

## CREDIT OPINION

22 October 2024

Update



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### RATINGS

#### Volkswagen Financial Services Overseas AG

Domicile	Braunschweig, Germany
Long Term Rating	A3
Type	LT Issuer Rating - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# Volkswagen Financial Services Overseas AG

Update following rating affirmation and outlook change to negative

## Summary

[Volkswagen Financial Services Overseas AG's](#) (VW FS Overseas) A3 issuer ratings carry a negative outlook and reflect the company's ba2 standalone assessment and strategic importance to its parent [Volkswagen Aktiengesellschaft](#) (Volkswagen, A3 negative<sup>1</sup>).

VW FS Overseas' A3 long-term issuer ratings and outlook are aligned with Volkswagen's ratings, based on the captive's strategic significance to its carmaking parent, our expectation that Volkswagen would support VW FS Overseas if required, as well as the domination and profit and loss transfer agreement in place between the two companies. VW FS Overseas' credit profile, therefore, reflects its ba2 standalone assessment and the uplift derived from affiliate support from Volkswagen.

VW FS Overseas' ba2 standalone assessment incorporates the company's narrow focus on enhancing its parent's vehicle sales in Asia-Pacific and Latin America, which drives strong portfolio growth and results in asset-class concentration risk; its adequate financial profile, characterised by solid profitability and sufficient capitalisation; and its funding mix, which relies significantly on secured (asset-backed) and wholesale market funding.

## Credit strengths

- » Implicit and explicit support from the parent protects creditors
- » Low historical losses on the loan portfolio indicate sound underwriting standards
- » Solid profitability and good leverage ratio will likely be maintained under the new setup

## Credit challenges

- » The continued reshaping of the automobile industry towards low-emission, alternative-fuel vehicles could eventually hurt VW FS Overseas' sound asset quality and profitability in the current volatile economic and geopolitical environment.
- » Elevated credit risks due to VW FS Overseas regional focus on the more volatile Asia-Pacific and Latin America regions
- » Very high reliance on confidence-sensitive wholesale funding carries refinancing risks

## Outlook

- » The negative outlook reflects the negative outlook on the parent Volkswagen and reflects our assessment of the very strong contractual and economic rationale for Volkswagen to support its financial services entities.

- » The strategic importance of VW FS Overseas for the distribution of Volkswagen vehicles and the formal commitment of Volkswagen through a long-term control and profit-and-loss transfer agreement effectively leads to an alignment of the issuer's long-term ratings and outlook with that of Volkswagen.

### Factors that could lead to an upgrade

- » VW FS Overseas' and its guaranteed subsidiaries' ratings could be upgraded following an upgrade of Volkswagen's rating.
- » VW FS Overseas' ba2 standalone assessment could be upgraded if it displays a solid asset quality through the cycle, improves its capitalisation or reduces its dependence on more confidence-sensitive market funding.
- » However, a change in VW FS Overseas' standalone assessment will, in the absence of changes to Volkswagen's ratings and/or support probability, not lead to changes in the captive's rating.

### Factors that could lead to a downgrade

- » VW FS Overseas' and its guaranteed subsidiaries' ratings could be downgraded if Volkswagen's ratings were to be downgraded.
- » A downgrade of VW FS Overseas' and its guaranteed subsidiaries' ratings could also be triggered if Volkswagen were to loosen its ties with its financial services subsidiaries. This loosening could lead to a lowering of our support assumption for VW FS Overseas and a downgrade of the associated ratings to a level below the parent's issuer ratings.
- » VW FS Overseas' ba2 standalone assessment could be downgraded following an unexpected erosion of the company's capital base or if the company's asset quality declines significantly, particularly if associated with a meaningful deterioration of macroeconomic conditions in the countries of operation leading to tighter disposable income or higher unemployment.
- » The standalone assessment could also be downgraded if there is an extended mismatch of VW FS Overseas' confidence-sensitive wholesale funding with that of the company's lease and lending assets.
- » However, a change in VW FS Overseas' standalone assessment will, in the absence of changes to Volkswagen's ratings and/or support probability, not lead to changes in the captive's rating.

### Profile

As part of the reorganisation of Volkswagen's captive finance operations, Volkswagen Financial Services Overseas AG (previously named Volkswagen Financial Services AG) has spun off and transferred its European subsidiaries and participations and further assets and liabilities to [Volkswagen Financial Services AG](#) (VW FS AG, previously named Volkswagen Financial Services Europe AG, A3 stable<sup>2</sup>).

