VOLKSWAGEN FINANCIAL SERVICES

THE KEY TO MOBILITY

ANNUAL REPORT
OF VOLKSWAGEN LEASING GMBH

2016

Volkswagen Leasing GmbH

At a Glance

€ million	2016	2015	2014	2013	2012
Lease asset acquisitions	14,904	13,728	11,951	10,379	10,199
Lease assets	23,753	21,141	19,206	17,940	16,776
Total assets	27,767	24,549	21,744	19,354	18,229
Leasing income	14,681	14,001	12,942	11,451	10,582

Thousands of vehicles	2016	2015	2014	2013	2012
New leases	590	555	517	439	431
Lease portfolio	1,281	1,181	1,110	1,014	956

Fundamental Company Information

Volkswagen Leasing GmbH: A Model of Success for 50 Years.

BUSINESS MODEL

The establishment of Volkswagen Leasing GmbH 50 years ago in 1966 not only created a new Group company but also laid the foundations for leasing in the automotive sector in Germany. Today, the Company is part of the Financial Services division and is responsible for the operating activities related to the leasing business with retail and business customers as well as the fleet management business within the Volkswagen Group in Germany, Italy and Poland.

ORGANIZATION OF VOLKSWAGEN LEASING GMBH

Volkswagen Leasing GmbH focuses on the operating activities for the leasing business with retail and business customers as well as on the fleet management/services business. The organization of Volkswagen Leasing GmbH is consistently based on the needs of its different customer groups, namely retail, business and fleet customers. In addition to facilitating innovative rental and leasing models and offering other new mobility services, the Company's fundamental organizational arrangements ensure that there is a continual expansion in after sales services in the automotive context. The sales and customer service units are closely integrated with the product development and marketing units.

The Fleet Customer Sales unit brings together the internal sales and field sales departments of Volkswagen Leasing GmbH with design units so that the Company is in the best possible position to expand new areas of business, such as fuel cards, and establish the associated products in the market. The Middle Office unit, which concentrated on the key areas of marketing, claims and services management, was restructured and dissolved effective April 1, 2016 in connection with the departure from the Company's Management team of Mr. Thomas Rennebaum, within whose responsibility it had previously lain. Marketing and brand management activities were transferred to Volkswagen Bank GmbH, claims and services management activities to Sales Fleet Customers.

The Back Office unit was previously responsible for the used vehicle center, the Risk Management System and the other back-office activities of Volkswagen Leasing GmbH. Harald Heßke assumed management responsibility for this area from Dr. Heidrun Zirfas in 2016. The used vehicle center was assigned to Volkswagen Financial Services AG at the beginning of 2016.

In 2016, Volkswagen Financial Services AG initiated a reorganization of its structures under company law, encompassing all legal entities. The aim of the restructuring is to segregate European lending and deposits business from the other financial services activities going forward. From 2017, detailed plans will be drawn up for the restructuring and preparations will be carried out for its implementation in terms of any necessary changes to organizational structures. The aim of the restructuring is to increase transparency and clarity for supervisory authorities. The structure and organization of Volkswagen Leasing GmbH satisfy the requirements of the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements for Risk Management in Banks and Financial Services Institutions).

BRANCHES

- Audi Leasing, Braunschweig
- SEAT Leasing, Braunschweig
- ŠKODA Leasing, Braunschweig
- AutoEuropa Leasing, Braunschweig
- Ducati Leasing, Braunschweig

INTERNATIONAL BRANCHES

- Volkswagen Leasing GmbH, Milan, Italy
- Volkswagen Leasing GmbH, Verona, Italy
- Volkswagen Leasing GmbH, Bolzano, Italy
- Volkswagen Leasing GmbH, Warsaw, Poland

INTERNAL MANAGEMENT

Volkswagen Leasing GmbH is included in Volkswagen Financial Services AG's consolidated financial statements in accordance with the International Financial Reporting Standards (IFRSs). The companies in the Group – and therefore also Volkswagen Leasing GmbH – are thus managed internally on the basis of the IFRS figures. Operating profit or loss[1] is the main internal key performance indicator. The differences between the operating profit and the profit before tax in accordance with the Handelsgesetzbuch (HGB – German Commercial Code) are caused by shifts in the period of recognition, which largely arise from the differences in the accounting treatment of leases (operating leases and finance leases) under the HGB and IFRSs, and by differences in the accounting treatment of ABS transactions, which have an adverse impact on the HGB profit before tax. The most significant non-financial performance indicators are penetration[2], the volume of existing contracts[3] and new contracts[4]. Return on equity (RoE) and the cost/income ratio (CIR) are used as further key performance indicators, but at the level of the Volkswagen Financial Services AG Group, of which the Company forms part.

CHANGES IN EQUITY INVESTMENTS

Volkswagen Leasing GmbH has carried out an upstream transfer of shares in the affiliated companies Euromobil Autovermietung GmbH, Isernhagen, carmobility GmbH, Braunschweig, and Vehicle Trading International (VTI) GmbH, Braunschweig, to Volkswagen Financial Services AG.

1 Operating profit or loss includes net income from leasing transactions after provision for credit risks, net fee and commission income, general and administrative expenses, and other operating income and expenses. The interest expenses, general and administrative expenses and net other operating income/expenses that are not components of operating profit or loss comprise, for example, interest income and expenses from tax audits or interest costs from unwinding the discount on other provisions.
2 Ratio of new contracts for new Group vehicles to deliveries of Group vehicles in the German market.
3 Contracts recognized as of the reporting date.
4 Contracts recognized for the first time in the reporting period.

Report on Economic Position

The pace of global economic growth was slightly slower in 2016 than in the previous year. The volume of existing contracts increased again despite persistently difficult conditions.

GLOBAL ECONOMY

GLOBAL ECONOMIC DEVELOPMENT

The moderate growth rate of the global economy slowed to 2.5% (previous year: 2.8%) in fiscal year 2016. While economic momentum decelerated in the industrialized countries as a whole, growth rates in emerging economies remained virtually constant year-on-year. Inflation increased as a result of the expansionary monetary policies pursued by many central banks and due to rising energy and commodity prices.

Europe

The economy of Western Europe continued to recover in the reporting period. At 1.7% (previous year: 2.0%), growth in gross domestic product (GDP) was slightly lower than in the previous year. The picture was mixed as regards economic growth in both Northern and Southern Europe. The UK's Brexit referendum in June, when a small majority voted to leave the EU, had a dramatic effect, with direct consequences including uncertainty in the financial markets and dimmer economic prospects for the United Kingdom and Europe as a whole. The eurozone unemployment rate continued to decrease, falling to an average of 10.6% (previous year: 11.3%), though rates remained considerably higher in Greece and Spain.

Although GDP grew by a total of 1.3% (previous year: 0.8%) in Central and Eastern Europe in the reporting period, it remained at a relatively low level. Whereas the comparatively high rate of growth in Central Europe weakened considerably compared with the previous year, the recessionary period of the previous year in Eastern Europe came to an end. The recovery in energy prices was the main positive factor in this trend, while the unresolved conflict between Russia and Ukraine continued to have a negative impact.

Germany

The German economy continued to profit from positive consumer sentiment and a good labor market, with the 1.8% (previous year: 1.5%) rise in GDP being somewhat stronger than in the previous year.

FINANCIAL MARKETS

In 2016, global financial markets were characterized by some degree of uncertainty and the environment continued to be dominated by the expansionary monetary policies pursued by international central banks. The main sources of uncertainty included recurring doubts about economic growth in key industrialized nations, the United Kingdom's membership of the European Union (EU), geopolitical conflicts, political developments and the unexpected instability in the price of oil. The European Central Bank (ECB) maintained its expansionary monetary policy to achieve its inflation targets; in March, it cut its key interest rate to 0.0% and increased its negative interest rate for bank deposits at the ECB to –0.4%. This reduced rates of return to negligible levels and led to a shift toward a willingness to invest in higher risk equities and paper. In June, the ECB extended its bond-buying program to include unsecured corporate bonds and raised the volume of monthly buying. At the end of the year, the ECB decided to reduce the program's monthly volume but to extend the bond-buying once again to the end of 2017.

The uncertainty in the Italian banking system has persisted, even after the change of government in December, and government bailouts are becoming necessary in some cases. The Bank of England reduced its key interest rate and announced an asset-buying program covering government and corporate bonds. Coupled with hopes for a slow rise in interest rates in the USA, this led to a rally on stock markets. The US presidential election in the fall of 2016 generated uncertainty in financial markets. At the moment, it is not yet possible to assess the long-term impact from the new political situation in the USA.

Following falls in market prices at the end of the third quarter, hopes for an extension to the ECB's bond-buying program and for a cut in the basic interest rate by the People's Bank of China initially led to a rise in equity prices in the fourth quarter. However, at the same time, market players were unnerved by negative economic indicators from China and the fall in the oil price. European stock markets responded positively to the widely expected hike in the benchmark rate by the US Federal Reserve (Fed) towards the end of the fourth quarter. The rate increase was implemented in December, with the Fed nudging up the target range for its federal funds rate by 25 basis points to 0.5%-0.75%. Three further rises are planned for 2017, taking the range to 1.25%-1.5%.

Germany

Growth in the German economy was robust, although some momentum was lost at the end of the year compared with the first six months. A slide into deflation was successfully averted, and consumer spending and a sustained high level of exports remain the drivers of the German economy.

AUTOMOTIVE MARKET

GLOBAL DEMAND FOR PASSENGER CARS REACHES RECORD HIGH

Worldwide, the number of new passenger car registrations increased to 81.1 million vehicles in fiscal year 2016, exceeding the previous year's record level by 5.4%. Demand rose in the Asia-Pacific, Western Europe, North America and Central Europe regions, while new passenger car registrations in South America, Eastern Europe and Africa failed to match the prior-year levels.

Europe

New passenger car registrations in Western Europe rose by 5.8% in the reporting period to 14.0 million vehicles, the highest level since 2007. This better-than-expected trend was mainly attributable to the positive overall economic environment, low interest rates, low fuel prices and manufacturers' incentive programs. Double-digit growth rates were achieved in Italy (+15.4%) and Spain (+10.9%), especially due to the release of pent-up demand for replacement vehicles.

At 2.7 million vehicles, the number of new passenger car registrations in Central and Eastern Europe was down 2.3% year-on-year. The decline in Eastern Europe was mainly attributable to the Russian market, which contracted for the fourth year in succession (–11.7%) primarily because of the continuing weak economy and ongoing political tensions. By comparison, new passenger car registrations in the EU member states of Central Europe increased by a substantial 15.2% to 1.1 million units.

Germany

In Germany, 3.4 million new passenger vehicles were registered in 2016, 4.5% more than in the previous year. This positive demand trend was due in particular to higher real incomes, the strong labor market and attractive financing options. New passenger car registrations for both private (+6.8%) and commercial (+3.3%) customers contributed to this increase, which resulted in the highest passenger car market volume since 2009. A slight increase in domestic production (up 0.6% to 5.7 million vehicles) contributed to the ongoing recovery of the German passenger car market, whereas passenger car exports (up 0.2% to 4.4 million vehicles) were on a par with the high levels of the previous year.

MIXED REGIONAL DEMAND FOR COMMERCIAL VEHICLES

In 2016, demand for light commercial vehicles was up slightly overall on the previous year: in total, around 9.6 million (previous year: 9.5 million) vehicles were registered worldwide.

