S&P Global
Ratings

Environmental, Social, And Governance Evaluation

Volkswagen Financial Services

Summary

Volkswagen Financial Services AG (VWFS) offers financial service products to private, corporate, and fleet customers. The company is headquartered in Braunschweig, Germany, and also offers services internationally. These services include vehicle financing, leasing, insurance, fleet management, and rental solutions. VWFS is a wholly owned subsidiary of Volkswagen AG (VW), a car manufacturer, and a sister company of Volkswagen Bank GmbH. In 2024, VWFS and Volkswagen Bank will be combined under a new financial holding company, regulated by the European Central Bank (ECB).

Our ESG Evaluation of 68 on VWFS reflects the company's relatively high exposure to environmental risks, compared with other non-banking financial institutions (NBFIs), given its focus on financial products for automobiles. The company is taking some actions to mitigate this exposure. Among others, it provides services to customers to help electrify their fleets. However, VWFS still has some work to do when it comes to tracking downstream greenhouse gas (GHG) emissions and developing ESG frameworks and policies to manage them. VWFS manages social risks well, especially with regard to its workforce. Our assessment of VWFS' governance profile takes into account that the supervisory board (SB) is somewhat behind German corporate governance standards, even though it is characteristic of a wholly owned subsidiary. For example, the SB has very low levels of independence, as does the parent company's SB. Furthermore, VWFS' reporting on nonfinancial performance and board members' skillsets is limited.

We assess VWFS' preparedness as adequate, with VWFS playing an important role in the wider VW group's strategy. Specifically, VWFS aims to build a mobility platform to provide customers with a range of mobility solutions and to support financing of electric vehicles (EVs). On the other hand, VWFS remains quite highly exposed to transition risks, given its large exposure to the automotive sector.

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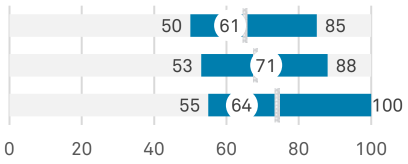
ESG Profile Components (figures subject to rounding)

Entity-specific assessment			Sector/region analysis			
E (30%)	26	+	E (30%)	35	=	E
S (30%)	33	+	S (30%)	38	=	S
G (40%)	29	+	G (40%)	35	=	G

Achieved and attainable scores



Entity within its primary sector/region

Entity's sectors/ regions versus all sectors/ regions

Min and max scores possible given sectors/regions. The gray line represents performance in line with industry standards.

ESG Profile 65

Preparedness +3

Low	Emerging	**Adequate**	Strong	Best in class

ESG Evaluation

68

A higher score indicates better sustainability. Figures subject to rounding.

Component Scores

Environmental Profile

Sector/Region Score	**35/50**
Greenhouse gas emissions	**Lagging**
Waste and pollution	**Good**
Water use	**Good**
Land use and biodiversity	**Good**
General factors (optional)	**None**
Entity-Specific Score	**26/50**
E-Profile (30%)	**61/100**

Social Profile

Sector/Region Score	**38/50**
Workforce and diversity	**Good**
Safety management	**Good**
Customer engagement	**Good**
Communities	**Good**
General factors (optional)	**3**
Entity-Specific Score	**33/50**
S-Profile (30%)	**71/100**

Governance Profile

Sector/Region Score	**35/35**
Structure and oversight	**Developing**
Code and values	**Good**
Transparency and reporting	**Developing**
Financial and operational risks	**Neutral**
General factors (optional)	**None**
Entity-Specific Score	**29/65**
G-Profile (40%)	**64/100**

ESG Profile **(including any adjustments)** **65/100**

Preparedness Summary

VWFS plays a core role in implementing VW's wider New Auto strategy through its own Mobility 2030 strategy. Specifically, VWFS' role in the wider group's strategy is to take responsibility for the group's mobility solutions offering, which will provide customers with access to both short- and long-term solutions. VWFS will achieve this by developing a mobility platform to provide customers with access to a range of mobility solutions. VWFS and its parent company share the same strategic direction and this is supported by strong ties between VWFS' SB and the parent company. The chair of VWFS' SB is the CFO at VW, while many other SB members have roles in the wider group. As a captive finance entity, however, VWFS' strategy and oversight are somewhat dependent on its parent company, which, as an automotive company, is highly exposed to transition risks.

