

RatingsDirect®

[SPSF] New Issue: Driver Japan Ten

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[SPSF] New Issue: Driver Japan Ten

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¥60 Billion Beneficial Interests And ABL Due June 2029

Ratings As Of Feb. 25, 2021

Class	Amount (bil. ¥)	Rating	Interest rate	Legal final maturity date	Overcollateralization ratio (%)§
Beneficial interests 2	33.8	AAA (sf)	Fixed	June 28, 2029	6.5
ABL 2	26.2	AAA (sf)	Fixed	June 28, 2029	6.5

§We define the overcollateralization ratio as: $1 - (A+B)/(C-D-E)$; A: the rated obligations and equally ranked obligations; B: prior obligations to the rated obligations; C: underlying assets (including cash); D: liquidity reserves; E: obligations, except for senior, mezzanine, or subordinate obligations (seller's interest, etc.) ABL--Asset-backed loan.

Profile

Closing date	Feb. 25, 2021
Collateral	Auto loan receivables
Originator/Trustor 1/Servicer	Volkswagen Financial Services Japan Ltd.
Trustee (Trusts 1 and 2)	Shinsei Trust & Banking Co. Ltd.
Collection account	MUFG Bank Ltd.
Arrangers	BNP Paribas Securities (Japan) Ltd. and Mizuho Securities Co. Ltd.
ABL 1 Lender/Trustor 2	Mizuho Securities Co. Ltd.
Underwriter	BNP Paribas Securities (Japan) Ltd.
Subservicers/Guarantors of auto loan receivables	SMBC Finance Service Co. Ltd. and JACCS Co. Ltd.

Credit Support

Overcollateralization	(1) Credit support provided through overcollateralization mitigates the credit risk of the beneficial interests and ABLs. (2) Principal payments in cash for the subordinate beneficial interest will not be made until credit enhancement reaches the target level. Accordingly, credit enhancement for the ABL 1 is set to rise to the target level as seasoning increases. After credit enhancement reaches the target level, payments convert to pro rata on the ABL 1 and subordinate beneficial interest. We incorporate an impact of pro rata-basis redemption in our cash flow analysis. (3) During the one-year revolving period, the amount of the subordinate beneficial interest that serves as credit enhancement increases if the originator entrusts additional loans.
Early amortization triggers	Early amortization triggers would mitigate the potential adverse impact on redemption of ABL 1.

Transaction Structure

Servicing risk	A backup servicer was not appointed at the closing date. If certain credit events stipulated in trust agreements occur, trustee 1 will appoint a backup servicer and, in certain cases, have that backup servicer take over servicing operations from the initial servicer. This structure mitigates the risk of servicing activities being disrupted for an extended period.
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Transaction Structure (cont.)

Liquidity risk	A cash reserve funded at closing for four months' worth of interest payments and transaction expenses mitigates liquidity risk. In addition, this cash reserve is nonamortizing during the transaction term and ultimately serves as credit support.
Commingling risk	Advance payment collections by the servicer and overcollateralization mitigate commingling risk.
Counterparty risk	Under the transaction documents, qualified banks have a short-term credit rating of 'A-1' or above. In the future, if the bank of the account is no longer eligible as a qualified bank, the account will be transferred within 30 days to a financial institution that is eligible.

Assumed Scenarios

(%)	Base scenario	'AAA' stress scenario
Cumulative default rate	0.8	4.0
Losses on balloon payments	0.0	7.0
Monthly prepayment rate	1.0	0.05 to 3.0
Cumulative default rate considering losses on balloon payments	0.8	6.9
Excess spread	--	1.0
Break-even overcollateralization level	--	5.9

Rationale

S&P Global SF Japan Inc. (SPSF) today said that it has assigned its 'AAA (sf)' ratings to Driver Japan ten's beneficial interests 2 and its corresponding asset-backed loan (ABL 2) under the transaction. Both are due June 2029; they are worth a combined ¥60.0 billion (see tables above). The collateral comprises Japanese auto loan receivables that Volkswagen Financial Services Japan Ltd. (VWFSJ) originated.

The ratings reflect our views primarily on the following.

- We assume a cumulative default rate on the initial receivables balance of 0.8% under our base scenario during the transaction term, based on the characteristics of and historical data on the underlying auto loan assets, performance data on past series, and our overall outlook for the future performance of Japanese auto loan assets.
- We also assume a cumulative default rate of 6.9% under our 'AAA' stress scenario, considering that the underlying assets include auto loans with balloon payments (such loans have equal payments during the loan's life except for the last "balloon" payment, which is significantly larger).
- Credit support, provided through overcollateralization, mitigates the credit risk of the underlying assets.
- Credit support available to the beneficial interests 2 and ABL 2 withstood our 'AAA' stress scenario after analyzing the cash flow stressed on all the parameters, including default rates.
- Advance payment collections by the transaction's servicer mitigate commingling risk.
- Cash reserves in order to provide liquidity support for interest payments on rated classes and transaction costs are funded on its closing date.
- Initial servicer VWFSJ, and subservicers JACCS Co. Ltd. and SMBC Finance Service Co. Ltd. (SMBC Finance) are able to fulfill their roles in the transaction.
- As soon as the overcollateralization ratio has reached a certain level after a revolving period, the principal will be redeemed on a pro rata basis. The transaction's payment structure will convert principal payments to a monthly

pass-through turbo structure if these early amortization triggers hit.

- The transaction's legal structure establishes that the entrustment of the underlying assets is not considered as security interest and thus the underlying assets are not considered as part of the originator's property in the event of its bankruptcy.