In Western Europe, the number of new vehicle registrations rose by 10.0% during the year to 1.8 million units, driven by the region's positive economic performance. The markets in Italy (+28.9%), Spain (+11.6%) and France (+9.4%) recorded high growth rates.

In Germany, the 2015 figure was significantly exceeded by 10.2%.

The markets in Central and Eastern Europe saw significant growth on the whole with 303 thousand (previous year: 287 thousand) vehicle registrations.

OVERALL ASSESSMENT OF BUSINESS PERFORMANCE

In the opinion of the Management of Volkswagen Leasing GmbH, the business performed well in 2016.

In 2016, Volkswagen Financial Services yet again received the best brand award from FIRMENAUTO magazine in the leasing and fleet management category. It also won the TopPerformer award from trade publication Autoflotte in the leasing category.

Volkswagen Leasing GmbH celebrated its 50th anniversary in the reporting period. When it commenced operations on October 18, 1966, it was the first automobile leasing company in Germany. It developed over the decades from newcomer to leasing and mobility pioneer and now ranks as the largest automobile leasing company in Europe.

Volkswagen Leasing GmbH initially focused very much on commercial customers, but in more recent years it has begun to take a particular interest in simple leasing agreement processing and private customers.

The popularity of different forms of car-sharing as an alternative to ownership continues to grow. The Company continued to expand its private leasing business successfully in 2016 to meet the wishes and needs of private customers for mobility, flexibility and independence. The number of new contracts came in well ahead of expectations.

The RückgabeschutzPlus service, which remains unmatched in the German market, helps private customers protect themselves against the financial consequences of minor damage present when the vehicle is returned at the end of the lease.

Volkswagen Leasing GmbH is successfully meeting the new mobility requirements of private customers with reliable, fair and transparent handling processes at all stages, not just at the end of the agreement.

The Charge&Fuel Card combines the benefits of a conventional fuel card with the option of using it to pay for charging electric vehicles. Since July 1, 2016, vehicle charging has been billed at a competitive standard nationwide rate. Thanks to the Charge&Fuel Card, electric vehicle owners now need just the one card for authentication and payment when refueling and recharging.

The associated Charge&Fuel App offers an easy-to-use search function and provides drivers with a quick overview of the locations of all usable charging points throughout Germany.

In 2016, this network was expanded to around 4,000 charging points with high-quality location data.

The Charge&Fuel card was awarded the "Innovationspreis 2016 Privatkundengeschäft" (2016 innovation prize, retail business) in the "Payments" category at the Retail Banking Conference forming part of the 19th Euro Finance Week in Frankfurt am Main.

Volkswagen Leasing is continuing with its consistent expansion of its fuel and service card business too, investing strategically in sales activities and more personalized customer propositions as well as supporting the different drive types (diesel, gasoline, CNG and electric) compatible with the products. The proposition has now been extended to cover the entire fleet of fleet customers to provide a single-source solution for fuel purchasing.

The commercial segment accounted for the lion's share of overall new registrations in 2016. The story was the same at Volkswagen Leasing GmbH, which saw commercial leasing business grow as a result. Demand for comprehensive mobility solutions remains strong and there has been a clear increase in associated services. This development was supported by the individual leasing measures configured in conjunction with the Group brands and an expanding SUV market, which is growing ever more attractive in fleet business.

The popularity of supplementary service packages covering aspects such as servicing and inspection and replacement of expendable parts continues to grow in private customer business and Volkswagen Leasing GmbH intends to keep its services in this area under constant development. The programs launched in 2016 enabled the Company to capitalize on this trend very successfully, paving the way to double-digit growth rates in the service segment.

Enhancements to the leasing programs delivered further growth in private customer leasing business, with both new and low-mileage used vehicles, in addition to these strong growth rates in the service area.

The implementation of the ROUTE2025 strategy, with its four strategic priority issues, made its mark at Volkswagen Leasing GmbH too in 2016.

The #DFLEET project launched under the banner of the digitalization priority issue, for example, involves the successful development of a portal solution for individual and fleet customers that makes it possible to initiate self-service actions, view contract data and digitalize output documents. The second priority issue concerns the substantial expansion of business with used vehicles up to eight years old. The main activity in relation to the operational excellence and profitability priority issue is the end-to-end analysis of processes encompassing all relevant areas. The aim of this undertaking is to devise a blueprint that can be used in future to configure other processes according to the same logic. The fourth priority issue is culture: constantly evolving customer needs, the spread of digitalization and other important developments make it essential that the Company embrace change, which is why Volkswagen Financial Services AG launched a new cultural movement in 2016. The aim is to breathe life into this concept and further develop it in 2017 together with employees from all areas and we at Volkswagen Leasing GmbH will certainly be making an active contribution.

On September 18, 2015, the US Environmental Protection Agency (EPA) issued a Notice of Violation, publicly announcing that irregularities in relation to nitrogen oxide (NOx) emissions had been discovered in emissions tests on certain vehicles with Volkswagen Group diesel engines. This was followed by further notifications regarding the extent of the diesel issue. As a result of this situation, the Board of Management of our parent company Volkswagen Financial Services AG set up a task force in 2015. This task force initially continued its activities in 2016, i.e. reporting regularly to the Board of Management, interfacing with the Volkswagen Group and its brands, and maintaining close contact with the international subsidiaries, regulatory authorities and investors. Concerns focused on funding, the credit quality of the dealer network and residual value risk. The impact from the diesel issue on these concerns is currently receding. Further details are described in the relevant sections of this report. The work of the task force has been suspended since December 2016 because the effects of the diesel issue on the Volkswagen Financial Services AG subgroup are now dissipating and can be handled within normal processes. The Volkswagen Group provided support in dealing with the effects.

The growth in the volume of existing leases demonstrates the positive trend in fiscal year 2016. This volume went up by 100 thousand year-on-year, reaching a record level of 1,281 thousand units. Volkswagen Leasing GmbH again increased its total assets year-on-year.

Please refer to the notes for details of significant events that occurred after the end of the fiscal year.

CHANGES IN KEY PERFORMANCE INDICATORS FOR FISCAL YEAR 2016 COMPARED WITH PRIOR-YEAR FORECASTS

A significantly lower operating profit in accordance with IFRSs had been predicted for the German market in fiscal year 2016. The operating profit in accordance with IFRSs of €242.2 million generated by Volkswagen Leasing GmbH in the German market was somewhat better than forecast but still well short of the prior-year level of €288.8 million.

New contracts and the volume of existing contracts were expected to be down slightly on the prior year in 2016. Both new contracts and the volume of existing contracts increased substantially year-on-year as a result of the ongoing expansion in the integration of financial services into the sales activities of the Volkswagen Group brands.

The penetration rate based on all new Volkswagen Bank GmbH and Volkswagen Leasing GmbH financing and leasing contracts in the German market increased slightly to 59.1% in defiance of the forecasts. The penetration rate solely in respect of Volkswagen Leasing GmbH in the German market increased significantly compared with the prior year to 44.7%.

In Italy, we expected a slight year-on-year increase in 2016 in new contracts and the volume of existing contracts, in operating profit in accordance with IFRSs and in the penetration rate. Operating profit in accordance with IFRSs rose faster than expected in Italy reaching €21.6 million (previous year: €15.5 million). New contracts and the volume of existing contracts were both up slightly on the prior year as forecast. The penetration rate, which had been forecast to rise, declined slightly.

The forecast for our branch in Poland for 2016 predicted a substantial year-on-year increase in operating profit in accordance with IFRSs in combination with marginal growth in both new contracts and the volume of existing contracts and a significantly increased penetration rate. Actual results show an operating loss in accordance with IFRSs of €6.6 million for 2016, well down on the prior-year operating profit of €0.9 million and mainly attributable to the increased provision for credit risks. New contracts and the volume of existing contracts increased significantly faster than expected. As forecast, the penetration rate was up considerably on the prior year.

RESULTS OF OPERATIONS

In the reporting period, leasing income rose by €0.7 billion to €14.7 billion. Of this rise in income, €0.3 billion was attributable to increased proceeds from the disposal of former lease vehicles (which accounted for €7.9 billion of the total leasing income) and €0.2 billion to ongoing lease installments. The other sources of increased income included the subsidies received and higher income from services. The larger portfolio of contracts will lift revenue in the coming years.

Leasing expenses went up by €0.3 billion to €8.2 billion year-on-year. This item mainly comprises the net carrying amounts of vehicles disposed of and service lease expenses.

General and administrative expenses decreased by €42 million to €346 million, mainly as a consequence of lower IT costs, personnel expenses and charges for services provided by third parties.

Depreciation and write-downs of lease assets amounted to €5.2 billion (previous year: €4.7 billion). This figure includes write-downs of €0.3 billion (previous year: €0.3 billion). Write-downs of lease assets are recognized taking account of existing collateral and support payments relating to the diesel issue.

The funding costs of Volkswagen Leasing GmbH rose to €359 million in 2016 (previous year: €282 million), partly due to a greater growth-related funding requirement and partly as a result of a change to the funding structure with the emphasis on our asset-backed securities (ABS) programs.

Write-downs of and valuation allowances on receivables and additions to provisions in the leasing business came to €714 million (previous year: €631 million). This increase was mainly attributable to a growth-related year-on-year rise in additions to the provisions for future expenses from servicing and wear-and-tear products.

Income from the reversal of write-downs and of valuation allowances on receivables and from the reversal of provisions in the leasing business fell significantly to €138 million (previous year: €180 million). This was largely due to the level of reversals of provisions in the leasing business being lower than in the prior year.

Net other operating income rose by €47.8 million year-on-year to €230.9 million in 2016. The figure also includes support payments in the amount of €64.6 million from Volkswagen Financial Services AG to compensate for higher funding costs and realized residual value losses resulting from the diesel issue. Other operating expenses in the reporting period increased by €7.1 million to €43.4 million.

The differences between the HGB and IFRS financial reporting frameworks produce significant differences in the results of Volkswagen Leasing GmbH under each framework, especially when business is expanding. The sharp rise in new business at Volkswagen Leasing GmbH leads to higher one-time expenses under the HGB, whereas under the IFRSs these expenses are distributed over the term of the leasing agreement. Financial reporting in accordance with the HGB, moreover, sees a higher funding expense figure recorded in connection with ABS transactions than under the IFRSs, which provide for these programs to be consolidated. While the result from ordinary business activities in accordance with the HGB was significantly lower than in the prior year at €–260.8 million (previous year: €-36.7 million), operating profit in accordance with IFRSs for the German market amounted to €242.2 million (previous year: €288.8 million). This is mainly attributable to increased risk costs. Income from the reversal of provisions was also significantly lower than in the prior year. The diesel issue had no net effect on the operating profit in accordance with IFRSs for the German market.

In Italy, operating profit in accordance with IFRSs rose by €6.1 million, amounting to €21.6 million for the reporting period (previous year: €15.5 million). In Poland, the Company recorded an operating loss in accordance with IFRSs of €6.6 million (previous year: operating profit of €0.9 million)

NET ASSETS AND FINANCIAL POSITION

Total assets rose by €3.3 billion to €27.8 billion. Lease assets, which represent the core business of Volkswagen Leasing GmbH, amounted to a total of €23.8 billion and therefore accounted for approximately 85.6% of total assets.

Acquisitions of lease assets rose by €1.2 billion to €14.9 billion. The gross carrying amount of lease assets increased from €28.8 billion to €32.1 billion. The net carrying amount as of the reporting date was €23.8 billion (previous year: €21.1 billion), equating to a rise of €2.7 billion or 12.8%.