Capabilities	
Awareness	**Good**
Assessment	**Good**
Action plan	**Good**
Embeddedness	
Culture	**Good**
Decision-making	**Excellent**

Preparedness Opinion (Scoring Impact) **Adequate (+3)**

ESG Evaluation **68**

Note: Figures are subject to rounding.

Environmental Profile

61/100

Sector/Region Score (35/50)

NBFIs' direct environmental risks are relatively small, compared with other sectors, given their low use of physical infrastructure and facilities. NBFIs' main environmental exposures are related to the risks their clients and portfolios face. We also consider the companies' ability to promote customers' sustainable behaviors through their financing activities. Typically, retail-focused NBFIs are less exposed to environmental risks than commercial and corporate lenders, such as banks, given their limited business scope and low exposure to high-emission sectors.

Entity-Specific Score (26/50)

Note: Figures are subject to rounding.

Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Lagging	**Good**	**Good**	**Good**	**None**

VWFS is yet to establish an ESG integration framework and policies to address its environmental exposure. We consider VWFS' environmental risks are higher than those of other NBFIs, due to its concentrated exposure to the automotive sector through its leasing and financing activity (81% of total loans to and receivables from customers). Furthermore, VFWS is yet to improve its tracking efforts and set clear targets for downstream GHG emissions. While most global peers already include use-phase emissions in their scope 3 calculations or are committed to do so, VWFS still does not factor in leased assets emissions in its calculation. Moreover, the company does not publicly report its GHG emissions and breakdown. Most of VWFS' efforts focus on reducing scopes 1 and 2 emissions. The company aims to reduce CO2 emissions in its operations by 50% by 2025 and intends to be carbon neutral by 2030. VWFS has not submitted those targets to the Science Based Targets initiative (SBTi) yet.

In line with some stronger peers, VWFS offers some green services. VWFS' electromobility program "Electrification-as-a-service" provides consulting and implementation services to help large corporate clients electrify their fleet. Furthermore, 24.5% of VWFS' car leasing activities focus on battery electric vehicles (BEVs), with a target to increase this offering to 80% by 2030. In addition, the company has put in place initiatives to incentivize clients to use EVs. Those initiatives include the maintenance and tire replacement for BEVs and a discount on the insurance premium for BEVs. Moreover, VWFS signed the "Braunschweig – Smart Green City" cooperation agreement to enhance the sustainable mobility infrastructure of the city.

In line with global peers, VWFS' efforts to mitigate downstream pollution risk are still limited. Although its EV fleet helps reduce air pollution, VWFS, just like its global peers, does not report on any pollution key performance indicators (KPIs). No immediate plans are in place to gather this information. Aside from that, VWFS collaborates on a project with the German Nature and Biodiversity Conservation Union (NABU) to protect and restore moorland and peatland. The company, whose exposure to biodiversity is low, has invested $4 million in the project since 2012.

We expect VWFS will formally take into account ESG integration considerations in 2024. Following the planned restructuring, we expect ESG frameworks and policies to be rolled out across the new holding company.

Social Profile

71/100

Sector/Region Score (38/50)

Social risk is highly material to the sector, which depends on customer satisfaction, changing preferences, digitalization, managing human capital to retain talent, and providing training on material topics, including customer satisfaction, information privacy, cybersecurity, mis-selling, and regulations. NBFIs are less regulated, and supervision is typically less strict than for banks. Over half of VWFS' employees are based in Germany, where social standards are high, with no other country representing over 10% of employees.

Entity-Specific Score (33/50)

Note: Figures are subject to rounding.

