darkened as the year progressed.

North America

Economic growth in the USA picked up in the reporting period, reaching 2.9 (2.2)%. The economy was supported mainly by domestic consumer demand. The unemployment rate in the United States in 2018 was at 3.9 (4.3)%. Based on the stable situation in the labor market and the expected inflation trend, the US Federal Reserve successively raised its key interest rate. The US dollar gained strength against the euro in the course of the year. In neighboring Canada and Mexico, GDP grew at a slower rate than in the previous year, at 2.1 (3.0)% and 2.2 (2.3)%, respectively.

South America

Brazil's economy once again recorded slight growth, at 1.4 (1.1)%. However, the situation in South America's largest economy remained tense due to political uncertainty, among other factors. The economic situation in Argentina deteriorated increasingly as the year went on. The country was in recession amid persistently high inflation: GDP fell by 1.7 (+2.9)%. In view of this difficult situation, the Argentine government requested financial aid from the International Monetary Fund.

Asia-Pacific

China's economy recorded a growth rate of 6.6 (6.9)% in 2018, but its rate of expansion was not quite as strong as in the previous year. The Chinese government responded to the trade disputes with the United States by stepping up state support measures. The Indian economy continued its posi¬tive trend, with growth in the reporting period of 7.2 (6.7)%. However, the pace of growth tapered off in the course of the year. Japan's GDP grew by only 0.8 (1.9)%.

TRENDS IN THE MARKETS FOR FINANCIAL SERVICES

Demand for automotive financial services remained high in 2018 despite a slight contraction in the overall market. Service products such as maintenance and servicing agreements and insurance were especially popular, as customers in more advanced automotive financial services markets are putting greater focus on optimizing overall running costs. In the fleet segment, some customers made use of support from automotive financial service providers in order to optimize their entire mobility management beyond mere fleet operation. There was also increased demand from both private and business customers for mobility services centered on vehicle usage rather than ownership.

In Europe, sales of financial services climbed further in the reporting period. Both increased vehicle sales and a significant rise in the number of finance and lease contracts were contributing factors. Growth was also generated in the used vehicle business, predominantly in Western and Central Europe. Demand for after-sales products, such as servicing, maintenance and spare parts agreements, as well as for automotive-related insurance saw an upward trend. The popularity of automotive financial services products continued to grow, especially in Spain and Italy. In the United Kingdom and France, the demand for financial services was sustained at a significant level

In the German market, the share of loan-financed or leased vehicles once again remained stable at a high level in 2018. Alongside traditional products, integrated mobility services in the business customer segment and after-sales products were particularly popular.

Demand for automotive financial services products in South Africa remained stable.

Sales of automotive financial services in North America remained at a high level in the reporting period. The USA again benefited from an uptrend in the overall market for financial services products; above all, the demand for leasing services through captive financial services providers remained high. Automotive financial services products also remained very popular in Mexico.

In Brazil, the recovery continued in 2018 despite the political tensions. Vehicle finance sales, sales of the country-specific Consorcio financial services product – a combination of savings plan and lottery – and sales of insurance and other services rose in the reporting period. The current economic crisis in Argentina halted the positive trend seen in 2017. The sharp rise in interest rates meant that it was a real challenge to sell financing and lease products in 2018, although the situation had stabilized a little by the end of the year.

Trends in the markets of the Asia-Pacific region were mixed during the reporting period. In China, the proportion of loan-financed vehicle purchases rose. Despite increasing restrictions on registrations in metropolitan areas, there is considerable potential for acquiring new customers for automotive-related financial services, particularly in the interior of the country. The demand for automotive financial services rose in the Indian market. In Japan and Korea, it remained steady overall. In Australia, a high level of demand for financial services products was sustained, despite a slight contraction in the vehicle market.

In the commercial vehicles segment, the European market for financial services once again saw growth; these products were also heavily in demand in China. In Brazil, the stabilization in the economic situation led to encouraging growth in the truck and bus business as well as in the associated financial services market.

TRENDS IN THE PASSENGER CAR MARKETS

In fiscal year 2018, the global market volume of passenger cars fell slightly below the prior-year level to 82.8 million vehicles (–1.2%) after increasing for eight years in a row. This decrease was attributable in particular to weaker performance in the Western Europe and Asia-Pacific regions in the fourth quarter. In the reporting period, stronger demand in Central and Eastern Europe as well as in South America was offset by declining volumes in the Asia-Pacific, Middle East, North America and Western Europe regions.

Sector-specific Environment

The sector-specific environment was influenced significantly by fiscal policy measures, which contributed considerably to the mixed trends in sales volumes in the markets last year. These measures included 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 movement of vehicles, parts and components more difficult.

Europe/Other Markets

In Western Europe, the total number of new passenger car registrations in the reporting period was down 0.7% in total on the prior-year figure, at 14.2 million. The continuing strong macroeconomic environment, positive consumer sentiment and low interest rates generated a slight increase in the first half of the year. The changeover to the new WLTP (Worldwide Harmonized Light Vehicles Test Procedure) as of September 1, 2018 led to pull-forward effects in the months of July and August and to significant declines from September until December in some cases. New vehicle registrations were mixed in the largest single markets. Spain (+7.0%) and France (+3.0%) continued to record increases. Both countries benefited from a buoyant macroeconomic environment. In Italy, falling demand from both private and commercial customers put a damper on market development (–3.1%), among other things, as a consequence of the political uncertainty during and after the formation of government. The UK passenger car market saw a continuation of the negative trend from the previous year (–6.8%). This was due, among other things, to the uncertain outcome of the Brexit negotiations with the EU. The share of diesel vehicles (passenger cars) in Western Europe slipped to 36.4 (44.4)% in the reporting year.

In the Central and Eastern Europe region, the market volume of passenger cars in fiscal year 2018 rose markedly by 11.0% year-on-year to 3.4 million vehicles. New passenger car registrations in the EU member states of Central Europe increased further by 8.0% to 1.4 million units. Passenger car sales in Eastern Europe also achieved a double-digit growth rate (+13.1%), starting from a low level. The Russian market was the main growth driver in the region with an increase of 13.2%. This was mainly attributable to government programs to promote sales as well as to pull-forward effects resulting from a value-added tax increase entering into force on January 1, 2019.

The Turkish passenger car market recorded a substantial drop in demand of 32.7%, largely due to the rapidly deteriorating macroeconomic situation. In South Africa (–0.1%), the number of new passenger car registrations in the reporting period stayed at the comparatively low level seen in recent years. The change in political environment as a result of the new presidency had little positive impact on the overall economy and the automotive market.

Germany

Amounting to 3.4 million units (–0.2%) in the reporting period, passenger car registrations in Germany sustained the previous year's high level. This was attributable not only to the buoyant macroeconomic environment but also to manufacturer discounts in the form of trade-in and scrapping bonuses for older diesel models as well as to an environmental bonus for electric-powered vehicles (all-electric and plug-in hybrid drives). The changeover to the WLTP test procedure as of September 1, 2018, which limited model availability in some cases, in total led to a slightly declining overall market, whereas the rise in new registrations for private customers (+2.0%) in particular had a positive effect.

Domestic production and exports once again fell short of the comparable prior-year figures in 2018: passenger car production decreased by 9.3% to 5.1 million vehicles, while passenger car exports fell by 8.9% to 4.0 million units. This was primarily caused by declining volumes in Europe resulting to some extent from the changeover to the WLTP.

North America

At 20.7 million vehicles, sales of passenger cars and light commercial vehicles (up to 6.35 tonnes) in the North America region in fiscal year 2018 did not match the high prior-year figure (–0.6%). In the US market, demand was almost flat on the 2017 level at 17.3 million units (+0.2%). A favorable labor market and the greater purchasing power of consumers largely compensated for increased financing costs resulting from higher interest rates. The shift in demand from traditional passenger cars (–13.5%) to light commercial vehicles such as SUVs and pickup models (+8.1%) also continued in the reporting period. Due to sales figures, which had declined since the second quarter, the Canadian automotive market remained below the record figure of the previous year (–2.6%). In Mexico, sales of passenger cars and light commercial vehicles fell short of the prior-year figure (–6.6%) for the second year in a row.

South America

In the markets of the South America region, the recovery continued in the reporting period – starting from a low level – with demand for passenger cars and light commercial vehicles rising by 6.2% to 4.5 million units. The main driver was the Brazilian automotive market, whose 13.8% growth outperformed the strong momentum of the preceding year. However, the market volume was still around a third lower than the record figure for 2012. Brazil's vehicle exports declined to 629 thousand units in the course of 2018, a decrease of 17.9% on the previous year's record high. Particularly from mid-year onwards, exports were impacted by the market trend in Argentina, where demand slumped on account of the progressive deterioration of the macroeconomic situation (–10.4%).

Asia-Pacific

After many years of uninterrupted growth, the market volume in the Asia-Pacific region decreased by 2.3% in fiscal year 2018 to 36.1 million units. This was mainly due to the weakness of the Chinese passenger car market (–4.6%). The trade dispute between China and the United States of America in the reporting period weighed on business and consumer confidence, among other things, and led to a marked decline in demand, especially in the second half of the year. By contrast, the Indian market continued growing and achieved a new record with a 4.8% increase in passenger car sales year-on-year. Alongside attractive financing products, the positive trend continued to profit from the goods and services tax introduced on July 1, 2017, which resulted in part in improved purchasing conditions for the consumer. The Japanese passenger car market almost matched the volumes recorded in the previous year (–0.4%).

TRENDS IN THE MARKETS FOR COMMERCIAL VEHICLES

Overall demand for light commercial vehicles in fiscal year 2018 was slightly lower than in the previous year. A total of 9.0 (9.2) million vehicles were registered worldwide.

Despite the uncertain outcome of the Brexit negotiations between the EU and the UK, new registrations in Western Europe were up 2.8% to 2.0 million units. In Germany, the comparative figure for 2017 was exceeded by 6.0%. The market in Spain grew distinctly and the market in France recorded moderate growth, while Italy and the United Kingdom registered a decline.

The markets in Central and Eastern Europe grew noticeably on the whole, with 352 (324) thousand light commercial vehicle registrations including 130 (124) thousand in Russia alone. Most of the markets in this region succeeded in maintaining or exceeding their prior-year results.

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.

Registration volumes of light commercial vehicles in the Asia-Pacific region decreased to 6.0 million units (–2.7%) in the reporting period. In China, the region's dominant market and the largest market worldwide, demand for light commercial vehicles of 3.0 million units was down 12.0% on the prior-year figure. This decline is mainly due to the shift in demand for micro vans towards more cost-effective MPVs and SUVs. As a consequence of the sustained economic growth, new registrations in India increased sharply compared to 2017; here, 710 (575) thousand new units were registered. The market volume in Japan rose by 3.2% to 770 thousand vehicles. The number of new vehicle registrations in Thailand and Indonesia saw a significant increase versus the previous year.

Global demand for mid-sized and heavy trucks with a gross weight of more than six tonnes in the markets that are relevant for the Volkswagen Group was higher in fiscal year 2018 than in the previous year, with 591 thousand new vehicle registrations (+6.6%).

In Western Europe, the number of new truck registrations exceeded the prior-year figure by 2.2% at a total of 297 thousand vehicles. In Germany, Western Europe's largest market, the previous year's level was also exceeded slightly. While demand in the United Kingdom and in Spain witnessed a decline, it rose in France and Italy.

The Central and Eastern Europe region saw demand rise by 6.0% to 169 thousand units on the back of the positive economic performance. The Russian market deteriorated as the year progressed and recorded only slight year-on-year growth over the year as a whole. New registrations there increased by 2.6% to 78 thousand vehicles.

In fiscal year 2018, the market volume in South America rose compared with the previous year. Here, the number of new vehicle registrations rose by 19.5% to 125 thousand units. In Brazil, the region's largest market, demand for trucks grew very sharply compared with the relatively low figure for the prior-year period as a consequence of the economic recovery. By contrast, Argentina saw new registrations fall by more than a quarter. This was due to weak economic performance with a related weakening of the peso and rising interest rates.

Demand for buses in the markets that are relevant for the Volkswagen Group was slightly higher than in the previous year. The markets in Brazil as well as in Central and Eastern Europe contributed in particular to this growth. Demand in Western Europe was slightly down on the previous year's level.

GLOBAL DELIVERIES TO CUSTOMERS OF THE VOLKSWAGEN GROUP[1]

	DELIVERIES OF VEHICLES		
	2018	2017	Change in percent
Deliveries of passenger cars worldwide[2]	**10,101,297**	**10,038,756**	**+ 0.6**
Volkswagen Passenger Cars	6,244,869	6,230,335	+ 0.2
Audi	1,812,485	1,878,105	−3.5
ŠKODA	1,253,741	1,200,535	+ 4.4
SEAT	517,627	468,431	+ 10.5
Bentley	10,494	11,089	−5.4
Lamborghini	5,750	3,815	+ 50.7
Porsche	256,255	246,375	+ 4.0
Bugatti	76	71	+ 7.0
Deliveries of commercial vehicles worldwide	**732,715**	**702,778**	**+ 4.3**
Volkswagen Commercial Vehicles	499,723	497,862	+ 0.4
Scania	96,475	90,782	+ 6.3
MAN	136,517	114,134	+ 19.6

1 The delivery figures for 2017 have been restated following statistical updates.
2 Including the Chinese joint ventures.

FINANCIAL PERFORMANCE

In 2018, the global economy continued to enjoy robust expansion, although the pace of growth eased off slightly. Following the reorganization, Volkswagen Financial Services AG reported stable growth overall.

Operating profit improved by a substantial 38.6% to €844 (609) million. This improvement was largely attributable to the rise in net income from service contracts, the increased net fee and commission income and the fall in the provision for credit risks.

Profit before tax amounted to €818 (643) million, a significant improvement on the prior-year level.

Return on equity amounted to 10.5 (8.4)%.

Interest income from lending transactions and marketable securities amounted to €1,967 million (–0.7%) and was thus roughly at the prior-year level.

Net income from leasing transactions came to €835 (910) million, a decrease compared with the equivalent prior-year figure. The impairment losses on lease assets of €216 (211) million included here were attributable to normal market fluctuations and expectations.

Interest expenses were slightly higher than in the previous year at €1,070 million (+2.2%).

Net income from service contracts amounted to €170 (93) million, significantly above the prior-year figure.

Net income from insurance business was also higher than the prior-year figure at €148 million (+25.4%).

The provision for credit risks of €221 (491) million was significantly below the prior-year level. Credit risks to which the Volkswagen Financial Services AG Group is exposed as a result of various critical situations (economic crises, impact of block on sales) in Russia, Brazil, Mexico, India and the Republic of Korea were accounted for in the reporting period by recognizing valuation allowances. These valuation allowances were increased by €8 million year-on-year to €666 million.

The net fee and commission income amounted to €220 (128) million, significantly above the level in the prior-year period.

From fiscal year 2018, the following income statement line items have been added within operating profit or loss to adjust the breakdown in line with the standard market presentation: net gain or loss on hedges, net gain or loss on financial instruments measured at fair value and net gain or loss on disposal of financial assets measured at fair value not recognized in profit or loss; for this reason, there are no comparative prior-year figures for these items.

General and administrative expenses were on a level with the previous year at €1,632 (1,645) million. This figure also includes costs associated with services for other entities in the Volkswagen Group. Accordingly, costs of €421 (495) million were passed on to other entities in the Volkswagen Group and reported under net other operating income/expenses. At 59 (68)%, the cost/income ratio was better than in the previous year.

At €434 million (–22.8%), the net other operating income/expenses was below the figure achieved in the previous year. An amount of €95 (136) million was recognized through profit or loss in net other operating income/expenses and added to the provisions for legal risks. The share of profits and losses of equity-accounted joint ventures fell year-on-year to €51 (76) million.

The net loss on miscellaneous financial assets of €76 (net loss of 42) million included impairment losses of €83 million in the reporting period in respect of an unconsolidated subsidiary in China. Together with the other income and expense components, these figures meant that the Volkswagen Financial Services AG Group generated a profit from continuing operations, net of tax, of €548 million (+5.4%).

Under the current control and profit-and-loss transfer agreement for Volkswagen Financial Services AG, a loss of €149 million reported by Volkswagen Financial Services AG in its single-entity financial statements prepared in accordance with HGB was absorbed by the sole shareholder Volkswagen AG.

The German companies continued to account for the highest business volumes with 43.4% of all contracts, forming a strong and solid foundation.

Once again in 2018, Volkswagen Leasing GmbH was able to increase both the number of leases and operating profit compared with the previous year, despite tough conditions. The company thus continued to make a significant contribution to the Group's operating profit.

In the vehicle insurance segment, Volkswagen Autoversicherung AG continued to stabilize its business and expand its activities in 2018. Volkswagen Autoversicherung AG's portfolio was on a level with the previous year at more than half a million policies (vehicle insurance and guaranteed asset protection insurance).

Since November 2018, Volkswagen Autoversicherung AG has also been offering its third-party motor vehicle insurance product in the leasing business.

In 2018, Volkswagen Versicherung AG was operating primary and reinsurance business in 13 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 €72.1 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 90% of the Group's total assets.

The volume of retail financing lending rose by €0.4 billion to €16.7 billion (+2.5%). Contracts entered into by the international joint ventures have also been included in the current contracts and new contracts with immediate effect. The number of new contracts came to 1,140 thousand, slightly below the adjusted prior-year level (1,182 thousand). The number of current contracts stood at 2,723 thousand at the end of the year.

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 €4.1 billion (+13.3%).

Receivables from leasing transactions were up 5.1% year-on-year to €19.8 billion.

Lease assets recorded growth of €1.5 billion to €13.1 billion (+13.1%).

A total of 798 thousand new leases were entered into in the reporting period. The number of lease vehicles as of December 31, 2018 was 1,841 thousand. As in the previous year (1,327 thousand), the largest contribution to business growth again came from Volkswagen Leasing GmbH, which had a contract portfolio for 1,436 thousand lease vehicles (+8.2%). Total assets of the Volkswagen Financial Services AG Group rose to €80.5 billion (+16.7%). This growth is primarily the result of the increase in loans to and receivables from customers and in lease assets and hence reflects the business expansion over the fiscal year.

The number of service and insurance contracts at the year-end was 5,600 thousand. The new business volume of 2,081 thousand contracts was down compared with the adjusted prior-year figure (2,144 thousand).

Deposit Business and Borrowings

In terms of capital structure, the significant liability items included liabilities to banks in the amount of €12.3 billion (+11.9%), liabilities to customers amounting to €12.3 billion (+27.6%) and notes, commercial paper issued of €41.0 billion (+26.4%). Information on the funding and hedging strategy is provided in a separate section of the management report.

Subordinated Capital

The subordinated capital decreased by 30.6% year-on-year to €3.0 billion.

Equity

The subscribed capital of Volkswagen Financial Services AG remained unchanged at €441 million in fiscal year 2018. Equity in accordance with IFRSs was €8.0 (7.6) billion. This resulted in an equity ratio of 10.0% (equity divided by total assets) based on total assets of €80.5 billion.

Within equity, an amount of €1 billion was transferred from capital reserves to retained earnings; this resulted from an authorized repayment of capital reserves to Volkswagen AG. At the same time, an increase in the capital reserves of €1 billion was authorized by Volkswagen AG for June 30, 2019; this will offset the reduction in the capital reserves applied in the year under review.

Changes in Off-Balance-Sheet Liabilities

Off-balance-sheet liabilities decreased by a total of €320 million year-on-year to €702 million as of December 31, 2018.

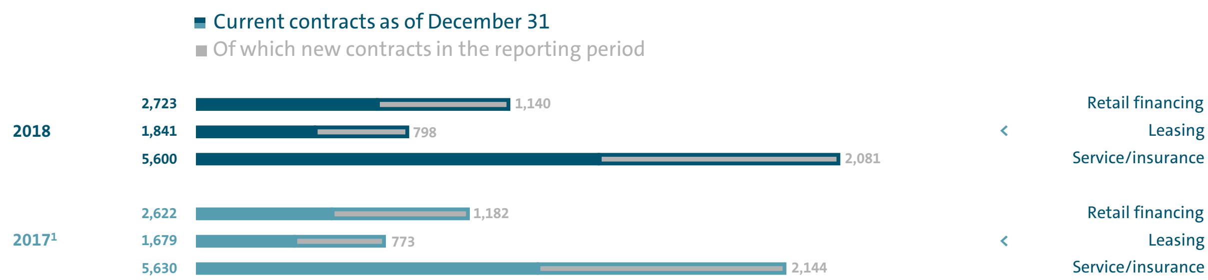
KEY FIGURES BY SEGMENT AS OF DECEMBER 31, 2018

in thousands	Germany	China	Mexico	Brazil	Other companies[1]	VW FS AG Group
Current contracts	**4,409**	**1,229**	**715**	**473**	**3,336**	**10,164**
Retail financing	0	1,207	245	382	889	2,723
of which: consolidated	0	1,207	245	382	428	2,262
Leasing business	1,326	21	74	8	412	1,841
of which: consolidated	1,326	0	74	5	214	1,619
Service/insurance	3,084	1	396	83	2,036	5,600
of which: consolidated	3,084	0	396	56	714	4,250
New contracts	**1,601**	**563**	**276**	**234**	**1,345**	**4,019**
Retail financing	0	546	80	179	335	1,140
of which: consolidated	0	546	80	179	176	981
Leasing business	562	17	34	4	180	798
of which: consolidated	562	0	34	1	105	703
Service/insurance	1,038	0	162	51	830	2,081
of which: consolidated	1,038	0	162	31	301	1,533
€ million						
Loans to and receivables from customers attributable to						
Retail financing	–	7,306	1,311	2,464	5,595	16,676
Dealer financing	8	611	601	535	2,308	4,062
Leasing business	17,641	–	463	32	1,624	19,760
Lease assets	11,102	–	139	12	1,830	13,083
Investment[2]	4,381	–	14	1	1,043	5,439
Operating profit/loss	270	194	118	144	117	844
Percent						
Penetration[3]	43.1	13.5	50.9	37.5	–	22.3
of which: consolidated	43.1	13.0	50.9	36.8	–	18.9

1 The Other Companies segment covers the following markets: Australia, Belgium, France, India, Italy, Japan, Korea, Poland, Portugal, and Russia. Relating to the number of contracts and penetration, it also covers the following markets: Argentina, the Netherlands, Norway, Switzerland, South Africa, Taiwan and Turkey. It also includes the Volkswagen Financial Services AG holding company, the holding and financing companies in Belgium, France and the Netherlands, EURO-Leasing companies in Denmark, Germany and Poland, Volkswagen Insurance Brokers GmbH, Volkswagen Versicherung AG and consolidation effects.
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



1 Adjustment of prior-year figures due to inclusion of contracts entered into by international joint ventures.

Liquidity Analysis

The companies of Volkswagen Financial Services AG are funded primarily through capital market and ABS (asset-backed securities) programs. Confirmed and unconfirmed credit facilities with other banks and with Volkswagen AG are also available to protect against unexpected fluctuations in cash flows. It is generally expected that credit facilities will be used. The purpose of the confirmed credit facilities with Volkswagen AG is solely to provide liquidity backup; the use of these facilities would not therefore normally be anticipated.

To ensure there is appropriate liquidity management, Treasury prepares liquidity maturity balances, carries out cash flow forecasts 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.

The internal control system (ICS) at Volkswagen Financial Services AG is used to measure liquidity risk individually for significant companies. This liquidity risk is managed using a maturity structure for Treasury liabilities. This approach includes a limit system covering the subsequent twelve months. The limits are reviewed each month in a process that acts as an early warning indicator. Reports are submitted centrally on a quarterly basis. A Group limit for Volkswagen Financial Services AG is also determined and managed appropriately; 53% of this limit was utilized as of December 31, 2018.

Various subsidiaries of Volkswagen Financial Services AG must satisfy a range of regulatory liquidity requirements at local level. For example, Volkswagen Leasing GmbH has to satisfy the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements for Risk Management). Compliance with these requirements is determined and continuously reviewed as part of the liquidity risk management system. Additionally, the cash flows for the coming twelve months are projected and compared against the potential funding available in each maturity band.

A further strict requirement imposed under banking regulations is that any liquidity requirements identified in institution-specific stress scenarios must be covered by providing an adequate liquid cash buffer over seven-day and thirty-day time horizons. No immediate need to take action was identified for Volkswagen Leasing GmbH from a regulatory or economic perspective.

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

Volkswagen Financial Services AG and its subsidiaries issued a number of bonds in different currencies during the year under review. In addition to euro bonds, bonds denominated in pound sterling, Swedish krona and Norwegian krone were issued under Volkswagen Financial Services AG's debt issuance program. Bonds based on local documentation requirements were also successfully issued in local capital markets outside Europe, such as Brazil, Australia, Mexico and Russia. Very successful placements of asset-backed securities (ABSs) were also carried out.

Volkswagen Financial Services AG was active in global markets with various ABS transactions. Notably, it carried out its first issue in Turkey.

Besides these well-established sources of funding, Volkswagen Financial Services AG was able to place a number of borrower's note loans with a range of investors, notably in Asia. The issuance of commercial paper and the use of bank credit lines completed the funding mix.

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 following tables show the transaction details:

CAPITAL MARKET

Issuer	Month	Country	Volume and currency	Maturity
Volkswagen Financial Services N.V., Amsterdam	February	United Kingdom	GBP 300 million	4.3 years
Volkswagen Financial Services AG, Braunschweig	April	Germany	EUR 2.25 billion	1.5, 3 and 5 years
Volkswagen Financial Services N.V., Amsterdam	April	Norway	NOK 500 million	3 years
Volkswagen Financial Services Australia Pty. Ltd., Chullora	April	Australia	AUD 400 million	3 years
Volkswagen Financial Services N.V., Amsterdam	May	Sweden	SEK 500 million	3 years
Volkswagen Leasing S.A. de C.V., Puebla	May	Mexico	MXN 2 billion	4 years
Banco Volkswagen S.A., São Paulo	June	Brazil	BRL 489.2 million	2 years
Volkswagen Financial Services AG, Braunschweig	July	Germany	EUR 500 million	2 years
OOO Volkswagen Bank RUS, Moscow	August	Russia	RUB 5 billion	3 years
Volkswagen Leasing GmbH, Braunschweig	August	Germany	EUR 2.5 billion	2.5, 4.5 and 7 years
Volkswagen Financial Services N.V., Amsterdam	August	United Kingdom	GBP 500 million	3 years
Volkswagen Financial Services Australia Pty. Ltd., Chullora	August	Australia	AUD 350 million	3.5 years
Volkswagen Financial Services N.V., Amsterdam	October	Sweden	SEK 500 million	3 years
Volkswagen Financial Services AG, Braunschweig	October	Germany	EUR 2.6 billion	2, 5 and 8 years
Volkswagen Bank S.A., Puebla	November	Mexico	MXN 1 billion	4 years
Volkswagen Financial Services Japan Ltd., Tokyo	November	Japan	JPY 2 billion	2.5 years

ABSS

Issuer	Transaction name	Month	Country	Volume and currency
Volkswagen Financial Services Japan Ltd., Tokyo	Driver Japan Seven	February	Japan	JPY 58.8 billion
Volkswagen Dogus Finansman A.S., Istanbul	Driver Turkey Master	February	Turkey	TRY 1,088 million
Volkswagen Leasing GmbH, Braunschweig	VCL 26	April	Germany	EUR 1.6 billion
Volkswagen Financial Services Australia Pty. Ltd., Chullora	Driver Australia Five	April	Australia	AUD 750 million
Volkswagen Leasing GmbH, Braunschweig	VCL 27	November	Germany	EUR 957 million

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. Following the transfer of Volkswagen Bank GmbH to become a direct subsidiary of Volkswagen AG, this association between ratings has become even closer.

In October 2018, S&P confirmed its short-term and long-term ratings for Volkswagen Financial Services AG at A-2 and BBB+ respectively. Over the course of the whole year, the outlook was "stable". Moody's left its short-term and long-term ratings for Volkswagen Financial Services AG unchanged at P-2 and A3 respectively. In April 2018, the outlook was raised from "negative" to "stable" because operating performance was better than expected.

Volkswagen Financial Services AG

(Condensed, in accordance with the HGB)

BUSINESS PERFORMANCE 2018

Volkswagen Financial Services AG reported a result from ordinary activities amounting to a loss of €8 million for fiscal year 2018.

Sales revenue amounted to €538 (574) million, with cost of sales also coming to €538 (567) million. These items include the income from cost allocations to Group companies and the expenses related to personnel and administrative costs.

Other operating income came to €15 (192) million, with other operating expenses amounting to €59 (12) million. Other operating income included income from the reversal of provisions for cash deposits amounting to €6 million. Other operating expenses included expenses from financial asset transfers of €35 million and rating costs of €10 million.

Net investment income increased by €950 million to net income of €464 (net expense of 487) million because all the companies in Germany bar two transferred profits. The increase was primarily attributable to the net profit of €211 (net loss of 578) million reported by Volkswagen Leasing GmbH. In addition, a dividend from a foreign investee of €38 million was included in the result from ordinary activities.

The loss after tax of €149 million will be absorbed by Volkswagen AG pursuant to the existing control and profit-and-loss transfer agreement.

Long-term financial assets rose by 36.9% to €8,194 million. The change resulted from the following items: loan increases of €2,074 million and capital increases and contributions to capital reserves at affiliated companies and investees of €657 million. Further changes in long-term financial assets resulted from business acquisitions of €16 million, capital repayments from affiliated companies of €301 million, impairment losses of €202 million and asset transfers of €35 million.

Receivables from affiliated companies rose by €974 million (28.2%). This increase was predominantly attributable to time deposits and loans as well as to receivables in connection with the transfer of profits. Loans to and receivables from other investees or investors increased by €1,774 million (69.1%), and were mainly attributable to time deposits and loans.

The increase in provisions of €52 million (12.5%) arose mainly from higher provisions for pensions of €47 million.

Bonds rose year-on-year by €5,350 million to €6,100 million, an increase of 713.3%.

Liabilities to banks in connection with borrower's note loans rose by €101 million to €1,299 million. Liabilities to affiliated companies declined by €1,204 million (18.9%), largely as a consequence of the repayment of time deposits and loans. €1,000 million was withdrawn from capital reserves by Volkswagen AG.