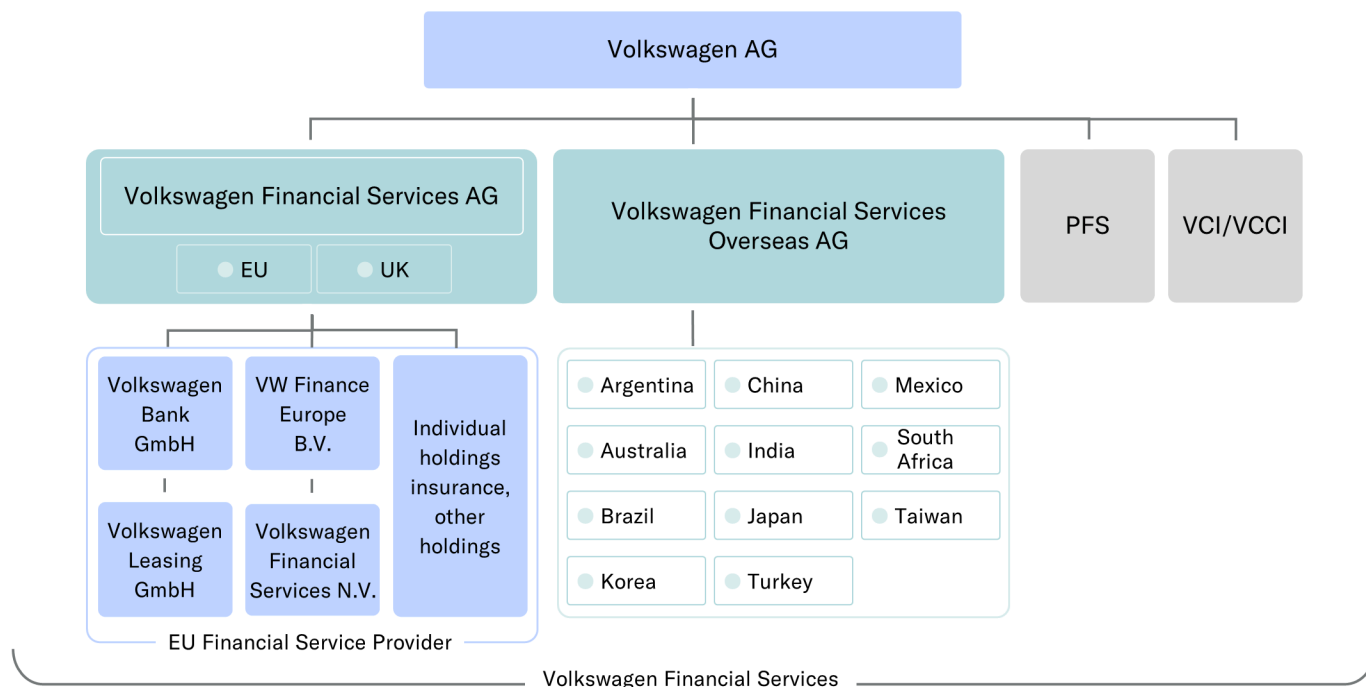
As part of the reorganisation, VW FS Overseas will primarily focus on the non-European and non-UK bank and nonbank activities in Asia-Pacific and Latin America and deconsolidate or transfer most of its holdings to VW FS AG, the newly formed EU parent financial holding company of Volkswagen's captive finance operations.

As a result of the deconsolidation and various asset, liability and share transfers, VW FS Overseas' balance sheet size will shrink to approximately €31 billion as of 1 July 2024, from €146.3 billion reported as of 31 December 2023.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

Exhibit 1

## New organisational structure of Volkswagen's financial services operations



Abbreviations: PFS = Porsche Financial Services GmbH; VCI = VW Credit Inc.; VCCI = VW Credit Canada Inc.

Sources: Moody's Ratings and company filings

## Detailed credit considerations

### Parental support from Volkswagen affords greater protection to creditors

VW FS Overseas has strategic importance to Volkswagen as it controls most of the group's banking and non-banking financial operations in Asia-Pacific and Latin America. The importance is illustrated by a control and profit and loss transfer agreement with Volkswagen. According to the agreement, Volkswagen is obliged to absorb any net losses of VW FS Overseas and to provide security to its creditors (in accordance with section 303 of German AktG). Although the agreement does not constitute a full guarantee of VW FS Overseas' obligations by Volkswagen, the carmaker has a strong economic incentive to support its captive because of the latter's important role as financing provider supporting group sales, warranting full uplift to the carmaker's ratings.