Volkswagen Leasing GmbH continued to expand its business activities in Germany in the reporting period.

As of the reporting date, the portfolio of vehicles had increased to approximately 1,281,000 units compared with approximately 1,181,000 as of the prior year reporting date. Of this figure, the Italian branches accounted for approximately 25,000 vehicles (previous year: 26,000) and the Polish branch 55,000 vehicles (previous year: 43,000). The increase in the portfolio was due to the net effect from the addition of approximately 590,000 new units and the disposal of around 490,000 vehicles.

The performance of the business is illustrated by the growth in the volume of leases – a key performance indicator for the leasing sector – over a number of years.

GROWTH IN THE VOLUME OF VEHICLE LEASES (THOUSANDS)

2016		2015		2014		2013		2012	
Additions	Balance	Additions	Balance	Additions	Balance	Additions	Balance	Additions	Balance
590	1,281	555	1,181	517	1,110	439	1,014	431	956

In terms of capital structure, the main liability items are the liabilities to customers of €12.7 billion (previous year: €10.7 billion) and the notes and commercial paper issued amounting to €7.2 billion (previous year: €7.3 billion).

Equity

Volkswagen Leasing GmbH's subscribed capital remained unchanged at €76 million in fiscal year 2016. Based on the total assets of €27.8 billion, the equity ratio was 0.8% (previous year: 0.9%).

Liquidity Analysis

The companies of Volkswagen Financial Services AG are funded primarily through capital market and ABS programs and by the direct banking deposits held by Volkswagen Bank GmbH. Volkswagen Bank GmbH holds liquidity reserves in the form of securities deposited in its operational safe custody account with Deutsche Bundesbank. Proactive management of the operational safe custody account, which allows Volkswagen Bank GmbH to participate in funding facilities, has proven to be an efficient liquidity reserve approach. The securities deposited as collateral in the operational safe custody account include, in addition to bonds from various countries amounting to €1.8 billion, senior ABS bonds issued by special purpose entities of Volkswagen Leasing GmbH, Volkswagen Finance S.A. and Volkswagen Bank GmbH amounting to €9 billion. Standby lines of credit at other banks are also available to protect against unexpected fluctuations in cash flows. There are no plans to make use of these standby lines of credit; their sole purpose is to serve as backup to safeguard liquidity.

To ensure there is appropriate liquidity management, Treasury prepares four different funding matrices, carries out cash flow forecasts, uses this information to determine the relevant range of liquidity coverage and takes action as required. In these calculations, the legally determined cash flows are taken as a basis for funding instruments, whereas estimated cash flows are used for other factors that affect liquidity. In the reporting period, the range of liquidity coverage taking into account simulated, limited funding and a partial withdrawal of overnight deposits came to a minimum of 37 weeks.

A stricter constraint on the management of liquidity at Volkswagen Bank GmbH and in the entities within the regulatory basis of consolidation of Volkswagen Financial Services AG is the liquidity coverage ratio (LCR). From January to December in the year under review, this ratio varied between 82% and 157% for the regulatory basis of consolidation and was therefore well above the lower regulatory limit of 70% at all times. The changes in the liquidity ratio are continuously monitored by Treasury and proactively managed by issuing a lower limit for internal management purposes. Central bank balances and government bonds are eligible as highly liquid assets for the purposes of the LCR.

The requirement under the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements Risk Management) for Volkswagen Bank GmbH and Volkswagen Leasing GmbH to provide a highly liquid cash buffer and appropriate liquidity reserves to cover any liquidity requirements over seven-day and thirty-day time horizons was also satisfied at all times, even under various stress scenarios. Compliance with this requirement is determined and continuously reviewed as part of the liquidity risk management system. In this process, the cash flows for the coming twelve months are projected and compared against the potential funding available in each maturity band. Adequate potential funding to cover the liquidity requirements was available at all times, both in the normal scenario and in the stress tests required by MaRisk.

FUNDING

Strategic Principles

In terms of funding, Volkswagen Leasing GmbH generally pursues a strategy of diversification with the aim of achieving the best possible balance of cost and risk. This means accessing the widest possible variety of funding sources in the various regions and countries with the objective of safeguarding funding on a long-term basis at optimum terms.

Implementation

The funding situation remained challenging in 2016 due to the diesel issue. Volkswagen Leasing GmbH did not issue any unsecured bonds on capital markets in the reporting period, instead funding itself successfully using alternatives such as commercial paper.

Volkswagen Leasing GmbH was also active in the market in 2016 with its ABS program. German lease receivables were securitized in April 2016 as part of the “Volkswagen Car Lease 23” (VCL 23) transaction. The transaction had a volume of €750 million. In November 2016, “Volkswagen Car Lease 24” (VCL 24) was placed in the market and the total value was increased from €750 million to €1.25 billion because of the significant investor interest.

This package of measures ensured that Volkswagen Leasing GmbH had adequate liquidity at all times during 2016.

Report on Opportunities and Risks

The proactive management of opportunities and risks is a fundamental element of the successful business model used by Volkswagen Leasing GmbH.

RISKS AND OPPORTUNITIES

In this section, we report on the risks and opportunities that arise in connection with our business activities. The risks and opportunities are summarized in various categories. Unless specifically stated, there were no material year-on-year changes to the individual risks or opportunities.

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

MACROECONOMIC OPPORTUNITIES

Against the backdrop of likely further economic growth in the vast majority of markets, the Management of Volkswagen Leasing GmbH expects to see a moderate increase in the number of vehicle deliveries to Volkswagen Group customers, enabling it to build on its position in global markets on a sustainable basis. Volkswagen Leasing GmbH supports this positive trend by providing financial services products designed to promote sales.

The probability of a global recession is considered to be low overall. However, diminished rates of global economic growth or a period of below-average growth rates cannot be ruled out. The macroeconomic environment could also give rise to opportunities for Volkswagen Leasing GmbH if actual trends turn out to be better than forecast.

STRATEGIC OPPORTUNITIES

As well as continuing its international focus by tapping new markets, Volkswagen Leasing GmbH believes that developing innovative products that are tailored to customers' changing mobility requirements offers additional opportunities. Growth areas such as mobility products and service offerings (parking and payment) are being systematically leveraged and expanded. Further opportunities may be created by launching established products in new markets. An increase in the interest rate differential between the long and short ends of the yield curve in key currency areas would open up the prospect of a positive effect on operating profit.

The digitalization of our business represents a significant opportunity for Volkswagen Leasing GmbH. We aim to be able to offer all of our products worldwide online as well by 2025. By expanding digital sales channels, we are addressing the changing needs of our customers and strengthening our competitive position.

OPPORTUNITIES FROM CREDIT RISK

Opportunities may arise in connection with credit risk if the losses actually incurred on lending transactions turn out to be lower than the prior calculations of expected loss and the associated provisions recognized on this basis. A situation in which the incurred losses are lower than the expected losses can occur particularly in individual countries in which economic uncertainty is dictating a conservative risk approach but in which the economic circumstances then stabilize, resulting in an improvement in the credit quality of the borrowers concerned.

OPPORTUNITIES FROM RESIDUAL VALUE RISK

Residual values of vehicles continuously change in line with market circumstances. When vehicles are remarketed, Volkswagen Leasing GmbH may be presented with the opportunity to achieve a price that is higher than the calculated residual value if increasing demand pushes up market values more than expected.

KEY FEATURES OF THE INTERNAL CONTROL SYSTEM AND THE INTERNAL RISK MANAGEMENT SYSTEM IN RELATION TO THE FINANCIAL REPORTING PROCESS

The internal control system (ICS) of Volkswagen Leasing GmbH, as far as it is relevant to the accounting system, is defined as the sum of all principles, procedures and activities aimed at ensuring the effectiveness, efficiency and propriety of the financial reporting and ensuring compliance with the relevant legal requirements. The Internal Risk Management System (IRMS) related to the accounting system is concerned with the risk of misstatement in the bookkeeping system as well as in external financial reporting. The sections below describe the key elements of the ICS/IRMS as they relate to the financial reporting processes of Volkswagen Leasing GmbH.

- The Management of Volkswagen Leasing GmbH is the governing body with responsibility for the executive management of the business. In this role, the Management has set up accounting, customer service, treasury, risk management, controlling and compliance units, each with clearly separated functions and clearly assigned areas of responsibility and authority, to ensure that the Company carries out accounting and financial reporting processes properly. Key overarching functions are managed by the Board of Management of Volkswagen Financial Services AG and via the Managements of Volkswagen Bank GmbH and Volkswagen Leasing GmbH.
- Group-wide rules and regulations have been put in place as the basis for a standardized, proper and continuous financial reporting process.
- For example, the accounting policies are governed by internal accounting regulations, including the accounting provisions in accordance with the HGB in conjunction with the Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute (RechKredV – German Bank Accounting Regulation).
- At Company level, specific control activities aimed at ensuring the propriety and reliability of financial reporting include the analysis and any necessary adjustment of the accounting data submitted by the individual units and subledgers.
- These activities are supplemented by the clear delineation of areas of responsibility and by various monitoring and review mechanisms. The overall aim is to ensure that all transactions are accurately recognized in the accounts, processed and evaluated, and then properly reported.
- These monitoring and review mechanisms are designed with both integrated and independent process components. For example, automated IT process controls account for a significant proportion of the integrated process activities alongside manual process controls, such as double-checking by a second person. These controls are enhanced by specific functions at Group level carried out by the parent company Volkswagen AG, for example functions within the responsibility of the Group Tax department.
- Risk management is comprehensively integrated into the financial reporting process through ongoing risk monitoring and the risk reporting system.
- Internal auditing is a key component of Volkswagen Leasing GmbH's monitoring and control system. The Internal Audit department carries out regular audits of accounting-related processes in Germany and abroad as part of its risk-oriented auditing activities and reports on these audits directly to the Management of Volkswagen Leasing GmbH.

In sum, the existing internal monitoring and control system of Volkswagen Leasing GmbH is intended to ensure that the financial position of Volkswagen Leasing GmbH as of the reporting date December 31, 2016 has been based on information that is reliable and has been properly recognized. No material changes were made to the internal monitoring and control system of Volkswagen Leasing GmbH after the reporting date.

ORGANIZATIONAL STRUCTURE OF RISK MANAGEMENT

At Volkswagen Leasing GmbH, risk is defined as the danger of loss or damage that could occur if an expected future development turns out to be less favorable than planned.

Volkswagen Leasing GmbH, including its branches and equity investments, (hereinafter: Volkswagen Leasing GmbH) is exposed to a large number of risks typical for the financial services sector as part of its primary operating activities. The Company takes on these risks on a responsible basis so that it can specifically exploit associated market opportunities.

Volkswagen Leasing GmbH has implemented a Risk Management System to identify, assess, manage, monitor and communicate risks. The Risk Management System comprises a framework of risk principles, organizational structures and processes for assessing and monitoring risks. The individual elements are tightly focused on the activities of the individual divisions. This structure makes it possible to identify any trends that could represent a risk to the business as a going concern at an early stage so that appropriate corrective action can then be initiated. No material changes were made to the risk management methodology in the reporting period.

Appropriate procedures are in place to ensure the adequacy of the Risk Management System. Firstly, the Group Risk Management unit continuously monitors the system. Secondly, the individual elements in the system are regularly reviewed on a risk-oriented basis by Internal Audit and as part of the audit of the annual financial statements by the independent auditors.