Workforce and diversity	Safety management	Customer engagement	Communities	General factors
Good	**Good**	**Good**	**Good**	**3**

VWFS' shift from a traditional automotive financial services provider to VW group's mobility platform provider supports the customer engagement strategy of the wider group. The new mobility platform will allow customers to input their requirements, such as the time horizon requirement for vehicles. The platform will then suggest the most appropriate products from VWFS' offering, including financing, leasing, rental, and instant mobility options. Furthermore, the wider VW group is moving away from a traditional franchise model to an agency model. As such, pricing is consistent across dealerships and online sales channels. To ensure that it offers its services responsibly, VWFS checks if new customers can continue to make payments in challenging periods. Yet, we note that the lack of globally consistent customer satisfaction data limits our assessment. VWFS is currently rolling out a global customer satisfaction survey, with the first results expected in late 2023.

VWFS employees consider the company an attractive place to work, as evidenced by very low turnover rates. Total turnover rates have consistently remained below 1% in recent years, notably lower than the median for the wider NBFI sector (11%). VWFS' training focuses on digitalization, in line with the company's shifting business model. Benefits are also solid. For example, the headquarters have on-site childcare, and there are options to take career breaks at short notice. On the other hand, although the proportion of women in the company (50% in 2022) is higher than the NBFI sector median (43%), the proportion of women in management positions remains relatively low. In 2022, it was 23% in the second management level and 16% in the first management level. Plans to increase the number of women in senior positions are made by the local regions and take the local context into account. Methods to increase the number of women in senior positions are in line with those of peers and include diversity considerations during succession reviews and bias awareness checklists in the hiring process.

Community initiatives focus on health, education, sports, and nature and are broadly in line with those of peers. Like other financial service companies, VWFS focuses on financial literacy. For example, it has been working with school children on this topic for over a decade.

VWFS has multiple initiatives to manage employee wellbeing and the safety related to its products, in line with peers. For example, the company offers reduced premiums for third-party liability insurance for cars with better safety features.

Governance Profile

64/100

Sector/Region Score (35/35)

VWFS is headquartered in Germany, where governance standards are among the best internationally. VWFS' operations are concentrated in Germany (30% of current contracts as at end-2022), followed by the U.K. (14%), and China (7%).

Entity-Specific Score (29/65)

Note: Figures are subject to rounding.

Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Developing	**Good**	**Developing**	**Neutral**	**None**

In our opinion, the composition of the SB and the committee structure, while characteristic of a wholly owned subsidiary like VWFS, is behind German standards and global best practice. Independence is limited, with just one out of ten SB members considered independent. The other members have ties to the wider VW group and its shareholders, with one member representing workers through the trade union IG Metall. Attendance rates dropped to 90% in 2022, from 96% in 2021, and there are relatively few meetings (three in 2022). On the other hand, gender diversity is high. 40% of the SB are female, compared with around 30% for SBs in Germany. Although the composition of the SB will change when the company undergoes restructuring in 2024, we expect that the independence rate will remain low, with one member likely to be independent. The restructuring will also lead to an increase in the number of committees, beyond the existing audit committee, given that the entity will be regulated in line with the German law. Our assessment is further limited by the lack of information provided on the board members' skillset, which limits our ability to assess their individual and combined contribution to the SB. Despite this, we understand that two board members hold roles that are related to digitalization and data, both of which are central to VWFS' strategic direction.

VWFS maintains the code and values of VW. VWFS follows its parent company's code of conduct, which covers corruption and bribery, discrimination, confidentiality of information, conflicts of interest, antitrust, money laundering, environment, health and safety, and whistleblowing.

VW has introduced a controversy management process, following events in the past decade. VWFS' parent company has experienced some high-profile cases, such as the 2015 emissions cheating scandal. These highlighted governance failures at the VW Group and made VWFS vulnerable to reputation risks. Although VW's board has been reshuffled since 2015 (10 out of 19 members were appointed in 2016 or later), independence rates remain low. The chair is not independent, and most other members represent shareholders.

VWFS' financial reporting is solid and in line with IFRS, but nonfinancial reporting is relatively limited, compared with German standards. The company's annual report includes some social indicators, such as the proportion of women and employee turnover. Yet, it does not yet include GHG emissions. We understand that VWFS will include these in the 2023 annual report. Furthermore, remuneration disclosure is limited. While the total amount paid to top management is disclosed, the breakdown between management board members is not. Any targets that their performance is measured against are also not public. Finally, there is very limited public information about SB members beyond their names.