The equity ratio was 18.5% (26.2%). Total assets at the end of the reporting period amounted to €16,988 million.

NUMBER OF EMPLOYEES

Volkswagen Financial Services AG had a total of 5,163 (5,023) employees as of December 31, 2018. 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 2018, 794 (750) employees were leased to Volkswagen Leasing GmbH. In addition, 148 (150) employees were leased to Volkswagen Insurance Brokers GmbH, 86 (68) to Volkswagen Versicherung AG, 8 (7) to Volkswagen Autoversicherung AG, 163 (151) to MAN Financial Services GmbH and 2,658 (2,643) to Volkswagen Financial Services Digital Solutions GmbH. Volkswagen Financial Services AG employed 132 vocational trainees as of December 31, 2018.

MANAGEMENT, AND OPPORTUNITIES AND RISKS RELATING TO THE BUSINESS PERFORMANCE OFVOLKSWAGEN 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 20 to 28) of this annual report.

INCOME STATEMENT OF VOLKSWAGEN FINANCIAL SERVICES AG, BRAUNSCHWEIG, FOR FISCAL YEAR 2018

€ million	2018	2017
Revenue	538	574
Cost of sales	−538	−567
Gross profit	**0**	**7**
General and administrative expenses	−200	−262
Other operating income	15	192
Other operating expenses	−59	−12
Net investment income/expense	464	−487
Financial result	−228	0
Income tax expense	−141	84
Loss after tax	**−149**	**−478**
Profits transferred under a profit-and-loss transfer agreement	–	–
Losses absorbed under a profit-and-loss transfer agreement	149	478
Net income for the year	**–**	**–**
Profit brought forward	2	2
Assets reduced as a result of asset transfer	–	−8,849
Amount withdrawn from capital reserves	1,000	8,849
Net retained profits	**1,002**	**2**

BALANCE SHEET OF VOLKSWAGEN FINANCIAL SERVICES AG, BRAUNSCHWEIG, AS OF DECEMBER 31, 2018

€ million	Dec. 31, 2018	Dec. 31, 2017
Assets		
A. Fixed assets		
I. Financial assets	8,194	5,984
	8,194	**5,984**
B. Current assets		
I. Receivables and other assets	8,785	6,022
II. Cash-in-hand and bank balances	0	2
	8,785	**6,024**
C. Prepaid expenses	**9**	**4**
Total assets	**16,988**	**12,012**
Equity and liabilities		
A. Equity		
I. Subscribed capital	441	441
II. Capital reserves	1,600	2,600
III. Retained earnings	100	100
IV. Net retained profits	1,002	2
	3,143	**3,143**
B. Provisions	**468**	**416**
C. Liabilities	**13,376**	**8,453**
D. Deferred income	**1**	**–**
Total Equity and liabilities	**16,988**	**12,012**

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, the risks and opportunities that arise in connection with business activities are presented. The risks and opportunities are grouped into various categories. Unless specifically stated, there were no material year-on-year changes to the individual risks or opportunities.

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

Macroeconomic Risks and Opportunities

The Board of Management of Volkswagen Financial Services AG expects with further economic growth in the majority of markets a moderate increase in deliveries to customers of the Volkswagen Group. 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 the 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 key products are also available online around the world by 2020, thereby enabling the Company to enhance efficiency. By expanding digital sales channels, Volkswagen Financial Services AG is promoting direct sales and facilitating the extension of the used vehicle finance platform. In this way, changing customer needs are addressed and the competitive position of Volkswagen Financial Services AG reinforced.

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

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, 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, Treasury Controlling, ICS Steering, 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.
> Group-wide rules and accounting requirements have been put in place to ensure there is a standardized, proper and continuous financial reporting process for all domestic and foreign entities included in the consolidated financial statements in accordance with the International Financial Reporting Standards. The basis of consolidation is laid down and there is a mandatory requirement to use a standardized, comprehensive set of forms for mapping and processing intragroup transactions.
> Analyses and any adjustments to single-entity financial statements prepared by the consolidated entities are complemented by the reports submitted at Group level by the independent auditors, taking into account specific control activities aimed at ensuring that the consolidated financial reporting provides a true and fair view. The clear definition of areas of responsibility accompanied by various monitoring and review mechanisms ensures 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.
> The Subgroup Internal Audit department is a key component of the monitoring and control system. It 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 Group 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, 2018 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 THE RISK MANAGEMENT SYSTEM

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, is exposed to a large number of risks typical for the financial services sector as part of its primary operating activities. It takes on risks in a responsible manner so that it can specifically exploit resulting market opportunities.

An internal control system based on a Three-Lines-of-Defense model has been implemented to manage risk in the Volkswagen Financial Services AG Group. This structure functions as a monitoring and control system for risk. The 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.

Appropriate procedures are in place to ensure the adequacy of the risk management. Firstly, the relevant risk owner for individual types of risk continuously monitors and manages risks, which are pooled by the ICS Steering unit and reported to the Board of Management. Secondly, the individual elements in the system are regularly verified 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 Chairman of the Board. In this role, the Chairman of the Board submits regular reports to the Supervisory Board and Board of Management 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 (ICS Steering 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 ICS Steering unit is to provide framework constraints for the organization of the risk management system. This function includes drawing up and coordinating risk policy guidelines (to be carried out by the risk owner), developing and maintaining methodologies and processes relevant to risk management as well as issuing international framework standards for the procedures to be used around the world.

ICS Steering is a neutral, independent unit and reports directly to the Chairman of the Board of Management of Volkswagen Financial Services AG. Local risk management ensures that the requirements applicable to the international subsidiaries are implemented and complied with. 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.

BUSINESS STRATEGY AND RISK MANAGEMENT

Fundamental decisions relating to strategy and the instruments of risk management are the responsibility of the Board of Management. As part of this overall responsibility, the Board of Management has introduced a strategy process and drawn up a business 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 main risk management goals and measures for each category of risk are concerned by business policy focus and risk appetite. The attainment of goals is reviewed annually and any variances are analyzed to establish the causes.

The focus of the risk strategy, which is adopted and communicated by the Board of Management and applies throughout the Group, is based on risk appetite and the management requirements for each risk category and risk process. The risk appetite and these requirements are regularly specified for all categories of risk that have been deemed material by the Board of Management. Risk appetite and management requirements have an impact on the extent to which risk management measures are implemented by the risk owner for the individual risk categories. Further details and specifics for the individual risk categories are set out in operational requirements as part of the planning round in accordance with management requirements.

PRODUCT TRANSPARENCY AND NEW MARKET PROCESS

Before launching new products or commencing activities in new markets, Volkswagen Financial Services AG carries out processes – with the involvement of departments such as controlling and IT – to ensure that the Company is aware of the effects and requirements relating to the new product or market concerned and that an informed decision can then be made on this basis at an appropriate level of organizational authority.

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 because of the large proportion of business accounted for by retail lending. In terms of regional distribution, the Company aims for broadly based diversification of business across regions.

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.

Likewise, a captive provider cannot avoid collateral concentrations because the vehicle is the predominant collateral asset by virtue of the business model. A broad vehicle diversification also means that there is no residual value concentration. 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.

MATERIAL RISK CATEGORIES AND RISK REPORTING

A risk survey has identified the following risk categories that are material to Volkswagen Financial Services AG: credit risk, residual value risk, earnings risk, shareholder risk, operational risk, liquidity risk, interest rate risk, strategic risk, reputational risk, insurance company risks and compliance risk.

Under risk reporting, the material risk categories are reported on a regular basis to the Board of Management in the form of an ICS report for selected substantial risk categories. For this report, the international subsidiaries, which make up the First-Line-of-Defense, provide input to the respective risk owners of the Second-Line-of-Defense. Following a plausibility check and validation, this data is condensed at country level and forwarded to the ICS Steering unit. The ICS report presents the changes in risks for the Group and its regions on a year-on-year and period-on-period basis. They include quantitative information (financial data) and, if required, also a qualitative evaluation in consultation with the risk owners. In addition, the Board of Management is informed at regular intervals about impending negative developments by means of an early warning report. Ad hoc reports at the Group level are generated as needed to supplement the system of regular reporting.

OVERVIEW OF RISK CATEGORIES

Financial risks	Nonfinancial risks
Credit risk	Operational risk
Shareholder risk	Reputational risk
Interest rate risk	Compliance and conduct risk
Residual value risk	Strategic risk
Liquidity risk	
Earnings risk	
Risks of insurance companies	

FINANCIAL RISKS

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.

The aim of systematic credit risk monitoring by the international subsidiaries 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. Significant borrowers or borrower units are also monitored by ICS Steering.

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.

Lending or credit decisions at Volkswagen Financial Services AG are made primarily on the basis of the borrower credit check. In the companies, 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 local rating systems. Similarly, "golden rules" specify the parameters for developing, using and validating the scoring systems in the retail business.

Rating systems for corporate customers

Volkswagen Financial Services AG uses rating systems to assess the credit worthiness of corporate customers. This evaluation takes 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 payment 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 worthiness. 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. The models in use are centrally monitored and are adjusted and refined as required.

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. The models and systems in use are regularly monitored, validated, adjusted (where required) and refined at local level.

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. Local collateral guidelines with specific values take these rules into account. 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, analyzed and adapted.

Provisions

The calculation of provisions is based on the expected loss model in accordance with IFRS 9 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.

ICS Steering sets fundamental parameters in the form of golden rules and guidelines 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). Credit risk is also managed using reporting limits determined by Volkswagen Financial Services AG and specified separately for each individual company in accordance with the support strategy for the international subsidiaries. Regular reporting, business financial reviews and the yearly planning process are used to monitor credit risk at portfolio level.

CHANGES IN CREDIT RISK

Credit risk[1]	Dec. 31, 2018	Dec. 31, 2017
Amount utilized (€ million)	65,995	62,264
Default rate in %	2.3	2.2
Impairment ratio in %	2.3	2.1

1 Including joint ventures (full inclusion) and subsidiaries recognized at cost.

The rating and scoring processes on which the impairment ratio is based include default probabilities of future events. The provisions exceed the actual losses incurred.

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. Country risk would need to be taken into account, in particular, in connection with funding and equity investment activities involving foreign companies and in connection with the lending and leasing business operated by the local companies. Given the focus of business activities in the Group, there is little chance that country risk (such as foreign exchange risks or legal risks) will arise. In addition, the causes of country risk are necessarily reflected in the other direct and indirect risk categories involved (e.g. credit risk).

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

In 2018, the Brexit negotiations in the United Kingdom did not have any impact on the risk situation as regards credit and residual value risk. Nevertheless, the risk situation continues to be closely monitored so that the Company can respond proactively to any emerging developments. Various scenarios were analyzed in 2018 in connection with the imminent Brexit vote, allowing the Company to be prepared for all eventualities. There are also regular discussions with the supervisory authorities about the latest developments.

Shareholder Risk

Shareholder risk refers to the risk that equity investments made by Volkswagen Financial Services AG could potentially lead to losses in connection with capital provided (as a result of lack of dividends, write-downs to going-concern value, losses on disposal or decrease in hidden reserves), profit-and-loss transfer agreements (loss absorption) or liability risks (for example, in the case of letters of comfort).

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.

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.

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. Interest rate risk is managed on the basis of limits using interest rate derivatives as part of the risk strategy defined by the Board of Management of Volkswagen Financial Services AG. Monitoring is performed by Treasury on the basis of a service agreement with Volkswagen Bank GmbH. A report on interest rate risk at Volkswagen Financial Services AG is submitted to the Board of Management each quarter. As of December 31, 2018, 83% of the limit was utilized.

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 an opportunity in 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.

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.

Direct residual value risk is quantified using expected loss, which 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 expected loss for the portfolio is determined by aggregating the individual expected losses for all vehicles.

In the case of indirect residual value risk, the risk arising in connection with determining residual value is generally quantified using a methodology similar to that applied for direct residual value risk, but the methodology also takes into account further risk parameters (dealer default and other factors specific to this risk category).

CHANGES IN DIRECT RESIDUAL VALUE RISK

Direct residual value risk[1]	Dec. 31, 2018	Dec. 31, 2017
Number of contracts	848,538	724,673
Guaranteed residual values (€ million)	11,062	9,385
Risk exposure in %	7.2	6.3

1 Including joint ventures (full inclusion) and subsidiaries recognized at cost.

As part of the management of residual value risk, Volkswagen Financial Services AG has firstly specified rules for managing residual value. The processes for this include the calculation of the risk exposures of forward-looking residual value forecasts. Secondly, it has established uniform requirements for the Group, which reflect the accounting standards governing the recognition of provisions for risks on a pro rata basis. On the basis of this mandatory outer framework, the division/markets monitor and control their business policy activities, planning, decisions, etc. in compliance with their assigned authority. Regular reporting, business financial reviews and the yearly planning process are used to monitor residual value risk at portfolio level.

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. If liquidity risk were to materialize, higher costs and lower selling prices for assets could lead to a negative impact on financial performance. The consequence of liquidity risk in the worst-case scenario is insolvency caused by illiquidity. Liquidity risk management ensures that this situation does not arise. The expected cash flows at Volkswagen Financial Services AG are brought together and evaluated in operations serviced by the Treasury unit of Volkswagen Bank GmbH.

The primary objective of liquidity management is to safeguard the ability of the Company to meet its payment obligations at all times. This can be guaranteed through the use of drawdowns under credit facilities available with third-party banks and with Volkswagen AG. To measure liquidity risk, Volkswagen Financial Services AG has set up a system of limits throughout the Group. This system restricts funding-related cash outflows over a time horizon of twelve months. A broad diversification of funding maturities is therefore necessary to ensure compliance with the limits. To manage liquidity, the Operational Liquidity Committee (OLC) holds meetings every four 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. ICS Steering communicates the main risk management information and relevant early warning indicators relating to liquidity risk. As of December 31, 2018, 53% of the limit was utilized.

Earnings Risk

Earnings risk refers to the risk that actual figures will vary from the budgeted income statement earnings in the management strategy for the Volkswagen Financial Services AG Group. It is derived from any variance in the actual income (negative variance) and actual expenses (positive variance) in comparison with the budgeted figures.

The risk is largely determined by the business strategy and internal business planning as well as by changes in general operating parameters (such as the level of sales in the Volkswagen Group, business volume, technical processes, competitive environment).

Earnings risk is quantified on the basis of the anticipated variance of the operating profit compared with budget. To this end, the trends in actual figures compared with forecasts are monitored at market level during the course of the year. This comparison is included in the standard reporting procedure carried out by Controlling.

RISKS OF INSURANCE COMPANIES

The mission of the insurance companies in the Volkswagen Financial Services AG Group is to support sales of the Volkswagen Group's products. This is achieved in a number of ways, but mainly by offering guarantee insurance as a primary insurer and inward reinsurance.

Underwriting risk is one of the key types of risk to which insurance companies are exposed. Within Volkswagen Financial Services AG, this risk arises in the subsidiaries Volkswagen Versicherung AG, Volkswagen Insurance Company DAC and Volkswagen Reinsurance Company DAC. 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. A key feature of the risk position faced by insurance companies is that premiums are collected at the beginning of an insurance period but the associated contracted benefits are of a random nature. Depending on the insurance business operated by the company concerned, underwriting risk can be subdivided in accordance with the requirements of the European Insurance and Occupational Pensions Authority (EIOPA) into the risks associated with three different classes of insurance: non-life underwriting risk, life underwriting risk and health underwriting risk.

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.

The materiality of non-life, life and health underwriting risks is assessed through a qualitative evaluation of the risks based on the magnitude of the potential loss and the associated probability that the risks will materialize. The risks are quantified using the standard formula specified in Solvency II. The risks are managed by the independent risk control function in each insurance company. The results are then reported to the relevant units.

The management of risk at the insurance companies includes, in addition to underwriting risk, other risks that are not subsumed under the risk categories described above and below because of partially differing regulatory definitions. Depending on the insurance business involved, these risks may include the following:

- Counterparty default risk
- Market risk
- Inflation risk
- Operational risk
- Liquidity risk
- Miscellaneous non-quantifiable risks.

The risks of insurance companies in the Volkswagen Financial Services AG Group therefore reflect the entire risk profile of the insurance companies and allow the risks to be managed using a dedicated system appropriate to the business mission.

NONFINANCIAL RISKS

Operational Risk

Operational risk (OpR) is defined as the risk of loss that could result from inadequate or failed internal processes (process risk), people (HR risk), systems (technological risk), projects (project risk), legal positions or contracts (legal risk), or from external events (catastrophe risk).

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. Processes and responsibilities are set out in the operational risk manual.

The annual risk self-assessment is used to determine a forward-looking monetary assessment of potential risks. A standardized risk questionnaire is provided for this purpose. The local experts use these questionnaires to determine and record the potential level of risk and the probability that a risk could materialize. 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.

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 ICS Steering 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 the integration of all relevant operational risk units.

Details of operational risk are reported regularly as part of the ICS report to the Board of Management. Ad hoc reports are issued in addition to the ongoing reports, provided that the relevant specified criteria are satisfied.

The actual losses incurred as a result of operational risks amounted to €69.8 (50.8) million as of December 31, 2018.

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) 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.

Compliance and Conduct Risk

At Volkswagen Financial Services AG, compliance risk refers to risks that could arise from non-compliance with statutory rules and regulations or internal requirements.
This is as opposed to conduct risk, which is defined as the risk arising from inadequate conduct by the Company toward the customer, unreasonable treatment of the customer or provision of advice where products that are not suitable for the customer are used.

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

The role of the Chief Compliance Officer within Compliance is to work towards implementing effective procedures to ensure compliance with legal rules and requirements, and toward establishing appropriate controls. This is carried out mainly by stipulating binding requirements at Group level. In turn, these then provide a framework for specifying detailed requirements for which local compliance officers are responsible. Local companies are independently responsible for implementing the centrally defined requirements. Responsibility for complying with any further rules and regulations lies with the company concerned.

Overall, the emergence of a compliance culture is being nurtured by constantly promoting the Volkswagen Group's Code of Conduct and by raising employees' awareness of risk. The main instruments used to foster this culture are a tone-from-the-top approach, classroom training, and e-learning programs. The compliance culture is also being consolidated by communication measures, including the distribution of guidelines and other information media as well as employee participation in compliance programs.

The Chief Compliance Officer supports and advises the Board of Management in matters relating to the avoidance of compliance risks and reports to the board at regular intervals.

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.

SUMMARY

Risks remained at a constant level during the reporting year.

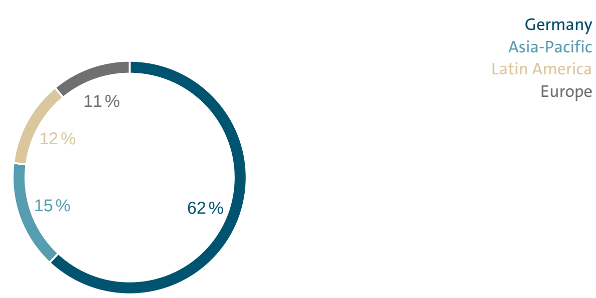
Human Resources Report

Strengthening leadership and management in the digital times and fostering a willingness to change.

EMPLOYEES

The Volkswagen Financial Services AG Group had a total workforce of 8,603 (8,555) employees as of December 31, 2018. Of these, 5,340 (5,198), or 62%, were employed in Germany and 3,263 (3,357), or 38%, at our international sites. Owing to economic considerations, 364 (371) 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, 2018



HUMAN RESOURCES 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, the objective is to continue to drive forward development around the other strategic cornerstones of customers, volume, profitability and operational excellence. Through the use of specific activities to develop and retain personnel, coupled with profit-sharing arrangements commensurate with the work performed, the Company aims to encourage top performance, with the objective of providing outstanding customer service with top employees and improving its excellent globally recognized reputation as a top employer still further.

Responsibility for implementing the employee strategy at an international level lies locally with the international subsidiaries, supported by the international HR unit at the head office. The Human Resources Strategy Card remains the most important management tool for implementing the HR strategy. The objectives and definitions set out in the tool provide our local companies with a uniform basis to be applied around the globe. The local entities hold regular meetings with the head office – at least once a year – to report on their progress 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 using the HR toolbox so that synergies can also be leveraged between the different local companies.

In the year under review, the strategic focus both in Germany and at the international sites was on strengthening employee willingness to change and on reinforcing leadership and management in the digital times.

To foster a willingness to change, eight inhouse job fairs were held in 2018, which included motivational speeches and departmental “market stalls”. Other events included various seminars on the subject and a two-hour “Quali-Quick” session, in which the employees are given short motivational briefings. This is intended to promote employee willingness to change. On the subject of leadership and management in the digital times, the Company organized national IT innovation days, external presentations and an event for managers held over several days covering the topic of digital entrepreneurship. Many of the international subsidiaries arranged a variety of discussion sessions and workshops for managers and experts (for example in Belgium, Mexico and Portugal) and went as far as integrating the topic into the General Management Program – the professional development event for prospective managing directors.

The Company assesses the extent to which it has achieved its objective of being a top employer by regularly taking part in external employer competitions. Its aim is to continue to enhance working conditions and implement corresponding action with a view to becoming one of the TOP20 employers in the “Great Place to Work” employer ranking by 2025, not just in Europe but worldwide. Volkswagen Financial Services AG has once again entered the competition for an award from “Great Place to Work” in 2019 based on a comprehensive presentation of its HR activities (which is nearly 500 pages long) and a survey of 1,000 employees. Participation in “Great Place to Work” in Europe had been suspended in the previous year because of the Europe-wide reorganization.

Customer satisfaction with the work of the employees is given top priority at Volkswagen Financial Services AG. The results of external and internal customer satisfaction surveys are used as indicators of target achievement. A system of internal customer feedback, which reflects satisfaction with internal collaboration, has now been introduced in 16 countries (Argentina, Australia, Austria, Brazil, China, Germany, India, Italy, Japan, Korea, Mexico, Poland, Portugal, Russia, Taiwan and Turkey).

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.

IMPLEMENTATION OF THE CORPORATE STRATEGY

ROUTE2025 is complemented by “The FS Way” and the associated leadership and management principles. The FS Way 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 to enable the Company to live up to the 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 customers, responsibility, trust, courage and enthusiasm, combined with an attitude of continuously looking for improvement and proactively making the changes this requires. The FS values fit very neatly into the new basic principles of the Volkswagen Group, known as the “Essentials”. The FS values are repeatedly explored, discussed and turned into specific action at events for managers and employees, especially from the perspective of digital transformation.

Since the launch in the second half of 2018 of Together4Integrity (T4I), a group-wide integrity and compliance program, strategy has been focused on the issues of compliance, culture and integrity in relation to processes, structures, attitudes and conduct. T4I is a program aimed at organizing and tracking integrity and compliance initiatives throughout the Group but it will also help to refine and improve the corporate culture at Volkswagen Financial Services AG so that the culture becomes more focused on integrity. The HR unit is using its processes, tools, rules and policies to make a significant contribution to the creation of a working environment in which the values and conduct requirements of Volkswagen Financial Services AG are taken seriously. The objectives of the T4I initiatives assigned to the HR unit are to enshrine the issues of integrity and compliance in key HR processes (recruitment, professional development, remuneration, disciplinary processes and employee retention) and give these issues greater focus. The implementation of initiatives was launched at the end of 2018 and will be continued throughout 2019 and subsequent years in accordance with the framework plan for the Group.

HUMAN RESOURCES PLANNING AND DEVELOPMENT

In 2018, 44 new vocational trainees/dual vocational training students started their professional careers at Volkswagen Financial Services AG in Braunschweig focusing on specialist professional IT qualifications in application development, professional banking qualifications and professional insurance and finance qualifications. 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 2018, vocational trainees were once again recruited predominantly to train for specialist professional IT qualifications in application development, and dual vocational training students mainly to become business informatics specialists, with a view to designing vocational training on a forward-looking basis and incorporating the topic of digitalization. A degree study program in computer science is also offered at the Braunschweig University of Technology.

At EURO-Leasing GmbH, Sittensen, 2018 saw two vocational trainees begin their training for professional qualifications in fleet and international business.

As of December 31, 2018, a total of 130 vocational trainees and dual vocational training students were employed in Germany across all levels and professions. In Germany, a total of 44 vocational trainees were offered permanent positions in the reporting period.

The company in Brazil also continues to offer young people the opportunity to receive vocational training.

In order to continue to attract qualified, committed employees for the Company, Volkswagen Financial Services AG has a rigorous concept for recruiting and retaining young university graduates. This process has undergone a transformation in the last few years. Based on the introduction of a new recruiting tool (SAP Success Factors), the Company has been pursuing the objective of enabling applicants to enjoy a simple, but optimum, comprehensive candidate experience in the recruitment process. For those involved in the process internally, the introduction of the Success Factors tool means that the process of managing applicants is faster and simpler.

It is hugely important for the Company to continuously analyze its own business, competitors and target groups, especially in view of the shortage of specialists in the IT sector.

A well-established framework is provided by 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, Martin Luther University in Halle-Wittenberg, Alpen-Adria Universität Klagenfurt and Hildesheim University. A distinction is made between academic research partnerships and strategic partnerships. A wide variety of activities, such as trips, workshops and practical projects, 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. In addition to the partnerships with universities in Germany, the Company is also involved in international partnerships, for example in Italy, the United Kingdom and Spain.

The twelve-month trainee program for digital talents, which takes place both in Germany and abroad, is another element in the Company's strategy to ensure its future viability. The development program for young graduates is complemented by a three-year doctoral program.

Another 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 270 talented individuals have already taken part in the programs for young talent, experts and management talent groups. The objectives are to provide individual personal and professional development and to enhance the participant's profile in the Company.

The international subsidiaries of Volkswagen Financial Services AG also offer a wide variety of programs for expert and management talent.

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 systematic, professional training for employees based on structured profiles of skills and qualifications, which are discussed annually in a skills development appraisal. The skills development needs of the various departments are determined annually at the strategic skills development conferences. This is then used as the basis for a forward-looking expansion of skills development activities.

The close relationship with the job family academies in the Volkswagen Group broadens the selection of available skills development opportunities and leverages synergies across the different job families.

The FS Academy skills development portfolio relating to electric mobility and digitalization is being constantly expanded in response to the ever-increasing significance of environmentally friendly and digital mobility concepts in the Volkswagen Group. The FS Academy is thereby making a significant contribution to the digital transformation within the Group. Using a variety of approaches, managers and employees are being trained in digital and agile concepts, technologies and methodologies, and are being prepared going forward for the shifting requirements presented by day-to-day work in the digital age. Efforts are focused on delivering practical knowledge with a high degree of participant involvement and by means of digital learning formats, which can be used at any time in any location.

The FS Academy has also been focusing on expanding the development program geared toward building skills in classic and agile project management methods, with a view to establishing these as a strong point within the Company. The program also gives employees the opportunity to achieve product owner and scrum master certification, enabling them to assume overall leadership responsibility in agile projects.

As a result of the introduction of the "FS Academy online" digital learning platform in 2018, the entire skills development and qualifications offering from the FS Academy (list of courses, specialist forums, lectures/presentations and e-learning sessions) has now been made available centrally with a booking option. The learning platform supports the whole of the skills development process for employees, including the search for a suitable learning option, the registration, the participation and, at the end, the digital provision of materials, such as photographic material, handouts and participation certificates. In addition, employees can use FS Academy online to participate directly in different types of online-based learning such as e-learning sessions. The new learning platform – which up to now has been introduced in Germany, the Netherlands and Japan – provides the basis for a new learning culture that enhances employees' personal responsibility for their own learning.

Since 2014, FS Academy International has been available so that a uniform approach to skills development and qualifications can also be provided at an international level. Skills development profiles applicable internationally are in place in fleet, risk, IT and project management activities. In 2017, some of these profiles were already being used for the second year in a row in skills development appraisals. A skills development profile for IT management functions that is valid internationally was rolled out in 2018.

The strategic approaches of FS values and the resulting leadership principles have also been incorporated at Volkswagen Financial Services AG 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 mandatory and modular "Erfolgreich durchstarten" (hit the ground running) program for new and newly appointed managers, there are advanced modules for enhancing the management know-how of experienced managers as well as the option of an individual review to assess the current level of a manager's skills. The program is complemented by the "Boxenstopp Führung" (management pit stop), which gives all managers 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.

Volkswagen Financial Services AG 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 350 employees with line management responsibilities.

The international subsidiaries also attach great importance to continuously enhancing management skills. The international "leadership license" standard, comprising training modules and a concluding assessment center event, has now been introduced in all international subsidiaries.

Furthermore, professional development has become internationally established as an integral part of management. A few of the international subsidiaries carry out the management assessment center (MAC) themselves or offer it in collaboration with the Group brands in the country concerned. In an alternative option, managers can participate in cross-regional MACs offered once or twice a year.

To promote an entrepreneurial spirit in Volkswagen Financial Services AG, an internal program known as FS.Start.Up was run for the first time in 2018. The program was open to any employees who wished to contribute business ideas, such as new business models, new product suggestions or process improvements, that are in line with the ROUTE 2025 corporate strategy. The ideas were initially made accessible to anyone throughout the Company using a web-based platform. A shortlist was then drawn up, after which the employees or start-up teams were then required to pitch their ideas briefly to a selection panel comprising members of the Board of Management and senior managers. The teams that were able to make a convincing presentation to the panel received supplementary funding for the necessary support to enable them to take their ideas to the next stage.

INCREASE IN THE PROPORTION OF WOMEN

As of December 31, 2018, women accounted for 47.7% of the workforce of Volkswagen Financial Services AG in Germany, but this is not yet reflected in the percentage of women in management positions. Volkswagen Financial Services AG is working on giving special consideration to female candidates in recruitment and succession planning, in combination with measures to improve work-life balance as well as the development of HR tools. With regard to the proportion of women in management, on the Board of Management and on the Supervisory Board, the Company is striving to meet the targets it set itself for the first time in 2010 and revised in 2016 under the Gesetz zur gleichberechtigten Teilhabe von Frauen und Männern in Führungspositionen (FührposGleichberG – German Act on the Equal Representation of Women and Men in Management Positions). In 2018, the targets to be achieved by 2023 were redefined as a result of the separation of Volkswagen Bank GmbH from Volkswagen Financial Services AG and were then approved by the Board of Management.