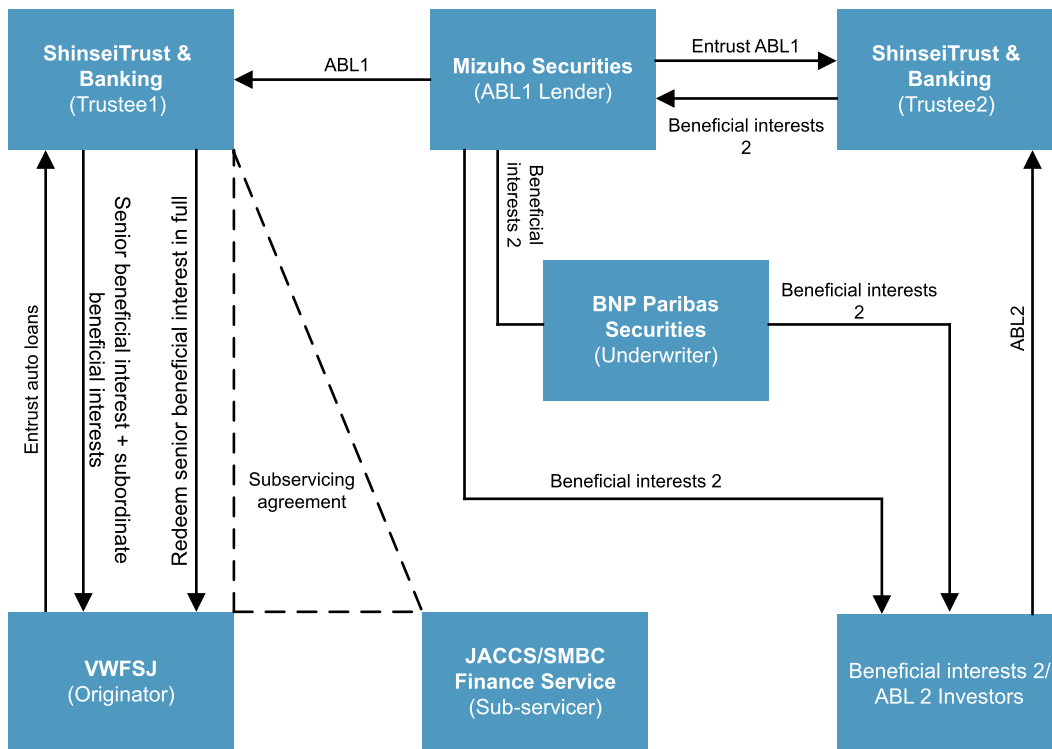
S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Transaction Structure

The ¥60 billion beneficial interests 2 and ABL 2 are backed by a pool of auto loan receivables that VWFSJ originated. The transaction structure is shown below (see chart 1).

Driver Japan Ten

Transaction structure



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1. The originator entrusted a pool of auto loan receivables and cash with Shinsei Trust & Banking Co. Ltd. (Shinsei Trust; trustee 1). At the entrustment, the lien on the receivables was perfected against third-party claims via registration of the transfer of the receivables, pursuant to regulations for perfection under Japan's Special Perfection Law. Perfection against obligor claims will be suspended unless certain events, such as a servicer replacement, occur. The originator received the senior beneficial interest and subordinate beneficial interest. Upon entrustment of the auto loans, the originator transferred withheld ownership of the relevant purchased vehicles to trustee 1. However, withheld ownership was not registered in trustee 1's name.
2. Trustee 1 raised funds from Mizuho Securities Co. Ltd. (ABL 1 Lender). Trustee 1 then redeemed the senior beneficial interest in full on the trust commencement date. The originator holds the subordinate beneficial interest for the life of the transaction.
3. The ABL 1 Lender entrusted ABL 1 with Shinsei Trust, which serves also as trustee 2. Then, BNP Paribas Securities (Japan) Ltd. as underwriter and Mizuho Securities as ABL 1 Lender sold the beneficial interests 2 to investors through a private placement. Investors also chose to lend money through ABL 2 instead of purchasing the beneficial interests 2. At the transfer of the beneficial interests 2, their assignment was perfected against obligor and third-party claims following trustee 2's written consent to a notarially certified date, pursuant to Article 94 of the Trust Law.
4. During the revolving period, the originator may entrust further auto loan receivables with trustee 1 if funds are available.
5. The originator will continue to collect the receivables with the subservicers.

The ABL 1, beneficial interests 2, and ABL 2 carry fixed rates of interest and dividend. Trustee 1 is scheduled to pay interest and principal on ABL 1 from its account to a separate account for trustee 2 on each monthly trust calculation date. After the one-year revolving period, trustee 1 will redeem ABL 1 sequentially until overcollateralization reaches 11.5%--which is 5.0 percentage points higher than the level at closing. As soon as overcollateralization has reached 11.5%, trustee 1 will redeem the principal on ABL 1 and the subordinate beneficial interest pro rata.

Trustee 2 will use collections from ABL 1 to pay interest and principal on the beneficial interests 2 and ABL 2 via a pass-through structure after deducting its trustee fee. The payment priority of the beneficial interests 2 and ABL 2 is *pari passu* throughout the transaction term.

In this transaction, a backup servicer was not appointed at closing. In the event that certain credit events stipulated in trust agreements occur, trustee 1 will appoint a backup servicer and, in certain cases, have that backup servicer take over servicing operations from the initial servicer.

Cash Flow

Delivery of collections

Each monthly collection period of this transaction starts on the 11th of each month and ends on the 10th of the following month. JACCS will collect payments from the receivables it subservices on behalf of VWFSJ through automatic withdrawal from the obligors' accounts on the 27th of each month. SMBC Finance will collect the same on

the 26th of each month. JACCS and SMBC Finance, as the guarantors, will transfer the full amount of scheduled collected proceeds--regardless of the amount of actual collected proceeds--to VWFSJ on the same respective days. VWFSJ makes advance payment to trustee 1 for one month of scheduled collections on the fourth business day before the 28th of the month when automatic withdrawal occurs. It reimburses the advance payment four business days before the 28th of the following month. In this transaction, the modified following business day convention will apply to the 28th of each month.

Trustee 1 will distribute interest and principal on ABL 1 one business day before the 28th of each month. Trustee 2 will distribute interest and principal on the beneficial interests 2 and ABL 2 on the 28th of the same month.

Revolving period

During the revolving period, VWFSJ can entrust additional auto loan receivables with trustee 1. The revolving period starts on the trust commencement date and ends on March 10, 2022, at the latest. It will end earlier if and when any of the early amortization events described below occur.

During the revolving period, trustee 1 will use interest and principal collected from the auto loan receivables less an amount equivalent to the sum of trustee fees, servicing fees, and other expenses to pay interest on ABL 1. Then, trustee 1 will retain excess cash collected from the asset pool (retained cash) in a trust. However, if VWFSJ entrusts additional auto loan receivables, it will receive a newly issued senior beneficial interest and subordinate beneficial interest and will use the retained cash to redeem the new senior beneficial interest. As soon as overcollateralization has reached 8.5%, payment to the subordinate beneficial interest will start using the excess overcollateralization or earnings.

Repayment of beneficial interests and ABL

After the revolving period has ended, trustee 1 will use interest and principal collected from the auto loan receivables, less an amount equivalent to the sum of trustee fees, servicing fees, and other expenses, to pay interest on ABL 1. Then ABL 1 will redeem sequentially until overcollateralization reaches 11.5%. As soon as overcollateralization has reached 11.5%, trustee 1 will transfer principal payments received pro rata to ABL 1 and the subordinate beneficial interest. The percentage of overcollateralization for ABL 1 will remain constant as long as the portfolio's performance stays within the following predetermined boundaries:

- The cumulative gross loss ratio exceeds 0.50% during the first six months after closing, 0.80% between month six and month 15, or 1.15% between month 15 and month 24, and trustee 1 therefore repays ABL 1 sequentially until overcollateralization reaches 17.0% for ABL 1.
- Additional credit enhancement reaches the required level, and the repayment therefore reverts to pro rata.
- The cumulative gross loss ratio exceeds 1.6% at any time, and amortization therefore permanently switches to sequential payments.