As such, VW FS Overseas' default probability and expected loss are closely linked with those of its parent Volkswagen. We continue to believe that there is a strong willingness of the parent to provide support due to the reasons mentioned above and, thus, the senior unsecured rating of VW FS Overseas is aligned with the A3 issuer rating of Volkswagen.

### Asset quality remains exposed to car market cyclicality

We assign a weighted average Asset Risk score of Baa3 to VW FS Overseas. The Baa3 weighted average Asset Risk score reflects our view of the captive's exposure to potential asset quality deterioration and higher loan losses, driven by slowing and more volatile economic growth in its regions of operation. In particular, [China](#) (A1 negative) is a key sales market for Volkswagen; and its economic health is also important for other markets in the region and globally.

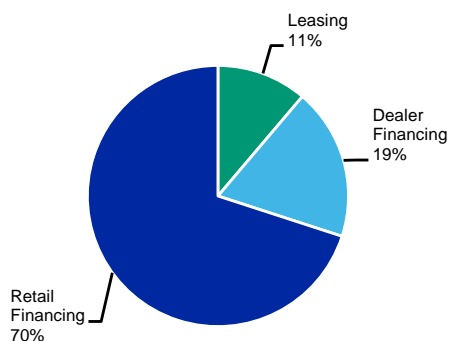
VW FS Overseas' asset quality performance is influenced by its significant concentrations to the car financing business, including dealers' inventories of Volkswagen group vehicles, and retail loan collateral and lease residual exposures. VW FS Overseas' risk profile is, therefore, affected by trends in new and used car values and macroeconomic conditions in the markets in which the carmaker and its captive operate. Moreover, the future sales performance of cars in general appears significantly less certain and predictable as a result of shifting consumer preferences, higher inflation tightening disposable incomes and the effects of carbon transition and related regulation on the captive's stock of financed and leased vehicles.

Since VW FS Overseas primarily provides financing solutions, with leasing serving only as a supplementary business segment as of today, credit risks are considered the primary driver of the captive's asset quality. However, residual value risks can also materialize indirectly. For instance, at the car dealer level, these risks could translate into additional credit risks for VW FS Overseas. However, because of the importance of the dealer network to the broader group's value chain, Volkswagen has supported car dealers in the past and will likely continue to provide support in case of need, thereby alleviating potential asset-quality strain.

Volkswagen's strategic objectives underscore the crucial role that its overseas captive finance arm plays. We predict lending volumes at VW FS Overseas to steadily increase over time in order to support Volkswagen's strategic objectives. However, we anticipate problem loan ratios to rise from the current levels as the above mentioned risk factors are likely to affect VW FS Overseas' portfolio volume and quality.

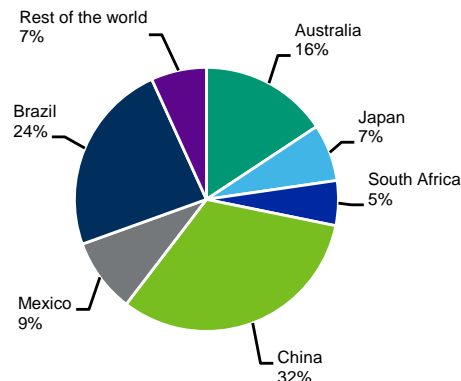
Exhibit 3 illustrates that China, Brazil, and Australia were the most important regions for VW FS Overseas as of year-end 2023, based on historical data and our estimates. Given Volkswagen's strategic focus, we anticipate the current overseas markets, in particular China, to grow in relative importance.

Exhibit 2  
**VW FS Overseas' estimated business volume split Q1 2024E**  
 Based on pro-forma Moody's Ratings' estimates



Based on data after reorganisation for year-end 2023.  
 Sources: Moody's Ratings estimates and company filings

Exhibit 3  
**VW FS Overseas' estimated portfolio split by country**  
 Emerging markets and China are likely to outgrow mature economies



Based on data after reorganisation.  
 Sources: Moody's Ratings estimates and company filings

**Solid capital ratio expected**

We assign a Capital score of Baa2 to VW FS Overseas, capturing our expectation that the captive will display a tangible common equity/tangible managed assets (TCE/TMA) of around 14% going forward.

The targeted level of TCE/TMA will help accommodate future expansion plans and is broadly in line with most global peers, indicating a competitive capital position for the captive. Possible risks to its capitalisation might stem from the asset risks previously outlined, notably due to VW FS Overseas' focus on riskier overseas markets. However, the profit and loss agreement with Volkswagen serves as a mitigating factor to its overall sound capitalisation.