PROPORTION OF WOMEN – TARGET AND ACTUAL VALUES FOR GERMANY

	Target 2021	Target 2018	Actual 2018
Second management level	27.8	25.0	24.6
First management level	16.8	12.6	12.5
Board of Management	16.7	–	25.0
Supervisory Board	25.0	–	33.3

Therefore, the targets for the first and second management levels in Germany were not quite attained.

Seven mentees successfully completed the cross-brand mentoring program run throughout the Group with the aim of increasing the proportion of women in management. The aim of the nine-month program was for suitably qualified female employees to receive advice, support and coaching from managers in the Group.

The Supervisory Board has adopted the following targets for the proportion of women to be achieved by the end of 2021: 25.0% for the Supervisory Board and 16.7% for the Board of Management. At the end of 2018, the proportion of women on the Supervisory Board was 33.3%; the equivalent figure for the Board of Management was 25%.

Volkswagen Financial Services AG also pays close attention to diversity, and therefore to the proportion of women, at an international level. In 2018, women accounted for 20.3% of the management level globally. At the upper management level, the proportion of women was 30.3%, equating to an increase of 9.4 percentage points compared with 2017. Internationally, the overall proportion of women at Volkswagen Financial Services AG was 45.6% in 2018. The Board of Management maintains the necessary transparency through regular progress reports.

DIVERSITY

In addition to the specific advancement of women, the notion of diversity has been an integral component of the corporate culture at Volkswagen Financial Services AG since 2002. Volkswagen Financial Services AG sent a clear signal with its corporate initiative around the Diversity Charter, which was signed in 2007. Under this initiative, the Company undertook to recognize and appreciate diversity, and to promote it according to skills and ability. In 2018, Volkswagen Financial Services AG adopted a Diversity Policy to reinforce this approach. The Diversity Policy ensures that diversity is recognized as the norm rather than some kind of special feature. Diversity becomes a strength through the conscious appreciation of the diversity in the workforce. Volkswagen Financial Services AG operates at an international level and this workforce diversity makes a substantial contribution to the successful performance of the business.

HEALTH AND FAMILY

To promote the health of employees, Volkswagen Financial Services AG continually enhances its holistic healthcare concept and the different associated areas of activity in line with demand. The Company raises awareness of healthcare and healthy living among vocational trainees and in the individual departments, tailored to specific needs and target groups.

One of the 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.

Volkswagen Financial Services AG provides regular information and training to management staff on health-related topics to enable them to recognize health problems 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, health-oriented management behavior is encouraged.

Since 2015, the Company has offered a social coach function, an impartial first port of call for 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.

The promotion of healthcare and healthy living is also of key importance at Volkswagen Financial Services AG's international subsidiaries. The local companies offer a wide variety of health programs, organize sports events and include measures to foster healthcare and healthy living into the design and arrangement of offices.

Volkswagen Financial Services AG promotes a family-friendly environment and offers numerous (and continuously expanding) 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 (even during holiday periods), making it unrivaled in Germany.

Report on Expected Developments

The global economic growth is expected to slow down somewhat in 2019. We also assume that global demand for vehicles will vary from region to region and remain at the prior-year level on the whole.

The main opportunities and risks arising from the operating activities 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 the planning process on an ongoing basis so that Volkswagen Financial Services AG can exploit them as soon as possible.

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

DEVELOPMENTS IN THE GLOBAL ECONOMY

Our forecasts are based on the assumption that global economic growth will slow down somewhat in 2019. We still believe risks will arise from protectionist tendencies, turbulence in the financial markets and structural deficits in individual countries. In addition, growth prospects will be negatively affected by continuing geopolitical tensions and conflicts. We therefore anticipate weaker momentum than in 2018 in both the advanced economies and the emerging markets. 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 from 2020 to 2023.

Europe/Other Markets

In Western Europe, economic growth is likely to slow down in 2019 compared with the reporting period. Resolving struc¬tural problems continues to pose a major challenge, as do the uncertain impacts of the United Kingdom's planned exit from the EU.

In Central Europe, we estimate that growth rates in 2019 will be lower than those for the past fiscal year. The economic situation in Eastern Europe should stabilize further, providing the conflict between Russia and Ukraine does not worsen. The growth of the Russian economy is expected to lose some of its momentum.

For Turkey, we expect the growth rate to taper off further amid higher inflation. The South African economy will probably be dominated by political uncertainty and social tensions again in 2019 resulting, in particular, from high unemployment. Growth is therefore likely to remain at a low level.

Germany

We expect that gross domestic product (GDP) in Germany will increase slower in 2019 than in the reporting period. The situation in the labor market will probably remain stable and bolster consumer spending.

North America

We assume that the economic situation in the USA will remain stable in 2019. GDP growth should be lower than in the reporting period, however. The US Federal Reserve could further raise the key interest rate throughout 2019. Economic growth is likely to continue to slow down in Canada and Mexico.

South America

The Brazilian economy will most likely stabilize further in 2019 and record somewhat stronger growth than in the reporting period. Amid sustained high inflation, the economic situation in Argentina is expected to remain tense.

Asia-Pacific

In 2019, the Chinese economy is expected to continue growing at a relatively high level, but will lose some of its momentum compared with prior years owing to the trade disputes with the USA. For India, we anticipate an expansion rate on a similar scale to the previous years. In Japan, growth is forecast to remain weak.

TRENDS IN THE MARKETS FOR FINANCIAL SERVICES

Volkswagen Financial Services AG believes that automotive financial services will be very important for vehicle sales worldwide in 2019. The Company expects demand to continue rising in emerging markets where market penetration has so far been low, such as China. Regions that already benefit from developed automotive financial services markets will see a continuation of the trend toward customers requiring mobility at the lowest possible total cost. Integrated end-to-end solutions, comprising mobility-related service modules such as insurance and innovative packages of services, will become increasingly important in this regard. Additionally, demand is expected to increase for new forms of mobility, such as car sharing, and for integrated mobility services including parking, refueling and charging. The Company anticipates that this trend will continue in the period from 2020 to 2023.

In the mid-sized and heavy commercial vehicles category, demand for financial services products is rising in emerging markets. In these countries in particular, financing solutions support vehicle sales and are thus an essential component of the sales process. In mature markets, Volkswagen Financial Services AG is projecting increased demand in 2019 for telematics services and services aimed at reducing total operating costs. This trend is also expected to continue in the period 2020 to 2023.

TRENDS IN THE PASSENGER CAR AND LIGHT COMMERCIAL VEHICLES MARKETS

We expect trends in the markets for passenger cars in the individual regions to be mixed in 2019. Overall, global demand for new vehicles will probably be at the 2018 level. We are forecasting growing demand for passenger cars worldwide in the period from 2020 to 2023.

Trends in the markets for light commercial vehicles in the individual regions will be mixed again in 2019; on the whole, we anticipate a slight dip in demand in 2019. We expect a return to the growth trajectory for the years 2020 to 2023.

The Volkswagen Group is well prepared for the future challenges pertaining to the automotive mobility business and the mixed developments in regional automotive markets. Our brand diversity, our presence in all major world markets, our broad, selectively expanded product range and pioneering technologies and services place us in a good competitive position worldwide. Our goal is to offer all customers mobility and innovations suited to their needs and thus ensuring long-term success.

Europe/Other Markets

For 2019, we anticipate that the volume of new passenger car registrations in Western Europe will be in line with that seen in the reporting period. The uncertain impact of the United Kingdom's planned exit from the EU is likely to further exacerbate the ongoing uncertainty among consumers, continuing to put a damper on demand. We expect to see slight growth in the Italian market in 2019, whereas growth momentum in Spain will probably slow somewhat. We anticipate volumes in the French passenger car market to be on a level with the previous year. In the United Kingdom, we estimate that new vehicle registrations in 2019 will be at the prior-year level.

For light commercial vehicles we expect demand in Western Europe in 2019 to narrowly miss the prior-year level owing to the uncertain impact of the United Kingdom's planned exit from the EU. We estimate a marked decline in Italy and a moderate decline in the United Kingdom and France. In Spain, we anticipate a noticeable increase in demand.

Sales of passenger cars in 2019 are expected to slightly exceed the prior-year figures in markets in Central and Eastern Europe. In Russia, we anticipate a market volume that is slightly higher than in the previous year following the marked recovery in the reporting period. The number of new registrations should continue to grow in most of the other markets in this region.

Registrations of light commercial vehicles in the Central and Eastern European markets in 2019 will probably be somewhat lower than in the previous year. In Russia, we expect the market volume to decline perceptibly compared with 2018.

We anticipate a further substantial downturn in the passenger car market in Turkey. The volume of new registrations in South Africa in 2019 is likely to increase slightly year-on-year.

Germany

After a positive performance overall in recent years, we expect demand in the German passenger car market to fall slightly year-on-year in 2019.

We anticipate that registrations of light commercial vehicles will be around the previous year's level.

North America

The volume of demand in the markets for passenger cars and light commercial vehicles (up to 6.35 tonnes) in North America as a whole and in the United States of America is likely to be slightly lower in 2019 than in the prior year. Demand will probably remain highest for models in the SUV and pickup segments. In Canada, the number of new registrations is also projected to be on a level with the previous year. By contrast, in Mexico we anticipate that demand will pick up slightly year-on-year.

South America

Owing to their dependence on demand for raw materials worldwide, the South American markets for passenger cars and light commercial vehicles are heavily influenced by developments in the global economy. We expect to see an overall moderate increase in new registrations in the South American markets in 2019 compared with the previous year. In Brazil, demand volume is expected to rise markedly again in 2019 following the increase in the reporting period. However, we anticipate that demand in Argentina will be perceptibly lower year-on-year.

Asia-Pacific

In 2019, the passenger car markets in the Asia-Pacific region are likely to slightly outperform the level of the reporting period. We expect demand in China to increase slightly again in 2019 after slipping in 2018. Attractively priced entry-level models in the SUV segment in particular should continue to see strong demand. For as long as there is no resolution in sight, the trade dispute between China and the United States will continue to weigh on business and consumer confidence. In the Indian market we anticipate somewhat stronger growth than in the previous year. Japan's market volume is forecast to diminish moderately in 2019.

The market volume for light commercial vehicles in 2019 will probably just miss the previous year's figure. We are expecting demand in the Chinese market to fall noticeably short of the prior-year level. For India, we are forecasting a moderately higher volume in 2019 than in the reporting period. In the Japanese market, demand is likely to be moderately below the previous year's level.

TRENDS IN THE MARKETS FOR COMMERCIAL VEHICLES

In the markets for mid-sized and heavy trucks that are relevant for the Volkswagen Group, new registrations in 2019 are set to be slightly up on the level seen in 2018. We anticipate a solid increase for the period from 2020 to 2023.

We assume that demand in Western Europe will taper off moderately year-on-year in 2019. In Germany, we also expect the market to decline slightly compared to the previous year.

Central and Eastern European markets should record a moderate increase in demand. In Russia we expect to see a marked rebound in demand in 2019.

We assume that demand in the South America region will pick up perceptibly in 2019.

In the bus markets that are relevant for the Volkswagen Group, we anticipate a slight increase in demand in 2019 compared with the prior-year level. We forecast moderate growth for the market in Western Europe in the same period. In Central and Eastern Europe, we anticipate a slight drop in demand. In South America, new registrations will probably be moderately higher than the prior-year level

For the period 2020 to 2023, we expect noticeable growth overall in the demand for buses in the markets that are relevant for the Volkswagen Group.

INTEREST RATE TRENDS

In 2018 and also at the beginning of the current fiscal year, the overall picture regarding central banks' interest rate policies was somewhat varied. In the USA and the United Kingdom, the central banks have already hiked interest rates, whereas the ECB has continued to pursue its expansionary monetary policy. The level of interest rates still remains close to the historic lows. This divergence in central bank policy is likely to continue because there are signs of an end to the economic downturn in Europe, but also indications of an end to the overheating economy in the USA resulting from the expansionary fiscal policy. Further rises in interest rates in the US dollar and pound sterling zones will probably ensue.

If necessary, the ECB will gradually scale back its policy of cheap money in 2019. It is not anticipated that there will be any initial rise in interest rates before the ECB has completely ended its bond-buying program. Interest rates will therefore probably remain stable in the eurozone for the time being.

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. In addition, new mobility solutions will enhance the traditional idea of owning a vehicle. As a result, mobility is being redefined in many respects.

Volkswagen Financial Services AG closely monitors developments in the mobility market and is working on new models to support alternative marketing approaches and establish new mobility concepts with the aim of safeguarding and expanding its existing business model. Simple, convenient, transparent, safe, reliable, flexible – these are the key requirements that the Company's business must satisfy.

In collaboration with the automotive brands in the Volkswagen Group, Volkswagen Financial Services AG is aiming to be a leader in the development of new mobility services, as has been the case in the conventional automotive business for many years.

Based on traditional leasing, long-term rentals, car and truck hire as well as car sharing, Volkswagen Financial Services AG – through its subsidiaries – can already cover a large proportion of the mobility needs of its customers. The Company has taken a huge step towards becoming a mobility service provider with the expansion of vehicle-related mobility services. Volkswagen Financial Services AG already offers its customers an attractive portfolio of services covering the customer desire for convenience and flexibility. Efforts are focusing on the global expansion of innovative payment solutions for digital business models in the Volkswagen Group, the further expansion of cashless and mobile settlement of parking charges in North America and Europe and the further development of the electric vehicle charging and fuel card services in Europe. In this context, Volkswagen Financial Services AG intends to continue to serve as a one-stop shop for its customers. In addition, the Europe-wide processing of toll business will be integrated into the services for business customers and other activities will focus on driving forward the further expansion of the fleet business.

As in the case of vehicles with conventional petrol/diesel engines, Volkswagen Financial Services AG closely partners the Volkswagen Group brands in the marketing of electric vehicles. An attractive range of leasing services in particular – complemented by packages covering maintenance and wear-and-tear repairs – plays a key role in the marketing of electric vehicles produced by the Volkswagen Group.

Volkswagen Financial Services AG is also, for example, a partner of Audi AG in the implementation of the recently launched e-tron charging service, which provides customers buying the new Audi e-tron with access to more than 70,000 public charging points in Europe. Euromobil GmbH (a subsidiary of Volkswagen Financial Services AG), together with Volkswagen, provides Volkswagen e-Golf customers with access to replacement mobility so that, for example, such customers are able to use petrol/diesel vehicles for longer trips, should the need arise.

In this context, Volkswagen Financial Services AG intends to continue to serve as a one-stop shop for its customers, remaining true to the essence of its brand promise “The Key to Mobility” going forward.

NEW MARKETS/INTERNATIONALIZATION/NEW SEGMENTS

The financing, leasing, insurance and mobility services businesses are essential 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 enhance its international focus by expanding the product range in existing markets, taking over companies and portfolios from Volkswagen Bank GmbH and by developing new markets.

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.

Forecast for Credit and Residual Value Risk

As regards credit risk, Volkswagen Financial Services AG anticipates that the risk position will remain stable in 2019, but the volume of loans and receivables will grow. This growth is likely to be driven by the established sales promotion programs with the brands and the continuous expansion of the fleet business. However, a slowdown in the growth of the global economy in 2019 will probably also have an impact. Certain markets (such as Brazil, Russia and Turkey) are already being monitored; this will be continued in 2019 so that, if required, suitable measures can be implemented to reach the defined goals for the current year. The volume of loans and receivables and the credit risk situation are likely to be positively impacted by the transfer of portfolios and companies from Volkswagen Bank GmbH to Volkswagen Financial Services AG as a consequence of the restructuring of the Group – particularly transfers from the high-volume British market (if the UK leaves the EU without a deal with the other member states, i.e. if there is a Hard Brexit).

In the residual value portfolio, the volume of contracts is projected to continue to grow in fiscal year 2019. In this case too, the main drivers will be the growth programs implemented by the Company and further expansion in the fleet business. In addition, the transfer of portfolios and companies from Volkswagen Bank GmbH to Volkswagen Financial Services AG as a consequence of the restructuring of the Group – particularly transfers from the high-volume British market (in the event of a Hard Brexit) – will probably lead to a greater residual value portfolio.

The public debate about the use of diesel vehicles being prohibited in major European cities could also impact the residual value portfolio in 2019.

Forecast for Liquidity Risk

The risk development is categorized as stable. Established sources of funding remain available. To ensure that this situation is maintained in the long term, funding diversification continues to be extended in individual markets and existing sources of funding are being expanded.

OUTLOOK FOR 2019

Volkswagen Financial Services AG's Board of Management expects global economic growth in 2019 to be slightly lower than in the previous year. 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. We expect growth in the major industrialized nations to moderate slightly compared to 2018.

When the above factors and the market trends are considered, the following overall picture emerges: earnings expectations assume a slight increase in funding costs, greater levels of cooperation with the individual Group brands, increased investment in digitalization for the future and continued uncertainty about macroeconomic conditions in the real economy and the impact of this uncertainty on factors such as risk costs, as well as the potential effects of geopolitical upheaval. We forecast that, as a result of the transfer of portfolios and companies from Volkswagen Bank GmbH caused by the restructuring of the Group – particularly in the high-volume British market (in the event of a Hard Brexit) – new contracts, current contracts, penetration and business volume will all be significantly higher in 2019 than the levels achieved in fiscal year 2018. Based on the effects described above and assuming that the margin in the coming year remains stable, operating profit for fiscal year 2019 is projected to exceed the prior-year level.

The forecast earnings growth and stable capital adequacy are expected to lead to a higher return on equity in 2019 compared with the previous year. We expect the cost/income ratio in 2019 to be at the level of the previous year.

FORECAST CHANGES IN KEY PERFORMANCE INDICATORS FOR FISCAL YEAR 2019 COMPARED WITH PRIOR-YEAR FIGURES

	Actual 2018	Forecast for 2019[1]	
Nonfinancial performance indicators			
Penetration (percent)	22.3	> 22.3	Slightly higher than in the previous year
Current contracts (thousands)	10,164	> 10,164	Significantly higher than in the previous year
New contracts (thousands)	4,019	> 4,019	Significantly higher than in the previous year
Financial performance indicators			
Volume of business (€ million)	53,581	> 53,581	Significantly higher than in the previous year
Operating profit (€ million)	844	> 844	Significantly higher than in the previous year
Return on equity (percent)	10.5	> 10.5	Slightly higher than in the previous year
Cost/income ratio (percent)	59	= 59	At prior-year level

1 Assuming a Hard Brexit.

Braunschweig, February 8, 2019
The Board of Management

Lars Henner Santelmann

Dr. Mario Daberkow

Frank Fiedler

Christiane Hesse

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 have been made on the basis of the information available and which Volkswagen Financial Services AG currently considers to be realistic. The estimates given entail a degree of risk, and the actual developments may differ from those forecast. 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 the 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 2018 Annual Report develop differently to current expectations, or additional risks and opportunities or other factors emerge that affect the development of the business.

CONSOLIDATED FINANCIAL STATEMENTS

Income Statement

of the Volkswagen Financial Services AG Group

€ million	Note	Jan. 1 – Dec. 31, 2018	Jan. 1 – Dec. 31, 2017[1]	Change in percent
Interest income from lending transactions and marketable securities		1,967	1,981	−0.7
Income from leasing transactions		8,813	8,368	5.3
Depreciation, impairment losses and other expenses from leasing transactions		−7,978	−7,458	7.0
Net income from leasing transactions	19	835	910	−8.2
Interest expense	20	−1,070	−1,047	2.2
Income from service contracts		1,359	1,592	−14.6
Expenses from service contracts		−1,188	−1,499	−20.7
Net income from service contracts	21	170	93	82.8
Income from insurance transactions		308	287	7.3
Expenses from insurance transactions		−161	−169	−4.7
Net income from insurance business	22	148	118	25.4
Provision for credit risks	8, 23	−221	−491	−55.0
Fee and commission income		423	287	47.4
Fee and commission expenses		−203	−160	26.9
Net fee and commission income	24	220	128	71.9
Net gain or loss on hedges	8, 25	−12	–	X
Net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income	26	4	–	X
General and administrative expenses	27	−1,632	−1,645	−0.8
Other operating income		731	852	−14.2
Other operating expenses		−297	−290	2.4
Net other operating income/expenses	28	434	562	−22.8
Operating profit		**844**	**609**	**38.6**
Share of profits and losses of equity-accounted joint ventures		51	76	−32.9
Net gain or loss on miscellaneous financial assets	29	−76	−42	81.0
Other financial gains or losses	30	−1	−1	0.0
Profit before tax		**818**	**643**	**27.2**
Income tax expense	6, 31	−270	−122	X
Profit from continuing operations, net of tax		**548**	**520**	**5.4**
Profit from discontinued operations, net of tax[2]		–	384	−100.0
Profit after tax		**548**	**904**	**−39.4**
Profit after tax attributable to noncontrolling interests		0	0	0.0
Profit after tax attributable to Volkswagen AG		548	904	−39.4

1 Prior year adjusted as described in the disclosures relating to the changes to the presentation of the income statement in the section "Adjustment of prior-year figures".
2 Profit after tax of the operations discontinued on September 1, 2017 (European lending and deposits business).

Statement of Comprehensive Income

of the Volkswagen Financial Services AG Group

€ million	Note	Jan. 1 – Dec. 31, 2018	Jan. 1 – Dec. 31, 2017
Profit after tax		**548**	**904**
Pension plan remeasurements recognized in other comprehensive income	47		
Pension plan remeasurements recognized in other comprehensive income, before tax		8	38
Deferred taxes relating to pension plan remeasurements recognized in other comprehensive income	6, 31	–3	–11
Pension plan remeasurements recognized in other comprehensive income, net of tax		5	28
Fair value valuation of other participations and securities (equity instruments) that will not be reclassified to profit or loss, net of tax		–	–
Share of other comprehensive income of equity-accounted investments that will not be reclassified to profit or loss, net of tax		0	–1
Items that will not be reclassified to profit or loss		**5**	**27**
Exchange differences on translating foreign operations	4		
Gains/losses on currency translation recognized in other comprehensive income		–127	–365
Transferred to profit or loss		–	246
Exchange differences on translating foreign operations, before tax		–127	–119
Deferred taxes relating to exchange differences on translating foreign operations		–	–
Exchange differences on translating foreign operations, net of tax		–127	–119
Hedging	8		
Fair value changes recognized in other comprehensive income (OCI I)		10	–4
Transferred to profit or loss (OCI I)		–15	0
Cash flow hedges (OCI I), before tax		–5	–4
Deferred taxes relating to cash flow hedges (OCI I)	6, 31	1	1
Cash flow hedges (OCI I), net of tax		–4	–3
Fair value changes recognized in other comprehensive income (OCI II)		–	–
Transferred to profit or loss (OCI II)		–	–
Cash flow hedges (OCI II), before tax		–	–
Deferred taxes relating to cash flow hedges (OCI II)		–	–
Cash flow hedges (OCI II), net of tax		–	–
Fair value valuation of securities and receivables (debt instruments) that may be reclassified to profit or loss	8		
Fair value changes recognized in other comprehensive income		–2	–13
Transferred to profit or loss		1	–34
Fair value valuation of securities and receivables (debt instruments) that may be reclassified to profit or loss, before tax		–1	–47
Deferred taxes relating to fair value valuation of securities and receivables (debt instruments) recognized in other comprehensive income	6, 31	0	13
Fair value valuation of securities and receivables (debt instruments) that may be reclassified to profit or loss, net of tax		–1	–34
Share of other comprehensive income of equity-accounted investments that may be reclassified subsequently to profit or loss, net of tax		–25	–24
Items that may be reclassified to profit or loss		**–157**	**–181**
Other comprehensive income, before tax		–150	–157
Deferred taxes relating to other comprehensive income		–1	3
Other comprehensive income, net of tax		**–151**	**–154**
Total comprehensive income		**396**	**751**
Profit/loss after tax attributable to noncontrolling interests		0	0
Total comprehensive income attributable to Volkswagen AG		396	751

€ million	Jan. 1 – Dec. 31, 2017
Classification of total comprehensive income attributable to Volkswagen AG	
Continuing operations	248
Discontinued operations	503

Balance Sheet

of the Volkswagen Financial Services AG Group

€ million	Note	Dec. 31, 2018	Dec. 31, 2017	Change in percent
Assets				
Cash Reserve	7, 33	54	40	35.0
Loans to and receivables from banks	8	1,819	1,444	26.0
Loans to and receivables from customers attributable to				
Retail financing		16,676	16,269	2.5
Dealer financing		4,062	3,584	13.3
Leasing business		19,760	18,809	5.1
Other loans and receivables		18,514	11,143	66.1
Total loans to and receivables from customers	8, 34	59,012	49,804	18.5
Derivative financial instruments	8, 35	582	555	4.9
Marketable securities	8	290	257	12.8
Equity-accounted joint ventures	36	671	631	6.3
Miscellaneous financial assets	9, 36	404	373	8.3
Intangible assets	10, 37	64	59	8.5
Property and equipment	11, 38	295	265	11.3
Lease assets	13, 39	13,083	11,571	13.1
Investment property	13, 39	10	10	0.0
Deferred tax assets	6, 40	1,539	1,035	48.7
Current tax assets	6	122	137	−10.9
Other assets	41	2,517	2,772	−9.2
Total		**80,462**	**68,953**	**16.7**

€ million	Note	Dec. 31, 2018	Dec. 31, 2017	Change in percent
Equity and liabilities				
Liabilities to banks	14, 43	12,291	10,982	11.9
Liabilities to customers	14, 43	12,345	9,673	27.6
Notes, commercial paper issued	44, 45	41,029	32,453	26.4
Derivative financial instruments	8, 46	105	211	−50.2
Provisions for pensions and other post-employment benefits	15, 47	366	360	1.7
Underwriting provisions and other provisions	16, 17, 48	909	888	2.4
Deferred tax liabilities	6, 49	783	447	75.2
Current tax liabilities	6	420	348	20.7
Other liabilities	50	1,176	1,613	−27.1
Subordinated capital	45, 51	3,023	4,354	−30.6
Equity	53	8,016	7,624	5.1
Subscribed capital		441	441	X
Capital reserves		1,600	2,600	−38.5
Retained earnings		6,812	5,264	29.4
Other reserves		−839	−683	22.8
Equity attributable to noncontrolling interests		2	2	0.0
Total		**80,462**	**68,953**	**16.7**

Statement of Changes in Equity

of the Volkswagen Financial Services AG Group

				OTHER RESERVES						
					Hedging transactions					
€ million	Subscribed capital	Capital reserves	Retained earnings	Currency translation	Cash flow hedges (OCI I)	Deferred hedging costs (OCI II)	Equity and dept instruments	Equity-accounted investments	Noncontrolling interests	Total equity
Balance as of Jan. 1, 2017	**441**	**10,449**	**6,564**	**−514**	**10**	**–**	**36**	**−35**	**–**	**16,951**
Profit after tax	–	–	904	–	–	–	–	–	0	904
Other comprehensive income, net of tax	–	–	28	−119	−3	–	−34	−25	0	−154
Total comprehensive income	**–**	**–**	**932**	**−119**	**−3**	**–**	**−34**	**−25**	**0**	**751**
Capital increases	–	1,000	–	–	–	–	–	–	–	1,000
Loss assumed by Volkswagen AG	–	–	478	–	–	–	–	–	–	478
Non-cash assets distributed due to the derecognition of companies classified as discontinued operations	–	−8,849	−2,710	–	–	–	–	–	–	−11,559
Other changes	–	–	0	1	–	–	–	–	2	3
Balance as of Dec. 31, 2017	**441**	**2,600**	**5,264**	**−633**	**7**	**–**	**2**	**−59**	**2**	**7,624**
Balance before adjustment on Jan. 1, 2018	**441**	**2,600**	**5,264**	**−633**	**7**	**–**	**2**	**−59**	**2**	**7,624**
Change in accounting treatment as a result of IFRS 9	–	–	−152	–	–	–	0	–	0	−152
Balance as of Jan. 1, 2018	**441**	**2,600**	**5,112**	**−633**	**7**	**–**	**2**	**−59**	**2**	**7,472**
Profi after tax	–	–	547	–	–	–	–	–	0	548
Other comprehensive income, net of tax	–	–	5	−126	−4	–	−1	−25	0	−151
Total comprehensive income	**–**	**–**	**553**	**−126**	**−4**	**–**	**−1**	**−25**	**0**	**396**
Capital increases	–	0	–	–	–	–	–	–	–	0
Loss assumed by Volkswagen AG	–	–	149	–	–	–	–	–	–	149
Other changes[1]	–	−1,000	999	–	–	–	–	–	–	−1
Balance as of Dec. 31, 2018	**441**	**1,600**	**6,812**	**−759**	**3**	**–**	**1**	**−84**	**2**	**8,016**

1 The “Other changes” item includes an amount of €1 billion transferred from capital reserves to retained earnings; this resulted from an authorized repayment of capital reserves to Volkswagen AG. At the same time, an increase in the capital reserves of €1 billion was authorized by Volkswagen AG for June 30, 2019; this will offset the reduction in the capital reserves applied in the year under review. The “Other changes” item also reflects a reduction in equity resulting from the deconsolidation of Volkswagen-Versicherungsdienst GmbH, Vienna.

Further information on equity is presented in note (53).

Cash Flow Statement

of the Volkswagen Financial Services AG Group

€ million	Jan. 1 – Dec. 31, 2018	Jan. 1 – Dec. 31, 2017
Profit after tax	**548**	**904**
Depreciation, amortization, impairment losses and reversals of impairment losses	2,187	3,176
Change in provisions	46	100
Change in other noncash items	106	1,577
Loss on disposal of financial assets and items of property and equipment	−29	−511
Net interest expense and dividend income	−1,613	−1,640
Other adjustments	5	−4
Change in loans to and receivables from banks	−404	1,332
Change in loans to and receivables from customers	−10,131	−7,771
Change in lease assets	−3,668	−4,527
Change in other assets related to operating activities	212	−254
Change in liabilities to banks	1,466	2,261
Change in liabilities to customers	2,717	−2,310
Change in notes, commercial paper issued	8,756	6,216
Change in other liabilities related to operating activities	−430	321
Interest received	2,680	2,687
Dividends received	3	5
Interest paid	−1,070	−1,052
Income taxes paid	−314	−246
Cash flows from operating activities	**1,067**	**264**
Proceeds from disposal of investment property	–	–
Acquisition of investment property	–	–
Proceeds from disposal of subsidiaries and joint ventures[1]	32	−4,323
Acquisition of subsidiaries and joint ventures	−142	−109
Proceeds from disposal of other assets	6	4
Acquisition of other assets	−81	−81
Change in investments in marketable securities	−39	166
Cash flows from investing activities	**−224**	**−4,343**
Proceeds from changes in capital	0	1,000
Loss absorption by/profit transfer to Volkswagen AG	478	−130
Change in cash funds attributable to subordinated capital	−1,302	1,774
Cash flows from financing activities	**−824**	**2,644**
Cash and cash equivalents at end of prior period	**40**	**1,478**
Cash flows from operating activities	1,067	264
Cash flows from investing activities	−224	−4,343
Cash flows from financing activities	−824	2,644
Effect of exchange rate changes	−5	−3
Cash and cash equivalents at end of period	**54**	**40**

1 Prior year adjusted as a result of the derecognition of the cash and cash equivalents and net assets relating to the companies in the discontinued operations (European lending and deposits business) on the derecognition date (September 1, 2017).