Discount rate

The discount rate applied to each loan (includes additional auto loans that VWFSJ may entrust during the revolving period) in Driver Japan ten's pool is set to be the greater of: (1) a predetermined rate (which is set, based on the entrusted pool, such that the cash flow from the assets covers the fixed interest rate of ABL 1, plus fees and expenses),

and (2) the applicable interest rate in the relevant auto loan agreement.

Early amortization triggers

This transaction is structured with early amortization triggers, which mitigates the potential adverse impact on redemption of ABL 1. In the early amortization period, trustee 1 repays ABL 1 sequentially. Early amortization trigger events include, but are not restricted to, the following:

- The cumulative gross loss ratio exceeds 1.6%;
- A servicer replacement event occurs;
- A subservicer replacement event occurs; and
- The outstanding cash amount in the trust account exceeds 10% of the portfolio volume for three consecutive months.

Credit enhancement

Overcollateralization provides credit protection for the transaction. In addition, the structure benefits from a nonamortizing cash reserve, which serves primarily as liquidity support and ultimately as credit support. Meanwhile, advance payments by the transaction's servicer mitigate commingling risk.

Originator

VWFSJ, established in 1990, is a subsidiary of Volkswagen Finance Overseas B.V. that in turn is controlled by Germany-based Volkswagen Financial Services AG, which car manufacturer Volkswagen AG owns. VWFSJ's primary business is to provide financing for customers of Volkswagen AG and grant credit to car dealers. These car dealers sell predominantly Volkswagen and Audi vehicles, along with those of Bentley, Lamborghini, and Ducati, in Japan. VWFSJ outsources its auto loan operations—including credit and scoring, processing contract applications, and collections—to JACCS and SMBC Finance. These two companies also provide guarantees to VWFSJ against losses from auto loans. VWFSJ had ¥386.2 billion in total assets and 79 employees as of Oct. 31, 2020.

Subservicers

JACCS is a Japanese consumer credit company, providing shopping credit, auto loans, and credit cards to retail customers. It is an equity method affiliate of MUFG Bank Ltd.

SMBC Finance is a part of Sumitomo Mitsui Financial Group Inc.; it functions as the group's diversified financial arm. It was formed in July 2020 through the merger of Cedyne Financial Corp. and SMBC Finance. It mainly engages in credit card, credit sales, and transaction businesses.

Collateral Description

The entrusted collateral pool backing the transaction comprises 26,193 auto loans, with a total discounted principal balance of about ¥64,171.28 million. The assets meet the major eligibility criteria listed below.

- No receivable is in default or overdue.
- The borrower has made at least two monthly payments.
- The borrower makes monthly payments via automatic withdrawal or remittance.
- The borrower makes monthly payments in equal monthly installments, and without skipped or irregular payments (except for annual or semiannual bonus payments and final balloon payments).
- The current principal outstanding balance of each receivable is greater than ¥50,000 and less than ¥10,000,000.
- The remaining number of monthly installments is no higher than 82.
- JACCS or SMBC Finance guarantees the receivables.

According to the transaction documents, receivables added to the portfolio during the revolving period need to comply with the same eligibility criteria as the receivables entrusted at closing. In addition, the portfolio's concentration in used cars and in the amount of balloon payments should not exceed certain limits during the revolving period. The concentration limit for balloon payments is 50%, that for used cars is 35%, and that for non-Volkswagen group brand cars is 5% of the total amount of loans. All limits are as of the day immediately after the trust commencement date and the additional entrustment date.

The largest single contract from an obligor represents about 0.03% of the portfolio and the top 20 loans from obligors make up 0.37% of the portfolio. The average outstanding loan balance is ¥2.45 million.

The entrusted contracts contain no maintenance components, and each borrower has paid at least two installments. The underlying assets of this transaction comprise consumer loan contracts (84.0%) and business loan contracts (16.0%). Also, 7.2% of the loan contracts are amortizing and 92.8% incorporate a balloon feature. The share for the balloon payment amount is 36.4% of the total initial amount of all loans.

Loans have an original maturity of between six and 84 months, and the remaining terms are between one and 81 months. The securitized portfolio comprises predominantly auto loans for Volkswagen and Audi vehicles. The collateral pool does not contain auto loans for the purchase of Ducati vehicles.

The largest car dealer represented about 11.4% of the mother portfolio and the top 20 dealers comprised 54.1% of the mother portfolio as of Oct. 31, 2020.

The composition of the entrusted pool of entrusted receivables is similar to that of the pools of entrusted receivables underlying past series of transactions issued by the originator. The proportion of used car loans and balloon loans has increased moderately.

Table 1 shows: attribute data of VWFSJ's entire auto loan book (the mother pool) as of Oct. 31, 2020; the pool of entrusted receivables as of Feb. 10, 2021; and attribute data of the entrusted receivables pools of the past series. The mother pool consists of receivables that VWFSJ originated and JACCS or SMBC Finance guarantees. Some of the receivables in the mother pool failed to meet the eligibility criteria for the entrusted pool. An overview of the loan products securitized in the Driver Japan ten transaction also follows (see table 2).