**Forecasted profitability to remain solid despite challenges**

We assign a Baa3 Profitability score to VW FS Overseas, indicative of our forecast that the captive's net income to average managed assets ratio will approximately settle within a range of 1.0%-1.5% in 2024 and potentially beyond.

In alignment with Volkswagen's expansion plans for the target growth regions in Asia-Pacific and Latin America, we anticipate greater earnings momentum to build for VW FS Overseas as and when macroeconomic conditions stabilise. This is likely to lead to robust demand momentum for financing solutions, aided by the recovery of supply chains and global car markets as well as Volkswagen's new model release strategy.

However, the transition towards alternative fuel or battery electric vehicles, given their uncertain future prospects, may add volatility to the captive's earnings. Furthermore, household disposable incomes continue to be suppressed by rising inflation and persistently higher interest rates, which is likely to increase earnings volatility driven by cyclical variances in consumer financial health and the demand for new or used vehicles.

### Very high reliance on wholesale and secured funding

We assign a weighted average Cash Flow and Liquidity Score of Ba2 to VW FS Overseas. The assigned score captures VW FS Overseas' almost exclusive reliance on secured and wholesale funding, which renders the company vulnerable to market disruptions and illiquidity in the absence of a deposit-generating franchise.

This very high reliance on market funding is mitigated by a good match of funding tenors with those of the financed lending assets. It is VW FS Overseas' strategy to achieve a matching maturity of assets and liabilities of around 80%. Together with its fairly diversified local funding franchises with well established funding channels in all key regions and currencies of operations, this supports the availability of secured (asset-backed) and unsecured funding for VW FS Overseas.

We anticipate that secured funding sources will play an increasingly crucial role in VW FS Overseas' funding mix moving forward. In the event that the local operating entities encounter funding challenges, the company has the capacity to leverage its own funding sources for support. In addition to a multi-billion and multi-currency debt issuance and commercial paper program, these potential funding sources encompass a multi-billion Euro committed standby liquidity facility from the parent company, highlighting the importance of VW FS Overseas' operations and well-being to the execution of Volkswagen's strategy.

### Operating environment

We assign a Ba2 weighted Operating Environment score to VW FS Overseas, based on the industry and macro-level risks at its financing operations across the Asia-Pacific and Latin America regions as well as our expectation of future diversification of the portfolio towards markets with a weaker assessment of macro-level risks, such as China and Brazil.

The operating environment score acts as a cap on VW FS Overseas' overall Ba2 adjusted financial profile because the score is the lower than the standalone financial profile of Ba1.

### Macro-level and industry risk indicators for key markets

While headquartered in Germany, VW FS Overseas' operations primarily span the lending markets of China, Brazil, Australia, Mexico and Japan. As such, the macro level indicators relevant to these markets vary widely, from Aa1 for Australia to Baa2 for Mexico.

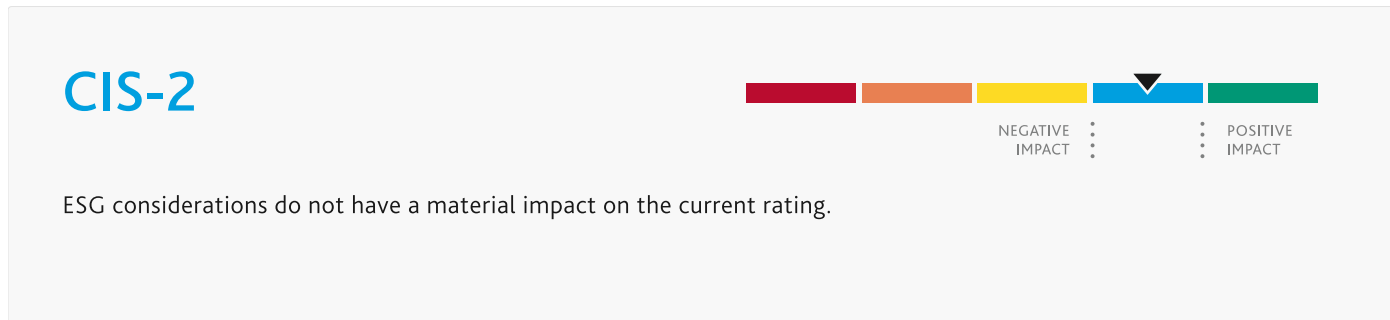
To account for the various levels of risk, we assign a Ba industry risk score for VW FS Overseas' lending operations in China, Mexico, and Brazil. This score reflects our anticipation that the combination of unseasoned and rapidly expanding loan books, along with high political and regulatory risks, will cumulatively create a challenging operating environment for VW FS Overseas. Although we view Australia in a more positive light, it only constitutes a minor and likely declining proportion within the captive's geographical mix.