Within Volkswagen Leasing GmbH, responsibility for risk management and credit analysis is assigned to a particular member of the Management. In this role, the Management member concerned submits regular reports to the other members and to the sole shareholder, Volkswagen Financial Services AG, on the overall risk position of Volkswagen Leasing GmbH.

An important feature of the Risk Management System at Volkswagen Leasing GmbH is the clear, unequivocal separation of tasks and areas of responsibility, both organizationally and in terms of personnel, between the holding company (Group Risk Management unit) and the markets (local risk management) to ensure that the system is fully functioning at all times and regardless of any particular personnel involved.

One of the functions of the Group Risk Management unit is to provide framework constraints for the organization of the Risk Management System. This function includes drawing up risk policy guidelines, developing and maintaining methodologies and processes relevant to risk management as well as issuing and monitoring international framework standards for the procedures to be used.

In particular, these activities involve providing models for carrying out credit assessments, quantifying the different categories of risk, determining risk-bearing capacity and measuring collateral. Group Risk Management is therefore responsible for identifying possible risks, analyzing, quantifying and assessing risks, and for determining the resulting measures to manage the risks. Group Risk Management is a neutral, independent unit and reports directly to the Management of Volkswagen Leasing GmbH.

Local risk management units ensure that the requirements specified by Group Risk Management are implemented and complied with in each market.

Local risk management is responsible for the detailed design of local structures for the models and procedures used for risk measurement and management, and carries out local implementation from process and technical perspectives. There is a direct line of reporting from local risk management to Group Risk Management.

To summarize, continuous monitoring of risks, transparent and direct communication with the Management and the integration of all information obtained into the operational Risk Management System form a foundation for the best possible leveraging of market potential based on conscious, effective management of the overall risk faced by Volkswagen Leasing GmbH.

RISK STRATEGY AND RISK MANAGEMENT

Fundamental decisions relating to strategy and the instruments of risk management are the responsibility of the Management of Volkswagen Leasing GmbH.

As part of this overall responsibility, the Management of Volkswagen Leasing GmbH has introduced a MaRisk-compliant strategy process and drawn up a business and risk strategy. The ROUTE2025 business strategy sets out the fundamental views of the Management of Volkswagen Leasing GmbH on key matters relating to business policy. It includes the objectives for each major business activity and the strategic areas for action to achieve the relevant objectives. The business strategy also serves where appropriate as the starting point for creating a consistent risk strategy.

The risk strategy is reviewed each year and on an ad hoc basis on the basis of a risk inventory, risk-bearing capacity and legal requirements. It is adjusted where appropriate and discussed with the Annual General Meeting of Volkswagen Leasing GmbH. The risk strategy describes the main risk management goals and action plans for each category of risk taking into account the business policy focus (business strategy), risk tolerance and risk appetite. A review is carried out annually to establish whether the goals have been attained. The causes of any variances are analyzed and then discussed at the Annual General Meeting of Volkswagen Leasing GmbH.

The risk strategy includes all material quantifiable and non-quantifiable risks. Further details and specifics for the individual risk categories are set out in risk substrategies and included in operational requirements as part of the planning round.

The Management of Volkswagen Leasing GmbH is responsible for specifying and subsequently implementing the overall risk strategy at Volkswagen Leasing GmbH.

RISK INVENTORY

The objective of the risk inventory, which has to be carried out at least annually, is to identify the main categories of risk. To this end, all known categories of risk are investigated to establish whether they arise at Volkswagen Leasing GmbH. In the risk inventory, the relevant categories of risk are examined in greater detail, quantified or, if they cannot be quantified, assessed by experts, and then evaluated to determine whether they are material for Volkswagen Leasing GmbH.

The risk inventory carried out using the base data as of December 31, 2015 came to the conclusion that the following quantifiable categories of risk should be classified as material: counterparty default risk, earnings risk, direct residual value risk, market risk, liquidity risk and operational risk; it also concluded that reputational risk and strategic risk, which are not quantifiable, should also be considered material. Indirect residual value risk was classified as immaterial because it accounted for a low proportion of the overall risk. Other existing subcategories of risk are taken into account within the categories specified above.

RISK-BEARING CAPACITY, RISK LIMITS AND STRESS TESTING

A system has been set up to determine the risk-bearing capacity of Volkswagen Leasing GmbH. This system compares the economic risk against available financial resources referred to as the “risk-taking potential”. An institution has the capacity to bear its risk if, as a minimum, all material risks to which the institution is exposed are covered at all times by the institution’s risk-taking potential.

The results from the risk inventory provide the basis for the level of detail in the design of the risk management process and for inclusion in risk-bearing capacity. In line with standard banking practice, risks are assessed using the net method.

The main risks are quantified as part of the risk-bearing capacity analysis (which is relevant to the management of risks) using a going concern approach with a standard confidence level of 90% (exception: liquidity risk (funding risk) with a confidence level of 99%) and a time horizon of one year.

In addition, Volkswagen Leasing GmbH uses a system of limits derived from the risk-bearing capacity analysis to specifically manage risk cover capital in accordance with the level of risk tolerance determined by the Management.

The establishment of the risk limit system as a core component of capital allocation limits the risk at different levels, thereby safeguarding the economic risk-bearing capacity of Volkswagen Leasing GmbH. Risk-taking potential is determined from the available equity and earnings components subject to various deductions. In line with the risk tolerance of the Management of Volkswagen Leasing GmbH, only a portion of this risk-taking potential is specified as a risk ceiling in the form of an overall risk limit. The overall risk limit is apportioned to counterparty default risk, residual value risk, market risk, liquidity risk (funding risk) and operational risk for the purposes of operational monitoring and control. In this process, the limit allocated to counterparty default risk, itself an overarching category of risk, is subdivided into individual limits for credit risk, shareholder risk, issuer risk and counterparty risk.

In a second step, the limits for the risk categories (with the exception of those for shareholder risk, issuer risk, counterparty risk and liquidity risk (funding risk)) are broken down and allocated at the level of the branches.

The limit system provides the Management with a tool that enables it to meet its strategic and operational corporate management responsibilities in accordance with statutory requirements.

The overall economic risk of Volkswagen Leasing GmbH as of September 30, 2016 amounted to €893 million. The apportionment of this total risk by individual risk category was as follows:

DISTRIBUTION OF RISKS BY TYPE OF RISK
as of September 30, 2016

1 Global amount for non-quantifiable risks, strategic risk and reputational risk.

CHANGES IN RISK, BY RISK CATEGORY

	30.09.2016		31.12.2015	
	€ million	Percent	€ million	Percent
Risk category				
Credit risk	338	38	313	41
Shareholder, issuer and counterparty risk	1	0	2	0
Residual value risk	265	30	222	29
Earnings risk	170	19	158	20
Market risk	17	2	20	3
Liquidity risk (funding risk)	0	0	0	0
Operational risk	57	6	17	2
Other risks[1]	45	5	39	5
Total	**893**	**100**	**771**	**100**

1* Global amount for material non-quantifiable risks: reputational and strategic risk..

The risk-taking potential of €2.4 billion as of September 30, 2016 comprised reported equity plus the forecast result for the next twelve months (overall €2.4 billion) less adjustment items (€0.0 billion). As of September 30, 2016, 38% of risk-taking potential was utilized by the risks outlined above. In the period January 1, 2016, to September 30, 2016 the maximum utilization of the risk-taking potential in accordance with Pillar II was 39%.

Up to December 31, 2016, there were no indications of any material changes in the utilization of the risk-taking potential.

Volkswagen Leasing GmbH not only determines its risk-bearing capacity in a normal scenario, but also carries out stress tests throughout the Company, the results of which are reported directly to the Management. Stress tests are used to examine the potential impact from exceptional but plausible events on the risk-bearing capacity and earnings performance of Volkswagen Leasing GmbH. The purpose of these scenarios is to facilitate early identification of those risks that would be particularly affected by the trends simulated in the scenarios, so that any necessary corrective action can be initiated in good time. The stress tests include both historical scenarios (such as a repeat of the financial crisis in the years 2008 to 2010) and hypothetical scenarios (such as a global economic downturn or a sharp drop in sales in the Volkswagen Group). In addition, inverse stress tests are used to identify what events could represent a threat to the ability of Volkswagen Leasing GmbH to continue as a going concern.

The calculations of risk-bearing capacity confirmed that all material risks that could adversely impact the net assets, results of operations or liquidity position were adequately covered by the available risk-taking potential at all times. In the reporting period, Volkswagen Leasing GmbH managed risk such that the utilized risk-taking potential was below the overall risk limit set internally. The stress tests did not indicate any need for action.

RISK CONCENTRATIONS

Volkswagen Leasing GmbH is a captive financial services provider in the automotive sector. The business model, which focuses on promoting vehicle sales for the different brands in the Volkswagen Group, causes concentrations of risk, which can take various forms.

Concentrations of risk can arise from an uneven distribution of activity in which

- just a few lessees/contracts account for a large proportion of the leases (counterparty concentrations)
- a small number of sectors account for a large proportion of the leases (sector concentrations)
- many of the leases are with businesses within a defined geographical area (regional concentrations)
- receivables are secured by just one type of collateral or by a limited range of collateral types (collateral concentrations)
- residual values subject to risk are limited to a small number of vehicle segments or models (residual value concentrations), or
- Volkswagen Leasing GmbH's income is generated from just a few sources (income concentrations).

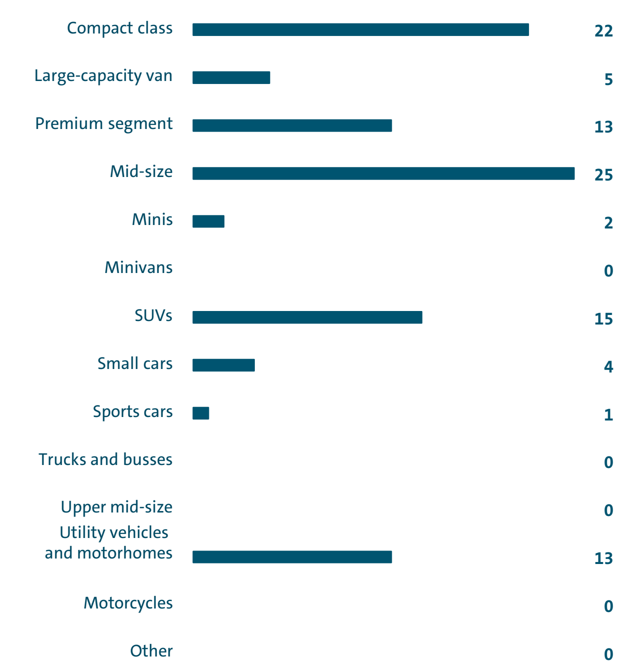
One of the objectives of Volkswagen Leasing GmbH's risk policy is to reduce such concentrations by means of broad diversification.

Counterparty concentrations from customer business are only of minor significance in Volkswagen Leasing GmbH because of the large proportion of business accounted for by retail leases. From a regional perspective, Volkswagen Leasing GmbH has a concentration of business in the German market, but looks to achieve broad nationwide diversification within the country.

In contrast, sector concentrations in the dealer business are part of the nature of the business for a captive provider and these concentrations are therefore individually analyzed. Overall, no particular impact has been identified, even in periods of economic downturn like the crisis experienced in recent years.