Table 1

Attribute Data Of Receivables Pools						
	Driver Japan ten mother pool (as of Oct. 31, 2020)	Driver Japan ten entrusted pool (as of Feb. 10, 2021)	Driver Japan nine entrusted pool (as of Feb. 10, 2020)	Driver Japan eight entrusted pool (as of Feb. 10, 2019)	Driver Japan seven entrusted pool (as of Feb. 10, 2018)	Driver Japan six entrusted pool (as of Feb. 10, 2017)
Country of origin	Japan	Japan	Japan	Japan	Japan	Japan
Total receivables (¥)*	265,638,055,944	64,171,277,269	64,172,991,168	69,520,797,756	58,823,742,157	64,171,706,472
No. of contracts	125,749	26,193	26,586	30,362	25,466	30,757
Guarantee providers§	SMBCFS (51.5%); JACCS (48.5%)	SMBCFS (56.8%); JACCS (43.2%)	SMBCFS (56.7%); JACCS (43.3%)	SMBCFS (57.6%); JACCS (42.4%)	SMBCFS (58.8%); JACCS (41.2%)	SMBCFS (61.1%); JACCS (38.9%)
Customer type	Retail (82.0%); Corporate (18.0%)	Retail (84.0%); Corporate (16.0%)	Retail (83.9%); Corporate (16.1%)	Retail (85.1%); Corporate (14.9%)	Retail (84.8%); Corporate (15.2%)	Retail (85.6%); Corporate (14.4%)
Vehicle type†	New (74.8%); Used (25.2%)	New (71.3%); Used (28.7%)	New (74.6%); Used (25.4%)	New (75.3%); Used (24.7%)	New (76.2%); Used (23.8%)	New (77.1%); Used (22.9%)
Geographic concentration	Tokyo (17.7%); Kanagawa (9.9%); Osaka (7.8%); Aichi (7.0%); Saitama (6.4%)	Tokyo (17.9%); Kanagawa (10.4%); Osaka (7.5%); Aichi (7.4%); Saitama (6.5%)	Tokyo (16.8%); Kanagawa (10.9%); Osaka (7.4%); Aichi (7.3%); Saitama (6.8%)	Tokyo (18.1%); Kanagawa (10.1%); Aichi (7.3%); Osaka (7.2%); Saitama (6.8%)	Tokyo (18.0%); Kanagawa (10.4%); Aichi (7.3%); Osaka (6.7%); Saitama (6.6%)	Tokyo (17.7%); Kanagawa (10.2%); Aichi (6.9%); Saitama (6.6%); Osaka (6.3%)
Average outstanding receivables size (¥)*	2,112,447	2,449,940	2,413,789	2,289,731	2,309,893	2,086,410
Outstanding loan size range (¥)*	5,268 to 60,899,301	50,049 to 9,999,457	50,419 to 9,996,172	51,322 to 9,987,070	50,096 to 9,976,018	50,096 to 9,980,361
Weighted-average seasoning (months)	17.5	8.8	9.1	9.3	9.6	11.8
Weighted-average remaining term (months)	33.6	41.4	40.5	39.2	38.9	36.3
Weighted-average interest rate (%)	2.22	2.14	2.27†	2.32‡	2.12‡	2.06‡
Asset redemption profile	Amortizing loans (7.1%); balloon loans (92.9%); balloon payment share (43.6%)	Amortizing loans (7.2%); balloon loans (92.8%); balloon payment share (36.4%)	Amortizing loans (8.7%); balloon loans (91.3%); balloon payment share (36.4%)	Amortizing loans (10.9%); balloon loans (89.1%); balloon payment share (37.7%)	Amortizing loans (10.6%); balloon loans (89.4%); balloon payment share (38.2%)	Amortizing loans (13.6%); balloon loans (86.4%); balloon payment share (39.5%)
Manufacturer breakdown	Volkswagen (50.5%); Audi (42.0%); Others (7.5%)	Volkswagen (50.1%); Audi (49.3%); Others (0.6%)	Volkswagen (51.2%); Audi (48.3%); Others (0.5%)	Volkswagen (54.6%); Audi (45.1%); Others (0.3%)	Volkswagen (51.8%); Audi (47.8%); Others (0.4%)	Volkswagen (51.6%); Audi (48.1%); Others (0.3%)
Type of loan products**	Owner's Plan (4.7%); Solutions (47.8%); S-Loan (45.0%); S-Loan Plus (0.1%); others (2.4%)	Owner's Plan (3.8%); Solutions (50.3%); S-Loan (42.6%); S-Loan Plus (0.0%); others (3.4%)	Owner's Plan (5.5%); Solutions (48.8%); S-Loan (42.4%); S-Loan Plus (0.1%); others (3.2%)	Owner's Plan (6.5%); Solutions (45.9%); S-Loan (42.4%); S-Loan Plus (0.8%); others (4.4%)	Owner's Plan (7.3%); Solutions (40.2%); S-Loan (46.5%); S-Loan Plus (2.8%); others (3.2%)	Owner's Plan (10.8%); Solutions (38.8%); S-Loan (44.2%); S-Loan Plus (3.4%); others (2.8%)

*The receivables balance of the mother pool is actual, while that of the final pool are discounted by the aforementioned discount rate. §SMBCFS indicates SMBC Finance Service Co. Ltd. or former Cedyna Financial Corp. †Used includes refinanced loans. ‡We calculated the weighted-average interest rate using the interest rates applied in the auto loan agreements and the principal amounts of the discounted loans. The discounted weighted-average interest rate is slightly higher than this rate. **Solutions includes Loans of Audi Future Drive.

Table 1 (continued)

Attribute Data Of Receivables Pools					
	Driver Japan five entrusted pool (as of Feb. 10, 2016)	Driver Japan four entrusted pool (as of Feb. 10, 2015)	Driver Japan three entrusted pool (as of Feb. 10, 2014)	Driver Japan two entrusted pool (as of Feb. 10, 2013)	Driver Japan one entrusted pool (as of Dec. 10, 2011)
Country of origin	Japan	Japan	Japan	Japan	Japan
Total receivables (¥)*	64,176,234,995	34,225,000,579	32,086,508,758	30,270,523,940	27,322,416,961
No. of contracts	31,976	16,751	15,890	14,160	17,182
Guarantee providers§	SMBCFS (62.0%); JACCS (38.0%)	SMBCFS (63.5%); JACCS (36.5%)	SMBCFS (65.8%); JACCS (34.2%)	SMBCFS (73.0%); JACCS (27.0%)	JACCS (100.0%)
Customer type	Retail (85.0%); Corporate (15.0%)	Retail (85.0%); Corporate (15.0%)	Retail (85.4%); Corporate (14.6%)	Retail (86.3%); Corporate (13.7%)	Retail (86.2%); Corporate (13.8%)
Vehicle type†	New (79.5%); Used (20.5%)	New (82.8%); Used (17.2%)	New (82.4%); Used (17.6%)	New (82.0%); Used (18.0%)	New (80.7%); Used (19.3%)
Geographic concentration	Tokyo (17.4%); Kanagawa (10.5%); Aichi (6.9%); Osaka (6.6%); Saitama (6.0%)	Tokyo (18.3%); Kanagawa (10.5%); Aichi (7.1%); Osaka (6.3%); Saitama (5.4%)	Tokyo (18.0%); Kanagawa (10.0%); Aichi (7.4%); Osaka (6.3%); Saitama (6.2%)	Tokyo (20.6%); Kanagawa (11.3%); Aichi (8.1%); Saitama (5.8%); Chiba (5.0%)	Osaka (15.9%); Fukuoka (9.8%); Hokkaido (6.4%); Hiroshima (4.9%); Nagano (4.7%)
Average outstanding receivables size (¥)*	2,007,013	2,043,162	2,019,289	2,137,749	1,590,177
Outstanding loan size range (¥)*	50,072 to 9,997,761	50,449 to 9,981,969	50,080 to 9,964,054	50,072 to 9,963,395	50,185 to 9,615,910
Weighted-average seasoning (months)	13.4	12.8	12.4	11.7	17.1
Weighted-average remaining term (months)	32.7	36.1	38.0	40.2	36.4
Weighted-average interest rate (%)	1.96‡	2.21‡	2.49‡	2.50‡	2.81‡
Asset redemption profile	Amortizing loans (16.1%); balloon loans (83.9%); balloon payment share (41.0%)	Amortizing loans (21.5%); balloon loans (78.5%); balloon payment share (35.9%)	Amortizing loans (27.8%); balloon loans (72.2%); balloon payment share (32.3%)	Amortizing loans (27.9%); balloon loans (72.1%); balloon payment share (29.8%)	Amortizing loans (33.6%); balloon loans (66.4%)
Manufacturer breakdown	Volkswagen (51.5%); Audi (48.2%); Others (0.3%)	Volkswagen (49.6%); Audi (49.9%); Others (0.5%)	Volkswagen (52.6%); Audi (47.1%); Others (0.3%)	Volkswagen (53.2%); Audi (46.5%); Others (0.3%)	Volkswagen (59.5%); Audi (40.3%); Others (0.2%)
Type of loan products**	Owner's Plan (14.4%); Solutions (38.3%); S-Loan (41.5%); S-Loan Plus (4.1%); others (1.7%)	Owner's Plan (20.6%); Solutions (37.0%); S-Loan (37.2%); S-Loan Plus (4.3%); others (0.9%)	Owner's Plan (26.3%); Solutions (39.6%); S-Loan (29.2%); S-Loan Plus (3.4%); others (1.5%)	Owner's Plan (25.9%); Solutions (39.9%); S-Loan (29.2%); S-Loan Plus (3.0%); others (2.0%)	Owner's Plan (30.6%); Solutions (38.8%); S-Loan (24.0%); S-Loan Plus (3.6%); others (3.0%)