Disclosures on the cash flow statement are presented in note (65).

Notes to the Consolidate Financial Statements

of the Volkswagen Financial Services AG Group as of December 31, 2018

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, 2018 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 315e(1) of the Handelsgesetzbuch (HGB – German Commercial Code). All IFRSs issued by the International Accounting Standards Board (IASB) up to December 31, 2018 for which mandatory application was required in fiscal year 2018 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 20 – 28. 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 8, 2019. This date marked the end of the period in which adjusting events after the reporting period were recognized.

Adjustment of Prior-Year Figures

The structure of the income statement prepared by the VW FS AG Group has been modified to increase transparency in the reporting of the Group's performance as part of voluntary changes to accounting policies. Key elements are the introduction of a subtotal for operating profit/loss, the presentation of income and expenses from service business as separate items in the income statement and, as part of the implementation of IFRS 9, the reporting of gains and losses from the measurement of financial instruments in the new income statement items "Net gain or loss on hedges" and "Net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income".

The following table shows a reconciliation of the prior-year comparative figures from the previous presentation of the income statement to the new presentation, broken down by reconciliation columns according to the reason for the change.

Previous presentation	Jan. 1 – Dec. 31, 2017 before adjustment	ADJUSTMENT OF THE PRESENTATION FOR: Reversal of provisions	Service contracts	Other adjustments	Jan. 1 – Dec. 31, 2017 restated	Amended presentation
Interest income from lending transactions	1,987	–	–	−6	1,981	Interest income from lending transactions and marketable securities
Income from leasing transactions and service contracts	9,961	–	−1,592	–	8,368	Income from leasing transactions
Expenses from leasing transactions and service contracts	−6,940	78	−596	–	−7,458	Depreciation, impairment losses and other expenses from leasing transactions
Depreciation of and impairment losses on lease assets and investment property	−2,095	–	2,095	–	–	
Net income from leasing transactions before provision for credit risks	926	78	−93	–	910	Net income from leasing transactions
Interest expense	−1,052	–	–	5	−1,047	Interest expense
	–	–	1,592	–	1,592	Income from service contracts
	–	–	−1,499	–	−1,499	Expenses from service contracts
	–	–	93	–	93	Net income from service contracts
Income from insurance transactions	287	–	–	–	287	Income from insurance transactions
Expenses from insurance transactions	−169	–	–	–	−169	Expenses from insurance transactions
Net income from insurance business	118	–	–	–	118	Net income from insurance business
Net income from lending, leasing and insurance transactions before provision for credit risks	1,979	–	–	–	–	
Provision for credit risks from lending and leasing business	−491	–	–	–	−491	Provision for credit risks
Net income from lending, leasing and insurance transactions after provision for credit risks	1,488	–	–	–	–	
Fee and commission income	287	–	–	–	287	Fee and commission income
Fee and commission expenses	−161	1	–	–	−160	Fee and commission expenses
Net fee and commission income	127	1	–	–	128	Net fee and commission income
Net gain/loss on the measurement of derivative financial instruments and hedged items	11	–	–	−11	–	
	–	–	–	–	–	Net gain or loss on hedges
	–	–	–	–	–	Net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income
Share of profits and losses of equity-accounted joint ventures	76	–	–	−76	–	
Net gain/loss on marketable securities and miscellaneous financial assets	−42	–	–	42	–	
General and administrative expenses	−1,682	29	–	7	−1,645	General and administrative expenses
Other operating income	972	−108	–	−11	852	Other operating income
Other operating expenses	−308	–	–	17	−290	Other operating expenses
Net other operating income/expenses	664	−108	–	6	562	Net other operating income/expenses
					609	**Operating profit/loss**

Previous presentation	Jan. 1 – Dec. 31, 2017 before adjustment	ADJUSTMENT OF THE PRESENTATION FOR: Reversal of provisions	Service contracts	Other adjustments	Jan. 1 – Dec. 31, 2017 restated	Amended presentation
	–	–	–	76	76	Share of profits and losses of equity-accounted joint ventures
	–	–	–	−42	−42	Net gain or loss on miscellaneous financial assets
	–	–	–	−1	−1	Other financial gains or losses
Profit/loss before tax	**643**	**–**	**–**	**–**	**643**	**Profit/loss before tax**
Income tax expense	−122	–	–	–	−122	Income tax expense
Profit/loss from continuing operations, net of tax	**520**	**–**	**–**	**–**	**520**	**Profit/loss from continuing operations, net of tax**
Profit/loss from discontinued operations, net of tax	384	–	–	–	384	Profit/loss from discontinued operations, net of tax
Profit/loss after tax	**904**	**–**	**–**	**–**	**904**	**Profit/loss after tax**
			–	–	0	Profit/loss after tax attributable to noncontrolling interests
Profit/loss after tax attributable to Volkswagen AG	904	–	–	–	904	Profit/loss after tax attributable to Volkswagen AG

The basis of the changes to the presentation of the income statement is described in the table below.

Basis for reconciliation column	Description
Reversal of provisions	Implementation of a voluntary change in accounting policy as permitted by IAS 8.14b) to improve the presentation of income from the reversal of provisions and accrued liabilities. Up to fiscal year 2018, income from the reversal of provisions and of accrued liabilities was only recognized under other operating income. From fiscal year 2018, some of the income from the reversal of provisions and of accrued liabilities is allocated to “Depreciation, impairment losses and other expenses from leasing transactions”, “Fee and commission expenses” and “General and administrative expenses” on the income statement, in which the associated provisions were recognized in previous fiscal years. The reclassification of income from the reversal of provisions and accrued liabilities improves the presentation of the income statement for the VW FS AG Group. The prior-year figures have been restated accordingly.
Service contracts	Implementation of a voluntary change in accounting policy as permitted by IAS 8.14b) to improve the presentation of the net income/expense from service contracts. a) Net income/expense from service contracts was previously included in the income statement under net income from leasing transactions before provision for credit risks. As service contracts do not arise solely in connection with leases, the associated income/expense is now presented separately under “Income from service contracts” and “Expenses from service contracts”. b) As a consequence of separating out the net income/expense from service contracts, the expenses from leasing transactions previously reported under expenses from leasing transactions and service contracts can now be combined with depreciation of and impairment losses on lease assets and investment property in a new income statement item referred to as “Depreciation, impairment losses and other expenses from leasing transactions”, thereby improving the presentation of the net income from leasing transactions in the same way as the other net income items on the face of the income statement.
Other adjustments	Implementation of a voluntary change in accounting policy as permitted by IAS 8.14b) to improve the presentation of the net income/loss from operating activities as a subtotal referred to as “Operating profit/loss”. Net income/expenses and net gains/losses that are not allocated to operating profit/loss or the existing “Share of profits and losses of equity-accounted joint ventures” or “Net gain or loss on miscellaneous financial assets” line items have been recognized under the new “Other financial gains or losses” item.

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 2018.

Since January 1, 2018, there has been a requirement to apply amendments to IAS 40 Investment Property, which clarify when a property falls within the scope, or no longer falls within the scope, of IAS 40.

It has also been necessary to apply amendments to IFRS 1 and IAS 28 introduced by the International Accounting Standards Board under its Annual Improvements – 2014–2016 Cycle. The short-term exemptions in IFRS 1 First-time Adoption of International Financial Reporting Standards available to entities applying IFRSs for the first time have been deleted. IAS 28 Investments in Associates and Joint Ventures now includes a clarification for investment entities.

IFRS 2 Share-based Payment has also been amended. The classification and measurement of transactions involving share-based payment are clarified in these amendments.

In addition, amendments to IFRS 4 Insurance Contracts had to be applied from January 1, 2018. These amendments reduce the impact from the different initial application dates specified for IFRS 9 and IFRS 17.

IFRIC 22 Foreign Currency Transactions and Advance Consideration now also applies. This clarifies which exchange rates are to be used in foreign currency transactions involving advance payments.

The provisions mentioned above and the other amended provisions do not materially affect the VW FS AG Group's financial position and financial performance.

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.

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 procedure for classifying and measuring financial liabilities under IFRS 9 is largely unchanged compared with the current accounting requirements under 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. The change in the measurement methodology to an expected loss model described above leads to an increase in the provision for credit risks. This increase in the provisions for credit risks results firstly from the requirement to recognize a provision for credit risks for performing financial assets that have not been affected by a significant increase in credit risk since initial recognition. Secondly, the increase arises from the requirement to recognize a provision for credit risks on the basis of the total expected time to maturity for financial assets that have been affected by a significant increase in credit risk since initial recognition.

As regards hedge accounting, IFRS 9 introduces wider designation options and the need to implement more complex recognition and measurement logic. IFRS 9 also removes the quantitative limits for the effectiveness test.

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

The following tables show the main effects of the new accounting requirements under IFRS 9 concerning the classification and measurement of financial assets and the impairment of financial assets.

Within the “Derivative financial instruments designated as hedges” class, there have been no reclassifications to or from other classes as a consequence of IFRS 9.

CHANGES IN BALANCE SHEET CARRYING AMOUNTS AS OF JANUARY 1, 2018 AS A RESULT OF IFRS 9

€ million	DEC. 31, 2017 Before adjustments	Adjustments	JAN. 1, 2018 After adjustments
Assets			
Cash reserve	40	–	40
Loans to and receivables from banks	1,444	−1	1,443
Loans to and receivables from customers attributable to			
Retail financing	16,269	−5	16,264
Dealer financing	3,584	−6	3,577
Leasing business	18,809	−157	18,652
Other loans and receivables	11,143	−27	11,116
Total loans to and receivables from customers	49,804	−194	49,610
Derivative financial instruments	555	–	555
Marketable securities	257	0	257
Equity-accounted joint ventures	631	−7	625
Miscellaneous financial assets	373	–	373
Deferred tax assets	1,035	47	1,082
Current tax assets	137	–	137
Other assets	2,772	−6	2,765
Equity and liabilities			
Liabilities to banks	10,982	–	10,982
Liabilities to customers	9,673	–	9,673
Notes, commercial paper issued	32,453	–	32,453
Derivative financial instruments	211	–	211
Deferred tax liabilities	447	−15	432
Current tax liabilities	348	–	348
Other liabilities	1,613	4	1,617
Subordinated capital	4,354	–	4,354
Equity	7,624	−151	7,473
Retained earnings	5,264	−151	5,113

In addition to the adjustments set out in the table, the revised requirements relating to the recognition of the provision for credit risks also had an impact on the measurement of lease assets. The effect of the adjustment on the carrying amount of lease assets amounted to €1 million. This initial application effect has been recognized in other comprehensive income after taking into account deferred taxes.

FINANCIAL ASSETS AND FINANCIAL LIABILITIES MEASURED AT FAIR VALUE CLASS: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

		RECLASSIFICATIONS		
	Measured at fair value, IAS 39	From measured at amortized cost	To measured at amortized cost	Measured at fair value, IFRS 9
€ million	Carrying amount Dec. 31, 2017	Fair value Dec. 31, 2017	Fair value Dec. 31, 2017	Carrying amount Jan. 1, 2018
Assets				
Cash reserve	–	–	–	–
Loans to and receivables from banks	–	–	–	–
Loans to and receivables from customers	–	495	–	495
Derivative financial instruments	62	–	–	62
Marketable securities	257	–	–	257
Equity-accounted joint ventures	–	–	–	–
Miscellaneous financial assets	0	–	–	0
Current tax assets	–	–	–	–
Other assets	–	–	–	–
Total	**319**	**495**	**–**	**814**
Equity and liabilities				
Liabilities to banks	–	–	–	–
Liabilities to customers	–	–	–	–
Notes, commercial paper issued	–	–	–	–
Derivative financial instruments	77	–	–	77
Current tax liabilities	–	–	–	–
Other liabilities	–	–	–	–
Subordinated capital	–	–	–	–
Total	**77**	**–**	**–**	**77**

FINANCIAL ASSETS AND FINANCIAL LIABILITIES MEASURED AT AMORTIZED COST CLASS: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

	Measured at amortized cost IAS 39		RECLASSIFICATIONS From measured at fair value				To measured at fair value		Measured at amortized cost IFRS 9	
€ million	Carrying amount Dec. 31, 2017	Fair value Dec. 31, 2017	Fair value Dec. 31, 2017	Carrying amount adjustment Jan. 1, 2018	Provision for credit risks adjustment Jan. 1, 2018	Carrying amount Jan. 1, 2018	Carrying amount Dec. 31, 2017	Fair value Dec. 31, 2017	**Carrying amount Jan. 1, 2018**	**Fair value Jan. 1, 2018**
Assets										
Cash reserve	40	40	–	–	–	–	–	–	40	40
Loans to and receivables from banks	1,444	1,444	–	–	–	–	–	–	1,444	1,444
Loans to and receivables from customers	49,804	49,893	–	–	–	–	499	495	49,306	49,397
Derivative financial instruments	–	–	–	–	–	–	–	–	–	–
Marketable securities	–	–	–	–	–	–	–	–	–	–
Equity-accounted joint ventures	–	–	–	–	–	–	–	–	–	–
Miscellaneous financial assets	–	–	–	–	–	–	–	–	–	–
Current tax assets	50	50	–	–	–	–	–	–	50	50
Other assets	1,034	1,034	–	–	–	–	–	–	1,034	1,034
Total	**52,373**	**52,462**	**–**	**–**	**–**	**–**	**499**	**495**	**51,874**	**51,966**
Equity and liabilities										
Liabilities to banks	10,982	11,013	–	–	–	–	–	–	10,982	11,013
Liabilities to customers	9,673	9,703	–	–	–	–	–	–	9,673	9,703
Notes, commercial paper issued	32,453	32,453	–	–	–	–	–	–	32,453	32,453
Derivative financial instruments	–	–	–	–	–	–	–	–	–	–
Current tax liabilities	40	40	–	–	–	–	–	–	40	40
Other liabilities	672	675	–	–	–	–	–	–	672	675
Subordinated capital	4,354	3,685	–	–	–	–	–	–	4,354	3,685
Total	**58,173**	**57,570**	**–**	**–**	**–**	**–**	**–**	**–**	**58,173**	**57,570**

PROVISION FOR CREDIT RISKS ON FINANCIAL ASSETS: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

€ million	From financial assets measured at fair value through OCI, IAS 39	From financial assets measured at amortized cost, IAS 39	No measurement category under IAS 39	Total
To financial assets measured at fair value through profit or loss, IFRS 9				
Dec. 31, 2017	–	3	–	3
Adjustments	–	−3	–	−3
Jan. 1, 2018	–	–	–	–
To financial assets measured at fair value through other comprehensive income, IFRS 9 (equity instruments)				
Dec. 31, 2017	–	–	–	–
Adjustments	–	–	–	–
Jan. 1, 2018	–	–	–	–
To financial assets measured at fair value through other comprehensive income, IFRS 9 (debt instruments)				
Dec. 31, 2017	–	–	–	–
Adjustments	0	–	–	0
Jan. 1, 2018	0	–	–	0
To financial assets measured at amortized cost, IFRS 9				
Dec. 31, 2017	–	1,241	–	1,241
Adjustments	–	95	–	95
Jan. 1, 2018	–	1,337	–	1,337
To lease receivables				
Dec. 31, 2017	–	–	561	561
Adjustments	–	–	157	157
Jan. 1, 2018	–	–	717	717
To credit commitments				
Dec. 31, 2017	–	–	–	–
Adjustments	–	–	4	4
Jan. 1, 2018	–	–	4	4
To financial guarantees				
Dec. 31, 2017	–	–	–	–
Adjustments	–	–	0	0
Jan. 1, 2018	–	–	0	0
Total as of Jan. 1, 2018	**0**	**1,337**	**721**	**2,058**

CARRYING AMOUNTS OF FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

€ million	Carrying amount IAS 39 Dec. 31, 2017	Reclassifications	IFRS 9 adjustments	IFRS 9 carrying amount Jan. 1, 2018	Change in retained earnings Jan. 1, 2018
Financial assets measured at fair value through profit or loss, IAS 39	**62**				
Additions					
Available-for-sale financial assets, IAS 39		29	–	29	–
Financial assets measured at amortized cost, IAS 39		499	–3	495	3
Deductions					
Financial assets measured at amortized cost, IFRS 9		–	–	–	–
Financial assets measured at fair value through other comprehensive income, IFRS 9		–	–	–	–
Financial assets measured at fair value through profit or loss, IFRS 9				**586**	

CARRYING AMOUNTS OF FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

€ million	Carrying amount IAS 39 Dec. 31, 2017	Reclassifications	IFRS 9 adjustments	IFRS 9 carrying amount Jan. 1, 2018	Change in retained earnings Jan. 1, 2018
Available-for-sale financial assets, IAS 39	**257**				
Additions					
Financial assets measured at amortized cost, IAS 39		–	–	–	–
Financial assets measured at fair value through profit or loss, IAS 39		–	–	–	–
Deductions					
Financial assets measured at amortized cost, IFRS 9		–	–	–	–
Financial assets measured at fair value through profit or loss, IFRS 9		29	–	29	–
Financial assets measured at fair value through other comprehensive income, IFRS 9				**228**	

CARRYING AMOUNTS OF FINANCIAL ASSETS MEASURED AT AMORTIZED COST: RECONCILIATION FROM IAS 39 TO IFRS 9 AS OF JANUARY 1, 2018

€ million	Carrying amount IAS 39 Dec. 31, 2017	Reclassifications	IFRS 9 adjustments	IFRS 9 carrying amount Jan. 1, 2018	Change in retained earnings Jan. 1, 2018
Financial assets measured at amortized cost, IAS 39	**33,548**				
Additions					
Available-for-sale financial assets, IAS 39		–	–	–	–
Financial assets measured at fair value through profit or loss, IAS 39		–	–	–	–
Deductions					
Financial assets measured at fair value through other comprehensive income, IFRS 9		–	–	–	–
Financial assets measured at fair value through profit or loss, IFRS 9		499	–	499	–
Financial assets measured at amortized cost, IFRS 9				**33,049**	

IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

IFRS 15 revises the financial reporting requirements for revenue recognition. There was no impact on the VW FS AG Group from the changeover as of January 1, 2018 because the previous procedures essentially already complied with the new regulations under IFRS 15.

New and Revised IFRSs Not Applied

VW FS AG has not applied in its 2018 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 2018.

Standard/interpretation		Published by the IASB	Application requirement[1]	Adopted by EU	Expected impact
IFRS 3	Business Combinations: Definition of a Business	October 22, 2018	January 1, 2020	No	No material impact
IFRS 9	Amendments to IFRS 9 – Financial Instruments: Prepayment Features with Negative Compensation	October 12, 2017	January 1, 2019	Yes	None
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 16	Leases	January 13, 2016	January 1, 2019	Yes	Detailed description following the table overview
IFRS 17	Insurance Contracts	May 18, 2017	January 1, 2021	No	Changes to presentation and measurement methods that, as a whole, do not have a material impact; extended disclosures in the notes
IFRS 1 and IAS 8	Presentation of Financial Statements and Accounting Policies, Changes in Accounting Estimates and Errors: Definition of Material	October 31, 2018	January 1, 2020	No	No material impact
IAS 19	Employee Benefits: Remeasurement on a Plan Amendment, Curtailment or Settlement	February 7, 2018	January 1, 2019	No	No material impact
IAS 28	Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures	October 12, 2017	January 1, 2019	No	None
	Improvements to International Financial Reporting Standards 2017[3]	December 12, 2017	January 1, 2019	No	No material impact
IFRIC 23	Uncertainty over Income Tax Treatments	June 7, 2017	January 1, 2019	Yes	No material impact

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)

IFRS 16 LEASES

IFRS 16 amends the provisions governing the accounting treatment of leases and supersedes the previously applicable IAS 17 and the associated interpretations.

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 must recognize both a right-of-use asset and a lease liability in their balance sheet. The lease liability is measured at the present value of the outstanding lease payments, whereby the lease payments are discounted using the lessee's incremental borrowing rate, whereas the right-of-use asset is generally measured at the amount of the lease liability plus any initial direct costs. 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. There are exemptions for short-term leases or those of low value. The VW FS AG Group will elect to make use of the exemptions available in IFRS 16 for these leases. In such cases, it will therefore continue to recognize the lease payments as an expense in the income statement rather than recognizing a right-of-use asset and lease liability in respect of the lease concerned.

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.

The VW FS AG Group will account for leases in accordance with the requirements of IFRS 16 from January 1, 2019 using the modified retrospective transition method. On the changeover date, the lease liability is measured at the value of the remaining lease payments, discounted to present value using the lessee's incremental borrowing rate. To simplify matters, the right-of-use assets are recognized at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments. As the amounts initially recognized for the right-of-use assets and lease liabilities will be virtually identical, the total assets (total equity and liabilities) are only expected to increase by a negligible amount (in the low three-digit million range). This is due in part to the application of the exemptions described above. No material impact on equity is anticipated.

In contrast to the current procedure, in which operating lease expenses are reported in full under general and administrative expenses, only the depreciation charge in respect of the right-of-use assets is posted in general and administrative expenses under IFRS 16. Interest expenses from unwinding the discount on lease liabilities are recognized under interest expenses. It is anticipated that these changes will give rise to a slight decrease in general and administrative expenses and a marginal increase in interest expenses in the income statement.

The change to the recognition of operating lease expenses is projected to have only a minor impact on the cash flow statement.

Moreover, there will be significantly more extensive disclosures in the notes.

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, 2018.

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 when amounts are added together.

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. 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. The purpose of the structured entities is to facilitate asset-backed-securities transactions to fund the financial services business.

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 or reversals of 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 made 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 or reversals of impairment losses.

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

	2018	2017[1]
VW FS AG and consolidated subsidiaries		
Germany	8	8
International	37	42
Subsidiaries recognized at cost		
Germany	8	7
International	39	35
Associates, equity-accounted joint ventures		
Germany	2	2
International	7	7
Associates, joint ventures and equity investments recognized at cost		
Germany	4	3
International	7	6
Total	**112**	**110**

1 The presentation of the prior year has been adjusted in connection with a corresponding adjustment to the shareholdings as of December 31, 2018. Following a change to the counting method, subsidiaries of joint ventures are no longer treated as separate entities in the categories “Associates, equity-accounted joint ventures” and “Associates, joint ventures and equity investments recognized at cost”.

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/listofholdings2018.

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 Volkswagen Immobilien Vermietgesellschaft für VW-/Audi-Händlerbetriebe mbH, Braunschweig
> Volkswagen-Versicherungsdienst GmbH, Braunschweig
> Volkswagen Insurance Brokers GmbH, Braunschweig
> MAN Financial Services GmbH, Munich
> EURO-Leasing GmbH, Sittensen

SUBSIDIARIES

The following significant changes occurred at subsidiaries in the reporting period.

Effective March 1, 2018, Volkswagen-Versicherungsdienst GmbH, Braunschweig, sold 85% of the shares in its subsidiary Volkswagen-Versicherungsdienst GmbH, Vienna, to Porsche Bank AG, Salzburg. On the same date, Volkswagen-Versicherungsdienst GmbH, Vienna, ceased to be fully consolidated in the VW FS AG Group because of the associated loss of control. The end of full consolidation and remeasurement of the remaining shares at fair value gave rise to an income of €29 million, which has been reported under other operating income. The remaining 15% shareholding is reported under miscellaneous financial assets as an associate and, for reasons of materiality, is included in the consolidated financial statements at cost.

In March 2018, Volkswagen Financial Services AG acquired a 60% interest in the Portuguese company Softbridge - Projectos Tecnológicos S.A., Porto Salvo and its subsidiary VTXRM - Software Factory Lda., Porto Salvo. For reasons of materiality, neither of these two companies is fully consolidated.

In May 2018, Volkswagen Financial Services AG acquired 100% of the shares in a shelf company in Greece, and subsequently renamed this company Volkswagen Financial Services Hellas A.E. Volkswagen Financial Services France S.A.S., Roissy-en-France was established in August 2018 as a wholly owned subsidiary. In September 2018, Volkswagen Financial Services AG took over all the shares in Volkswagen Financial Services Ireland Ltd., Dublin, from Volkswagen Bank GmbH, Braunschweig. For reasons of materiality, all three companies are included at cost as subsidiaries.

In May 2018, the 51% equity investment in Volkswagen Insurance Service (Great Britain) Ltd., Milton Keynes was sold to Volkswagen Financial Services (UK) Ltd., Milton Keynes, a wholly owned subsidiary of Volkswagen Bank GmbH, Braunschweig.

The changes described above did not have a material 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 leasing and insurance products for Volkswagen Group vehicles to business and private customers in the Netherlands. VW FS 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:

	VOLKSWAGEN PON FINANCIAL SERVICES B.V. (NETHERLANDS)		VOLKSWAGEN D'IETEREN FINANCE S.A. (BELGIUM)		VOLKSWAGEN MØLLER BILFINANS A/S (NORWAY)	
€ million	2018	2017	2018	2017	2018	2017
Shareholding (percent)	60 %	60 %	50 %	50 %	51 %	51 %
Loans to and receivables from banks	7	3	0	0	2	1
Loans to and receivables from customers	844	198	1,628	1,348	1,973	1,809
Lease assets	1,466	1,204	540	498	–	–
Other assets	280	173	116	44	11	23
Total	**2,598**	**1,578**	**2,284**	**1,890**	**1,986**	**1,833**
of which: noncurrent assets	2,214	1,185	1,354	1,172	1,624	1,585
of which: current assets	384	393	931	718	363	248
of which: cash	7	3	0	0	2	1
Liabilities to banks	0	0	2,002	1,651	1,571	1,488
Liabilities to customers	1,768	735	114	88	57	51
Notes, commercial paper issued	575	454	–	–	–	–
Other liabilities	83	239	15	15	56	52
Equity	173	150	153	135	302	241
Total	**2,598**	**1,578**	**2,284**	**1,890**	**1,986**	**1,833**
of which: noncurrent liabilities	1,463	941	1,014	634	1,002	906
of which: current liabilities	962	487	1,117	1,120	682	685
of which: noncurrent financial liabilities	1,461	941	1,005	625	924	831
of which: current financial liabilities	881	450	997	1,026	647	657
Revenue	773	677	569	369	96	86
of which: interest income	67	48	31	26	93	84
Expenses	738	670	539	352	63	55
of which: interest expense	11	13	6	8	27	22
of which: depreciation and amortization	315	270	106	91	1	0
Profit/loss from continuing operations, before tax	**35**	**8**	**30**	**17**	**33**	**30**
Income tax expense or income	10	2	10	6	6	5
Profit/loss from continuing operations, net of tax	**25**	**6**	**20**	**11**	**27**	**26**
Profit/loss from discontinued operations, net of tax	–	16	–	–	–	–
Other comprehensive income, net of tax	0	0	0	–2	–	–
Total comprehensive income	**25**	**23**	**20**	**9**	**27**	**26**
Dividends received	–	7	–	–	–	–

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)
2017			
Equity of the joint venture as of Jan. 1, 2017	292	126	218
Profit/loss	22	11	26
Other comprehensive income	0	–2	–
Change in share capital	–	–	16
Change due to demerger of companies	–153	–	–
Exchange differences on translating foreign operations	–	–	–19
Dividends	12	–	–
Equity of the joint venture as of Dec. 31, 2017	**150**	**135**	**241**
Share of equity	90	68	123
Goodwill	41	–	–
Carrying amount of the share of equity as of Dec. 31, 2017	**131**	**68**	**123**
2018			
Equity of the joint venture as of Jan. 1, 2018[1]	147	133	238
Profit/loss	25	20	27
Other comprehensive income	0	0	–
Change in share capital	–	–	41
Exchange differences on translating foreign operations	–	–	–4
Dividends	–	–	–
Equity of the joint venture as of Dec. 31, 2018	**173**	**153**	**302**
Share of equity	401	77	154
Goodwill	41	–	–
Carrying amount of the share of equity as of Dec. 31, 2018	**144**	**77**	**154**

1 As a consequence of the impact from the new IFRS 9 accounting requirements on financial assets in equity-accounted joint ventures, there is a difference between the carrying amounts as of December 31, 2017 and the carrying amounts as of January 1, 2018.

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

€ million	2018	2017
Carrying amount of the share of equity as of Dec. 31	**296**	**310**
Profit/loss from continuing operations, net of tax	10	44
Profit/loss from discontinued operations, net of tax	–	6
Other comprehensive income, net of tax	–1	0
Total comprehensive income	**9**	**50**

In November 2018, the Volkswagen Pon Financial Services B.V. Group acquired the 60% equity investment held by Volkswagen-Versicherungsdienst GmbH in VVS Verzekerings-Service N.V., Amersfoort, and since then has accounted for this company according to the equity method.

October 2018 saw the establishment of Volkswagen Losch Financial Services S.A., Luxembourg, in which Volkswagen Financial Services AG holds a 60% interest. The company is accounted for 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 €268 million (previous year: €229 million) was pledged as collateral in connection with ABS transactions and was therefore not available to the VW FS AG Group.

Financial guarantees to joint ventures amounted to €146 million (previous year: €82 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 identified assets less 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 net value of the identified 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.

In the consolidation, the recognition and measurement arising from the independence of the individual companies is adjusted such that they are then presented as if they belonged to a single economic unit. Loans/receivables, liabilities, income and expenses relating to business relationships between consolidated entities are eliminated in the consolidation. Intragroup transactions are conducted on an arm's-length basis. Any resulting intercompany profits or losses are eliminated. 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.