## ESG considerations

### Volkswagen Financial Services Overseas AG's ESG credit impact score is CIS-2

Exhibit 4

#### ESG credit impact score



Source: Moody's Ratings

VW Financial Services Overseas AG's (VW FS Overseas) ESG Credit Impact Score is **CIS-2** and reflects the mitigating rating impact of support from its automotive parent. VW FS Overseas is exposed to material environmental and social risks, reflecting the high risk exposure of its automotive parent Volkswagen AG and the bank's role as facilitator of sales. The company's governance risks are low.

Exhibit 5

#### ESG issuer profile scores



Source: Moody's Ratings

### Environmental

VW FS Overseas faces high environmental risks, primarily related to carbon transition. As a facilitator of sales for its automotive parent, the company's exposure to carbon transition risk is consistent with that of Volkswagen AG and the global auto manufacturing sector because of stricter environmental regulation and the trend towards low and zero emission vehicles. In response, VW FS Overseas supports Volkswagen AG's electric mobility strategy targeting to provide financing solutions for 80% of Volkswagen AG's electric vehicles in the medium term. VW FS Overseas' exposure to other environmental risks is low.

### Social

VW FS Overseas faces high social risks from societal trends. VW FS Overseas' key product is auto lending, the demand for which is subject to societal trends like higher adoption of mass transportation and heightened environmental awareness and is highly correlated to the ability of its parent to meet consumers' demand. In line with other retail consumer-focused finance companies, VW FS Overseas is also exposed to fines and reputational damage due to product mis-selling or other types of misconduct. High cyber and personal data risks are also key considerations as more applications are submitted online.

### Governance

VW FS Overseas' governance risks are low. VW FS Overseas has well-developed risk management and governance practices in place, in line with industry practices. Its score for board structure, policies and procedures is aligned with that of its parent, given VW FS Overseas' strategic importance to its parent and brand sharing.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Support and structural considerations

### Affiliate support

Based on the application of Moody's Methodology of Captive Finance Subsidiaries of Nonfinancial Corporations, the ratings of VW FS Overseas are aligned with its ultimate parent, Volkswagen. This is based on VW FS Overseas strategic significance to its parent, our expectation that Volkswagen would support VW FS Overseas if required, as well as the explicit support agreement.

### Government support considerations

The probability of government support to be 'Low' for VW FS Overseas, which does not result in any rating uplift from government support. This assumption reflects VW FS Overseas' relatively small size compared with the German banking system, its insignificant share in the domestic deposit market and its limited degree of systemic interconnectedness.

## Rating methodology and scorecard factors

The methodologies we use in rating for VW FS Overseas are the [Finance Companies Methodology](#), published in July 2024, and the [Captive Finance Subsidiaries of Nonfinancial Corporations Methodology](#), published in August 2024.

## Ratings

Exhibit 6

Category	Moody's Rating
<b>VOLKSWAGEN FINANCIAL SERVICES OVERSEAS AG</b>	
Outlook	Negative
Issuer Rating	A3
Senior Unsecured MTN	(P)A3
Commercial Paper	P-2
Other Short Term	(P)P-2
<b>PARENT: VOLKSWAGEN AKTIENGESELLSCHAFT</b>	
Outlook	Negative
Issuer Rating	A3
Sr Unsec Bank Credit Facility -Dom Curr	A3
Senior Unsecured MTN -Dom Curr	(P)A3
Commercial Paper -Dom Curr	P-2
<b>VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.</b>	
Outlook	Negative
Bkd Senior Unsecured -Dom Curr	A3
Bkd Commercial Paper -Dom Curr	P-2
Bkd Other Short Term	(P)P-2
<b>VOLKSWAGEN FINAN. SERVICES AUSTRALIA PTY LTD</b>	
Outlook	Negative
Bkd Senior Unsecured -Dom Curr	A3
Bkd Other Short Term -Dom Curr	(P)P-2

Source: Moody's Ratings

## Endnotes

- 1 The rating shown here is Volkswagen's long-term issuer rating and outlook.
- 2 The rating shown here is VW FS AG's long-term issuer rating and outlook.



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