*The receivables balance of the mother pool is actual, while that of the final pool are discounted by the aforementioned discount rate. §SMBCFS indicates SMBC Finance Service Co. Ltd. or former Cedyna Financial Corp. †Used includes refinanced loans. ‡We calculated the weighted-average interest rate using the interest rates applied in the auto loan agreements and the principal amounts of the discounted loans. The discounted weighted-average interest rate is slightly higher than this rate. **Solutions includes Loans of Audi Future Drive.

Table 2

Overview Of Securitized Loan Products	
Loan product	Description
Owner's plan	Equal monthly payments and no balloon payment; bonus payments allowed
Solutions, etc.	Balloon payments and an option to have VWFSJ or the dealer guarantee the repurchase of the vehicle at a price equal to the balloon payment

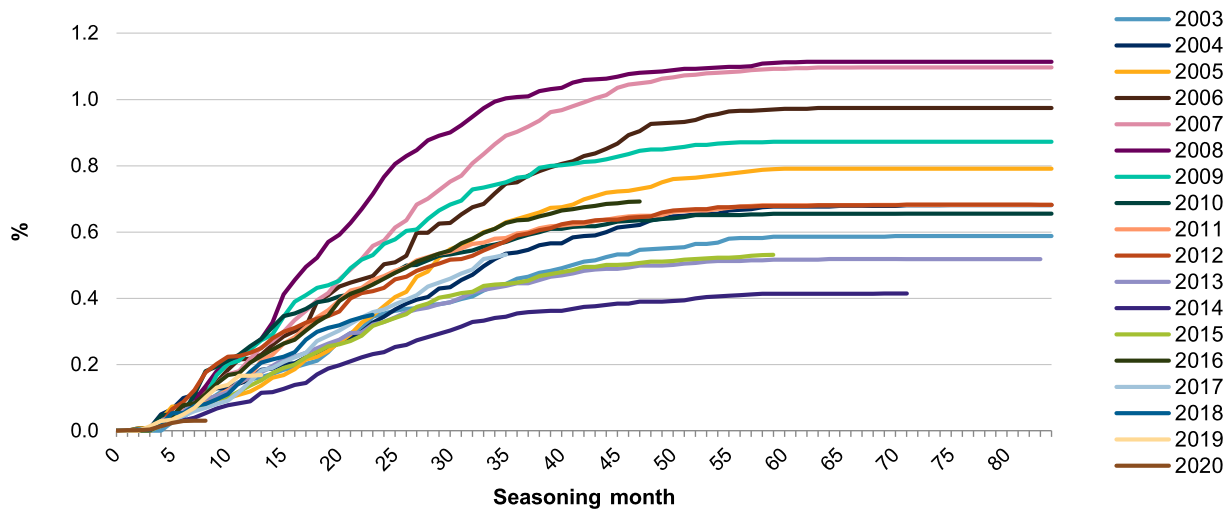
Table 2

Overview Of Securitized Loan Products (cont.)	
S-Loan, etc.	Balloon payments but no option to have VWFSJ or the dealer guarantee the vehicle repurchase at a price equal to the balloon payment
S-Loan Plus	Balloon payments and an option to sell the vehicle to the car dealer at a price previously agreed upon if the borrower buys a new Audi vehicle from that dealer.

Cumulative gross losses on the loans in the mother pool since the vintage year are shown below (see chart 2).

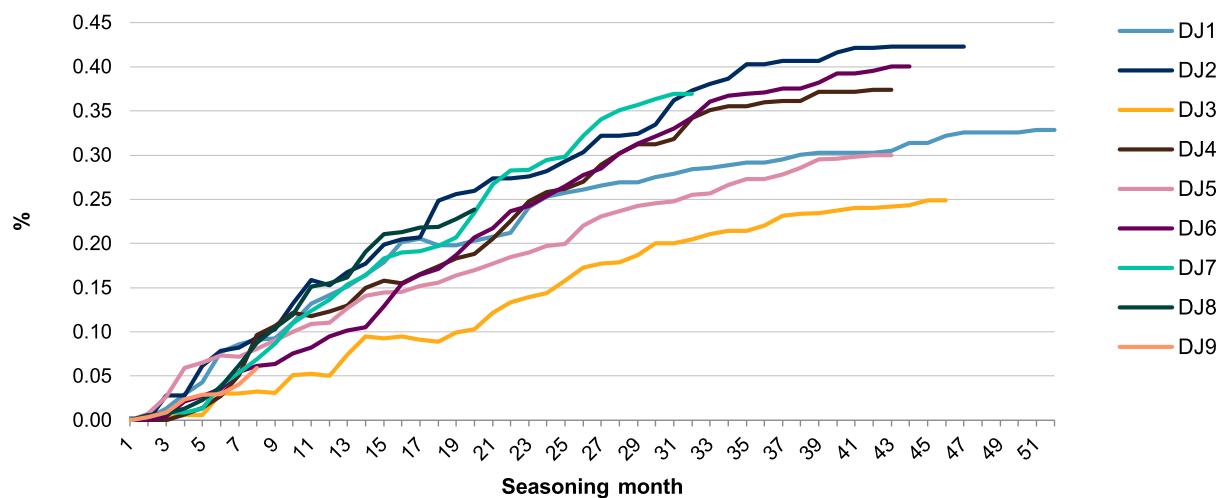
Chart 2

Cumulative Gross Losses On Loans In Mother Pool Since Vintage Year



Source: S&P Global Ratings, based on issuer data.
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The cumulative gross loss ratio (see note) of the past series are shown below (see chart 3).