Preparedness Opinion

Adequate
(+3)

Preparedness	Low	Emerging	**Adequate**	Strong	Best in class

VWFS plays a core role in enabling VW's wider New Auto strategy through its own Mobility 2030 strategy. Specifically, VWFS' role in the wider group's strategy is to take responsibility for the group's mobility solutions offering, which will provide customers with access to both short- and long-term solutions. It will achieve this by developing a mobility platform that provides access to a range of mobility solutions. VWFS and its parent company share the same strategic direction because of strong ties between VWFS' SB and the parent company. The chair of VWFS' SB is the CFO at VW, while most other SB members have roles in the wider group. As a captive finance entity, however, VWFS' strategy and oversight are somewhat dependent on its parent company, which, as an automotive company, is highly exposed to transition risks.

VWFS' SB, supported by the parent company, exhibits a solid awareness of trends and disruptions in the industry. The company's shift from a traditional captive finance company to a mobility solutions provider demonstrates its awareness and ability to capitalize on opportunities. When developing the Mobility 2030 strategy, VWFS considered over 40 trends and conducted scenario analyses to assess the strategy's resilience. Furthermore, VWFS has identified a shift in customer preference from financing of vehicles to leasing. This trend influences VWFS' restructuring. In particular, refocusing the leasing business as a subsidiary of Volkswagen Bank will mean that the leasing business can be run more cost-efficiently. On the other hand, the automotive industry remains highly exposed to disruptive risks, including climate transition risks, with the European Parliament voting to approve a new law banning the sale of petrol and diesel cars from 2035. The wider VW group is managing this risk well and is shifting its offering to EVs, with no planned further development of traditional internal combustion engine vehicles. As such, VWFS' exposure to financing and leasing vehicles with such engines should also reduce.

Vehicle-on-demand services are an area of growth, which benefits from the acquisition of Europcar through Green Mobility Holdings, a consortium led by VW. Europcar will be a key component of the mobility platform, particularly with regard to shorter-term products, such as car subscriptions and car sharing. Furthermore, Europcar has an existing network that connects major transport hubs, including airports, railway stations, and cities. Beyond this, VWFS is investing in software development companies and leasing companies to complement its existing services. Furthermore, we expect additional external partnerships will support VWFS' instant mobility options. Financial technology companies could limit the success of VWFS' mobility strategy, but we think that this risk is partially limited by VWFS' expertise, its access to customer data, and its understanding of customer trends from existing relationships.

Sustainability is a pillar of VWFS' Mobility 2030 strategy. VWFS encourages customers to reduce their emissions. For example, in collaboration with the wider VW group, VWFS contributes to "Electrification-as-a-service," which provides financing options to help customers decarbonize their fleets.

Finally, VWFS has a collaborative culture and supports employees' ideas. Since October 2020, the company has invited employees to submit their ideas through FS.IDEAS to improve their team and the wider business. A percentage of the costs the company saves by realizing an employee's idea is paid to the employee. VWFS expects that the initiative will lead to cost savings of €3 million by the end of 2023.

Sector And Region Risk

Primary sector(s)	NBFI
Primary operating region(s)	Germany United Kingdom

Sector Risk Summary

Environmental exposure

Environmental risks for non-banking financial institutions (NBFIs; including asset managers) balance the low use of physical infrastructure and facilities needed to operate against material indirect exposure from lending and investment activities (via borrowers and customers). Direct CO2 emissions are limited because NBFIs typically have relatively small footprints, but the fast-growing use of IT services especially in financial market infrastructure companies and some fintech companies in the lending space (digitization, cloud computing, big data) is increasing CO2 emissions. An NBFI's ability to consider these environmental risks and develop policies to ameliorate them can enhance/weaken its reputation. Regulators, investors, customers, and activists are increasingly looking at the nonbank sector's contribution and exposure to environmental risks through their lending and investment activities. For example, in certain subsectors, such as commercial real estate and fleet management, the exposure to physical infrastructure is higher and such subsectors may become the outliers for the environmental score. Nonbanks' ability to develop or acquire tools to assess and reduce the climate-related risks of their lending and investment portfolios is also an important environmental factor.