Likewise, a captive provider cannot avoid collateral concentrations because the vehicle is the predominant collateral asset by virtue of the business model. Risks can arise from concentrations of collateral if downward pricing trends in used vehicle markets or segments lead to lower proceeds from the recovery of assets and, as a consequence, there is a fall in the value of the collateral. Nevertheless, in terms of the vehicles used as collateral, Volkswagen Leasing GmbH enjoys a broad diversification across all vehicle segments (see following diagram) based on a large range of vehicles from the different brands in the Volkswagen Group.

COLLATERAL STRUCTURE AS OF SEPTEMBER 30, 2016
figures in %



This broad vehicle diversification also means that there is no residual value concentration at Volkswagen Leasing GmbH.

Income concentration arises from the very nature of the business model. Volkswagen Leasing GmbH's particular role, in which it helps to promote sales in the Volkswagen Group, gives rise to certain dependencies that directly affect income growth.

RISK REPORTING

A detailed risk management report is submitted to the Management of Volkswagen Leasing GmbH on a quarterly basis and to the Annual General Meeting. The starting point for the risk management report is risk-bearing capacity because of its importance from a risk perspective for the successful continued existence of the business as a going concern. To this end, the derivation of the available risk-taking potential, the utilization of limits and the current percentage allocation of the overall risk to the individual risk categories is also presented. In addition, Group Risk Management reports on counterparty default risk, direct residual value risk, market risk, liquidity risk and operational risk, both at an aggregate level and – mostly for markets – in detail. These reports include quantitative information (financial data) and also qualitative elements in the form of an assessment of the current situation and expected developments, including recommendations for action where appropriate. Additional reports are produced for specific risk categories. Ad hoc reports are generated as needed to supplement the system of regular reporting.

The high quality of the information contained in the risk management reports about structures and trends in the portfolios is maintained by a process of constant refinement and ongoing adjustment in line with current circumstances.

NEW PRODUCT AND NEW MARKET PROCESS

Before launching new products or commencing activities in new markets, Volkswagen Leasing GmbH first runs through its new product and new market process. All the units involved (such as Risk Management, Controlling, Accounting, Legal Affairs, Compliance, Treasury, IT) are integrated into the process. The process for every new activity involves the preparation of a written concept, which includes an analysis of the risks in connection with the new product or market and a description of the possible implications for management of the risks. Responsibility for approval or rejection lies with the relevant members of the Management of Volkswagen Leasing GmbH, the Board of Management of Volkswagen Financial Services AG and, in the case of new markets, also with the members of the Supervisory Board of Volkswagen Financial Services AG.

OVERVIEW OF RISK CATEGORIES

Financial risks	Non-financial risks
Counterparty default risk	Operational risk
Market risk	Compliance and conduct risk
Liquidity risk	Outsourcing risk
Residual value risk	Model risk
Earnings risk	Strategic risk
	Reputational risk

FINANCIAL RISKS

Counterparty Default Risk

Counterparty default risk refers to a potential negative variance between actual and forecast counterparty risk outcomes. The forecast outcome is exceeded if the loss incurred as a consequence of defaults or changes in credit rating is higher than the expected loss.

At Volkswagen Leasing GmbH, counterparty default risk encompasses the following risk categories: credit risk, counterparty risk, country risk, and shareholder risk.

Credit Risk

Credit risk is defined as the danger of incurring losses as a result of defaults in customer business, specifically the default of the lessee. Receivables from entities in the Volkswagen Group are also included in the analysis. The default is caused by the lessee's insolvency or unwillingness to pay. This includes a situation in which the counterparty does not make interest payments or repayments of principal on time or does not pay the full amounts.

Credit risk, which also includes counterparty default risk in connection with leases, accounts for the greatest proportion of risk exposures in the counterparty default risk category by some distance.

The aim of a systematic credit risk monitoring system is to identify potential lessee insolvencies at an early stage, initiate any corrective action in respect of a potential default in good time and anticipate possible losses by recognizing appropriate writedowns or provisions

If a loan default materializes, this represents the loss of a business asset, which has a negative impact on net assets, financial position and results of operations, depending on the amount of the loss. If, for example, an economic downturn leads to a higher number of insolvencies or greater unwillingness of lessees to make payments, the recognition of a higher write-down expense is required. This in turn has an adverse effect on operating profit.

Risk identification and assessment

Leasing decisions at Volkswagen Leasing GmbH are made primarily on the basis of the lessee credit check. These credit checks use rating or scoring systems, which provide the relevant departments with an objective basis for reaching a decision on the lease.

A set of procedural instructions outlines the requirements for developing and maintaining the rating systems. The Company also has a rating manual which specifies how the rating systems are to be applied as part of the approval process. Similarly, other written procedures specify the parameters for developing, using and validating the scoring systems in the retail business.

To quantify credit risk, an expected loss (EL) and an unexpected loss (UL) are determined at portfolio level for each entity. The UL is the value at risk (VaR) less the EL. The calculation uses an asymptotic single risk factor model (ASRF model) in accordance with the capital requirements specified by the Basel Committee on Banking Supervision (Gordy formula) taking into account the credit quality assessments from the individual rating and scoring systems used.

Rating systems for corporate customers
Volkswagen Leasing GmbH uses rating systems to assess the credit quality of corporate customers. These assessments take into account both quantitative factors (mainly data from annual financial statements) and qualitative factors (such as the prospects for future business growth, quality of management, market and industry environment, and the customer's payments record). When the credit assessment has been completed, the customer is assigned to a rating class, which is linked to a probability of default. A centrally maintained, workflow-based rating application is used for the most part to support this analysis of credit quality. The rating determined for the customer serves as an important basis for decisions on whether to grant or renew a lease and for decisions on provisions.

Scoring systems in the retail business
For the purposes of determining the credit quality of retail customers, scoring systems are incorporated into the processes for lease approval and for evaluating the existing portfolio. These scoring systems provide an objective basis for lease decisions. The systems use information about the lessee available internally and externally and estimate the probability of default for the requested lease, generally with the help of statistical models based on historical data covering a number of years. An alternative approach adopted for smaller or low-risk portfolios also uses generic, robust scorecards and expert systems to assess the risk involved in lease applications.

To classify the risk in the lease portfolio, both behavioral scorecards and straightforward estimation procedures at risk pool level are used, depending on portfolio size and the risk inherent in the portfolio.

Supervision and review of retail and corporate systems
The models and systems supervised by Group Risk Management are regularly validated and monitored using standardized procedural models for validating and monitoring risk classification systems. The models and systems are adjusted and refined, as required. These review procedures are applied to models and systems for assessing credit quality and estimating the probability of default (such as rating and scoring systems) and to models used for estimating loss given default.

In the case of the retail models and systems for credit assessment supervised by local risk management units outside Germany, the Group Risk Management unit reviews the quality of these models and systems on the basis of the locally implemented validation processes, determines action plans in collaboration with the local risk management units if a need for action is identified and monitors the implementation of the action plans. In the validation process, particular attention is paid to a review of the discriminant power of the models and an assessment of whether the model calibration is appropriate to the risk. The models and systems for corporate customers are handled in the same way, although a centralized approach is used for their supervision and validation.

Collateral
The general rule is the leasing transactions are secured by collateral to an extent that is commensurate with the risk. In addition, overarching rules specify the requirements that must be satisfied by collateral, the evaluation procedures and the evaluation bases. Further local regulations (collateral policies) set out specific values and special regional requirements that must be observed.

The values in the collateral policies are based on historical data and experience accumulated by experts over many years. As the operating activities of Volkswagen Leasing GmbH are focused on the leasing of vehicles, the vehicles themselves are hugely important as collateral assets. For this reason, trends in the market values of vehicles are closely monitored and analyzed. Procedures provide for adjustments to evaluation systems and vehicle remarketing processes if there are substantial changes in the market values of vehicles.

Group Risk Management also carries out regular quality assurance tests on local collateral policies. This includes a review of collateral values and implementation of any necessary adjustments.

Provisions
The calculation of provisions is derived from the rating and scoring processes. A distinction is made between receivables subject to severe risk of default and receivables subject to latent risk of default.

In the case of receivables subject to severe risk of default, specific valuation allowances are recognized for individual transactions and specific valuation allowances evaluated on a group basis are recognized for retail business. Classification as a receivable subject to severe risk of default depends on the credit assessment (scoring or rating). Global provisions are recognized for receivables subject to latent risk of default.

The following average values have been determined for the aggregate active portfolio (i.e. portfolio of receivables not in default) based on a time horizon of twelve months: probability of default (PD) 3.5% (previous year: 4.6%); loss given default (LGD) 34.9% (previous year: 34.9 %); and total volume of receivables based on the active portfolio €23.4 billion (previous year: €20.8 billion).

Risk monitoring and control
Group Risk Management sets framework constraints for the management of credit risk. These constraints form the mandatory outer framework of the central Risk Management System, within which the divisions/markets can operate in terms of their business policy activities, planning, decisions, etc. in compliance with their assigned authority.

Appropriate processes are used to monitor all leasing transactions in relation to financial circumstances, collateral and compliance with limits, contractual obligations and internal and external conditions. Individually specified approval limits determined by Volkswagen Leasing GmbH are also used to manage credit risk.

A credit risk portfolio rating, together with analyses of the breakdown of expected and unexpected risk, are used to monitor risk at portfolio level. This rating brings together various risk measures into one indicator, facilitating comparability between the international portfolios of Volkswagen Leasing GmbH.

Trends
Further growth in the volume of receivables within Volkswagen Leasing GmbH was achieved in fiscal year 2016. As in the previous year, the German portfolio was instrumental in driving growth based on its stable vehicle market environment. Overall, the credit risk of Volkswagen Leasing GmbH remained stable. The diesel issue in the Volkswagen Group did not have any impact on the portfolios of Volkswagen Leasing GmbH in 2016.

Counterparty Risk

Volkswagen Leasing GmbH defines counterparty risk as the risk of financial loss that could arise from monetary investments or investments in securities or notes if the counterparty fails to make payments of interest or repayments of principal as contractually required.

Counterparty risk arises in connection with interbank overnight and term deposits, derivatives and the purchase of pension fund units as part of the provision of pensions benefits for employees.

The primary objective in the management of counterparty risk is to identify potential defaults in a timely manner so that corrective action can – where possible – be initiated at an early stage. Another important objective is to ensure that the Company only takes on risks within the approved limits.

If a counterparty risk were to materialize, this would represent the potential loss of a business asset, which would have a negative impact on net assets, financial position and results of operations, depending on the amount of the loss.

Risk identification and assessment
Counterparty risk is recorded as part of the overall counterparty default risk category. The risk is determined by using a Monte Carlo simulation to calculate the unexpected loss (value at risk and expected shortfall) and the expected loss from a normal scenario and stress scenarios.

Risk monitoring and control
To establish effective monitoring and control, volume limits are specified in advance for each counterparty. The Treasury Back Office unit is responsible for monitoring compliance with these limits on a day-to-day basis. The volume limit is set at an appropriate, needs-driven level and is based on the credit assessment. The Credit Analysis department is responsible for the initial classification and then regular reviews. The Group Risk Management unit evaluates counterparty risks each month. Counterparty risks are reported to the Management in the monthly market risk report and the quarterly risk management report.

Country Risk

Country risk refers to risks in international transactions that are not attributable to the counterparty itself but that arise because of the counterparty’s domicile in a country outside Germany. For example, political or economic trends caused by a crisis or difficulties affecting the entire financial system in the country concerned may mean that cross-border services involving the movement of capital cannot be carried out because of transfer problems attributable to action implemented by the foreign government in question. Country risk would need to be taken into account at Volkswagen Leasing GmbH, particularly in connection with funding, equity investment activities involving foreign companies and in connection with the leasing business operated by the Company's branches. Given the focus of business activities at Volkswagen Leasing GmbH, there is little chance that country risks (such as legal risk) will arise.