Chart 3**Cumulative Gross Loss Ratio Of Previous Driver Japan Series**

Source: S&P Global Ratings, based on issuer data.

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Characteristics of the loan receivables

The entrusted loan receivables are from vehicle loan contracts that VWFSJ originated, using mainly Volkswagen and Audi dealers as agents.

The transaction securitizes some types of loans that contain balloon payments. Such loans have equal installments during the loan's life, except for the last installment (balloon payment), which is significantly higher than the regular installments. The final balloon payment for these loans is typically set to match or be lower than the estimated residual value of the car at loan maturity. Upon expiration, borrowers have the following three alternatives.

- Keep the vehicle or sell the vehicle to a third-party dealer such as a used car dealer, and pay the final installment in cash.
- Sell the vehicle to the car dealer. The dealer will settle the balloon payment on the borrower's behalf. The borrowers of "Solutions" loans can opt to have VWFSJ or the dealer guarantee the purchase at a price equal to the balloon payment. The borrowers of "S-Loan Plus" loans have an option to sell the vehicle to the car dealer at a price previously agreed upon if they buy a new Audi vehicle from that dealer (see table 2).
- Extend the loan or divide up the final scheduled payment of the loan, provided JACCS or SMBC Finance approves such an application from the borrower on behalf of VWFSJ.

In this transaction, trustee 1 will not accept extensions of auto loans. VWFSJ pays indemnity to trustee 1 regarding the receivables for which the borrowers exercised these options.

Originator review

We held a meeting with VWFSJ, JACCS, and SMBC Finance to review their policies and procedures for loan origination, underwriting, and servicing.

Origination/underwriting.

VWFSJ has outsourced its auto loan operations—including credit and scoring, processing contract applications, and collections—to SMBC Finance (including former Cedyne) since 2002 and JACCS since 2007. VWFSJ determines to which company—JACCS or SMBC Finance—it outsources operations by area and dealer. There were 431 dealers, including 246 Volkswagen car dealers and 124 Audi car dealers, as of Oct. 31, 2020.

Each subservicer, on behalf of VWFSJ, originates the loan contracts via the Volkswagen group dealer network, and makes credit decisions centrally. The subservicers use almost the same criteria that apply to their own auto loans. Generally, they base their credit decisions on auto-scoring results and conduct their own additional underwriting if necessary.

As for loans with balloon payments, the subservicers evaluate whether a customer can repay the entire loan, including the balloon payment, without resorting to selling the car and using the proceeds to complete repayment of the loan. VWFSJ sets the amount of the balloon payment conservatively, based on its projection of the residual value. VWFSJ also considers the subservicers' projections. Currently, the limit on balloon payments is essentially 50% of the vehicle price at the time of purchase for two-year loans, 40% for three-year loans, 30% for four-year loans, and 20% for five-year loans. However, the prices differ by car type and VWFSJ occasionally offers prices slightly higher than the above limits for some car types as sales promotions.

VWFSJ monitors dealers periodically. VWFSJ uses the criteria that the Volkswagen group uses globally, and checks dealers' financial information as well as their flow of inventory. If a subservicer finds that a dealer failed to comply with relevant laws while confirming a borrower's plans, the subservicer will report this to VWFSJ.

Servicing

The subservicers will collect payments on behalf of VWFSJ through automatic withdrawal from the obligors' accounts each month. Each subservicer, as a guarantor, will transfer the full amount of the scheduled collected proceeds—regardless of the amount of actual collected proceeds—to VWFSJ on the same day. The subservicers acquire overdue loans from VWFSJ after payment in subrogation. They service them through JACCS's contact center and SMBC Finance's control center.

Credit Analysis Of Underlying Collateral

Performance outlook for Japanese auto loan receivables

We expect the performance of consumer receivables—auto loan receivables, shopping credit receivables, credit card receivables (shopping and cashing receivables), and consumer loan receivables—backing ABS transactions to be somewhat negative in 2021.

The performance of securitizations differs depending on borrower attributes and borrower screening. Nevertheless, in 2020, the performance of auto loans backing consumer ABS transactions that we rate did not change materially even during the ongoing coronavirus crisis.

We think the performance of auto loans is highly correlated with the employment rate. Based on this and our forecasts

for the unemployment rate, we think it unlikely that there will be a huge deterioration in auto loan performance in 2021. That said, unemployment has been rising, particularly among nonpermanent employees who have had their contracts terminated. Borrowers who are self-employed or nonpermanent employees tend to have less stable income and could struggle to repay loans if they lose their jobs. In addition, with the pandemic situation fluid, prospects for the performance of auto loans are also somewhat uncertain.

Obligors may also sell their vehicles and use the proceeds to repay auto loans if they face difficulties. In such cases, conditions in the used car market may affect the performance of auto loans, in our view.

According to Japan Automobile Dealers Association, the number of registered used cars (passenger cars) decreased during the 2020 state of emergency, but later began recovering. The increase was driven by more people opting to use private vehicles and avoid crowded places such as trains and by the shutdown of automakers' factories. Given the current situation of the pandemic, however, we think the likelihood of increasing demand for used cars supporting auto loan performance is limited.

Assessment of the credit quality of the underlying assets

We examined surveillance data on the past nine series and the following data that VWFSJ provided:

- Monthly static and dynamic data on gross losses, early terminations (prepayments), and cancellations from the mother pool (from July 2002 to October 2020); and
- Attribute data of the entrusted pool as of Feb. 10, 2021.

We assessed the major factors that will affect the credit quality of the underlying assets of this transaction. We did so based on a comprehensive analysis of trends in the auto loan sector and economic trends in Japan.

Cumulative default rate

The transaction defines the default rate as either the amount of receivables on which obligors have failed to make monthly installment payments for three consecutive months, or in relation to which the unpaid balance can be declared immediately due and payable because of the occurrence of events of default prescribed in the auto loan agreement.

Under this transaction, upon the entrustment of an auto loan the originator transfers its withheld ownership of the relevant purchased vehicle to trustee 1. However, the withheld ownership is not registered in trustee 1's name. We base our calculation of the default rates on the total amount of defaulted receivables, and do not incorporate recoveries, including proceeds from vehicle sales and other recovery sources, or guarantees that JACCS and SMBC Finance provide.