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 which form 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 € =	2018	2017	2018	2017
Australia	AUD	1.62240	1.53285	1.58021	1.47300
Brazil	BRL	4.44485	3.97065	4.30729	3.60471
Denmark	DKK	7.46705	7.44510	7.45304	7.43871
United Kingdom	GBP	0.89690	0.88730	0.88476	0.87626
India	INR	79.90650	76.56700	80.71466	73.50146
Japan	JPY	125.91000	134.87000	130.40158	126.66763
Mexico	MXN	22.52035	23.61420	22.71496	21.33175
Poland	PLN	4.29780	4.17490	4.26098	4.25727
Republic of Korea	KRW	1,276.90000	1,278.22000	1,299.41384	1,275.94974
Russia	RUB	79.83765	69.33520	74.08214	65.88875
Sweden	SEK	10.25070	9.83140	10.25830	9.63700
Czech Republic	CZK	25.72450	25.57900	25.64308	26.32920
People's Republic of China	CNY	7.87725	7.80085	7.80766	7.62688

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 activities is included in the interest income from lending and securities transactions; leasing income is reported under income from leasing transactions. Expenses relating to the funding of financing and leasing transactions are reported in interest expenses. 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.

In the case of service contracts, such as maintenance or inspection agreements, revenue is recognized on either a percentage-of-completion or straight-line basis, depending on the type of service performed. Percentage of completion is normally calculated by considering the services provided up to the reporting date as a proportion of the total anticipated services (output-based). If the customer pays for services in advance, the Group recognizes a corresponding contractual liability until the relevant service is performed.

Net fee and commission income includes income and expenses from insurance brokerage as well as fees and commissions from the financing and financial services businesses. Fee and commission income from insurance brokerage is normally recognized in accordance with contractual arrangements when the entitlement arises, i.e. when the policyholder pays the related premium.

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.

Significant items reported within net other operating income are income arising from the allocation of costs to other entities in the Volkswagen Group and income from the reversal of provisions recognized in previous years within net other operating income.

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. Financial Instruments

Financial instruments are contracts that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

In the case of regular way purchases or sales, financial instruments are normally recognized on the settlement date, i.e. the date on which the asset is delivered.

Financial assets are classified and measured on the basis of the business model operated by an entity and the structure of its cash flows.

IFRS 9 breaks down financial assets into the following categories:
> financial assets measured at fair value through profit or loss,
> financial assets measured at fair value through other comprehensive income (debt instruments),
> financial assets measured at fair value through other comprehensive income (equity instruments), and
> financial assets measured at amortized cost.

Financial liabilities are classified using the following categories:
> financial liabilities measured at fair value through profit or loss, and
> financial liabilities measured at amortized cost.

In the VW FS AG Group, the categories shown above are allocated to the classes “financial assets and liabilities measured at amortized cost” and “financial assets and liabilities measured at fair value”.

The fair value option for financial assets and financial liabilities is not applied in the VW FS AG Group.

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.

Financial assets measured at amortized cost are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows. The contractual cash flows of these financial assets consist solely of payments of principal and interest on the principal amount outstanding, such that the cash flow criterion is satisfied.

Financial liabilities are measured at amortized cost unless these liabilities are derivatives. Note (14) Liabilities explains the accounting policies for financial liabilities measured at amortized cost.

The amortized cost of a financial asset or financial liability is the amount:

> at which the financial asset or financial liability is measured on initial recognition,
> minus any repayments of principal,
> adjusted, in the case of financial assets, for any recognized valuation allowances, impairment losses or uncollectibility and
> plus or minus the cumulative amortization of any difference between the initial amount and the maturity amount (premium, discount) using the effective interest method.

Financial assets (debt instruments) measured at fair value through other comprehensive income (with recycling) are held within a business model whose objective is to collect contractual cash flows and sell financial assets. The contractual cash flows of these financial assets consist solely of payments of principal and interest on the principal amount outstanding.

Changes in fair value that extend beyond the changes in the amortized cost of these financial assets are recognized in other comprehensive income (taking into account deferred taxes) until the financial asset concerned is derecognized. It is only at this point that the accumulated gains or losses are then recognized in profit or loss. The changes in amortized cost, such as impairment losses, interest determined in accordance with the effective interest method and foreign currency gains or losses, are immediately recognized in profit or loss.

Financial assets (debt instruments) for which the cash flow criterion is not satisfied, or that are managed within a business model that aims to sell these assets, are measured at fair value through profit or loss. The same applies to financial liabilities that are not measured at amortized cost.

Changes in the fair value are recognized in profit or loss.

In the VW FS AG Group, financial assets that represent an equity instrument are measured at fair value through other comprehensive income (without recycling) in exercise of the fair-value-through-OCI option unless they are held for trading purposes. The accumulated gains or losses from remeasurement are reclassified on derecognition to retained earnings and not to the income statement (i.e. they are not recycled through profit or loss).

To adjust the presentation of the income statement in line with standard practice in the market, the following items will be reported within operating profit or loss from the reporting period onward: net gain or loss on hedges, net gain or loss on financial instruments measured at fair value, and net gain or loss on the measurement of non-hedge foreign currency loans/receivables and liabilities, together with the net gains and losses on the corresponding hedged items. For this reason, there are no comparative prior-year figures within operating profit or loss for certain income statement line items (net gain or loss on hedges, net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income) or for some gains and losses from the measurement of foreign currency loans/receivables and liabilities under net other operating income/expense. The prior-year figures for the items referred to above are reported under the “Other financial gains or losses” income statement item.

Otherwise, the accounting policies for financial instruments in accordance with IAS 39, on which the prior-year comparative figures have been based, have not been changed. In this regard, please refer to the disclosures in the 2017 Annual Report.

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.

In individual cases, some loans to and receivables from customers are recognized at fair value through profit or loss because the cash flow criterion is not satisfied. Gains and losses arising from changes in fair value are recognized in profit or loss under net gain or loss on financial instruments measured at fair value.

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.

MARKETABLE SECURITIES

The "Marketable securities" balance sheet item largely comprises investments of resources in the form of fixed-income securities from public- and private-sector issuers as well as investment fund shares/units within the framework specified by the investment policy issued by Volkswagen Versicherung AG.

The fixed-income securities are allocated to the category of debt instruments measured at fair value through other comprehensive income. Valuation allowances for fixed-income securities are recognized in profit or loss under the "Provision for credit risks" line item. Interest determined in accordance with the effective interest method and effects from changes in exchange rates are also recognized in profit or loss. In addition, the differences between the amortized cost and fair value arising from the remeasurement of fixed-income securities are recognized in other comprehensive income, taking into account deferred taxes.

Shares/units in investment funds are allocated to the category of financial assets measured at fair value through profit or loss. Gains and losses arising from the remeasurement of shares/units in investment funds are recognized in profit or loss under gains and losses on financial instruments measured at fair value.

EQUITY INVESTMENTS

The equity investments included in the "Miscellaneous financial assets" balance sheet item are measured as equity instruments generally at fair value through other comprehensive income (without recycling) in exercise of the fair-value-through-OCI option. As the equity investments are strategic financial investments, this classification provides a more meaningful presentation of the investments.

If, in the case of non-material equity investments, there is no active market and fair values cannot be reliably determined without disproportionate time, effort and expense, such equity investments are accounted for at cost and reported under financial assets measured at fair value.

DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

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 (35) and (46).

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.

In the VW FS AG Group, entities enter into derivative transactions solely for hedging purposes as part of the management of interest rate and/or currency risk.

Derivatives are used as hedging instruments to hedge fair values or future cash flows (referred to as hedged items). Hedge accounting in accordance with IFRS 9 is only applied in the case of hedges that can be demonstrated to be effective, both on designation and continuously thereafter. The VW FS AG Group documents all relationships between hedging instruments and hedged items.

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 or loss on hedges. 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. Gains or losses arising from the ineffectiveness of fair value hedges are also recognized in gain or loss on hedges.

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.

The VW FS AG Group has not fully retained hedge accounting as provided for in IAS 39. Therefore, from the beginning of fiscal year 2018, only the provisions governing portfolio hedges under IAS 39 have been relevant in addition to the IFRS 9 provisions.

In the case of derivatives that are designated as hedges of future cash flows and that satisfy the relevant criteria, the designated effective portion of changes in the fair value of the derivative is recognized in other comprehensive income (OCI I). Effects on profit or loss under net gain or loss on hedges arise from the ineffective portion of hedges of changes in fair value as well as from the reclassification (on recognition of the hedged item) of changes in fair value previously recognized in other comprehensive income. The measurement of the hedged item remains unchanged.

Changes in the fair value of derivatives that do not satisfy the IFRS 9 criteria for hedge accounting are recognized in profit or loss under net gain or loss on financial instruments measured at fair value.

Derivatives not designated as hedging instruments are classified as financial assets or financial liabilities at fair value through profit or loss.

PROVISION FOR CREDIT RISKS

The provision for credit risks, which is recognized in accordance with the expected credit loss model specified by IFRS 9 and in accordance with uniform standards applied throughout the Group, encompasses all financial assets measured at amortized cost, financial assets in the form of debt instruments measured at fair value through other comprehensive income (with recycling), lease receivables that fall within the scope of IAS 17 and credit risks from off-balance-sheet irrevocable credit commitments and financial guarantees. The calculation of the provision for credit risks generally takes into account the exposure at default, the probability of default and the loss given default.

Financial assets are subject to credit risks, which are taken into account by recognizing valuation allowances in the amount of the expected loss; such valuation allowances are recognized for both financial assets with objective evidence of impairment and non-impaired financial assets. These allowances are posted to separate valuation allowance accounts.

The general approach is used for financial assets measured at amortized cost (with the exception of trade receivables), financial assets (debt instruments) whose changes in fair value are recognized in other comprehensive income and for irrevocable credit commitments and financial guarantees unless there is already objective evidence of impairment on initial recognition. Financial assets are broken down into three stages in the general approach. Stage 1 consists of financial assets that are being recognized for the first time or that have not demonstrated any significant increase in probability of default since initial recognition. In this stage, the model requires the calculation of an expected credit loss for the next twelve months. Stage 2 consists of financial assets for which the probability of default has increased significantly since initial recognition. Financial assets demonstrating objective indications of impairment are allocated to Stage 3. In Stages 2 and 3, an expected credit loss is calculated for the entire remaining maturity of the asset.

In the case of financial assets already impaired on initial recognition and classified as Stage 4 for the purposes of the disclosures, the provision for credit risks is recognized in subsequent measurement on the basis of the cumulative changes in the expected credit loss for the entire life of the asset concerned. Any financial instrument already classified as impaired on initial recognition remains in this stage until it is derecognized.

In the VW FS AG Group, the provision for credit risks relating to trade receivables and to operating and finance lease receivables accounted for in accordance with IAS 17 is uniformly determined using the simplified approach. In the simplified approach, an expected loss is calculated over the entire remaining maturity of the asset. The amount of the valuation allowance for trade receivables is calculated according to the amount by which the receivable is past due using a valuation allowance table (provision matrix).

Both historical information, such as average historical default probabilities for each portfolio, and forward-looking information is used to determine the measurement parameters for calculating the provision for credit risks. 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. In the case of significant individual impaired loans or receivables (e.g. dealer financing loans/receivables and fleet customer business loans/receivables), specific valuation allowances are recognized in the amount of the expected loss.

Impairment arises 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.

Reviews are regularly carried out to ensure that the valuation allowances are appropriate.

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 valuation allowances previously recognized are utilized. Income subsequently collected in connection with loans or receivables already written off is recognized in profit or loss.

Loans and receivables are reported in the balance sheet at the net carrying amount. The provision for credit risks relating to off-balance sheet irrevocable credit commitments and financial guarantees is recognized within other liabilities.

Disclosures relating to the provision for credit risks are presented separately in note (60).

9. Miscellaneous Financial Assets

Investments in subsidiaries that are not consolidated and other equity investments are reported as miscellaneous financial assets.

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 crises). Subsidiaries or joint ventures not consolidated for reasons of materiality do not fall within the scope of IFRS 9 and are therefore not included in the disclosures required by IFRS 7.

The accounting policies applicable to equity investments are set out in note (8) Financial Instruments.

10. Intangible Assets

Purchased intangible assets with finite useful lives are recognized at cost and amortized on a straight-line basis over their useful lives. These assets mainly consist of software, which is amortized over 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 12).

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 and margins. 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 6.8% (previous year: 7.5%). If necessary, the cost of equity rate is also adjusted using discount 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.).

11. 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 12).

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.

12. 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 fair value less 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.

13. 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 the substantial 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, the substantial 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, defined as fair value less costs to sell, 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. 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 depreciation, impairment losses and other expenses from leasing transactions. Lease payments received under subleases are reported as income from leasing business.

14. 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.

15. 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. In 2018, the total contributions made by the VW FS AG Group came to €37 million (previous year: €43 million). Contributions to the compulsory state pension system in Germany amounted to €33 million (previous year: €36 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. This means that 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 (47).

16. 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 profit-related and not-profit-related 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.

17. 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).

The share-based payment within other provisions consists of performance shares based on Volkswagen AG preferred shares. The commitments in relation to share-based payments are accounted for as cash-settled plans in accordance with IFRS 2. These cash-settled plans are measured during the term to maturity at fair value. This fair value is determined using a generally accepted valuation technique. The remuneration expense is treated as part of personnel expenses within general and administrative expenses and is allocated over the vesting period.

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.

Income from the reversal of other provisions is generally recognized in the income statement item or net income item in which the associated expense was recognized in previous fiscal years.

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 0.2% (previous year: 0.08%) has been used for the eurozone. The settlement amount also includes expected cost increases.

Any rights of recourse are not offset against provisions.

18. 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 is 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 experience combined with forward-looking parameters. Further information on determining valuation allowances can be found in the disclosures on the provision for credit risks (note 8).

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.

INCOME FROM SERVICE CONTRACTS

The calculation of contractual service rates in service contracts is subject to assumptions about expenses during the term of contracts; these assumptions are based on past experience. The parameters used in the calculation of contractual service rates are regularly reviewed. During the term of contracts, income from service contracts is recognized on the basis of expenses incurred, plus a margin derived from the contractual service rates.

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, 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, and employee turnover rates, 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

19. Net Income from Leasing Transactions

Income from leasing transactions includes rental income on investment property amounting to €1 million (previous year: €1 million). In both the reporting year and the previous year, income from leasing transactions only included negligible income from contingent payments under finance leases and did not include any income at all from contingent payments under operating leases.

In connection with assets leased as part of buyback transactions, payments of €401 million (previous year: €397 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 €216 million (previous year: €211 million) and are included in the depreciation, impairment losses and other expenses from leasing transactions. Impairment losses are based on continuously updated internal and external information, which is then fed into the forecasts of residual values for vehicles.

In the previous year, depreciation, impairment losses and other expenses from leasing transactions included impairment losses of €2 million recognized as a result of the impairment test on investment property.

Income from reversals of impairment losses on lease assets applied in prior years amounted to €42 million (previous year: €20 million) and is included in income from leasing business.

20. Interest Expense

Interest expenses include funding expenses for lending and leasing business. The net expense arising from interest income and expenses in the reporting period on derivatives not designated as hedging instruments amounts to €6 million (previous year: €14 million).

21. Net Income from Service Contracts

Of the total income recognized for service contracts, an amount of €1,064 million related to service contracts requiring the recognition of income at a specific time, and €295 million related to service contracts requiring the recognition of income over a period of time.

Of the income from service contracts recognized in the reporting period, income of €347 million had been included in the contractual liabilities for service contracts as of January 1, 2018.

22. Net Income from Insurance Business

The following table shows the net income from insurance business:

€ million	2018	2017
Insurance premiums earned	308	287
Insurance claims expenses	–113	–108
Reinsurance commissions and with-profits expenses	–48	–59
Other underwriting expenses	0	–2
Total	**148**	**118**

23. Provision for Credit Risks

The provision for credit risks relates to the following balance sheet items: loans to and receivables from banks, loans to and receivables from customers, marketable securities and other assets; in the context of the provision for credit risks in respect of credit commitments and financial guarantees, it also relates to the "Other liabilities" balance sheet item.

The breakdown of the amount recognized in the consolidated income statement is as follows:

€ million	2018	2017
Additions to provision for credit risks	–749	–684
Reversals of provision for credit risks	575	211
Direct write-offs	–86	–64
Income from loans and receivables previously written off	39	47
Net gain or loss from significant modifications	–	–
Total	**–221**	**–491**

Additional credit risks to which the VW FS AG Group is exposed as a result of the crises (economic crises, block on sales) in Russia, Brazil, India, Mexico and the Republic of Korea were accounted for in the reporting period by recognizing total expenses of €–8 million (previous year: expenses of €–155 million). The additions for Brazil, India, Mexico and the Republic of Korea were offset by reversals for Russia and Italy.

24. Net Fee and Commission Income

Net fee and commission income largely comprises income and expenses from insurance brokerage, together with fees and commissions from the financing business and financial services business. The breakdown is as follows:

€ million	2018	2017[1]
Fee and commission income	423	287
of which commissions from insurance broking	266	200
Fee and commission expenses	−203	−160
of which sales commission in the financing business	−138	−129
Total	**220**	**128**

1 Prior year adjusted as described in the disclosures on the adjustment of prior-year figures.

25. Net Gain or Loss on Hedges

The “Net gain or loss on hedges” item comprises gains and losses arising from the fair value measurement of hedging instruments and hedged items.

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

€ million	2018
Gains/losses on hedging instruments in fair value hedges	239
Gains/losses on hedged items in fair value hedges	−239
Gains/losses on the ineffective portion of hedging instruments in fair value hedges	−12
Gains/losses on the reclassification of cash flow hedge reserves	13
Gains/losses on the translation of foreign currency loans/receivables and liabilities in cash flow hedges	−13
Gains/losses on the ineffective portion of hedging instruments in cash flow hedges	0
Total	**−12**

As described in the disclosures on the adjustment of prior-year figures, these effects were included in other financial gains or losses in the previous year.

26. Net Gain or Loss on Financial Instruments Measured at Fair Value and on Derecognition of Financial Assets Measured at Fair Value through Other Comprehensive Income

The net gains or losses on derivatives not designated as hedging instruments, net gains or losses on marketable securities and loans/receivables measured at fair value through profit or loss and net gains or losses on derecognition of marketable securities measured at fair value through other comprehensive income are reported under this item. Gains and losses arising from changes in the fair value of derivatives that do not satisfy the IFRS 9 requirements for hedge accounting at micro level or the IAS 39 requirements for portfolio hedging are recognized under gains and losses on derivatives not designated as hedging instruments.

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

€ million	2018
Gains/losses on derivatives not designated as hedging instruments	4
Gains/losses on marketable securities measured at fair value through profit or loss	−1
Gains/losses on loans/receivables measured at fair value through profit or loss	2
Gains/losses on the derecognition of marketable securities measured at fair value through other comprehensive income	–
Total	**4**

As described in the disclosures on the adjustment of prior-year figures, effects from derivatives not designated as hedging instruments were included in other financial gains or losses in the previous year.

27. General and Administrative Expenses

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

€ million	2018	2017[1]
Personnel expenses	−744	−772
Non-staff operating expenses	−820	−803
Advertising, public relations and sales promotion expenses	−42	−26
Depreciation of and impairment losses on property and equipment, amortization of and impairment losses on intangible assets	−34	−62
Other taxes	−11	−12
Income from the reversal of provisions and accrued liabilities	20	29
Total	**−1,632**	**−1,645**

1 Prior year adjusted as described in the disclosures on the adjustment of prior-year figures.

The non-staff operating expenses include expenses of €30 million (previous year: €33 million) for leased assets under operating leases related in particular to land and buildings as well as office and operating equipment.

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

€ million	2018	2017
Financial statements audit services	2	2
Other attestation services	0	0
Tax consulting services	–	–
Other services	1	2
Total	**3**	**5**

The fee for financial statements audit services paid to the auditors in 2018 was mostly attributable to the audit of the consolidated financial statements of VW FS AG and of annual financial statements of German Group companies as well as to reviews of interim financial statements of German Group companies.

The other services performed by the independent auditors in the reporting period mainly consisted of issues relating to information technology and the General Data Protection Regulation.

28. Net Other Operating Income/Expenses

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

€ million	2018	2017[1]
Gains on the measurement of non-hedge foreign currency loans/receivables and liabilities	95	12
Income from cost allocations to other entities in the Volkswagen Group	421	495
Income from the reversal of provisions and accrued liabilities	73	123
Income from claims for damages	25	23
Income from the disposal of vehicles under loan agreements and finance leases	7	3
Income from non-significant modifications	8	–
Miscellaneous operating income	101	196
Losses on the measurement of non-hedge foreign currency loans/receivables and liabilities	–103	–15
Litigation and legal risk expenses	–95	–136
Expenses from the disposal of vehicles under loan agreements and finance leases	–9	–4
Expenses from non-significant modifications	–6	–
Other operating expenses	–84	–135
Total	**434**	**562**

1 Prior year adjusted as described in the disclosures on the adjustment of prior-year figures.

As described in the disclosures on the adjustment of prior-year figures, gains and losses on the measurement of non-hedge foreign currency loans/receivables and liabilities were included in other financial gains or losses in the previous year.

29. Net Gain or Loss on Miscellaneous Financial Assets

The net gain/loss on miscellaneous financial assets includes dividend income, income and expenses arising from profit or loss transfers, and net gains or losses arising from the recognition of impairment losses on shares in unconsolidated subsidiaries.

30. Other Financial Gains or Losses

Other financial gains or losses mainly consist of interest income and interest expenses in connection with tax-related issues, pensions and other provisions.

In the previous year, other financial gains or losses also included the following components:

€ million	2017
Gains/losses on hedging instruments in fair value hedges and cash flow hedges	–153
Gains/losses on hedged items in fair value hedges	163
Ineffective portion of hedging instruments in cash flow hedges	0
Gains/losses on the measurement of foreign currency loans/receivables and liabilities	9
Gains/losses on derivatives not designated as hedging instruments	–8
Total	**11**

For the reporting period, the gains/losses on hedging instruments in fair value hedges and cash flow hedges, the gains/losses on hedged items in fair value hedges, and the ineffective portion of hedging instruments in cash flow hedges are reported in the new income statement item “Net gain or loss on hedges”.

For the reporting period, the gains/losses on the measurement of foreign currency loans/receivables and liabilities, to the extent that they relate to foreign currency gains/losses on hedged items in cash flow hedges, are reported in the new income statement item “Net gain or loss on hedges”; in all other cases, they are included in other operating income or other operating expenses.

For the reporting period, the gains/losses on derivatives not designated as hedging instruments are reported in the new income statement item “Net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income”.

31. 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	2018	2017
Current tax income/expense, Germany	–141	81
Current tax expense, foreign	–269	–288
Current income tax expense	**–410**	**–206**
of which income (+)/expense (–) related to prior periods	(4)	(49)
Deferred tax income (+)/expense (–), Germany	60	–96
Deferred tax income (+)/expense (–), foreign	80	180
Deferred tax income (+)/expense (–)	**140**	**84**
Income tax expense	**–270**	**–122**

The reported tax expense in 2018 of €270 million (previous year: €122 million) is €25 million higher (previous year: €70 million lower) than the expected tax expense of €245 million (previous year: €192 million) calculated by applying the tax rate of 29.9% (previous year: 29.9%) 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	2018	2017
Profit/loss before tax	**818**	**643**
multiplied by the domestic income tax rate of 29.9% (previous year: 29.9%)		
= Imputed income tax expense in the reporting period at the domestic income tax rate	**−245**	**−192**
+ Effects from tax credits	0	0
+ Effects from domestic/foreign tax rates	14	9
+ Effects from changes in tax rates	−36	−1
+ Effects from permanent differences	−8	−13
+ Effects from tax-exempt income	44	48
+ Effects from loss carryforwards	−1	2
+ Effects from non-deductible operating expenses	−29	−14
+ Taxes attributable to prior periods	5	50
+ Other variances	−14	−11
= Current income tax expense	**−270**	**−122**

The statutory corporation tax rate in Germany for the 2018 assessment period was 15%. Including trade tax and the solidarity surcharge, this resulted in an aggregate tax rate of 29.86%.

In the German tax group, a tax rate of 29.8% (previous year: 29.9%) 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 19.0% and 40.0% (previous year: 19.0% and 45.0%).

As of December 31, 2018, there were unused tax loss carryforwards of €112 million (previous year: €99 million) for which deferred tax assets of €13 million (previous year: €10 million) had been recognized. Of these unused tax loss carryforwards, an amount of €97 million (previous year: €80 million) is deemed usable indefinitely. There were also tax loss carryforwards amounting to €15 million (previous year: €12 million) that must be used within the next five years. In the previous year, there were tax loss carryforwards amounting to €6 million that had to be used within five to ten years.

No deferred tax assets have been recognized in respect of certain tax loss carryforwards deemed to be unusable and amounting to €63 million (previous year: €62 million). Of these tax loss carryforwards that the Group is unable to use, €1 million could have been used subject to limitations within a period of up to five years and €62 million (previous year: €56 million) without any time restriction. In the previous year, there were also unusable tax loss carryforwards amounting to €6 million that could have been used subject to limitations within a period of up to ten years.

The tax credits granted by various countries led to the recognition of a tax benefit in an amount of €0.4 million (previous year: €0.2 million).

The benefit arising from previously unrecognized tax credits used to reduce current tax expense in the current fiscal year amounts to €1 million. In the previous year, the benefit arising from previously unrecognized temporary differences of prior periods used to reduce current tax expense amounted to €2 million and the benefit arising from previously unrecognized tax losses used to reduce current tax expense amounted to €0.3 million. In the previous year, deferred tax income from the reversal of an impairment loss on a deferred tax asset amounted to €1 million.

Changes in tax rates in 2018 have given rise to deferred tax expenses throughout the Group of €36 million (previous year: €0.6 million).

The Group has recognized deferred tax assets of €50 million (previous year: €157 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 or in the prior period.

In accordance with IAS 12.39, deferred tax liabilities of €28 million (previous year: €28 million) have not been recognized for temporary differences and undistributed profits of subsidiaries because VW FS AG has the relevant control.

Of the deferred taxes recognized in the balance sheet, an amount of €64 million (previous year: €66 million) relates to transactions reported in other comprehensive income. Within this figure, an amount of €67 million (previous year: €70 million) relates to actuarial gains or losses (IAS 19), €–2 million (previous year: €–3 million) to derivative financial instruments and €–0.3 million (previous year: €–0.7 million) to the fair value measurement of marketable securities.

32. 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	2018	2017
Income from fees and commissions	51	57
Expenses from fees and commissions	0	0
Total	**51**	**57**

Balance Sheet Disclosures

33. Cash Reserve

The cash reserve includes credit balances of €54 million (previous year: €40 million) held with foreign central banks.

34. Loans to and Receivables from Customers

The "Loans to and receivables from customers" item includes deductions arising from the provision for credit risks recognized to cover the expected credit risk. The provision for credit risks is presented in note (60).

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 and receivables from leasing transactions with a buyback agreement.

Some of the fixed-income exposures under 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 IFRS 9 in conjunction with IAS 32.

The reconciliation to the balance sheet values is as follows:

€ million	Dec. 31, 2018	Dec. 31, 2017
Loans to and receivables from customers	**59,012**	**49,804**
Fair value adjustment from portfolio hedging	–10	–9
Loans to and receivables from customers, net of fair value adjustment from portfolio hedging	59,022	49,813

Receivables from leasing transactions include due receivables amounting to €371 million (previous year: €257 million).

As of the reporting date, receivables from operating leases amounted to €135 million (previous year: €89 million).

The breakdown of receivables from finance leases as of December 31, 2017 and December 31, 2018 was as follows:

€ million	2018	2019 – 2022	from 2023	Total
Future payments from finance lease receivables	7,587	11,963	31	19,580
Unearned finance income from finance leases (discounting)	–334	–526	–2	–862
Present value of minimum lease payments outstanding at the reporting date	7,252	11,437	29	18,719

€ million	2019	2020 – 2023	from 2024	Total
Future payments from finance lease receivables	8,572	11,927	34	20,533
Unearned finance income from finance leases (discounting)	–403	–504	–2	–909
Present value of minimum lease payments outstanding at the reporting date	8,169	11,423	33	19,624

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 €21 million (previous year: €31 million).

At the end of the reporting period, valuation allowances of €666 million (previous year: €658 million) had been recognized within loans to and receivables from customers in relation to Russia, Brazil, India, Mexico and the Republic of Korea, which are affected by various crises (economic crises, block on sales).

35. 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, 2018	Dec. 31, 2017
Transactions to hedge against		
currency risk on assets using fair value hedges	24	54
currency risk on liabilities using fair value hedges	51	49
interest-rate risk using fair value hedges	396	361
of which hedges against interest-rate risk using portfolio fair value hedges	0	1
interest-rate risk using cash flow hedges	8	11
currency and pricing risk on future cash flows using cash flow hedges	32	18
Hedging transactions	**510**	**493**
Assets arising from derivatives not designated as hedges	71	62
Total	**582**	**555**

36. Equity-Accounted Joint Ventures and Miscellaneous Financial Assets

€ million	Equity-accounted investments	Miscellaneous financial assets	Total
Gross carrying amount as of Jan. 1, 2017	**659**	**289**	**948**
Foreign exchange differences	–	−1	−1
Changes in basis of consolidation	−80	−6	−86
Additions	15	93	109
Reclassifications	–	–	–
Disposals	–	0	0
Changes recognized in profit or loss	82	–	82
Dividends	−7	–	−7
Other changes recognized in other comprehensive income	−20	–	−20
Balance as of Dec. 31, 2017	**648**	**376**	**1,024**
Impairment losses Balance as of Jan. 1, 2017	**26**	**1**	**28**
Foreign exchange differences	–	–	–
Changes in basis of consolidation	−9	–	−9
Additions	–	2	2
Reclassifications	–	–	–
Disposals	–	–	–
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2017	**17**	**3**	**20**
Net carrying amount as of Dec. 31, 2017	**631**	**373**	**1,004**
Net carrying amount as of Jan. 1, 2017	**633**	**288**	**920**

€ million	Equity-accounted investments[1]	Miscellaneous financial assets	Total
Gross carrying amount as of Jan. 1, 2018	**642**	**376**	**1,018**
Foreign exchange differences	–	–1	–1
Changes in basis of consolidation	–	5	5
Additions	21	121	142
Reclassifications	–	–	–
Disposals	–	9	9
Changes/remeasurements recognized in profit or loss	51	–	51
Dividends	–	–	–
Other changes recognized in other comprehensive income	–25	–	–25
Balance as of Dec. 31, 2018	**689**	**492**	**1,181**
Impairment losses Balance as of Jan. 1, 2018	**17**	**3**	**20**
Foreign exchange differences	–	–	–
Changes in basis of consolidation	–	–	–
Additions	–	88	88
Reclassifications	–	–	–
Disposals	–	3	3
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2018	**17**	**88**	**105**
Net carrying amount as of Dec. 31, 2018	**671**	**404**	**1,075**
Net carrying amount as of Jan. 1, 2018	**625**	**373**	**997**

1 As a consequence of the impact from the new IFRS 9 accounting requirements on financial assets in equity-accounted joint ventures, there is a difference between the carrying amounts as of December 31, 2017 and the carrying amounts as of January 1, 2018. This difference is explained in the reconciliation of carrying amounts under Effects of New and Revised IFRSs – IFRS 9 Financial Instruments.