Shareholder Risk

Shareholder risk refers to the risk that losses with a negative impact on the carrying amount of an equity investment could be incurred after the contribution of capital or loans regarded as equity (e.g. silent contributions). Generally, Volkswagen Leasing GmbH only makes equity investments in the pursuit of its corporate objectives that support its own operating activities and are intended to be held on a long-term basis.

If shareholder risk were to materialize in the form of a loss of fair value or even the complete loss of an equity investment, this would have a direct impact on relevant financial data. The net assets and results of operations of Volkswagen Leasing GmbH would be adversely affected by writedowns recognized in profit or loss.

Risk identification and assessment
Shareholder risk is quantified on the basis of the carrying amounts of the equity investments and a probability of default and loss given default assigned to each equity invest-

ment using an ASRF model. Simulations are also carried out involving stress scenarios with rating migrations (upgrades and downgrades) or complete loss of equity investments.

Risk monitoring and control
Equity investments are integrated into the annual strategy and planning process of Volkswagen Leasing GmbH. It exercises influence over the business and risk policies of the equity investments through its representation on the relevant ownership or supervisory bodies. However, responsibility for the operational use of the risk management tools lies with the entities themselves.

Market Risk

Market risk refers to the potential loss arising from adverse changes in market prices or parameters that influence prices. At Volkswagen Leasing GmbH, it comprises interest rate risk.

The objective of market risk management is to keep the financial losses arising from this category of risk as low as possible. With this in mind, the Management has agreed limits for this category of risk. If limits are exceeded, the situation is escalated on an ad hoc basis to the Management and the Asset Liability Management Committee (ALM Committee). Action to reduce risk is discussed and initiated by the ALM Committee.

As part of risk management activities, market risk is included in the monthly risk report with a transparent analysis based on value at risk (VaR), a calculation offsetting the total market risk against the loss ceiling set for Volkswagen Leasing GmbH and recommendations for targeted measures to manage the risk.

Interest Rate Risk

Interest rate risk refers to potential losses that could arise as a result of changes in market interest rates. It occurs because of interest rate mismatches between asset and liability items in a portfolio or on the balance sheet.

Changes in interest rates that cause interest rate risk to materialize can have a negative impact on results of operations.

Risk identification and assessment
Interest rate risk for Volkswagen Leasing GmbH is determined as part of the monthly monitoring process using the value at risk (VaR) method with a 40-day holding period and a confidence level of 99%. The model is based on a historical simulation and calculates potential losses taking into account 1,000 historical market fluctuations (volatilities). Negative interest rates can also be processed in the historical simulation and are factored into the risk assessment.

The VaR calculated for operational management purposes estimates potential losses under historical market conditions, but stress tests are also carried out for forward-looking situations in which interest rate exposures are subject to exceptional changes in interest rates and worst-case scenarios. The results from the simulations are analyzed to assess whether any of the situations could represent a serious potential risk. This process also includes the monthly quantification and monitoring of the changes in present value resulting from the interest rate shock scenarios of +200 basis points and –200 basis points, as specified by the German Federal Financial Supervisory Authority (BaFin).

The calculation of interest rate risk uses notional maturities to take into account early repayments under termination rights.

Risk monitoring and control
Treasury is responsible for the management of this risk on the basis of decisions made by the ALM Committee. Interest rate risk is managed by using interest rate derivatives at both micro and portfolio levels. The hedge accounting arrangements are not included in the HGB financial statements. Group Risk Management is responsible for monitoring and reporting on interest rate risk.

A separate report on the latest position regarding interest rate risk at Volkswagen Leasing GmbH is submitted to the Management each month.

Currency Risk

Currency risk arises from mismatches between the amounts of asset and liability items denominated in foreign currency. However, open-ended foreign currency exposures of this nature are only permitted in individual cases.

If currency risks were to materialize, this could lead to losses in all items affected by a foreign currency.

Market risk trend
Overall, market risk remained stable during the reporting period. The quantified risk remained within the specified limits at all times.

Liquidity Risk

Liquidity risk is the risk of a negative variance between actual and expected cash inflows and outflows.

Liquidity risk is defined as the risk of not being able to meet payment obligations in full or when due, or – in the event of a liquidity crisis – the risk of only being able to raise funding at higher market rates or only being able to sell assets at a discount to market prices. This results in a distinction between illiquidity risk (day-to-day cash flow risk including deposit withdrawal/commitment drawdown risk and the risk of delayed repayment of loans on maturity), funding risk (structural liquidity risk) and market liquidity risk.

The primary objective of liquidity management at Volkswagen Leasing GmbH is to safeguard the ability of the Company to meet its payment obligations at all times.

If liquidity risk were to materialize, funding risk would result in higher costs and market liquidity risk would result in lower selling prices for assets, both of which would have a negative impact on results of operations. The worst consequence carried by the risk of insolvency is insolvency caused by illiquidity. Liquidity risk management at Volkswagen Leasing GmbH ensures that this situation does not arise.

Risk identification and assessment
The expected cash flows at Volkswagen Leasing GmbH are brought together and evaluated by the Treasury unit at Volkswagen Bank GmbH.

The Group Risk Management unit is responsible for identifying and recording liquidity risk. Stress tests are applied to funding matrices using a scenario approach with scenario triggers from the Company itself or the market, or a combination of the two. Two approaches are used to determine the parameters for these stress scenarios. The first approach uses observed historical events and specifies different degrees of impact from hypothetical, but conceivable events. To quantify the funding risk, this approach takes into account the relevant aspects of illiquidity risk and changes in spreads driven by credit ratings or the market. In the second approach, to ensure there is appropriate liquidity management, the Treasury also prepares four different funding matrices, carries out cash flow forecasts and uses this information to determine the relevant range of liquidity coverage.

Risk monitoring and control
To manage liquidity, the Operational Liquidity Committee (OLC) holds meetings every two weeks at which it monitors the current liquidity situation and the range of liquidity coverage. It decides on funding measures and prepares any necessary decisions for the decision-makers.

Group Risk Management communicates the main risk management information and relevant early warning indicators relating to risk of insolvency and funding risk. As far as risk of insolvency is concerned, these indicators involve appropriate threshold values for determined degrees of utilization over various time horizons, taking into account access to relevant sources of funding. The indicators relating to funding risk are based on potential funding costs, which are monitored using a system of limits.

A further strict requirement imposed under banking regulation is the need to provide a highly liquid cash buffer and appropriate liquidity reserves to cover any liquidity requirements over seven-day and thirty-day time horizons. For this reason, a contingency plan with an appropriate list of action points for obtaining liquidity has already been drawn up so that it can be implemented in the event of any liquidity squeeze.

The Management of Volkswagen Leasing GmbH is given an up-to-date report on the liquidity position on a monthly basis.

Development of liquidity risk
Liquidity risk has been significantly affected by the diesel issue, which has been to the fore since September 2015. However, as a whole, liquidity risk at the level of Volkswagen Leasing GmbH was stable.

Funding risk always remained within the specified limits.

Residual Value Risk

Residual value risk arises from the fact that the actual market value for a lease asset at the time of remarketing could be lower than the residual value calculated at the inception of the lease. On the other hand, there is an opportunity in that the remarketing could generate proceeds greater than the calculated residual value.

A distinction is made between direct and indirect residual value risk in relation to the bearer of this risk. Direct residual value risk refers to residual value risk borne directly by Volkswagen Leasing GmbH (contractually determined). An indirect residual value risk arises if the residual value risk has been transferred to a third party (such as a dealer) on the basis of a residual value guarantee. In such cases, the initial risk is a counterparty default risk in respect of the residual value guarantor. If the residual value guarantor defaults, the residual value risk reverts to Volkswagen Leasing GmbH.

The objective of residual value risk management is to keep the risks within the agreed limits. If a residual value risk materializes, the Company may have to recognize an exceptional writedown or a loss on disposal of the asset concerned, resulting in a negative impact on results of operations.

Risk identification and assessment
Direct residual value risks are quantified on the basis of expected loss (EL) and unexpected loss (UL). The EL equates to the difference between the latest forecast remarketing proceeds as of the measurement date and the contractual residual value specified at the inception of the lease for each vehicle. Other parameters such as remarketing costs are also taken into account in the calculation. The portfolio EL is calculated by aggregating the individual ELs for all the vehicles.

To determine the UL, the change is measured between the projected residual value one year before the end of the lease and the actual selling price achieved (adjusted for damage and mileage variances). In a first step, the change in value is determined for each individual lease for each period. However, given the size of the portfolio and the huge number of vehicles, systematic risk is significant and a second step is therefore carried out in which the average change in value compared with projected residual values is determined over several periods. The resulting markdown is calculated using the quantile function of the normal distribution with a specified confidence level.

The UL is calculated by multiplying the latest projected residual value by the markdown. This value is calculated independently of the EL and at individual lease level for each vehicle in the portfolio. As in the calculation of the EL, the portfolio UL is determined by aggregating the ULs for all the vehicles. This figure is generated quarterly. The results from the calculation of the EL and UL are fed in to the assessment of the risk situation, e.g. they are one of the factors used in assessing the adequacy of the provisions for risks and are included in the calculation of risk-bearing capacity.

In the case of indirect residual value risk, the method used to quantify the risk is generally similar to that used for direct residual value risk but also takes into account further risk parameters (dealer default and other factors specific to this category of risk).

The general requirements for developing, using and validating the risk parameters for direct and indirect residual value risk are laid down in a set of procedural instructions.

Risk monitoring and control

The Group Risk Management unit monitors residual value risk within Volkswagen Leasing GmbH.

As part of risk management procedures, the adequacy of the provision for risks and the potential residual value risk are regularly reviewed in respect of direct residual value risk; residual value opportunities are disregarded in the recognition of the provision for risks.

The analysis based on individual leases does not always fully cover the assumed risks as a result of the distribution of the risks (because of the difference between the residual value curve (degressive) and the incoming payments curve (linear) during the term of the lease). For risks already identified, the risk amounts allocated to the residual maturity must still be earned in the future and added to writedowns.

Based on the resulting potential residual value risk, various measures are initiated as part of a proactive risk management approach to limit the residual value risk. Residual value recommendations for new lease originations must take into account prevailing market circumstances and future influences. Various stress tests for direct residual value risks are also planned to create a comprehensive picture of the risk sensitivity of residual values. These stress tests will be carried out by experts with the involvement of risk specialists at head office and in the local units. Indirect residual value risks faced by Volkswagen Leasing GmbH are subject to plausibility checks and are assessed from the perspectives of risk amount and significance.

As part of risk management activities, Group Risk Management regularly reviews the potential indirect residual value risk and the adequacy of the associated provision for risks. Based on the potential indirect residual value risk determined in these activities, various measures are initiated in close collaboration with the brands and the dealer organization to limit the risk.

Trends

Volkswagen Leasing GmbH has seen steady year-on-year growth in the number of contracts, especially in Germany. The used vehicle market was not significantly affected by the diesel issue in the year under review. The diesel issue at the Volkswagen Group only had a marginal impact on residual value portfolio at Volkswagen Leasing GmbH.