For the cumulative default rate under the base scenario, we arrived at 0.7% of the total initial principal amount of the receivables. Meanwhile, we arrived at 0.8% for the cumulative default rate under the final base scenario, because we stipulate the minimum credit enhancement at 0.8% under our criteria "Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables," published Oct. 9, 2014. In addition, we arrived at a cumulative default rate of 4.0% under our stress scenario commensurate with a 'AAA' rating. A higher multiple (5x the average cumulative default rate assumption under the base scenario) resulted from a low cumulative default rate

under our base scenario, which is set at less than 1.0%.

The default rate of the mother pool has been relatively stable. Vintage pools that were originated in 2006 or before have reached cumulative default rates of 0.6% to 1.0% (see chart 2). The cumulative default rates of the mother pool's 2007 and 2008 vintages reached about 1.1%, reflecting the adverse effects of the economic recession and deterioration of the labor market after the collapse of Lehman Brothers in autumn 2008. The cumulative default rates of the vintage pools originated in 2009 and onwards have been improving. The cumulative default rates of the vintage pools originated between 2010 and 2013 fell to about 0.5%-0.7%, and have been declining in the pools originated in 2014 and onward.

Compared with the mother pools, the entrusted pools are characterized by: 1) higher shares of used vehicles, 2) shorter seasoning periods and longer residual periods, 3) smaller shares of corporate obligors, and 4) lower shares of balloon loans. However, these differences are only limited and will not cause material differences in default rates between the mother pools and the entrusted pools, in our view.

The performance of the past series have been relatively stable (see chart 3). We believe the credit quality of the obligors in this asset pool is relatively high compared with those of typical auto loans underlying auto loan ABS transactions in Japan. We base this on our consideration that: 1) the prices of Volkswagen and Audi vehicles are somewhat higher than those of domestic car manufacturers' vehicles, and 2) the fact new vehicles make up about 71% of the asset pool. The historical default rate, which has remained low, underpins our view.

So far, we have not observed any substantial effects of the pandemic on the default rates of the mother pools and past transactions. We expect the pandemic to have limited effect on the performance of this transaction. We base this view on our assumptions on the default rate for this transaction:

- We currently do not expect a material rise in unemployment rates, which are strongly correlated with auto loan defaults, and
- The credit quality of the obligors in this transaction is higher than that of typical auto loan obligors.

Considering all these factors, we assume the performance of securitization pools is mostly on the same level as the performance of pools originated from 2009 onward.

Although VWFSJ is a captive finance company of Volkswagen AG group, and its credit policy may be influenced by the change of the group's sales policy, JACCS and SMBC Finance's control of VWFSJ's credit policy as guarantors mitigates the risk that the manufacturer's business policy could constrain the policy.

Balloon payments

We take into account the additional risk from the loans with balloon payments in accordance with our criteria, as described below.

VWFSJ's historical data show only limited defaults on balloon payments. However, under our 'AAA' stress scenario we assume that borrowers must repay the debt in full only with cash at the same time as the vehicles' market values decline significantly in the two sets of circumstances below:

- When the originator and/or dealers become unable to repurchase vehicles; or
- When the originator becomes unable to provide refinancing loans.

We assume that 7% of the amount of balloon payments will default in our 'AAA' stress scenario. This is 1.75x higher than the 'AAA' cumulative default rate of 4.0% that we assume for the loans without balloon payments.

We view the credit quality of the obligors in this asset pool as relatively high compared with typical auto loans in the Japanese auto loan ABS deals. In addition, borrowers may be able to repay their debt by selling the relevant vehicles. VWFSJ's conservative credit policy for balloon payments, as well as the diversification of maturities, mitigates the risk of a decline in market value.

Although we don't assume recovery from the vehicles, we would expect borrowers to be able to sell their vehicles independently. In this transaction, there is a revolving period for one year in which VWFSJ can entrust additional receivables. In establishing a stress scenario commensurate with our 'AAA' rating, we incorporate the possibility that an increase in the share of balloon payments leads to deterioration of creditworthiness of the portfolio. However, additional entrustments heighten subordination and thus credit support.

Prepayment rate

Dynamic data of the mother pool that VWFSJ provided indicates a monthly prepayment rate of about 1.0% of the receivables' outstanding balance at the end of the previous month.

For the prepayment rate under the base scenario, we assumed 1.0% monthly. In addition, under our 'AAA' stress scenario, we arrived at a prepayment rate of 0.05% at minimum and 3.0% at maximum monthly.

Cancellations

Under this transaction, VWFSJ has to repurchase cancelled receivables. However, VWFSJ would be unable to fulfill its obligations with respect to repurchases if it were to go bankrupt. Because payments on the cancelled receivables would stop as a result of VMFSJ's bankruptcy, causing a temporary disruption of cash flow to the transaction, cancellations would impair the performance of the transaction. Generally, apart from cancellations that occur immediately after the origination of loan agreements, the number of cancellations of auto loan receivables is limited. In fact, the data shows actual cancellations are concentrated immediately after the origination of loan agreements, and the cancelled amount is limited. In addition, under this transaction, entrusted receivables fulfill the eligibility criterion of at least two monthly payments made. We regard the risk of cancellation in the receivables pool as low.

Cash Flow Analysis

We conducted cash flow analysis on multiple scenarios, which are based on the projected cash flow provided by the originator and applied stresses to various parameters, including cumulative default rate and prepayment rate, commensurate with ratings (see table 3).

Regarding the cumulative default rate, we assume all defaults would occur as assumed during 24 months. We also

assume three different patterns of default timing (frontloaded, standard and backloaded).

As a result, we confirmed the following regarding beneficial interests 2 and ABL 2 under the stress scenario commensurate with a 'AAA' rating:

- Interest payments will be made in full without delay.
- Principal payments will be made in full by the final legal maturity date in June 2029.

In conducting analysis, we consider benefits from the nonamortizing cash reserve, which serves primarily as liquidity support and ultimately as credit support. To determine the effect of pro rata amortization, when modeling the cash flow, we take into account the performance triggers, the subordination level during the revolving period, and the patterns of defaults in past transactions.

Table 3

Assumed Scenarios And Break-Even Overcollateralization Level		
(%)	Base scenario	'AAA' stress scenario
Cumulative default rate	0.8	4.0
Losses on balloon payments	0.0	7.0
Monthly prepayment rate	1.0	0.05 to 3.0
Cumulative default rate considering losses on balloon payments	0.8	6.9
Excess spread	-	1.0
Breakeven overcollateralization level	-	5.9

Scenario Analysis

We formulated scenarios for the underlying assets relating to this transaction, assuming a set of circumstances. Specifically, in our scenario analysis, we assumed that the performance of the underlying assets would diverge from the assumptions under our base scenario and examined how this would affect the transaction.

Setting scenarios and assumptions

In our opinion, the cumulative default rate is the parameter that most affects the ratings on ABS transactions backed by auto loan receivables. Specifically, we set two scenarios in which default rates are higher than the assumption we made under our base scenario (see table 4). Under this scenario analysis, we apply a cumulative default rate of 0.7% to our base-case assumption. We apply this because it is the rate before we adjust for minimum credit enhancements under our criteria.