In the third quarter of the reporting period, VW FS AG acquired the entity Verimi GmbH as an equity investment. With the acquisition of the shares and the subsequent capital increase, the carrying amount of the investment for VW FS AG amounts to €6 million. As the acquisition was so close to the reporting date, the purchase price and fair value were the same amount, as a result of which no change in fair value was recognized in the reporting period in other comprehensive income.

In addition, impairment losses in an amount of €83 million were recognized in the reporting period in respect of an unconsolidated subsidiary in China. The amount of the impairment losses equates to the amount by which the determined recoverable amount fell below the carrying amount prior to the recognition of the impairment losses. The methodology used to determine the recoverable amount was largely the same as that described in note (10) for testing goodwill for impairment.

37. Intangible Assets

€ million	Internally generated software	Brand names, customer base	Goodwill	Other intangible assets	Total
Cost					
Balance as of Jan. 1, 2017	**118**	**54**	**40**	**243**	**456**
Foreign exchange differences	−1	−1	1	−3	−5
Changes in basis of consolidation	−83	−21	−18	−155	−277
Additions	1	–	–	24	25
Reclassifications	–	–	–	–	–
Disposals	0	12	11	5	28
Balance as of Dec. 31, 2017	**35**	**20**	**12**	**104**	**171**
Amortization and impairment losses					
Balance as of Jan. 1, 2017	**102**	**12**	**–**	**192**	**306**
Foreign exchange differences	−1	0	–	−3	−3
Changes in basis of consolidation	−74	−10	–	−127	−211
Additions to cumulative amortization	3	1	–	20	24
Additions to cumulative impairment losses	–	12	11	–	22
Reclassifications	–	–	–	–	–
Disposals	–	12	11	4	26
Reversal of impairment losses	–	–	–	–	–
Balance as of Dec. 31, 2017	**30**	**3**	**–**	**79**	**113**
Net carrying amount as of Dec. 31, 2017	**4**	**18**	**12**	**24**	**59**
Net carrying amount as of Jan. 1, 2017	**17**	**43**	**40**	**51**	**150**

€ million	Internally generated software	Brand names, customer base	Goodwill	Other intangible assets	Total
Cost					
Balance as of Jan. 1, 2018	**35**	**20**	**12**	**104**	**171**
Foreign exchange differences	–1	0	0	–2	–4
Changes in basis of consolidation	–	–	–	–1	–1
Additions	1	–	–	26	27
Reclassifications	–	–	–	–	–
Disposals	–	–	–	4	4
Balance as of Dec. 31, 2018	**35**	**20**	**12**	**122**	**188**
Amortization and impairment losses					
Balance as of Jan. 1, 2018	**30**	**3**	**–**	**79**	**113**
Foreign exchange differences	0	0	–	–2	–2
Changes in basis of consolidation	–	–	–	–1	–1
Additions to cumulative amortization	1	0	–	11	13
Additions to cumulative impairment losses	–	–	–	2	2
Reclassifications	–	–	–	–	–
Disposals	–	–	–	0	0
Reversal of impairment losses	–	–	–	–	–
Balance as of Dec. 31, 2018	**31**	**3**	**–**	**90**	**124**
Net carrying amount as of Dec. 31, 2018	**4**	**17**	**12**	**32**	**64**
Net carrying amount as of Jan. 1, 2018	**4**	**18**	**12**	**24**	**59**

The goodwill of €12 million (previous year: €12 million) and brand names of €16 million (previous year: €16 million) in 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 remains in existence. The customer base in Poland is being amortized over a period of ten years.

Of the total recognized goodwill, €12 million (previous year: €12 million) was attributable to Poland. Of the total recognized brand names, €6 million (previous year: €6 million) was attributable to Poland and €10 million (previous year: €10 million) to Germany. The discount rates used in the impairment tests were 9.5% (previous year: 11.1%) for Poland.

The impairment tests for the reported goodwill and brand names are based on the value in use. The value in use determined for the reported goodwill and brand names in the impairment test for Poland exceeded the corresponding carrying amount, so no impairment loss requirement was identified for the reported goodwill or brand names. The VW FS AG Group also carried out sensitivity analyses as part of the impairment tests. In Poland, no conceivable change in a material assumption would lead to the recognition of an impairment loss for goodwill and brand names.

38. Property and Equipment

€ million	Land and buildings	Operating and office equipment	Total
Cost			
Balance as of Jan. 1, 2017	**313**	**251**	**564**
Foreign exchange differences	−2	−4	−6
Changes in basis of consolidation	−23	−166	−189
Additions	34	23	56
Reclassifications	−3	3	0
Disposals	1	11	12
Balance as of Dec. 31, 2017	**319**	**95**	**413**
Depreciation and impairment losses			
Balance as of Jan. 1, 2017	**105**	**144**	**250**
Foreign exchange differences	−1	−2	−2
Changes in basis of consolidation	−18	−107	−125
Additions to cumulative depreciation	9	26	35
Additions to cumulative impairment losses	–	–	–
Reclassifications	−1	1	0
Disposals	0	8	9
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2017	**95**	**54**	**149**
Net carrying amount as of Dec. 31, 2017	**224**	**41**	**265**
Net carrying amount as of Jan. 1, 2017	**208**	**106**	**314**

€ million	Land and buildings	Operating and office equipment	Total
Cost			
Balance as of Jan. 1, 2018	**319**	**95**	**413**
Foreign exchange differences	1	−2	0
Changes in basis of consolidation	–	−2	−2
Additions	16	38	54
Reclassifications	1	1	1
Disposals	1	10	10
Balance as of Dec. 31, 2018	**336**	**120**	**456**
Depreciation and impairment losses			
Balance as of Jan. 1, 2018	**95**	**54**	**149**
Foreign exchange differences	0	−1	0
Changes in basis of consolidation	–	−2	−2
Additions to cumulative depreciation	9	11	20
Additions to cumulative impairment losses	–	–	–
Reclassifications	1	0	1
Disposals	0	7	7
Reversal of impairment losses	–	–	–
Balance as of Dec. 31, 2018	**105**	**55**	**160**
Net carrying amount as of Dec. 31, 2018	**230**	**65**	**295**
Net carrying amount as of Jan. 1, 2018	**224**	**41**	**265**

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 €4 million (previous year: € 35 million) are included in land and buildings.

39. Lease Assets and Investment Property

€ million	Movable lease assets	Investment property	Total
Cost			
Balance as of Jan. 1, 2017	**18,968**	**21**	**18,988**
Foreign exchange differences	−195	0	−195
Changes in basis of consolidation	−6,045	−3	−6,048
Additions	11,368	–	11,368
Reclassifications	0	–	0
Disposals	9,038	–	9,038
Balance as of Dec. 31, 2017	**15,059**	**18**	**15,076**
Depreciation and impairment losses			
Balance as of Jan. 1, 2017	**4,272**	**7**	**4,279**
Foreign exchange differences	−40	0	−40
Changes in basis of consolidation	−1,162	−2	−1,164
Additions to cumulative depreciation	2,381	1	2,382
Additions to cumulative impairment losses	253	2	255
Reclassifications	0	–	0
Disposals	2,196	–	2,196
Reversal of impairment losses	20	–	20
Balance as of Dec. 31, 2017	**3,487**	**7**	**3,495**
Net carrying amount as of Dec. 31, 2017	**11,571**	**10**	**11,582**
Net carrying amount as of Jan. 1, 2017	**14,696**	**14**	**14,710**

In the prior year, we expected the following payments over the next few years from noncancelable leases:

€ million	2018	2019 – 2022	Total
Lease payments	104	232	337

The following table shows the present values in the prior year of future lease payments arising from buildings leased under finance leases:

€ million	2018	2019 – 2022	from 2023	Total
Lease payments	2	5	2	9
Interest component	0	1	0	1
Carrying amount of liabilities	**1**	**4**	**2**	**8**

€ million	Movable lease assets[1]	Investment property	Total
Cost			
Balance as of Jan. 1, 2018	**15,059**	**18**	**15,076**
Foreign exchange differences	−15	0	−15
Changes in basis of consolidation	–	–	–
Additions	8,167	–	8,167
Reclassifications	0	−1	−1
Disposals	6,310	–	6,310
Balance as of Dec. 31, 2018	**16,901**	**17**	**16,917**
Depreciation and impairment losses			
Balance as of Jan. 1, 2018	**3,487**	**7**	**3,495**
Foreign exchange differences	−4	0	−4
Changes in basis of consolidation	–	–	–
Additions to cumulative depreciation	1,969	1	1,969
Additions to cumulative impairment losses	216	–	216
Reclassifications	0	−1	−1
Disposals	1,811	–	1,811
Reversal of impairment losses	42	–	42
Balance as of Dec. 31, 2018	**3,816**	**7**	**3,823**
Net carrying amount as of Dec. 31, 2018	**13,084**	**10**	**13,094**
Net carrying amount as of Jan. 1, 2018	**11,571**	**10**	**11,582**

1 A difference between the carrying amounts as of December 31, 2017 and the carrying amounts as of January 1, 2018 arose as a result of the adjustment effects in respect of lease assets described under Effects of New and Revised IFRSs.

The fair value of investment property amounts to €15 million (previous year: €15 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: € 3 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	2019	2020 – 2023	Total
Lease payments	133	144	278

The following table shows the present values in the reporting period of future lease payments arising from buildings leased under finance leases:

€ million	2019	2020 – 2023	from 2024	Total
Lease payments	1	2	–	2
Interest component	0	0	–	0
Carrying amount of liabilities	**1**	**2**	**–**	**2**

40. Deferred Tax Assets

The deferred tax assets comprise exclusively deferred income tax assets, the breakdown of which is as follows:

€ million	Dec. 31, 2018	Dec. 31, 2017
Deferred tax assets	7,051	6,995
of which noncurrent	4,588	4,458
Recognized benefit from unused tax loss carryforwards, net of valuation allowances	13	10
of which noncurrent	13	10
Offset (with deferred tax liabilities)	−5,525	−5,969
Total	**1,539**	**1,035**

Deferred tax assets are recognized in connection with the following balance sheet items:

€ million	Dec. 31, 2018	Dec. 31, 2017
Loans, receivables and other assets	696	671
Marketable securities and cash	4	3
Intangible assets/property and equipment	17	18
Lease assets	5,720	5,616
Liabilities and provisions	615	687
Valuation allowances for deferred tax assets on temporary differences	–	–
Total	**7,051**	**6,995**

41. Other Assets

The details of other assets are as follows:

€ million	Dec. 31, 2018	Dec. 31, 2017
Vehicles returned for disposal	497	586
Restricted cash	596	850
Prepaid expenses	223	227
Other tax assets	152	117
Reinsurers' share of underwriting provisions	60	66
Miscellaneous	990	926
Total	**2,517**	**2,772**

Minimum lease payments of €666 million (previous year: €576 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, 2018	Dec. 31, 2017
Reinsurers' share of provision for claims outstanding	44	49
Reinsurers' share of provision for unearned premiums	13	16
Reinsurers' share of other underwriting provisions	2	2
Total	**60**	**66**

42. Noncurrent Assets

€ million	Dec. 31, 2018	of which noncurrent	Dec. 31, 2017	of which noncurrent
Cash reserve	54	–	40	–
Loans to and receivables from banks	1,819	208	1,444	166
Loans to and receivables from customers	59,012	29,947	49,804	27,890
Derivative financial instruments	582	467	555	443
Marketable securities	290	–	257	–
Equity-accounted joint ventures	671	671	631	631
Miscellaneous financial assets	404	404	373	373
Intangible assets	64	64	59	59
Property and equipment	295	295	265	265
Lease assets	13,083	11,005	11,571	9,555
Investment property	10	10	10	10
Current tax assets	122	5	137	5
Other assets	2,517	782	2,772	726
Total	**78,923**	**43,859**	**67,918**	**40,123**

43. 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.

Receivables from finance leases of €631 million (previous year: €685 million) were pledged as collateral for liabilities to banks.

The liabilities to customers include customer deposits of €75 million (previous year: €69 million).

The liabilities to customers also included contractual liabilities from service contracts amounting to €583 million, in connection with which income of €442 million was expected to be recognized in the next fiscal year, followed by income of €141 million in subsequent years.

44. Notes, Commercial Paper Issued

This item comprises bonds and commercial paper.

€ million	Dec. 31, 2018	Dec. 31, 2017
Bonds issued	38,464	30,055
Commercial paper issued	2,564	2,398
Total	**41,029**	**32,453**

Customer and dealer financing loans and receivables amounting to €175 million (previous year: €287 million) have been furnished as collateral for issued bonds not related to ABS transactions.

45. 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, 2018	Dec. 31, 2017
Bonds issued	13,072	12,345
Subordinated liabilities	57	1,348
Total	**13,129**	**13,694**

Of the total amount of liabilities arising in connection with ABS transactions, an amount of €9,941 million (previous year: €10,885 million) is accounted for by ABS transactions with financial assets. The corresponding carrying amount of loans/receivables from retail financing and leasing business is €10,661 million (previous year: €11,502 million). As of December 31, 2018, the fair value of the liabilities amounted to €9,967 million (previous year: €10,817 million). The fair value of the assigned loans/receivables, which continued to be recognized, amounted to €10,594 million (previous year: €11,665 million) as of December 31, 2018.

Collateral totaling €14,394 million (previous year: €15,079 million) has been furnished in connection with ABS transactions, of which €10,968 million (previous year: €11,898 million) is accounted for by collateral in the form of financial assets. 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.

The bulk of the public and private ABS transactions in the VW FS AG Group can be repaid early (with a clean-up call) when less than 10% of the original transaction volume remains outstanding.

46. 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, 2018	Dec. 31, 2017
Transactions to hedge against		
currency risk on assets using fair value hedges	24	9
currency risk on liabilities using fair value hedges	1	82
interest-rate risk using fair value hedges	32	36
of which hedges against interest-rate risk using portfolio fair value hedges	18	9
interest-rate risk using cash flow hedges	4	2
currency and pricing risk on future cash flows using cash flow hedges	5	6
Hedging transactions	**65**	**134**
Liabilities arising from derivatives not designated as hedges	40	77
Total	**105**	**211**

47. Provisions for Pensions and Other Post-Employment Benefits

The following amounts have been recognized in the balance sheet for benefit commitments:

€ million	Dec. 31, 2018	Dec. 31, 2017
Present value of funded obligations	243	245
Fair value of plan assets	156	168
Funded status (net)	**87**	**77**
Present value of unfunded obligations	276	281
Amount not recognized as an asset because of the ceiling in IAS 19	1	1
Net liability recognized in the balance sheet	**364**	**359**
of which provisions for pensions	366	360
of which other assets	2	1

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, which already reflect future increases in life expectancy. The updated "Heubeck 2018 G" mortality tables were used as the calculation basis in the reporting year. 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 2018 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, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Discount rate	2.00	1.90	2.90	7.41
Pay trend	3.50	3.60	4.39	5.78
Pension trend	1.51	1.50	4.00	4.05
Staff turnover rate	1.03	0.98	3.81	3.07

These assumptions are averages that were weighted using the present value of the defined benefit obligation. The reduction in the international discount rate results mainly from the effect of a changed scope of companies on the weighting of the average discount rate.

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 "2018 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	2018	2017
Net liability recognized in the balance sheet as of January 1	**359**	**477**
Current service cost	30	31
Net interest expense	6	8
Actuarial gains (–)/losses (+) arising from changes in demographic assumptions	6	0
Actuarial gains (–)/losses (+) arising from changes in financial assumptions	–14	–13
Actuarial gains (–)/losses (+) arising from experience adjustments	–9	–26
Income/expenses from plan assets not included in interest income	–8	–1
Change in amount not recognized as an asset because of the ceiling in IAS 19	0	0
Employer contributions to plan assets	14	17
Employee contributions to plan assets	–	–
Pension payments from company assets	4	5
Past service cost (including plan curtailments)	–	–
Gains (–) or losses (+) arising from plan settlements	–	–
Changes in basis of consolidation	–3	–50
Other changes	–2	–46
Foreign exchange differences from foreign plans	0	0
Net liability recognized in the balance sheet as of December 31	**364**	**359**

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	2018	2017
Present value of obligations as of January 1	**526**	**702**
Current service cost	30	31
Interest cost (unwinding of discount on obligations)	11	14
Actuarial gains (–)/losses (+) arising from changes in demographic assumptions	6	0
Actuarial gains (–)/losses (+) arising from changes in financial assumptions	–14	–13
Actuarial gains (–)/losses (+) arising from experience adjustments	–9	–26
Employee contributions to plan assets	–	1
Pension payments from company assets	4	5
Pension payments from plan assets	1	2
Past service cost (including plan curtailments)	–	–
Gains (–) or losses (+) arising from plan settlements	–	–
Changes in basis of consolidation	–3	–98
Other changes	–22	–74
Foreign exchange differences from foreign plans	–2	–4
Present value of obligations as of December 31	**519**	**526**

The actuarial gains/losses arising from changes in demographic assumptions result primarily from the initial application of the Heubeck 2018 G mortality tables.

As part of the regular review of our pension plans, a plan of Latin American subsidiaries was classified as a defined contribution plan in fiscal year 2018, resulting in a change in the recognition of the pension obligation in the above table. The reduction in the present value of the defined benefit obligation is recognized at €–20 million under other changes. This has no impact on the balance sheet, as the present value of the plan assets is reduced accordingly.

Changes in the relevant actuarial assumptions would have had the following effects on the defined benefit obligation:

Present value of defined benefit obligation if		DEC. 31, 2018 € million	DEC. 31, 2018 Change in percent	DEC. 31, 2017 € million	DEC. 31, 2017 Change in percent
Discount rate	is 0.5 percentage points higher	465	−10.49	472	−10.29
	is 0.5 percentage points lower	583	12.25	589	12.05
Pension trend	is 0.5 percentage points higher	541	4.29	547	4.02
	is 0.5 percentage points lower	501	−3.49	507	−3.63
Pay trend	is 0.5 percentage points higher	525	1.19	533	1.37
	is 0.5 percentage points lower	513	−1.09	519	−1.26
Longevity	increases by one year	534	2.83	539	2.52

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: 23 years).

The following table shows a breakdown of the present value of the defined benefit obligation by category of plan member:

€ million	2018	2017
Active members with pension entitlements	423	431
Members with vested entitlements who have left the Company	23	22
Retirees	73	72
Total	**519**	**526**

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	2018	2017
Payments due within the next fiscal year	6	5
Payments due between two and five years	28	25
Payments due in more than five years	486	496
Total	**519**	**526**

Changes in plan assets are shown in the following table:

€ million	2018	2017
Fair value of plan assets as of January 1	**168**	**227**
Interest income on plan assets determined using the discount rate	5	6
Income/expenses from plan assets not included in interest income	–8	–1
Employer contributions to plan assets	14	17
Employee contributions to plan assets	–	1
Pension payments from plan assets	1	2
Gains (+) or losses (–) arising from plan settlements	–	–
Changes in basis of consolidation	–	–48
Other changes	–20	–28
Foreign exchange differences from foreign plans	–2	–4
Fair value of plan assets as of December 31	**156**	**168**

Other changes are based on a change in the recognition of a plan of Latin American subsidiaries.

The investment of the plan assets to cover future pension obligations resulted in expenses amounting to €3 million (previous year: income amounting to €5 million).

Employer contributions to plan assets are expected to amount to €16 million (previous year: €15 million) in the next fiscal year.

Plan assets are invested in the following asset classes:

€ million	DEC. 31, 2018			DEC. 31, 2017		
	Quoted prices in active markets	No quoted prices in active markets	Total	Quoted prices in active markets	No quoted prices in active markets	Total
Cash and cash equivalents	12	–	12	11	–	11
Equity instruments	–	–	–	–	–	–
Debt instruments	1	–	1	25	–	25
Direct investments in real estate	–	–	–	–	–	–
Derivatives	–1	0	–1	1	–1	–1
Equity funds	23	–	23	24	–	24
Bond funds	118	–	118	105	–	105
Real estate funds	1	–	1	1	–	1
Other funds	–	–	–	–	–	–
Asset-backed securities	–	–	–	–	–	–
Structured debt securities	–	–	–	–	–	–
Other	0	2	2	0	2	2

Of the total plan assets, 82% (previous year: 70%) are invested in German assets, 1% (previous year: 1%) in other European assets and 17% (previous year: 28%) 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	2018	2017
Current service cost	30	31
Net interest on the net defined benefit liability	6	8
Past service cost (including plan curtailments)	–	–
Gains (–) or losses (+) arising from plan settlements	–	–
Net income (–) and expenses (+) recognized in profit or loss	**36**	**39**

48. Underwriting Provisions and Other Provisions

€ million	Dec. 31, 2018	Dec. 31, 2017
Underwriting provisions	416	399
Other provisions	492	489
Total	**909**	**888**

The following table shows the changes in underwriting provisions:

	UNDERWRITING PROVISIONS			
€ million	Provision for claims outstanding	Provision for unearned premiums	Other underwriting provisions	Total
Balance as of Jan. 1, 2017	**87**	**275**	**3**	**365**
Changes to basis of consolidation	–	–	–	–
Utilization	32	73	1	106
Additions	33	104	4	140
Balance as of Dec. 31, 2017	**88**	**305**	**6**	**399**

	UNDERWRITING PROVISIONS			
€ million	Provision for claims outstanding	Provision for unearned premiums	Other underwriting provisions	Total
Balance as of Jan. 1, 2018	**88**	**305**	**6**	**399**
Changes to basis of consolidation	–	–	–	–
Utilization	29	156	2	187
Additions	26	176	2	204
Balance as of Dec. 31, 2018	**84**	**325**	**7**	**416**

Maturity profile of underwriting provisions:

€ million	DEC. 31, 2018 Remaining maturity of more than one year	Total	DEC. 31, 2017 Remaining maturity of more than one year	Total
Provision for claims outstanding	52	84	38	88
Provision for unearned premiums	172	325	173	305
Other underwriting provisions	–	7	–	6
Total	**224**	**416**	**211**	**399**

Underwriting provisions for direct insurance business:

€ million	2018 Remaining maturity of more than one year	Total	2017 Remaining maturity of more than one year	Total
Balance as of Jan. 1	**76**	**148**	**69**	**144**
Utilization	51	101	8	38
Additions	12	86	15	42
Balance as of Dec. 31	**37**	**133**	**76**	**148**

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	2017			
	Vehicle insurance	Credit protection insurance	Other	Total
Balance as of Jan. 1	**51**	**90**	**80**	**221**
Utilization	4	29	35	68
Additions	3	93	2	98
Balance as of Dec. 31	**50**	**154**	**47**	**251**

€ million	2018 Vehicle insurance	Credit protection insurance	Other	Total
Balance as of Jan. 1	**50**	**154**	**47**	**251**
Utilization	5	67	14	86
Additions	5	99	14	118
Balance as of Dec. 31	**50**	**186**	**47**	**283**

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:

	Employee expenses	Litigation and legal risks	Miscellaneous provisions	Total
Balance as of Jan. 1, 2017	**119**	**545**	**183**	**847**
Foreign exchange differences	–1	–16	–2	–20
Changes in basis of consolidation	–34	–341	–93	–468
Utilization	51	20	38	110
Additions/new provisions	63	244	103	410
Unwinding of discount/effect of change in discount rate	–	7	–	7
Reversals	7	136	34	177
Balance as of Dec. 31, 2017	**88**	**282**	**119**	**489**
of which current	36	53	94	183
of which noncurrent	53	229	25	306
Balance as of Jan. 1, 2018	**88**	**282**	**119**	**489**
Foreign exchange differences	–1	–13	–2	–16
Changes in basis of consolidation	–1	–	–1	–2
Utilization	31	20	38	89
Additions/new provisions	40	92	55	187
Unwinding of discount/effect of change in discount rate	–	–1	–	–1
Reversals	5	63	8	76
Balance as of Dec. 31, 2018	**91**	**277**	**125**	**492**
of which current	37	46	98	181
of which noncurrent	54	231	26	311

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 timing of the cash outflows in connection with other provisions is expected to be as follows: 37% in the next year, 55% in the years 2020 to 2023 and 8% thereafter.

49. Deferred Tax Liabilities

The breakdown of the deferred tax liabilities is as follows:

€ million	Dec. 31, 2018	Dec. 31, 2017
Deferred tax liabilities	6,308	6,417
of which noncurrent	3,394	3,765
Offset (with deferred tax liabilities)	−5,525	−5,969
Total	**783**	**447**

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, 2018	Dec. 31, 2017
Loans, receivables and other assets	5,687	5,367
Marketable securities and cash	0	19
Intangible assets/property and equipment	7	5
Lease assets	527	519
Liabilities and provisions	87	506
Total	**6,308**	**6,417**

50. Other Liabilities

The details of other liabilities are as follows:

€ million	Dec. 31, 2018	Dec. 31, 2017
Deferred income	714	1,112
Other tax liabilities	194	176
Social security and payroll liabilities	129	133
Miscellaneous	139	192
Total	**1,176**	**1,613**

51. Subordinated Capital

The subordinated capital of €4,354 million (previous year: €4,354 million) was issued or raised by Volkswagen Leasing GmbH, Banco Volkswagen S.A., Volkswagen Financial Services Australia Pty. Ltd. and VW FS AG.

52. Noncurrent Liabilities

€ million	Dec. 31, 2018	of which noncurrent	Dec. 31, 2017	of which noncurrent
Liabilities to banks	12,291	4,044	10,982	4,119
Liabilities to customers	12,345	3,371	9,673	4,428
Notes, commercial paper issued	41,029	31,216	32,453	24,067
Derivative financial instruments	105	63	211	115
Current tax liabilities	420	145	348	122
Other liabilities	1,176	498	1,613	604
Subordinated capital	3,023	2,993	4,354	4,073
Total	**70,389**	**42,330**	**59,633**	**37,527**

53. 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 loss of €149 million (previous year: loss absorption of €478 million) in accordance with the HGB incurred by VW FS AG was absorbed.

54. Capital Management

In this context, "capital" is generally defined as equity in accordance with the 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 and to obtain capital for the planned growth over the next few years. Capital measures implemented by the parent company of VW FS AG have an impact on VW FS AG's equity in accordance with the IFRS.

As of December 31, 2018, the equity ratio was 10.0% (previous year: 11.1%).

Financial Instrument Disclosures

55. Carrying Amounts, Gains or Losses and Income or Expenses in respect of Financial Instruments, by Measurement Category

The carrying amounts of financial instruments (excluding hedge derivatives) as of December 31, 2017 broken down by IAS 39 measurement category are as follows:

€ million	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
Assets				
Cash Reserve	40	–	–	–
Loans to and receivables from banks	1,444	–	–	–
Loans to and receivables from customers	30,979	–	–	–
Derivative financial instruments	–	–	–	62
Marketable securities	–	257	–	–
Miscellaneous financial assets	–	0	–	–
Other assets	1,034	–	–	–
Total	**33,497**	**257**	**–**	**62**
Liabilities				
Liabilities to banks	–	–	10,982	–
Liabilities to customers	–	–	9,665	–
Notes, commercial paper issued	–	–	32,453	–
Derivative financial instruments	–	–	–	77
Other liabilities	–	–	672	–
Subordinated capital	–	–	4,354	–
Total	**–**	**–**	**58,124**	**77**

The carrying amounts of financial instruments (excluding hedge derivatives) as of December 31, 2018 broken down by IFRS 9 measurement category are shown in the following table:

€ million	Dec. 31, 2018
Financial assets measured at fair value through profit or loss	465
Financial assets measured at fair value through other comprehensive income (debt instruments)	254
Financial assets measured at fair value through other comprehensive income (equity instruments)	6
Financial assets measured at amortized cost	41,597
Financial liabilities measured at fair value through profit or loss	40
Financial liabilities measured at amortized cost	68,422

Receivables from leasing business of €19,760 million (previous year: €18,809 million) do not have to be allocated to any of these categories.

The net gains or losses and income or expenses of the previous year (excluding hedge derivatives) broken down by IAS 39 measurement category are as follows:

€ million	2017
Loans and receivables	2,612
Available-for-sale financial assets	10
Financial liabilities measured at amortized cost	−1,278
Financial assets and financial liabilities measured at fair value through profit or loss	−71

The net gains or losses and income or expenses in respect of financial instruments (excluding hedge derivatives) for fiscal year 2018 broken down by IFRS 9 measurement category are shown in the following table:

€ million	2018
Financial instruments measured at fair value through profit or loss	7
Financial assets measured at amortized cost	1,796
Financial assets measured at fair value through other comprehensive income (debt instruments)	2
Financial liabilities measured at amortized cost	−1,238

In 2018, the net gains/losses and income/expenses are determined as follows:

Measurement category	Measurement method
Financial instruments measured at fair value through profit or loss	Fair value in accordance with IFRS 9 in conjunction with IFRS 13, including interest and effects from currency translation
Financial assets measured at amortized cost	Interest income using the effective interest method and expenses/income from the recognition of valuation allowances in accordance with IFRS 9 and effects from currency translation
Financial assets measured at fair value through other comprehensive income (debt instruments)	Fair value valuation in accordance with IFRS 9 in conjunction with IFRS 13, interest income using the effective interest method and expenses/income from the recognition of valuation allowances in accordance with IFRS 9 and effects from currency translation
Financial liabilities measured at amortized cost	Interest expense using the effective interest method in accordance with IFRS 9 and effects from currency translation

The interest income from financial assets measured at amortized cost or at fair value through other comprehensive income included in interest income from lending transactions and marketable securities amounted to €2,041 million.