Earnings Risk (Specific Profit or Loss Risk)

Earnings risk refers to the risk that actual values will vary from the budgeted values for certain items on the income statement that are not already covered by the other categories of risks described elsewhere. Earnings risk includes the following risks:

- unexpectedly low fees and commissions (fee and commission risk);
- unexpectedly high costs (cost risk);
- excessively high income targets for new and existing business volume (sales risk); and
- unexpectedly low investment income.

The objective is to regularly analyze and monitor the potential risk associated with earnings risk to ensure that variances compared with budgeted values are identified at an early stage and any necessary corrective action is initiated. If the risk were to materialize, this would reduce income or increase costs and thereby also adversely impact operating profit.

Risk identification and assessment

Volkswagen Leasing GmbH quantifies earnings risk using a parametric earnings at risk (EaR) model with the confidence level specified in the calculation of risk-bearing capacity and a one-year forecast period.

The relevant income statement items provide the basis for these calculations. The estimates for earnings risk are then based on two perspectives: firstly, the observed, relative variances between target and actual values; secondly, the volatility and interdependencies between the individual items. Both components are incorporated into the EaR calculation.

Risk monitoring and control

During the course of the year, changes in the actual values at market level for the earnings risk exposures are compared against the forecast values. This comparison is included in the standard reporting procedure carried out by Controlling.

The results from the quarterly quantification of earnings risk are fed into the calculation of risk-taking potential as a deduction from risk-bearing capacity. The results are monitored by Group Risk Management.

NON-FINANCIAL RISKS

Operational Risk

Operational risk (OpR) is defined as the risk of loss resulting from inadequate or failed internal processes (process risk), people (HR risk) or systems (technological risk), or resulting from external events (third-party risk). This definition includes legal risk.

Other categories of risk, such as reputational or strategic risk, do not fall within the scope of operational risk because they are analyzed separately.

The objective of operational risk management is to present operational risks transparently and initiate precautionary or corrective measures with a view to preventing or, when this is not possible, mitigating the risks or losses. If an operational risk materializes, this represents an operational loss with the resulting loss of a business asset, which has a negative impact on net assets, financial position and results of operations, depending on the amount of the loss.

The operational risk strategy specifies the focus for the management of operational risk; the operational risk manual sets out the implementation process and allocates responsibilities.

Risk identification and assessment

Operational risks or losses are identified and assessed by local experts working in pairs (assessor and approver) with the help of two operational risk tools: a risk self-assessment and a loss database.

The risk self-assessment is used to determine a monetary assessment of future potential risks. A standardized risk questionnaire is provided once a year for this purpose. The local experts use these questionnaires to determine and record the details for various risk scenarios. The details include the possible amount of the risk and the probability of occurrence, in each case with typical and maximum figures.

The central loss database is used to ensure that information about monetary operational losses is collected internally on an ongoing basis and the relevant data is stored. A standardized loss form is made available to the local experts to aid this process. The experts use this form to determine and record the relevant data, including the amount and cause of the loss.

Risk monitoring and control

Operational risk is managed by the companies/divisions (operational risk units) on the basis of the guidelines in force and the requirements laid down by the special operational risk units responsible for specific risk categories. To this end, local management decides whether future risks or losses are to be ruled out (risk prevention), mitigated (risk mitigation), consciously accepted (risk acceptance) or transferred to third parties (risk transfer).

The Group Risk Management unit checks the plausibility of the information provided by the companies/divisions in the risk self-assessments, reviews the reported loss events and then initiates any necessary corrective action, reviews the operational risk system to ensure it is fully functioning and instigates appropriate modifications as required. This includes, in particular, the full integration of all operational risk units, a review to check compliance with the risk substrategies for operational risks and a review of the methods and procedures used for risk measurement.

Communications relating to operational risks are provided quarterly as part of the risk management reports. The quarterly details are supplemented by an annual operational risk report in which the main events in the year are presented and assessed again on a coherent basis. Ad hoc reports are issued in addition to the regular reports provided that the relevant specified criteria are satisfied.

Trends

The increase in operational risk in the past was based on a number of factors, notably the growth in the business of Volkswagen Leasing GmbH and a consideration of the legal risk. Provisions for legal risk stood at €126 million as of November 2016.

Training and briefing sessions were carried out to continue to raise awareness of operational risk in Volkswagen Leasing GmbH. These activities led to better recording of loss events. Experience and information gained about past loss events also means that potential future risks can be assessed more completely and more accurately.

Compliance and Conduct Risk

At Volkswagen Financial Services AG, compliance risk encompasses all risks that could arise from non-compliance with statutory rules and regulations or other official or regulatory requirements, or that could be caused by a breach of internal company regulations.

Separately from compliance risk, conduct risk is defined as the risk arising from inadequate conduct by the institution toward the customer, unreasonable treatment of the customer or provision of advice using products that are not suitable for the customer.

Volkswagen Financial Services AG is taking account of both categories of risk by setting up a local compliance function and this function is working toward specifying and implementing risk-mitigating measures.

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

As a component of the compliance function, the role of the compliance officer is to work toward implementing effective procedures to ensure compliance with key and core legal rules and regulations for the institution and toward establishing appropriate controls. This is achieved, in particular, by specifying mandatory “compliance requirements” for legal stipulations classified as material. These requirements include documenting responsibilities and processes, establishing controls to the extent required and raising employee awareness of pertinent rules so that employees comply with the rules as a matter of course, reflecting a fully functioning compliance culture.

Further regular activities are also nurturing the emergence of a compliance culture. These activities include, in particular, constantly promoting the Volkswagen Group's code of conduct, raising employee awareness on a risk-oriented basis (e.g. tone from the top, classroom training, e-learning programs, other media-based activities), carrying out communications initiatives, including distributing guidelines and other information media, and participating in compliance programs.

The compliance function has been set up on a decentralized basis. The departments are responsible for complying with the rules and regulations in their respective areas of activity. A compliance theme coordinator is being appointed for all key and core rules and regulations. The coordinator is responsible for adhering to and implementing the defined compliance requirements (such as documenting responsibilities, setting up controls, raising awareness and training employees).

Using the control plans and control documentation as a basis, the compliance function checks whether the implemented controls are appropriate. In addition, the findings from various audit activities will be used to evaluate whether there are indications that the implemented compliance requirements are ineffective, or whether the audits have identified material residual risks on the basis of which further action needs to be determined.

The compliance officer is responsible for coordinating ongoing legal monitoring, the purpose of which is to ensure that new or amended legal regulations and requirements are identified promptly. For their part, the compliance theme coordinators must work in collaboration with the legal department and the various other departments to implement measures aimed at identifying at an early stage new or amended regulations and requirements relevant to their areas of responsibility and, if such relevance is established, furnishing an analysis of materiality for the Company. The identified regulations and requirements must be notified immediately to the compliance officer.

The internal Compliance Committee will regularly conduct a materiality analysis on the basis of the outcomes from this legal monitoring. After taking into account the evaluated compliance risks, the Compliance Committee makes a decision on the materiality of new legal requirements applicable to the Company. Compliance risk primarily includes the risk of a loss of reputation vis-à-vis the general public or supervisory authorities and the risk of material financial loss.

Currently, the following specific legal fields have been determined as being generally material from the perspective of the Group:

- prevention of money laundering and terrorist financing,
- prevention of corruption and other criminal acts,
- data protection,
- consumer protection,
- securities trading law,
- banking supervisory law, and
- antitrust law.

The compliance requirements for the corporate group are specified centrally and must be implemented autonomously in the local companies. Any deviation from the minimum requirements or guidelines is only possible if accompanied by a description of the reasons (such as local statutory requirements) and only in consultation with, and with the consent of, the holding company function.

The holding company compliance function will receive regular reports and carry out on-site visits on a risk-oriented basis to ensure that the local compliance units are meeting their responsibilities.

To meet the statutory reporting requirements of the compliance function, the compliance officer must submit to the Management both regular reports on the outcome of the meetings of the Compliance Committee and ad hoc reports as necessary (for example, if control plans are not prepared by the required deadline).

The Management will also receive an annual compliance report and other comparable reports on an ad hoc basis, as required. The annual compliance report will contain a presentation of the appropriateness and effectiveness of the compliance requirements implemented to ensure compliance with key and core legal regulations and requirements.

Risk from Outsourcing Activities

Outsourcing describes a situation in which another entity (the outsourcee) is engaged to carry out activities and processes in connection with the provision of services that would otherwise be carried out by the outsourcing entity itself.

A distinction needs to be made between outsourcing and one-time or occasional procurement from third parties of goods or services or services that are typically obtained from a supervised entity and, because of the actual circumstances involved or legal requirements, cannot usually be supplied by the buying entity itself, either at the time of the purchase from the third party or in the future.

The objective of outsourcing risk management is to identify and minimize the risks from all outsourcing. As part of outsourcing management and detailed monitoring, measures may be initiated, where appropriate, to monitor a variance from an identified risk and ensure that the original risk position associated with an outsourced activity can be restored.

Ultimately, a variance from a determined risk may mean that the service provider has to be changed or, if possible and strategically desirable, the outsourcing arrangement ended. In this case, the activities may be performed by the Company itself or may be eliminated entirely.

Risk identification and assessment

Risks arising in connection with outsourced activities are identified by examining the circumstances and performing a risk analysis. In the first step, an examination of the circumstances is used to establish whether the planned activity constitutes procurement from a third-party supplier or an outsourcing arrangement. The risk analysis uses various criteria to determine the risk content in an outsourcing arrangement. The outcome is the classification of the outsourcing arrangement as material or immaterial. Material outsourcing arrangements are subject to more stringent levels of monitoring and control as well as special and stricter contractual provisions.

Risk monitoring and control

The risks from outsourcing activities are documented as part of operational risk. To ensure effective management of outsourcing risk, Volkswagen Leasing GmbH has issued a framework policy specifying the constraints that outsourcing arrangements must observe. Before any activity is outsourced, a risk analysis must be prepared to determine the risk in each case. This analysis procedure is one of the components of the constraints and ensures that an adequate level of monitoring and control is applied. The framework policy also specifies that all outsourced activities must be agreed with the Group Outsourcing Coordination unit. This coordination unit is therefore informed about all outsourcing activities and the associated risks and communicates quarterly on the risks to the Management.

In addition, all risks arising from outsourcing activities are subject to risk monitoring and control through the operational risk loss database and the annual risk self-assessment.

Model Risk

Model risk arises from inaccuracies in the risk values and must be taken into account, particularly in the case of underestimated risk and complex models.

Depending on the complexity of the model, model risk can occur in a number of areas of model development and application.

Potential model risks in the risk models are assessed by the model coordinator on a qualitative basis in an annual model risk process. The objective is to verify that the risks are covered by own funds.

The assessment is carried out using the following criteria: “simple”, “transparent”, “conservative”. If the presence of model risk is demonstrated, the model risk drivers are evaluated using a further qualitative assessment. A review is then carried out to establish whether the risk drivers can be minimized with appropriate action and/or whether quantitative backing with own funds is required.

Strategic Risk

Strategic risk is the risk of a direct or indirect loss arising from strategic decisions that are flawed or based on false assumptions.

Strategic risk also includes all risks that result from the integration/reorganization of technical systems, personnel or corporate culture (integration/reorganization risk). These risks may be caused by fundamental decisions about the structure of the business made by the Management in relation to the positioning of the company in the market.

The objective of Volkswagen Leasing GmbH is to manage its acceptance of strategic risk enabling it to systematically leverage earnings potential in its core business. In the worst-case scenario, a materialization of strategic risk could jeopardize the continued existence of the Company as a going concern. Strategic risk is recognized quantitatively by applying a deduction to aggregate risk cover in the calculation of risk-bearing capacity.