Table 4

Assumptions Of Scenario Analysis		
(%)	Scenario 1	Scenario 2
Cumulative default rate	0.9 (1.25x base-case assumption)	1.1 (1.5x base-case assumption)

Results of the scenario analysis

Our rating is 'AAA' under a scenario where the cumulative default rate is 0.9% (1.25x the cumulative default rate

assumption under our base scenario). Our rating is 'AA+' under a scenario where the cumulative default rate is 1.1% (1.5x the cumulative default rate assumption under our base scenario).

This analysis is based on an assumption that all assumptions for performance of underlying assets, except for the abovementioned cumulative default rates, remain unchanged after the initial rating. Even if the cumulative default rate develops as we assume in the scenario, the actual ratings may not be changed in line with the results of this analysis. This is because we determine the ratings from a comprehensive perspective, incorporating various factors in addition to those considered in this analysis.

Structural Analysis

Servicing risk and liquidity risk

VWFSJ acts as the transaction's servicer and JACCS and SMBC Finance as its subservicers. We conducted an operational review meeting with VWFSJ, JACCS, and SMBC Finance. We asked them about various issues, including their organizational structures as servicers/subservicers, their methods for managing receivables, and their system development. We believe that they have sufficient capability to fulfill their respective roles in this transaction.

VWFSJ could be discharged from its servicing activities in the event of certain credit events involving the company. Choosing a new servicer and entrusting servicing operations with that company may be a time-consuming process, and may result in a temporary disruption of collections from the receivables pool. This would, in turn, impair the performance of the transaction. In this transaction, a backup servicer was not appointed at the closing date. In the event that certain credit events in trust agreements occur, trustee 1 will appoint a backup servicer and, in certain cases, have that backup servicer take over servicing operations from the initial servicer. This structure mitigates the risk of servicing activities being disrupted for an extended period.

In addition, this transaction benefits from a cash reserve sufficient to cover four months' worth of interest payments and transaction expenses, funded at the transaction's closing.

Commingling risk

There is a risk that collected funds may not be transferred (maximum: one month's worth of collection proceeds) because of commingling if VWFSJ defaults. In this transaction, advance payment collections by VWFSJ mitigate this commingling risk. Overcollateralization also mitigates commingling risk.

Counterparty risk

A collection account is established in the name of trustee 2 at MUFG Bank. In the future, if the rating on the bank is lowered and the bank loses its status as a qualified bank (under the transaction documents, qualified banks have a short-term credit rating of 'A-1' or above), the collection account will be transferred within 30 days to a bank that satisfies the above criteria.

Legal Risk

Because the securitized asset pool of this transaction contains balloon auto loans, in our analysis, we considered the

typical characteristics and contract structure of balloon auto loans and other relevant factors. Based on our understanding of the above characteristics and contract structure, we then considered whether installment or balloon payments of auto loans can be impaired as a result of any adverse factors, such as the cancellation of a borrower's obligation to make such payments when the originator or a car dealer that provided the borrower with a buyback guarantee enters into insolvency proceedings.

We analyzed whether a borrower's obligation to make the installment or balloon payments would be cancelled through trustee 1's termination of the auto loan agreement by treating it as an executory bilateral contract when the originator--which guarantees to buy the vehicle back from the borrower after the borrower's completion of installment payments--becomes subject to insolvency proceedings before the originator and the borrower complete the performance of their respective obligations in relation to such a buyback guarantee. When the borrower exercises the option to have the originator buy back the vehicle, the originator is obligated to pay to the borrower the buyback price following such buyback and the borrower is obligated to hand over the vehicle to the originator. We note that: (1) such obligations of the originator and borrower arise based on the sale and purchase agreement, which is separate from the auto loan agreement; (2) the linkage between the originator's payment to meet the obligation to buy back the vehicle and the borrower's obligation to make the installment payments under the auto loan agreement is weak; and (3) the originator's payment to buy back the vehicle cannot be deemed as consideration for the borrower's installment payments. Therefore, there seems to be a low likelihood that the auto loan agreement would be terminated as a result of the originator's insolvency because the trustee treated the agreement as an executory bilateral contract.

In addition, we analyzed whether the borrower would be able to assert a payment suspension claim under the Installment Sales Act. When the originator or a car dealer that provides the borrower with the buyback guarantee enters into insolvency proceedings, there is a possibility that the insolvency trustee will deem the sale and purchase agreement as an executory bilateral contract, will terminate the sale and purchase agreement, and will not pay the buyback price for the vehicle under the sale and purchase agreement. However, the application of the buyback price to the balloon payment is only one of the options the borrower has to make the balloon payment. It would be unfair if the borrower became entitled to refuse to make the balloon payment simply because the borrower was prevented from exercising the option to use the buyback price. The insolvency trustee is also lawfully entitled to terminate the sale and purchase agreement under insolvency laws, and its failure to pay the buyback price as a result of its termination of the sale and purchase agreement would not constitute a default of the buyback guarantee. Therefore, there seems to be little possibility that the borrower would be able to refuse to make the installment payments or the balloon payment by asserting the payment suspension claim.

Surveillance

We will analyze regular servicer reports detailing the performance of the underlying collateral, monitor supporting ratings, and make regular contact with the servicer to ensure that it maintains minimum servicing standards and that any material changes in its operations are communicated and assessed.

The key performance indicators in the surveillance of this transaction are:

- Increases in credit enhancement for the obligations;

- Default rates;
- Delinquency rates; and
- Prepayment rates.

Note

The cumulative gross loss ratio is calculated as follows:

- The numerator is the sum of the discounted principal balance of all auto loan receivables that have defaulted from the initial cut-off date through to the end of the monthly period immediately preceding the relevant trust calculation date.
- The denominator is the sum of: (1) the aggregate discounted principal balance of the initial auto loan receivables as of the initial cut-off date, and (2) the aggregate discounted principal balance of all additional auto loan receivables (if any) entrusted as of the additional entrustment dates that occur within six months prior to the relevant trust calculation date.

Related Criteria

- Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Counterparty Risk Framework: Methodology And Assumptions, March, 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
- Global Methodology And Assumptions For Assessing The Credit Quality Of Securitized Consumer Receivables, Oct. 9, 2014
- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology For Servicer Risk Assessment, May 28, 2009

Related Research

- Japan Structured Finance Outlook: Recovery Or Relapse? Jan. 8, 2021
- How Will COVID-19 Affect Japanese Structured Finance? April 8, 2020
- Japanese Structured Finance Scenario And Sensitivity Analysis 2017: The Effects Of The Top Five Macroeconomic Factors, Dec. 26, 2017
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016

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