Interest income from lending transactions and marketable securities not allocated to the category of financial assets or financial liabilities measured at fair value through profit or loss amounted to €1,979 million for the restated previous year.

The interest expenses in an amount of €1,069 million (restated previous year: €1,048 million) relate to financial instruments not measured at fair value through profit or loss.

56. Classes of Financial Instruments

Financial instruments are divided into the following classes in the VW FS AG Group:
> Measured at fair value
> Measured at amortized cost
> Derivative financial instruments designated as hedges
> Not allocated to any measurement category
> Credit commitments and financial guarantees (off-balance-sheet)

Loans/receivables and liabilities designated as hedges with derivative financial instruments are included in the class “Measured at amortized cost”.

Within “Miscellaneous financial assets”, subsidiaries and joint ventures that are not consolidated for reasons of materiality are not deemed financial instruments in accordance with IFRS 9 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 IFRS 9 in the class “Measured at fair value”.

In connection with the initial application of IFRS 9 and IFRS 15, the carrying amounts of receivables from insurance contracts and contractual liabilities from service contracts are reported in the class “Not allocated to any measurement category” from fiscal year 2018. At the same time, as part of the implementation of IFRS 9, the carrying amounts of lease receivables and liabilities have been transferred from the “Measured at amortized cost” class to “Not allocated to any measurement category”. The prior-year figures for receivables from customers relating to the leasing business amounting to €18,809 million and for liabilities to customers relating to the leasing business amounting to €8 million have been adjusted accordingly in the presentation of the classes.

In this regard, the class “Not within the scope of IFRS 7” has been renamed “Not allocated to any measurement category”. For reasons of materiality, unconsolidated subsidiaries and joint ventures, equity-accounted joint ventures and other instruments (other than financial instruments) are also classified as “Not allocated to any measurement category”, in addition to the lease receivables and liabilities and receivables from insurance contracts described above, for reconciliation to the balance sheet.

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 ALLOCATED TO ANY MEASUREMENT CATEGORY	
	Dec. 31, 2018	Dec. 31, 2017	**Dec. 31, 2018**	Dec. 31, 2017	**Dec. 31, 2018**	Dec. 31, 2017	**Dec. 31, 2018**	Dec. 31, 2017	**Dec. 31, 2018**	Dec. 31, 2017
Assets										
Cash reserve	54	40	–	–	54	40	–	–	–	–
Loans to and receivables from banks	1,819	1,444	–	–	1,819	1,444	–	–	–	–
Loans to and receivables from customers[2]	59,012	49,804	358	–	38,880	30,996	–	–	19,774	18,809
Derivative financial instruments	582	555	71	62	–	–	510	493	–	–
Marketable securities	290	257	290	257	–	–	–	–	–	–
Equity-accounted joint ventures	671	631	–	–	–	–	–	–	671	631
Miscellaneous financial assets	404	373	6	0	–	–	–	–	398	373
Current tax assets[3]	122	137	–	–	14	50	–	–	108	86
Other assets	2,517	2,772	–	–	829	1,034	–	–	1,689	1,737
Total	**65,471**	**56,012**	**724**	**319**	**41,597**	**33,564**	**510**	**493**	**22,639**	**21,636**
Equity and liabilities										
Liabilities to banks	12,291	10,982	–	–	12,291	10,982	–	–	–	–
Liabilities to customers[2]	12,345	9,673	–	–	11,759	9,665	–	–	586	8
Notes, commercial paper issued	41,029	32,453	–	–	41,029	32,453	–	–	–	–
Derivative financial instruments	105	211	40	77	–	–	65	134	–	–
Current tax liabilities[3]	420	348	–	–	181	40	–	–	239	308
Other liabilities	1,176	1,613	–	–	139	672	–	–	1,038	941
Subordinated capital	3,023	4,354	–	–	3,023	4,354	–	–	–	–
Total	**70,389**	**59,633**	**40**	**77**	**68,422**	**58,165**	**65**	**134**	**1,862**	**1,257**

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.
2 Presentation of receivables from customers relating to the leasing business and of liabilities to customers relating to the leasing business has been changed: these items are now in the "Not allocated to any measurement category" class.
3 Revised presentation as a result of including financial instruments in "current tax assets" and "current tax liabilities".

The "Credit commitments and financial guarantees" class contains obligations under irrevocable credit commitments and financial guarantees amounting to €1,149 million (previous year: €1,267 million).

57. Measurement Levels for Financial Instruments in the Classes “Measured at Amortized Cost”, “Measured at Fair Value” and “Derivative Financial Instruments Designated as Hedges”

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 58). An equity investment measured at fair value through other comprehensive income and using inputs that are not observable in the market is also reported under Level 3. The main inputs used to measure this equity investment are strategic planning and cost of equity rates.

The following table shows the allocation of financial instruments to this three-level fair value hierarchy by class:

€ million	LEVEL 1		LEVEL 2		LEVEL 3	
	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Assets						
Measured at fair value						
Loans to and receivables from customers	–	–	–	–	358	–
Derivative financial instruments	–	–	71	62	–	–
Marketable securities	290	257	–	–	–	–
Miscellaneous financial assets	–	–	–	–	6	0
Measured at amortized cost						
Cash reserve	54	40	–	–	–	–
Loans to and receivables from banks	1,111	716	709	728	–	–
Loans to and receivables from customers[1]	–	–	532	496	38,491	30,562
Current tax assets[2]	–	–	14	50	–	–
Other assets	–	–	829	1,034	–	–
Derivative financial instruments designated as hedges	–	–	510	493	–	–
Total	**1,456**	**1,014**	**2,665**	**2,862**	**38,854**	**30,562**
Equity and liabilities						
Measured at fair value						
Derivative financial instruments	–	–	40	77	–	–
Measured at amortized cost						
Liabilities to banks	–	–	12,299	11,013	–	–
Liabilities to customers[1]	–	–	11,777	9,696	–	–
Notes, commercial paper issued	28,251	20,004	12,847	12,449	–	–
Current tax liabilities[2]	–	–	181	40	–	–
Other liabilities	–	–	140	675	–	–
Subordinated capital	–	–	1,990	3,685	–	–
Derivative financial instruments designated as hedges	–	–	65	134	–	–
Total	**28,251**	**20,004**	**39,339**	**37,769**	**–**	**–**

1 Prior-year figures have been adjusted as a result of the removal of lease receivables and lease liabilities from the “Measured at amortized cost” class.
2 Revised presentation as a result of including financial instruments in “current tax assets” and ”current tax liabilities”.

The fair value of receivables from customers relating to the leasing business in the “Not allocated to any measurement category” class is €19,840 million (previous year: €18,835 million) and is allocated to Level 3 in the fair value hierarchy. The liabilities to customers relating to the leasing business in the “Not allocated to any measurement category” class have a fair value of €2 million (previous year: €8 million) and are allocated to Level 2 in the fair value hierarchy.

The following table shows the changes in the loans to and receivables from customers and equity investments measured at fair value and allocated to Level 3.

€ million	2018[1]
Balance as of Jan. 1	**495**
Foreign exchange differences	−24
Portfolio changes	−107
Measured at fair value through profit or loss	−1
Measured at fair value through other comprehensive income	–
Balance as of Dec. 31	**363**

1 The opening carrying amount has been adjusted for the loans to and receivables from customers (see IFRS 9 disclosures).

The remeasurements recognized in profit or loss amounting to €–1 million have been reported in the income statement under net gain or loss on financial instruments measured at fair value and on derecognition of financial assets measured at fair value through other comprehensive income. Of the remeasurements recognized in profit or loss, a net loss of €1 million was attributable to loans to and receivables from customers held as of the reporting date.

The risk variables relevant to the fair value of the loans to and receivables from customers are risk-adjusted interest rates. A sensitivity analysis is used to quantify the impact from changes in risk-adjusted interest rates on profit or loss after tax.

If risk-adjusted interest rates as of December 31, 2018 had been 100 basis points higher, profit after tax would have been €5 million lower. If risk-adjusted interest rates as of December 31, 2018 had been 100 basis points lower, profit after tax would have been €6 million higher.

The risk variables relevant to the fair value of the equity investment are the growth rate within strategic planning and the cost of equity rates. As the acquisition of the equity investment in the fourth quarter of the reporting period was so close to the measurement date in the reporting period, the purchase price and fair value at the measurement date were the same amount, as a result of which no change in fair value was recognized for the reporting period in other comprehensive income.

58. Fair Values of Financial Instruments in the Classes “Measured at Amortized Cost”, “Measured at Fair Value” and “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 taking 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.

The fair value of the unlisted equity investment acquired in the reporting period was determined using a measurement model based on strategic planning. Due to the short maturity and the variable interest rate linked to the market interest rate, the fair value of irrevocable credit commitments is not material. The fair value of financial guarantees is not material either.

	FAIR VALUE		CARRYING AMOUNT		DIFFERENCE	
€ million	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Assets						
Measured at fair value						
Loans to and receivables from customers	358	–	358	–	–	–
Derivative financial instruments	71	62	71	62	–	–
Marketable securities	290	257	290	257	–	–
Miscellaneous financial assets	6	0	6	0	–	–
Measured at amortized cost						
Cash reserve	54	40	54	40	–	–
Loans to and receivables from banks	1,820	1,444	1,819	1,444	1	0
Loans to and receivables from customers[1]	39,023	31,058	38,880	30,996	143	62
Current tax assets[2]	14	50	14	50	–	–
Other assets	829	1,034	829	1,034	–	–
Derivative financial instruments designated as hedges	510	493	510	493	–	–
Equity and liabilities						
Measured at fair value						
Derivative financial instruments	40	77	40	77	–	–
Measured at amortized cost						
Liabilities to banks	12,299	11,013	12,291	10,982	8	32
Liabilities to customers[1]	11,777	9,696	11,759	9,665	18	31
Notes, commercial paper issued	41,098	32,453	41,029	32,453	69	0
Current tax liabilities[2]	181	40	181	40	–	–
Other liabilities	140	675	139	672	1	4
Subordinated capital	1,990	3,685	3,023	4,354	−1,034	−669
Derivative financial instruments designated as hedges	65	134	65	134	–	–

1 Prior-year figures have been adjusted as a result of the removal of lease receivables and lease liabilities from the “Measured at amortized cost” class.
2 Revised presentation as a result of including financial instruments in “current tax assets” and ”current tax liabilities”.

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	−0.306	2.774	0.917	0.087	6.445	9.168	−0.104	1.729	1.994	3.270	1.789	7.156	8.860	1.926	−0.349
Interest rate for one year	−0.263	2.765	0.984	0.009	6.567	9.142	−0.066	1.924	1.951	3.217	1.775	7.135	9.470	1.888	−0.207
Interest rate for five years	0.197	2.594	1.305	0.024	8.838	8.650	0.508	1.830	2.219	3.660	2.125	7.215	9.560	1.770	0.358
Interest rate for ten years	0.815	2.733	1.437	0.176	–	8.740	1.128	1.760	2.556	4.150	2.481	7.310	9.320	1.830	0.973

59. 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.

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 and collateral received in the form of cash deposits and receivables from ABS transactions.

							AMOUNTS NOT OFFSET IN THE BALANCE SHEET					
	Gross amount of recognized financial assets/ liabilities		Gross amount of recognized financial assets/ liabilities offset in the balance sheet		Net amount of financial assets/ liabilities reported in the balance sheet		Financial instruments		Collateral received/pledged		Net amount	
€ million	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Assets												
Cash reserve	54	40		–	54	40	–	–	–	–	54	40
Loans to and receivables from banks	1,819	1,444	–	–	1,819	1,444	–	–	–	–	1,819	1,444
Loans to and receivables from customers	58,998	49,804	–	–	58,998	49,804	–	–	−127	−67	58,871	49,737
Derivative financial instruments	582	555	–	–	582	555	−85	−92	–	–	496	463
Marketable securities	290	257	–	–	290	257	–	–	–	–	290	257
Miscellaneous financial assets	6	0	–	–	6	0	–	–	–	–	6	0
Current tax assets[1]	14	50	–	–	14	50	–	–	–	–	14	50
Other assets	829	1,034	–	–	829	1,034	–	–	–	–	829	1,035
Total	**62,591**	**53,184**	**–**	**–**	**62,591**	**53,184**	**−85**	**−92**	**−127**	**−67**	**62,379**	**53,025**
Equity and liabilities												
Liabilities to banks	12,291	10,982	–	–	12,291	10,982	–	–	–	–	12,291	10,982
Liabilities to customers	11,762	9,673	–	–	11,762	9,673	–	–	–	–	11,762	9,672
Notes, commercial paper issued	41,029	32,453	–	–	41,029	32,453	–	–	−482	−521	40,547	31,931
Derivative financial instruments	105	211	–	–	105	211	−85	−92	–	–	20	119
Current tax liabilities[1]	181	40	–	–	181	40	–	–	–	–	181	40
Other liabilities	139	672	–	–	139	672	–	–	–	–	139	672
Subordinated capital	3,023	4,354	–	–	3,023	4,354	–	–	–	–	3,023	4,354
Total	**68,530**	**58,344**	**–**	**–**	**68,530**	**58,385**	**−85**	**−92**	**−482**	**−521**	**67,963**	**57,771**

1 Revised presentation as a result of including financial instruments in “current tax assets” and ”current tax liabilities”.

60. Counterparty Default Risk

For qualitative information, please refer to the risk report (Credit Risk section, pages 23 to 24), which forms part of the management report.

PROVISION FOR CREDIT RISKS

Please refer to the provision for credit risks section in note (8) for disclosures on the accounting policies relating to the provision for credit risks.

The following table shows a reconciliation for the provision for credit risks relating to financial assets measured at amortized cost:

€ million	Stage 1	Stage 2	Stage 3	Simplified approach	Stage 4	Total
Balance as of Jan. 1, 2018	**338**	**489**	**462**	**14**	**33**	**1,337**
Exchange differences on translating foreign operations	−4	−9	−35	0	−4	−52
Changes in basis of consolidation	–	–	–	–	–	–
Newly granted/purchased financial assets (additions)	116	–	–	6	4	126
Other changes within a stage	−50	73	58	1	−2	79
Transfer to						
Stage 1	4	−22	−3	–	–	−21
Stage 2	−40	86	−15	–	–	31
Stage 3	−4	−12	118	–	–	102
Financial instruments derecognised during the period (derecognitions)	−48	−24	−48	−1	−1	−122
Utilizations	–	–	−227	0	0	−227
Model or risk parameter changes	3	8	25	–	1	36
Balance as of Dec. 31, 2018	**315**	**589**	**334**	**20**	**31**	**1,289**

The provision for credit risks in respect of financial assets measured at fair value through other comprehensive income is allocated to Stage 1 and was subject to change in the reporting period only as part of other changes within Stage 1. As the amount of provision for credit risks for these financial assets is negligible both as of December 31, 2018 and in relation to the changes during the fiscal year, these figures are not presented in a separate table.

The following table shows a reconciliation for the provision for credit risks relating to financial guarantees and credit commitments:

€ million	Stage 1	Stage 2	Stage 3	Stage 4	Total
Balance as of Jan. 1, 2018	**3**	**2**	**–**	**–**	**4**
Exchange differences on translating foreign operations	0	0	–	–	0
Changes in basis of consolidation	–	–	–	–	–
Newly granted/purchased financial assets (additions)	0	–	–	–	0
Other changes within a stage	0	–	–	–	0
Transfer to					
Stage 1	–	–	–	–	–
Stage 2	–	–	–	–	–
Stage 3	–	–	–	–	–
Financial instruments derecognized during the period (derecognitions)	−2	−2	–	–	−4
Utilizations	–	–	–	–	–
Model or risk parameter changes	–	–	–	–	–
Balance as of Dec. 31, 2018	**0**	**–**	**–**	**–**	**0**

The following table shows a reconciliation for the provision for credit risks relating to lease receivables in the class “Not allocated to any measurement category”:

€ million	Simplified approach
Balance as of Jan. 1, 2018	**717**
Exchange differences on translating foreign operations	−2
Changes in basis of consolidation	–
Newly granted/purchased financial assets (additions)	249
Other changes	12
Financial instruments derecognised during the period (derecognitions)	−313
Utilizations	−25
Model or risk parameter changes	–
Balance as of Dec. 31, 2018	**639**

The following table shows the reconciliation for the provision for credit risks relating to lending and leasing business for the previous year:

€ million	Specific valuation allowances	Portfolio-based valuation allowances	2017
Balance as of Jan. 1	**1,280**	**1,687**	**2,966**
Exchange rate and other changes	−65	−28	−93
Changes in basis of consolidation	−597	−596	−1,193
Additions	531	383	914
Utilization	248	–	248
Reversals	202	318	519
Interest income on impaired loans and receivables	24	–	24
Reclassification	−1	1	0
Balance as of Dec. 31	**674**	**1,128**	**1,802**

MODIFICATIONS

During the reporting period, there were contractual modifications of financial assets that did not lead to a derecognition of the asset concerned. These modifications were largely caused by changes in credit quality and related to financial assets for which the associated provision for credit risks equated to the lifetime expected credit loss. To simplify matters, in the case of trade receivables and lease receivables, the analysis only takes into account credit-quality-related modifications where the receivables concerned are more than 30 days past due. Prior to the contractual modification, the amortized cost amounted to €147 million. In the reporting period, the contractual modifications gave rise to total net expenses of €1 million.

At the reporting date, the gross carrying amount of financial assets that had been modified since initial recognition and that, in the reporting period, had also been transferred from Stage 2 or Stage 3 to Stage 1 amounted to €19 million. As a consequence, the measurement of the provision for credit risks for these financial assets was switched from the lifetime expected credit loss to a twelve-month expected credit loss.

MAXIMUM CREDIT RISK

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. The collateral held is in respect of loans to and receivables from banks and customers in the classes “Measured at amortized cost”, “Measured at fair value” and “Not allocated to any measurement category”. The types of collateral held include vehicles, other assets pledged as collateral, financial guarantees, marketable securities, cash collateral and charges on real estate. In the case of financial assets with objective indicators of impairment at the reporting date, the collateral reduced the risk by €361 million. For financial assets in the “Measured at fair value” class to which the IFRS 9 impairment requirements are not applied, the maximum credit and default risk was reduced at the reporting date by collateral held with a value of €65 million.

For financial assets on which impairment losses were recognized during the fiscal year and that are subject to enforcement measures, there are contractually outstanding amounts totaling €213 million.

The following table shows the maximum credit risk to which the VW FS AG Group was exposed as of the reporting date, broken down by class, and to which the impairment model was applied.

€ million	Dec. 31, 2018
Financial assets measured at fair value	254
Financial assets measured at amortized cost	41,597
Financial guarantees and credit commitments	1,149
Not allocated to any measurement category	19,760
Total	**62,760**

The VW FS AG Group intends to recover the following collateral accepted in the reporting period for financial assets:

€ million	Dec. 31, 2018	Dec. 31, 2017
Vehicles	61	43
Real estate	–	–
Other movable assets	–	–
Total	**61**	**43**

The vehicles are remarketed to Volkswagen Group dealers through direct sales and auctions.

DEFAULT RISK RATING CLASSES

The VW FS AG 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 rating 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 rating class 2. Accordingly, all loans and receivables in default are allocated to rating class 3.

The following table presents the gross carrying amounts of financial assets as of December 31, 2018, broken down by rating class:

€ million	Stage 1	Stage 2	Stage 3	Simplified approach	Stage 4
Default risk rating class 1 (loans/receivables not at risk of default – normal loans)	38,198	1,056	–	20,536	21
Default risk rating class 2 (loans/receivables at risk of default – loans with intensified loan management)	583	1,387	–	814	4
Default risk rating class 3 (loans/receivables in default – non-performing loans)	–	–	501	406	34
Total	**38,780**	**2,443**	**501**	**21,756**	**58**

The following table shows the default risk exposures for financial guarantees and credit commitments as of the reporting date, broken down by rating class:

€ million	Stage 1	Stage 2	Stage 3	Stage 4
Default risk rating class 1 (loans/receivables not at risk of default – normal loans)	1,149	–	–	–
Default risk rating class 2 (loans/receivables at risk of default – loans with intensified loan management)	–	–	–	–
Default risk rating class 3 (loans/receivables in default – non-performing loans)	–	–	–	–
Total	**1,149**	**–**	**–**	**–**

The following table presents the credit quality of financial assets as of December 31, 2017:

€ million	Gross carrying amount	Neither past due nor impaired	Past due but not impaired	Impaired
Measured at fair value	319	319	–	–
Measured at amortized cost				
Cash reserve	40	40	–	–
Loans to and receivables from banks	1,444	1,444	–	–
Loans to and receivables from customers[1]	32,237	30,753	833	651
Other assets	1,034	1,034	–	0
Derivative financial instruments designated as hedges	493	493	–	–
Not allocated to any measurement category				
Loans to and receivables from customers[1]	19,369	18,409	592	369
Total	**54,937**	**52,492**	**1,425**	**1,020**

1 Presentation of receivables relating to the leasing business changed in the “Not allocated to any measurement category” class.

The breakdown of neither past due nor impaired financial assets by risk class as of December 31, 2017, is as follows:

€ million	Neither past due nor impaired	Risk class 1	Risk class 2
Measured at fair value	319	319	–
Measured at amortized cost			
Cash reserve	40	40	–
Loans to and receivables from banks	1,444	1,444	–
Loans to and receivables from customers[1]	30,753	24,655	6,098
Other assets	1,034	1,008	26
Derivative financial instruments designated as hedges	493	493	–
Not allocated to any measurement category			
Loans to and receivables from customers[1]	18,409	15,865	2,544
Total	**52,492**	**43,824**	**8,668**

1 Presentation of receivables relating to the leasing business changed in the “Not allocated to any measurement category” class.

The age analysis of financial assets past due but not impaired, by class, as of December 31, 2017, is as follows:

€ million	Past due but not impaired	IN THE FOLLOWING AGED PAST DUE CATEGORIES Up to 1 month	1 to 3 months	More than 3 months
Measured at fair value	–	–	–	–
Measured at amortized cost				
Cash reserve	–	–	–	–
Loans to and receivables from banks	–	–	–	–
Loans to and receivables from customers[1]	833	660	173	1
Other assets	–	–	–	–
Derivative financial instruments designated as hedges	–	–	–	–
Not allocated to any measurement category				
Loans to and receivables from customers[1]	592	398	193	1
Total	**1,425**	**1,058**	**365**	**2**

1 Presentation of receivables relating to the leasing business changed in the “Not allocated to any measurement category” class.

61. 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		MORE THAN 5 YEARS	
	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Cash reserve	54	40	54	40	–	–	–	–	–	–	–	–
Loans to and receivables from banks	1,819	1,444	1,359	810	230	440	22	28	47	135	161	31
Total	**1,874**	**1,484**	**1,414**	**850**	**230**	**440**	**22**	**28**	**47**	**135**	**161**	**31**

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, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
Liabilities to banks	12,825	11,561	2,956	2,557	5,588	4,599	4,181	4,303	100	103
Liabilities to customers	11,826	9,787	5,335	3,169	3,226	2,117	3,016	3,705	250	797
Notes, commercial paper issued	42,287	33,560	2,587	2,462	7,577	6,220	26,801	21,065	5,322	3,813
Derivative financial instruments	3,721	4,495	1,021	1,318	818	1,759	1,877	1,415	5	2
Other liabilities	139	672	60	147	30	329	47	194	1	1
Subordinated capital	3,339	4,779	19	200	30	126	163	1,242	3,127	3,212
Irrevocable credit commitments	306	545	306	545	–	–	–	–	–	–
Total	**74,442**	**65,400**	**12,283**	**10,398**	**17,269**	**15,151**	**36,085**	**31,923**	**8,805**	**7,927**

Financial guarantees with a maximum possible drawdown of €844 million (previous year: €721 million) are assumed to be payable on demand at all times.

62. 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, 2018	Dec. 31, 2017
Interest-rate risk	170	188
Currency translation risk	51	60
Total market risk	**155**	**181**

As a result of correlation effects, the total market risk is not identical to the sum of the individual risks.

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. 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 at the level of the individual company based on an overall interest rate risk limit set for the entire Group and broken down into specific limits for each company. 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 interest rate swaps. Micro-hedges 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 interest rate swaps. Generally speaking, all cash flows in foreign currency are hedged.

DESCRIPTION OF HEDGES AND METHODOLOGIES FOR MONITORING HEDGE EFFECTIVENESS

If possible, the hedge strategy aims to recognize hedges for suitable underlying transactions (hedged items) using micro- or portfolio hedges. The vast majority of hedged items are assets or liabilities on the balance sheet. Future transactions are only used as hedged items in exceptional cases. The volume represented by the hedging instruments is generally exactly the same as the volume represented by the designated hedged items.

In the VW FS AG Group, hedges to which micro-hedge accounting is applied are normally held to maturity. Individual risk components are not separated out and designated for the purposes of hedge accounting.

In portfolio hedge accounting, derivatives are designated as hedges for interest rate hedging on a quarterly basis. Hedge effectiveness is reviewed for each maturity band. Derivatives are only included in portfolio hedge accounting for a hedging period if a high level of hedge effectiveness is achieved, both prospectively and retrospectively.

With the introduction of IFRS 9, hedge effectiveness in the VW FS AG Group is measured mostly prospectively using the critical terms match method. Hedge effectiveness is analyzed retrospectively by testing for ineffectiveness using the dollar offset method. The dollar offset method compares the changes in the value of the hedged item expressed in monetary units with the changes in the value of the hedging instrument expressed in monetary units. Hedge ineffectiveness in micro-hedge accounting largely results from differences between the mark-to-market (fair value) measurement of hedged items and that of hedging instruments. Individual yield curves are used when determining forward interest rates and prices and also when discounting future cash flows for hedged items and hedging instruments in order to obtain a measurement in line with the market. Other factors (e.g. in relation to counterparty risk) are only of minor significance as regards hedge ineffectiveness.

In portfolio hedge accounting, ineffectiveness generally arises where the changes in the fair values of hedging instruments do not fully offset those of the hedged items.

DISCLOSURES ON GAINS AND LOSSES FROM FAIR VALUE HEDGES

In fair value hedges, the transactions hedge the risk from changes in the fair value of financial assets and financial liabilities. Changes in fair value that arise from the recognition of hedging instruments at fair value and those from the recognition of the associated hedged items at the hedged fair value generally have an offsetting effect and are reported under the net gain or loss on hedges.

The following table shows the degree of hedge ineffectiveness from fair value hedges broken down by type of risk, equating to the differences between the gains or losses on hedging instruments and those on hedged items:

€ million	2018
Interest rate risk hedging	0
Currency risk hedging	−15
Combined interest rate and currency risk hedging	2

DISCLOSURES ON GAINS AND LOSSES FROM CASH FLOW HEDGES

Cash flow hedges are recognized with the aim of hedging risks arising from changes in future cash flows. These cash flows can arise from a recognized asset or a recognized liability.

The following table covering gains and losses from cash flow hedges shows the gains and losses on hedges recognized in other comprehensive income in the reporting period, the hedge ineffectiveness recognized under net gain or loss on hedges and the gains or losses arising from the reclassification of cash flow hedge reserves recognized under net gain or loss on hedges:

€ million	2018
Interest rate risk hedging	
Gain or loss from changes in the fair value of hedged items within hedge accounting	
Recognized in other comprehensive income	–7
Recognized in profit or loss	0
Reclassifications from the cash flow hedge reserve to the income statement	
As a result of the early termination of hedges	–
As a result of the recovery of the hedged item	0
Currency risk hedging	
Gain or loss from changes in the fair value of hedged items within hedge accounting	
Recognized in other comprehensive income	3
Recognized in profit or loss	0
Reclassifications from the cash flow hedge reserve to the income statement	
As a result of the early termination of hedges	–
As a result of the recovery of the hedged item	0
Combined interest rate and currency risk hedging	
Gain or loss from changes in the fair value of hedged items within hedge accounting	
Recognized in other comprehensive income	6
Recognized in profit or loss	0
Reclassifications from the cash flow hedge reserve to the income statement	
As a result of the early termination of hedges	–
As a result of the recovery of the hedged item	–6

In the table, effects recognized directly in equity are presented net of deferred taxes.

The gain or loss from changes in the fair value of hedges within hedge accounting reflects the basis for determining hedge ineffectiveness. Those gains or losses on changes in the fair value of hedging instruments that exceed the changes in the fair value of the hedged items constitute the ineffective portion of cash flow hedges. This ineffectiveness within a hedge arises as a result of differences in the parameters applicable to the hedging instrument and the hedged item. These gains or losses are recognized immediately under the gain or loss on hedges.

NOTIONAL AMOUNTS OF DERIVATIVE FINANCIAL INSTRUMENTS

The breakdown of the notional volume of the derivative financial instruments by remaining maturity as of December 31, 2017 was as follows:

	REMAINING CONTRACTUAL MATURITIES		
€ million	Up to 1 year	1 to 5 years	More than 5 years
Cash flow hedges			
Interest rate swaps	1,031	1,385	–
Cross-currency interest rate swaps	387	101	–
Currency forwards	–	–	–
Cross currency swaps	–	–	–
Miscellaneous			
Interest rate swaps	11,023	28,506	4,274
Cross-currency interest rate swaps	1,057	744	–
Currency forwards	1,490	2	–
Cross currency swaps	56	483	–
Total	**15,044**	**31,221**	**4,274**

The following table presents a maturity analysis of the notional amounts of hedging instruments reported under the hedge accounting rules and those of derivatives to which hedge accounting is not applied as of December 31, 2018:

€ million	RESIDUAL MATURITY Up to 1 year	1 – 5 years	More than 5 years	TOTAL NOTIONAL AMOUNT Dec. 31, 2018
Notional amounts of hedging instruments in hedge accounting				
Interest rate risk hedging				
Interest rate swaps	3,256	19,369	5,140	27,766
Currency risk hedging				
Currency forwards/cross currency swaps TRY	343	–	–	343
Currency forwards/cross currency swaps PLN	165	–	–	165
Currency forwards/cross currency swaps other currencies	151	65	–	216
Combined interest rate and currency risk hedging:				
Cross-currency interest rate swaps NOK	453	669	–	1,122
Cross-currency interest rate swaps USD	305	–	–	305
Cross-currency interest rate swaps, other foreign currencies	218	191	–	409
Notional amounts of other derivatives				
Interest rate risk hedging				
Interest rate swaps	10,005	15,113	130	25,248
Currency risk hedging				
Currency forwards/cross currency swaps	112	501	–	613
Combined interest rate and currency risk hedging:				
Cross-currency interest rate swaps	168	388	–	556

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.