Social exposure

Because the nonbank sector (including asset managers) is generally labor intensive and relies on customer trust, the management of human capital and customer relationships is paramount and poses material social risks. Evolving customer preferences, and greater use of digitization, automation, and AI brings new challenges and threats and require nonbanks to adjust their business models. This includes continuously training employees in new distribution channels, products, and regulations, as well as outsourcing and offshoring an increasing number of tasks to trim costs and reduce the workforce and physical footprint. Responsible management of supply chains will become more important. Another challenge is how to keep and attract talent, especially the younger generation, which tends to favor innovative and agile companies. Positively, nonbank employees typically benefit from safe and healthy working conditions relative to many other sectors. Some nonbanks depend on customer confidence to maintain their franchises. Issues regarding conduct with retail customers, such as misselling or fraudulent activities like money laundering or tax evasion, can be more substantial with nonbanks facing retail customers, and cause serious financial and reputational damage. IT issues that disrupt customers' access to nonbank services, risks of data leaks, and concerns over treatment/privacy of data are important franchise risks. Growth in the nonbank sector has been substantial since the 2008 global financial crisis. While regulators are closely watching certain subsectors such as payday lending, student loans, leveraged lending, and residential mortgage origination/servicing, the industry's regulation and supervision is typically less strict than for banks and this can sometimes result in more aggressive underwriting or collection practices, or more opaque pricing considerations for certain NBFIs (which may become the outliers for the social score).

Regional Risk Summary

Germany

Germany has strong institutional and governance effectiveness. Rule of law is strong, the judiciary is independent, and corruption is viewed as a minor issue. Germany ranks 10 of 180 on Transparency International's 2021 Corruption Perceptions Index. The German Corporate Governance Code (Kodex) is the reference document for best practices and works on a comply-or-explain basis. Its last iteration came into effect in 2020 when the EU Shareholder Rights Directive II was transposed into German law. Notable improvements include recommendations on board independence and board oversight of related-party transactions and executive pay, with a shareholder vote on the remuneration report becoming mandatory in 2022. While the recommendations are less specific than most European codes, companies exhibit strong governance practices. Companies are typically governed by a two-tier board system: a management board overseen by a supervisory board comprising non-executives including shareholder and employee representatives. The 2021 Act on Strengthening Financial Market Integrity (FISG) is an important milestone aimed at strengthening financial oversight at German companies. Besides requiring a minimum number of financial experts on boards, since January 2022 all listed companies must also form an audit committee.

United Kingdom

The U.K. benefits from strong corporate governance practices. Brexit-related policy uncertainties still linger, including disagreements with the European Union on the implementation of the Northern Ireland Protocol which may lead to frictions. Still, in our view, UK benefits from robust and independent institutions and high rule-of-law standards, as well as very low actual and perceived levels of corruption. Governance guidelines are primarily based on the U.K. Code of Corporate Governance published by the Financial Reporting Council (FRC) and updated in 2018. The revised and strengthened code provides a broad set of recommendations including executive remuneration and board composition, follows a comply-or-explain model, and is widely regarded as best practice internationally. The recent version strengthened provisions on the role of the audit and nomination committees, chair tenure, and stakeholder engagement. An updated version of the U.K. Stewardship Code published by the FRC also came into effect on Jan. 1, 2020. It sets out principles for investors. Overall levels of corporate disclosure on ESG are strong and the country benefits from a very active institutional investor base, which has been fueling the demand for better disclosure and corporate engagement. Legislation that took effect in 2019 will also require pension funds to disclose the financial risks they face arising from ESG factors. The U.K. ranks 11 of 180 on Transparency International's 2021 Corruption Perceptions Index.

Appendix

Related Research

- Environmental, Social, And Governance Evaluation: Analytical Approach, Sept. 20, 2022
- The ESG Risk Atlas: Sector And Regional Rationales And Scores, July 22, 2020
- Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide, July 22, 2020
- How We Apply Our ESG Evaluation Analytical Approach: Part 2, June 17, 2020

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