The average exchange rates used in the measurement of hedging instruments were as follows for the following currencies with significant nominal amounts: NOK 9.5866, USD 1.3117, TRY 6.5550, PLN 4.2944. The average exchange rates used for interest rate swaps and cross-currency interest rate swaps were as follows for the following currencies: EUR 0.33%, NOK 0.29%, AUD 2.84%, MXN 7.65% and JPY 0.53%.

DISCLOSURES ON HEDGING INSTRUMENTS USED IN HEDGE ACCOUNTING

The VW FS AG Group regularly uses hedging instruments to hedge changes in the fair value of financial assets and financial liabilities.

The following overview for the reporting period shows the notional amounts, fair values and changes in fair value to determine ineffectiveness in hedging instruments used in fair value hedges to hedge risk arising from changes in fair value:

€ million	Notional amount	Derivative financial instruments – assets	Derivative financial instruments – liabilities	Fair value change to determine ineffectiveness
Interest rate risk hedging				
Interest rate swaps	26,346	397	32	267
Currency risk hedging:				
Currency forwards/cross currency swaps	685	13	25	–15
Combined interest rate and currency risk hedging:				
Cross-currency interest rate swaps	788	61	–	60

The VW FS AG Group also uses hedging instruments to hedge the risk arising from changes in future cash flows.

The following table for the reporting period sets out the notional amounts, fair values and changes in fair value to determine ineffectiveness in hedging instruments used in cash flow hedges:

€ million	Notional amount	Derivative financial instruments – assets	Derivative financial instruments – liabilities	Fair value change to determine ineffectiveness
Interest rate risk hedging				
Interest rate swaps	1,420	8	3	2
Currency risk hedging:				
Currency forwards/cross currency swaps	40	0	0	0
Combined interest rate and currency risk hedging:				
Cross-currency interest rate swaps	1,048	32	5	31

The change in fair value to determine ineffectiveness equates to the change in the fair value of the designated components of the hedging instruments.

DISCLOSURES ON HEDGED ITEMS TO WHICH HEDGE ACCOUNTING IS APPLIED

Disclosures on hedged items, broken down by risk category and type of designation, are required in addition to the disclosures on hedging instruments.

The table below shows the hedged items hedged in fair value hedges as of December 31, 2018:

€ million	Carrying amount	Cumulative hedge adjustments	Hedge adjustments current period/fiscal year	Cumulative hedge adjustments from terminated hedges
Interest rate risk hedging:				
Loans to and receivables from banks	–	–	–	–
Loans to and receivables from customers	10,195	5	13	–
Liabilities to banks	–	–	–	–
Liabilities to customers	−506	−6	−7	–
Notes, commercial paper issued	−19,746	−148	−116	–
Subordinated capital	–	–	–	–
Currency risk hedging:				
Loans to and receivables from banks	–	–	–	–
Loans to and receivables from customers	533	−5	−5	–
Liabilities to banks	−26	1	−1	–
Liabilities to customers	–	–	–	–
Notes, commercial paper issued	–	–	–	–
Subordinated capital	–	–	–	–
Combined interest rate and currency risk hedging:				
Loans to and receivables from banks	–	–	–	–
Loans to and receivables from customers	381	−14	−6	–
Liabilities to banks	–	–	–	–
Liabilities to customers	−305	−48	−74	–
Notes, commercial paper issued	−166	−1	−5	–
Subordinated capital	–	–	–	–

The following table presents the hedged items hedged in cash flow hedges as of December 31, 2018:

€ million	Fair value change to determine ineffectiveness	RESERVE FOR Existing cash flow hedges	RESERVE FOR Terminated cash flow hedges
Interest rate risk hedging			
Designated components	−8	4	0
Deferred taxes	–	−2	0
Total interest rate risk	−8	2	0
Currency risk hedging:			
Designated components	0	0	–
Deferred taxes	–	0	–
Total currency risk	0	0	–
Combined interest rate and currency risk hedging:			
Designated components	−27	1	–
Deferred taxes	–	0	–
Total combined interest rate and currency risk	−27	1	–

CHANGES IN THE CASH FLOW HEDGE RESERVE

In the accounting treatment of cash flow hedges, the designated effective portion of a hedge is reported in other comprehensive income (in “OCI I”). All changes in the fair value of hedging instruments in excess of the effective portion are reported in profit or loss as hedge ineffectiveness.

The following table shows a reconciliation for the cash flow hedge reserve (OCI I):

€ million	Interest rate risk	Currency risk	Combined interest rate and currency risk	Total
Balance as of Jan. 1, 2018	**10**	**−3**	**1**	**7**
Gains or losses from effective hedges	−7	3	6	2
Reclassifications resulting from the recovery of the hedged item	0	0	−6	−6
Balance as of Dec. 31, 2018	**2**	**0**	**1**	**3**

In the table, the effects reported in equity are reduced by deferred taxes.

In the hedges used by the VW FS AG Group, no derivative components are undesignated.

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.
Local cash funds in certain countries (e.g. China, Brazil, India) are only available to the Group for cross-border transactions subject to exchange controls. There are otherwise no significant restrictions.

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.

Segment Reporting

64. Breakdown by Geographical Market

The delineation between segments follows that used for internal management and reporting purposes in the VW FS AG Group. Operating profit or loss is reported as the primary key performance indicator to the chief operating decision-makers. The information made available to management for management purposes is based on the same accounting policies as those used for external financial reporting.

Segment reporting (including the presentation of the prior year) has been adjusted in line with the changes to internal reporting. Management was previously based on regions. From now on, management will follow a geographical breakdown on a market basis. Foreign branches of German subsidiaries are allocated to the markets in which they are based. The geographical markets of Germany, China, Mexico and Brazil represent the reportable operating segments in accordance with IFRS 8. The German market includes companies in Germany and Austria in line with internal reporting. The other geographical markets are grouped together under other segments and, according to the criteria of IFRS 8, are not subject to separate reporting requirements.

Companies that are not allocated to any geographical market are reported in the reconciliation. The reconciliation also includes the VW FS AG holding company, the holding and financing companies in the Netherlands, France and Belgium, EURO Leasing companies in Germany, Denmark and Poland, Volkswagen 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. Effects from consolidation between the segments and from the provision for country risks are additionally included in the reconciliation.

In contrast to the presentation of segment reporting in the 2017 Annual Report, the 2017 breakdown by geographical market shown here does not include any profit or loss for the discontinued operations.

All business transactions between the segments – where such transactions take place – are conducted on an arm's-length basis. There were no intersegment transactions in the fiscal year under review.

In accordance with IFRS 8, non-current assets are reported exclusive of financial instruments, deferred tax assets, post-employment benefits and rights under insurance contracts.

BREAKDOWN BY GEOGRAPHICAL MARKET 2017:

€ million	Germany	China	Mexico	Brazil	Other segments	Segments total	Re-conciliation	Group
	JAN. 1 – DEC. 31, 2017							
Interest income from lending transactions and marketable securities in respect of third parties	8	628	242	612	424	1,913	68	1,981
Income from leasing transactions with third parties	7,054	–	214	12	859	8,139	229	8,368
Intersegment income from leasing transactions	–	–	–	–	–	–	–	–
Depreciation, impairment losses and other expenses from leasing transactions	−6,461	–	−131	−4	−709	−7,304	−232	−7,536
of which impairment losses in accordance with IAS 36	−169	–	−5	−1	−29	−205	−6	−211
Net income from leasing transactions	593	–	83	8	150	835	−2	832
Interest expense	−150	−239	−142	−257	−241	−1,030	−17	−1,047
Income from service contracts with third parties	1,402	–	–	1	166	1,570	22	1,592
Intersegment income from service contracts	–	–	–	–	–	–	–	–
Income from insurance business with third parties	–	–	–	–	–	–	287	287
Intersegment income from insurance business	–	–	–	–	–	–	–	–
Fee and commission income from third parties	113	–	51	78	30	271	16	287
Intersegment fee and commission income	–	–	–	–	–	–	–	–
Other amortization, depreciation and impairment losses	−12	−3	0	−17	−12	−45	−18	−62
Operating profit/loss	**111**	**224**	**94**	**87**	**162**	**679**	**−60**	**619**

BREAKDOWN BY GEOGRAPHICAL MARKET 2018:

€ million	Germany	China	Mexico	Brazil	Other segments	Segments total	Re-conciliation	Group
	JAN. 1 – DEC. 31, 2018							
Interest income from lending transactions and marketable securities in respect of third parties	7	697	263	480	419	1,866	101	1,967
Income from leasing transactions with third parties	7,492	–	203	13	956	8,664	149	8,813
Intersegment income from leasing transactions	–	–	–	–	–	–	–	–
Depreciation, impairment losses and other expenses from leasing transactions	−6,919	–	−126	−4	−783	−7,831	−148	−7,978
of which impairment losses in accordance with IAS 36	−175	–	−3	0	−39	−216	0	−216
Net income from leasing transactions	574	–	78	9	173	834	1	835
Interest expense	−124	−299	−158	−185	−247	−1,013	−57	−1,070
Income from service contracts with third parties	1,139	–	–	2	195	1,336	23	1,359
Intersegment income from service contracts	–	–	–	–	–	–	–	–
Income from insurance business with third parties	–	–	–	–	–	–	308	308
Intersegment income from insurance business	–	–	–	–	–	–	–	–
Fee and commission income from third parties	232	–	67	71	27	398	25	423
Intersegment fee and commission income	–	–	–	–	–	–	–	–
Other amortization, depreciation and impairment losses	−13	−3	0	−3	−14	−34	−1	−34
Operating profit/loss	**252**	**182**	**118**	**150**	**138**	**839**	**4**	**844**

Information on the main products (lending and leasing business) can be taken directly from the income statement.

The breakdown of non-current assets in accordance with IFRS 8 and of the additions to non-current lease assets by geographical market is shown in the following tables:

€ million	Germany	China	Mexico	Brazil
	JAN. 1 – DEC. 31, 2017			
Noncurrent Assets	9,592	4	42	273
Additions to lease assets classified as noncurrent assets.	4,166	–	20	11

€ million	JAN. 1 – DEC. 31, 2018			
	Germany	China	Mexico	Brazil
Noncurrent Assets	10,837	6	47	251
Additions to lease assets classified as noncurrent assets.	4,449	–	14	1

Investment recognized under other assets was of minor significance.

The following table shows the reconciliation to consolidated revenue, consolidated operating profit and consolidated profit before tax.

€ million	2018	2017
Segment revenue	**12,264**	**11,894**
Other companies	385	435
Consolidation	−87	−100
Group revenue	**12,561**	**12,229**
Segment profit or loss (operating profit or loss)	**839**	**679**
Other companies	30	68
Contribution to operating profit by included companies	8	34
Consolidation	−33	−161
Operating profit/loss	**844**	**619**
Share of profits and losses of equity-accounted joint ventures	51	76
Net gain or loss on miscellaneous financial assets	−76	−42
Other financial gains or losses	−1	−11
Profit/loss before tax	**818**	**643**

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.

The following tables show the breakdown of the changes in subordinated capital (as part of financing activities) into cash and non-cash transactions for the reporting year and the prior year.

			NON-CASH TRANSACTIONS			
€ million	As of Jan. 1, 2017	Cash changes	Exchange rate changes	Changes in basis of consolidation	Measurement changes	As of Dec. 31, 2017
Subordinated capital	3,183	1,774	−150	−453	–	4,354

			NON-CASH TRANSACTIONS			
€ million	As of Jan. 1, 2018	Cash changes	Exchange rate changes	Changes in basis of consolidation	Measurement changes	As of Dec. 31, 2018
Subordinated capital	4,354	−1,302	−29	–	–	3,023

66. Off-Balance-Sheet Liabilities

CONTINGENT LIABILITIES

The contingent liabilities of €303 million (previous year: €363 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. After an analysis of the individual cases 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 of those 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 €558 million (previous year: €768 million).

OTHER FINANCIAL OBLIGATIONS

€ million	DUE 2018	DUE 2019 – 2022	DUE from 2023	TOTAL Dec. 31, 2017
Purchase commitments in respect of				
Property and equipment	20	–	–	20
Intangible assets	0	–	–	0
Investment property	–	–	–	–
Obligations from				
Irrevocable credit and leasing commitments to customers	545	–	–	545
Long-term leasing and rental contracts	22	34	5	62
Miscellaneous financial obligations	31	1	–	32

€ million	DUE 2019	DUE 2020 – 2023	DUE from 2024	TOTAL Dec. 31, 2018
Purchase commitments in respect of				
Property and equipment	6	–	–	6
Intangible assets	0	–	–	0
Investment property	–	–	–	–
Obligations from				
Irrevocable credit and leasing commitments to customers	306	–	–	306
Long-term leasing and rental contracts	23	43	3	69
Miscellaneous financial obligations	18	0	–	18

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

	2018	2017
Salaried employees	8,403	10,073
Vocational trainees	124	136
Total	**8,527**	**10,209**

68. Benefits Based on Performance Shares (Share-Based Payment)

At the end of 2018, the Supervisory Board of VW FS AG resolved to adjust the remuneration system of the Board of Management with effect from January 1, 2019. The new remuneration system of the Board of Management comprises non-performance-related and performance-related components. The performance-related remuneration consists of an annual bonus with a one-year assessment period and a long-term incentive (LTI) in the form of a performance share plan with a forward-looking three-year term.

Each performance period of the performance share plan has a term of three years. At the time the LTI is granted, the annual target amount under the LTI is converted on the basis of the initial reference price of Volkswagen's preferred shares into performance shares of Volkswagen AG, which are allocated to the respective member of the Board of Management purely for calculation purposes. A cash settlement is made at the end of the three-year term of the performance share plan. The payment amount corresponds to the number of determined performance shares, multiplied by the closing reference price at the end of the three-year period plus a dividend equivalent for the relevant term. The payment amount under the performance share plan is limited to 200% of the target amount.

The beneficiaries of the performance share plan are the members of the Board of Management and other members of senior management. The way in which the performance shares work is largely identical in all cases. The personnel expenses that have arisen under the plan for both groups of beneficiaries comes to a total of €0.1 million. The total of the target amounts for the performance shares if 100% of each of the agreed targets is attained is €2 million.

69. 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 and therefore indirectly had significant influence over the VW FS AG Group. 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.

Volkswagen AG and other related parties in Volkswagen AG's group of consolidated entities provide the entities in the VW FS AG Group with funding on an arm's-length basis. As part of funding transactions, Volkswagen AG and other related parties in Volkswagen AG's group of consolidated entities sold vehicles to entities in the VW FS AG Group on an arm's-length basis. These transactions are presented in the "Goods and services received" line item. Volkswagen AG and its subsidiaries have also furnished collateral in our favor as part of the operating business.

The "Goods and services provided" line item primarily contains income from leasing transactions.

The business transactions with unconsolidated subsidiaries and joint ventures of VW FS AG mainly relate to the provision of funding and services. These transactions are always conducted on an arm's-length basis, e.g. when using the cost plus method for the provision of services.

The two tables below show the transactions with related parties. In these tables, the exchange rates used are the closing rate for asset and liability items, and the weighted average rates for the year for income statement items.

FISCAL YEAR 2017

€ 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	–	–	1,564	0	7,006	101	3,592
Valuation allowances on impaired loans and receivables	–	–	–	–	–	–	–
of which additions in current year	–	–	–	–	–	–	–
Obligations	–	–	4,029	–	9,890	241	112
Interest income	–	–	8	–	153	7	106
Interest expense	0	0	–10	–	–203	–2	–
Goods and services provided	0	–	587	0	3,150	90	152
Goods and services received	0	0	8,222	–	4,753	47	153

FISCAL YEAR 2018

€ 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	–	–	6,920	0	7,674	99	5,075
Valuation allowances on impaired loans and receivables	–	–	–	–	–	–	–
of which additions in current year	–	–	–	–	–	–	–
Obligations	–	–	6,595	–	6,926	224	163
Interest income	–	–	4	–	145	4	109
Interest expense	–	–	–15	–	–132	–2	–
Goods and services provided	–	–	654	–	1,718	77	377
Goods and services received	–	–	7,937	–	2,258	55	400

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.

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 €81 million (previous year: €338 million) were granted to related parties as part of dealer financing.

BOARD OF MANAGEMENT REMUNERATION

€ million	2018	2017
Short-term benefits	5	6
Long-term benefits	1	1
Termination benefits	–	–
Post-employment benefits	–1	2

The long-term benefits for the reporting period include the expenses of €0.1 million relating to the performance shares granted to the members of the Board of Management.

The total payments made to former members of the Board of Management and their surviving dependants amounted to €0.5 million (previous year: €0.5 million); the provisions recognized for this group of people to cover current pensions and pension entitlements amounted to €14 million (previous year: €14 million).

SUPERVISORY BOARD REMUNERATION

In accordance with a resolution passed by the Annual General Meeting, the members of the Supervisory Board are entitled to an annual allowance. This allowance 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 amounts received for these functions is deducted from the allowance entitlement from VW FS AG. As a result, a total amount of less than €0.06 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.

70. 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.

In the reporting period, VW FS AG maintained business relationships with structured entities in connection with acquired subordinated loans. 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. In the VW FS AG Group, the subordinated loans have been allocated to assets measured at fair value through profit or loss. Under the principles specified in IFRS 10, the ABS special purpose entities are not controlled by VW FS AG and are therefore not included in the consolidated financial statements. The acquisition of subordinated loans granted 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.

The purchase of the subordinated loans 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 was limited to the fair value of the subordinated loans reported in the balance sheet.

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 amount of the securitized assets is also disclosed.

€ million	ABS SPECIAL PURPOSE ENTITIES 2018
Reported in the balance sheet as of December 31	
Loans to and receivables from customers[1]	50
Maximum loss risk	50
Nominal volume of securitized assets	639

1 Subordinated loans granted

VW FS AG did not provide unconsolidated structured entities with any noncontractual support during the reporting period.

71. 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
China region
Germany, Europe regions (as of October 1, 2018)
Mobility Unit
Sales and Marketing (as of October 1, 2018)

DR. MARIO DABERKOW
Information Technology and Processes
South America & Mexico regions (as of October 1, 2018)

DR. CHRISTIAN DAHLHEIM (UNTIL SEPTEMBER 30, 2018)
Sales and Marketing (until September 30, 2018)
Germany, Europe, International regions
Latin America, South Africa regions (until September 30, 2018)

FRANK FIEDLER
Finance and Purchasing

CHRISTIANE HESSE
Human Resources and Organization
International region (as of October 1, 2018)

The members of the Supervisory Board are as follows:

FRANK WITTER
Chairman
Member of the Board of Management of Volkswagen AG
Finance and IT

DR. ARNO ANTLITZ
Deputy Chairman
Member of the Volkswagen Brand Board of Management
Controlling and Accounting

DR. KARLHEINZ BLESSING (UNTIL APRIL 16, 2018)
Deputy Chairman
Member of the Board of Management of Volkswagen AG
Human Resources and Organization

JOACHIM DREES
Chief Executive Officer of MAN SE and MAN Truck & Bus AG

MICHAEL GROSCHE (FROM OCTOBER 1, 2018)
Head of Fleet, Mobility and Remarketing of Volkswagen Financial Services AG

FRED KAPPLER (UNTIL SEPTEMBER 30, 2018)
Head of Group Sales of Volkswagen AG

ANDREAS KRAUß
Member of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

SIMONE MAHLER
Deputy Chairwoman of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

DR.-ING. PETER MERTENS (UNTIL OCTOBER 12, 2018)
Member of the Board of Management of AUDI AG
Technical Development

GABOR POLONYI (UNTIL AUGUST 31, 2018)
Head of Fleet Customer Management for Volkswagen Financial Services Digital Solutions GmbH

PETRA REINHEIMER
General Secretary of the Joint Works Council of Volkswagen Financial Services AG, Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

DR. HANS PETER SCHÜTZINGER (FROM OCTOBER 1, 2018)
Chief Executive Officer of Porsche Holding GmbH Salzburg

EVA STASSEK
Principal Representative of IG Metall Braunschweig

STEPHAN WOLF (UNTIL DECEMBER 31, 2018)
Deputy Chairman
Deputy Chairman of the General and the Group Works Councils of Volkswagen AG

72. 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; Volkswagen Doğuş Faktoring A.Ş., Kağıthane-Istanbul, Turkey.

73. Events After the Balance Sheet Date

On February 7, 2019, Volkswagen Financial Services AG acquired a 60% interest in FleetCompany GmbH, an Oberhaching-based company operating in more than 70 countries around the world under the brand name FleetLogistics. The other 40% of the company shares are held by the Munich-based former sole shareholder TÜV SÜD Auto Service GmbH, a wholly owned subsidiary of TÜV SÜD AG. Both shareholders have agreed to maintain the brand neutrality of FleetLogistics. The aim is to provide customers with a full offering which will also incorporate travel and fleet management. The investment is subject to the merger control approval of the competent antitrust authorities.

There were no other significant developments after the end of fiscal year 2018.

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 8, 2019

Volkswagen Financial Services AG
The Board of Management

Lars Henner Santelmann

Dr. Mario Daberkow

Frank Fiedler

Christiane Hesse

INDEPENDENT AUDITOR'S REPORT

To VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

AUDIT OPINIONS

We have audited the consolidated financial statements of VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 2018, and the consolidated statement of comprehensive income, consolidated statement of profit or loss, consolidated statement of changes in equity and consolidated statement of cash flows for the financial year from January 1 to December 31, 2018, and notes to the consolidated financial statements, including the presentation of the recognition and measurement policies. In addition, we have audited the group management report of VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig, which is combined with the Company's management report, for the financial year from January 1 to December 31, 2018. We have not audited the content of the statement on corporate governance pursuant to § [Article] 289f Abs. [paragraph] 4 HGB [Handelsgesetzbuch: German Commercial Code] (disclosures on the proportion of women) in accordance with the German legal requirements.

In our opinion, on the basis of the knowledge obtained in the audit,

> the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as at December 31, 2018, and of its financial performance for the financial year from January 1 to December 31, 2018, and
> the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of the above mentioned statement on corporate governance referred to above.

Pursuant to § 322 Abs. 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Audit Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from January 1 to December 31, 2018. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matter of most significance in our audit was as follows:
❶ Recoverability of lease assets

Our presentation of this key audit matter has been structured as follows:
① Matter and issue
② Audit approach and findings
③ Reference to further information

Hereinafter we present the key audit matter:
❶ Recoverability of lease assets

① Vehicles from current leases are reported under the balance sheet item "Lease assets" in the amount of EUR 13,083 million (16.3% of consolidated total assets) in the consolidated financial statements of VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT as of December 31, 2018. The measurement of the lease assets is based on amortized cost and the recoverable amount. The Volkswagen Financial Services Group performs a quarterly impairment test of the lease assets. The carrying amount of the relevant asset is compared with the corresponding recoverable amount in the context of the impairment test. The results of internal and external marketing and the executive directors' estimate of the development of market prices for vehicles are taken into account for this purpose. Write-downs amounting to EUR 216 million were recognized in respect of lease assets in the financial year on the basis of this valuation.

The measurement of the lease assets is, firstly, of great significance for the assets, liabilities, and financial performance of the Group in terms of amount and, secondly, involves considerable scope for judgment on the part of the executive directors, since the use of models and assumptions creates material uncertainties due to the estimates required for the measurement exercise. In addition, the current public discussion about the development of the residual values of vehicles with diesel engines (bans on diesel vehicles in inner cities, shift in demand towards vehicles with petrol engines) contributes further to the uncertainty involved in measuring the vehicles recognized. Against this background, this matter was of particular significance during our audit.

② Our audit included in particular assessing the valuations carried out by the Company with respect to whether these were up to date, as well as the methodology applied and the transparency of the valuation. At the same time, we obtained an understanding of the source data underlying the valuation, the value inputs and the assumptions made, evaluated those factors critically and assessed whether they are within a reasonable range. In addition to this, our assessment of the assumptions made by the executive directors with respect to marketing was based, among other things, on a comparison with general and sector-specific market expectations as well as documentation and explanations from the executive directors relating to the expected marketing results. Furthermore, we verified the classification of the vehicles as property and equipment and evaluated the accounting policies applicable as a result.

Overall, the valuation parameters and assumptions used by the executive directors are in line with our expectations and are also within the ranges considered by us to be reasonable.

③ The Company’s disclosures relating to the lease assets are contained in numbers 13, 18, 19 and 39 of the notes to the consolidated financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the statement on corporate governance pursuant to § 289f Abs. 4 HGB (disclosures on the proportion of women) which we obtained prior to the date of our auditor's report.

The annual report is expected to be made available to us after the date of the auditor's report.

Our audit opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

> is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
> otherwise appears to be materially misstated.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group’s ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group’s position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group’s financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

> Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
> Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.
> Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
> Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.
> Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.
> Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.
> Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.
> Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate

audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on April 23, 2018. We were engaged by the supervisory board on July 24, 2018. We have been the group auditor of VOLKSWAGEN FINANCIAL SERVICES AKTIENGESELLSCHAFT, Braunschweig, without interruption since financial year 1991.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Frank Hübner.

Hanover, February 8, 2019

PricewaterhouseCoopers GmbH
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 2018, 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 three regular meetings in the reporting period; there were no extraordinary meetings. The average attendance rate was 85%. One member of the Supervisory Board attended less than half of the meetings; all other members of the Supervisory Board were present at more than half of the meetings. Decisions were made on two matters by means of a written resolution circulated to each of the members for approval; the Chairman of the Supervisory Board also made eleven urgent decisions using the written procedure.

COMMITTEE ACTIVITIES

The Supervisory Board of Volkswagen Financial Services AG is not subject to an obligation to establish committees. Instead, the full Supervisory Board is responsible for performing the tasks of an audit committee pursuant to Article 39(2) of Directive 2014/56/EU in conjunction with section 107(3) of the Aktiengesetz (AktG – German Stock Corporation Act).

In this regard, the Supervisory Board held detailed discussions in the reporting period, addressing the supervision of the internal control, risk management and internal audit systems as well as the monitoring of the financial reporting and auditing process.

MATTERS DISCUSSED BY THE SUPERVISORY BOARD

At its meeting on March 7, 2018, following reports submitted by the independent auditors, 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 2017 prepared by the Board of Management. The Supervisory Board also issued a recommendation regarding the appointment of the independent auditors for 2018 and adopted new guidelines for non-audit services provided by auditors.

In addition, the Board of Management informed the Supervisory Board about key areas of focus in fiscal year 2018, which included the digitalization strategy, the mobility business area and the development of the financial services business in China. In other discussions, the Board of Management explained to the members of the Supervisory Board the operational excellence initiative launched at the beginning of 2018. Volkswagen Financial Services AG aims to use this initiative to achieve further improvements in its competitiveness in all areas. The Supervisory Board was also kept up to date with the progress of the implementation of the General Data Protection Regulation (GDPR), which came into force in May.

Other topics included the presentation of the overall financial planning and scheduled capital investment. Finally, the Supervisory Board gave its consent to a market launch in Luxembourg as part of a joint venture and the acquisition of a majority equity investment in a Portuguese software business.

In this meeting and also in the meetings held on June 13, 2018 and November 5, 2018, the Board of Management provided the Supervisory Board with comprehensive reports on the economic and financial position of the Company and the Group.

At the meeting of the Supervisory Board held on June 13, 2018, the Chief Digital Officer reported in detail on the latest implementation status of the digitalization project at Volkswagen Financial Services AG and on the procedures used in this project. The Head of the Mobility Unit also explained to the Supervisory Board how mobility themes are integrated within the Group from a strategic perspective and set out the latest key priorities in this area of business. In another presentation to the Supervisory Board, the Chief Compliance Officer reported how the internal control system and risk management system has been working since the restructuring in September 2017.

In addition, the Supervisory Board consented to the equity investment in ID provider Verimi, a restructuring of the Chinese leasing companies and further steps in the process of separating the lending business supervised by the European Central Bank from the other areas of business at Volkswagen Financial Services AG (Project Panda).

At the meeting on November 5, 2018, the Supervisory Board approved a new remuneration system for the Board of Management of Volkswagen Financial Services AG. It also adopted a proposal for the election of the independent auditors from fiscal year 2020. In further agenda items, the Supervisory Board addressed a number of other issues, notably the latest position of the Company with a particular focus on the Chinese market. In addition, the Board of Management provided an IT status report. This report focused on IT strategy and on changes in compliance and security.

The Supervisory Board also addressed the implementation status of action plans in the Together4Integrity program at Volkswagen Financial Services AG. In another item, the Head of Internal Audit presented the overall strategy for Internal Audit and reported on the status of the auditing program for the reporting period. The Supervisory Board also received information on the collaboration between Porsche Financial Services GmbH and Volkswagen Financial Services AG.

Finally, the Supervisory Board agreed to the acquisition of equity investments in a number of entities operating in the leasing and mobility business areas.

AUDIT OF THE ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Hanover, was appointed to audit both the consolidated financial statements of the Volkswagen Financial Services AG Group in accordance with the IFRS and the annual financial statements of Volkswagen Financial Services AG in accordance with HGB for the year ended December 31, 2018, including the bookkeeping system and management reports.

The consolidated financial statements of the Volkswagen Financial Services AG Group in accordance with the IFRS and the annual financial statements of Volkswagen Financial Services AG in accordance with HGB for the year ended December 31, 2018, together with the management reports, were submitted to the Supervisory Board. The auditor, PricewaterhouseCoopers GmbH 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 February 13, 2019, 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.

Under the current control and profit-and-loss transfer agreement, the loss reported by Volkswagen Financial Services AG in accordance with the HGB for fiscal year 2018 was absorbed by 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, February 13, 2019

Frank Witter
Chairman of the Supervisory Board

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