Reputational Risk

Reputational risk refers to the risk that an event or several successive events could cause reputational damage (in the eyes of the general public), which in turn could limit current and future business opportunities or activities (potential earnings), thereby leading to an indirect adverse financial impact (customer base, sales, funding costs, etc.) and/or direct financial losses such as penalties, litigation costs, etc.

The responsibilities of the Corporate Communications unit include avoiding negative reports in the press or similar announcements that could inflict damage on the reputation of the Company. If this is unsuccessful, the unit is then responsible for assessing the situation and initiating appropriate communications aimed at specific target groups to limit the reputational damage as far as possible. The strategic objective is therefore to prevent or reduce any negative variance between actual reputation and the level of reputation the Company expects. A loss of reputation or damage to the Company’s image could have a direct impact on financial performance.

Reputational risk is recognized quantitatively by applying a markdown in the calculation of risk-bearing capacity. This global approach is reassessed each year from a qualitative perspective.

SUMMARY

Volkswagen Leasing GmbH accepts risks on a responsible basis as part of its operating activities. This approach is based on a comprehensive system for identifying, measuring, analyzing, monitoring and controlling risks, which is part of a holistic risk- and return-oriented management system. The risk-bearing capacity was assured at all times in 2016. We do not believe that there are any risks to the continued existence of our business as a going concern.

The process of continuous refinement in the system was maintained in 2016, for example by adjusting methodologies and models, systems, processes and IT.

Volkswagen Leasing GmbH will also continue to invest in optimizing the Comprehensive Control System and Risk Management Systems in order to satisfy the statutory and business management requirements for risk management and control.

FORECAST OF MATERIAL RISKS

Credit Risk Forecast

A stable risk position is predicted for 2017 overall, aided by the positive macroeconomic situation in Germany. We do not anticipate any impact from the diesel issue on credit risk.

Market Risk Forecast

We are expecting a generally stable market risk situation for fiscal year 2017, based on the expected relatively stable interest rate environment.

Liquidity Risk Forecast

The future risk trend very much depends on how the diesel issue evolves and on how the Company refines the management approach in connection with the funding structure. If, for example, the capital market cannot be used as currently planned, it will be necessary to switch to other, generally shorter-term, sources of funding. This could then be reflected in a higher funding cost risk and also in a higher insolvency risk.

Residual Value Risk Forecast

We expect the volume of contracts to continue to grow in fiscal year 2017. The main drivers behind this are the implemented growth program, continued economic recovery in the markets and further expansion in the fleet business. The diesel issue should not affect the residual value portfolio in 2017.

Operational Risk Forecast

Based on future business growth and the trend in operational risk as described in the risk report, we anticipate a constant to moderately rising level of risk. In this context, we expect the effectiveness of fraud protection to remain stable and the high level of quality in processes and in staff skills and qualifications to be maintained.

Human Resources Report

Promoting a culture of open feedback and discussion as a priority issue in the context of the ROUTE2025 corporate strategy.

The operating activities of Volkswagen Leasing GmbH in Germany are carried out by employees of Volkswagen Financial Services AG. These employees are assigned to Volkswagen Leasing GmbH under staff leasing arrangements. As of December 31, 2016, Volkswagen Leasing GmbH had 959 staff members (previous year: 1,279) in Germany.

The branches in Milan and Verona (Italy) had 90 employees (previous year: 78) as of December 31, 2016 and these individuals held employment contracts with Volkswagen Leasing GmbH. The branch in Warsaw had three employees as of December 31, 2016.

The Human Resources unit of Volkswagen Financial Services AG has overarching responsibility for human resources in all the German companies in the Volkswagen Financial Services Group.

The ROUTE2025 program has created new areas of focus in terms of HR strategy. Six strategic areas for action are listed under the heading “Top Employer/Top Employees”. These areas for action are helping Volkswagen Financial Services AG to position itself as “the key to mobility”. With the support of the best employees, our objective is to continue to drive forward development around the strategic cornerstones of customers, volume, profitability and operational excellence. Based on specific activities to develop and retain personnel, coupled with profit-sharing arrangements commensurate with the work performed, we aim to encourage top performance and ensure we provide outstanding customer service with top employees, but also, as a first-rate employer, take our excellent globally recognized reputation to yet another level. One of the factors that will help us achieve this objective is to give more attention to a culture of feedback, open discussion and appreciative cooperation.

Initially, the key priority is to promote a culture of open feedback and discussion and of customer- and service-oriented cooperation. This includes not only cooperation between departments within the Company, but equally collaboration between the head office and the branches, between the branches themselves and cooperation with the customer.

The Human Resources Strategy Card remained the most important management tool for implementing our HR strategy. The objectives and definitions set out on the card provide uniform guidance for our local entities around the world from the two perspectives of top employer and top employees. The content is regularly reviewed to ensure it is up to date. The local entities hold regular meetings with the head office – at least twice a year – to report on their successes and share detailed information in this regard. Depending on the situation, support measures are agreed and/or highly positive examples are systematically made available to other branches so that synergies can also be leveraged between the different local companies.

We assess the extent to which we have achieved our objective of being a top employer by regularly taking part in external employer competitions. Twelve companies have now already been included in national lists of the best companies or have been certified as a “Great Place to Work”. These companies also include Volkswagen Financial Services AG in Germany which took first place in Germany for the third time in succession. In 2016, it also received accolades from FOCUS magazine and the employer evaluation platform kununu as a top company and in the “Best Employers in Germany” awards.

The satisfaction of our customers with the work of our employees is given top priority at Volkswagen Financial Services AG. For this reason, the results of external and internal customer satisfaction surveys are also used as indicators of target achievement.

Business units that have no direct contact with external customers have the opportunity to use the “Internal customer feedback on customer and service orientation” to invite all internal employees who are customers of the business unit concerned to express their satisfaction in an online survey on the basis of defined customer and service orientation criteria.

The results from the internal customer surveys and from the external customer survey data currently in development will in future provide the basis for calculating the top KPI “Customer satisfaction”.

In the annual employee appraisal, managers and employees determine any need for further skills and qualifications and agree suitable professional development measures. In addition to employee appraisals, further skills development meetings are held in which managers and employees are able to discuss individual development activities on the basis of a pre-prepared skills profile.

Skills development conferences are also held at regular yearly intervals. At these conferences, carefully chosen managers from the various units address the issue of skills development with a forward-looking approach in collaboration with employees of the FS Academy; they discuss the future areas for action and the resulting strategic requirements in terms of skills and qualifications. Technical training was offered for employees requiring technical skills. Because of the growing significance of environmentally compatible and digital mobility concepts in the Volkswagen Group, a wide variety of lecture series on e-mobility were launched in cooperation with the Volkswagen Sales Academy and Volkswagen Group AutoUni. The e-up! and e-Golf were used as examples to explain the strategic goals and concepts of the Volkswagen brand and the special technical aspects of e-mobility.

Report on Expected Developments

The momentum of the global economy is expected to be somewhat stronger in 2017 than in the previous year.
Volkswagen Leasing GmbH intends to benefit from this trend based on its wide range of products and presence in the markets.

The main opportunities and risks arising from the operating activities and their forecasts having been set out in the report on opportunities and risks, the section below now outlines the expected future developments. These developments give rise to opportunities and potential benefits that are included in our planning process on an ongoing basis so that we can exploit them as soon as possible.

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

GLOBAL ECONOMIC DEVELOPMENT

In our forecasts, we assume that global economic growth in 2017 will be slightly above the previous year's level. We believe risks will arise from protectionist tendencies, turbulence in the financial markets and structural deficits in individual countries. In addition, growth prospects will continue to be hurt by geopolitical tensions and conflicts. We expect the economic upturn to continue in the large majority of industrialized nations, with stable rates of expansion overall. Most emerging markets will probably see faster growth than in the previous year. We expect the strongest rates of expansion in Asia's emerging economies.

Furthermore, we anticipate that the global economy will also continue to grow in the period 2018 to 2021.

In Western Europe, the economic recovery is expected to decelerate to some extent in 2017 compared with the reporting period. Resolving structural problems and the uncertain outcome of the Brexit negotiations between the EU and the United Kingdom represent major challenges.

For Central Europe, we estimate that growth rates in 2017 will be similar to those of the past fiscal year. In Eastern Europe, the economic situation should stabilize further, providing the smoldering conflict between Russia and Ukraine does not worsen.

In Germany, GDP is slated to rise in 2017 at a similar pace as in the reporting period. The situation in the labor market is expected to remain stable, bolstering consumer spending.

FINANCIAL MARKETS

We predict that economic growth in 2017 will be slightly higher than in the previous year. Geopolitical tensions, uncertainty in financial markets and structural deficits in individual countries will have an adverse impact. Trends in capital markets will continue to maintain downward pressure on returns because of the loose monetary policy that is being sustained in the eurozone and in Japan. The ECB will continue its bond-buying program because core inflation is still rising too slowly and the structural deficits in southern European countries have not yet been eliminated. Interest rate rises by the Federal Reserve in the USA could have a negative impact on a weakening global economy.

Further economic recovery is anticipated in Europe. Challenges will be presented by the negotiations for the UK's exit from the EU and by structural problems in some European countries. Regardless of the conflict with Ukraine, the Russian economy is likely to grow slightly. The ECB's decision in December to maintain its loose monetary policy will continue to exacerbate the problems caused by the scarcity of available bonds.

Economic growth in Germany is expected to remain at the level of the previous year overall. Although there is likely to be a slowdown in export growth in 2017, the rise in the statutory minimum wage will give a clear boost to macroeconomic wage growth during the year.

AUTOMOTIVE MARKET TRENDS

We expect trends in the passenger car markets in the individual regions to be mixed in 2017. Overall, growth in global demand for new vehicles will probably be slower than in the reporting period.

The Volkswagen Group is well positioned to deal with the mixed developments in automotive markets around the world. Our broad, selectively expanded product range featuring the latest generation of engines as well as a variety of alternative drives puts us in a good position globally compared with our competitors. Our goal is to offer all customers the mobility and innovations they need, sustainably strengthening our competitive position in the process.

We estimate that demand for passenger cars worldwide will continue to increase in the period 2018 to 2021.

For 2017, we anticipate that unit sales volumes in Western Europe will fall somewhat short of the level seen in the reporting period. Pre-crisis levels are not expected to be reached, even in the medium term. The continuing uncertainty among consumers precipitated by the debt crisis is likely to be exacerbated by the uncertain outcome of the Brexit negotiations between the EU and the UK, putting a damper on demand. In Italy, the recovery will probably continue in 2017 but at a much slower pace.

In the Central and Eastern European markets, demand for passenger cars in 2017 should exceed the weak prior-year figure. We expect to see further growth in demand in the Central European markets.

Following the positive trend of recent years, we forecast that the volume of the German passenger car market in 2017 will be slightly lower than in the previous year.

We expect trends in the markets for light commercial vehicles in the individual regions to be mixed again in 2017. Overall, we envisage modest growth in demand, a trend that is likely to continue in the period 2018 to 2021.

Due to the uncertainty caused by the United Kingdom's European Union membership referendum in June 2016, we estimate that demand for light commercial vehicles in Western Europe in 2017 will be slightly below the previous year's level. We anticipate that registrations in Germany will be around the previous year's level.

In the Central and Eastern European markets, registrations of light commercial vehicles in 2017 will probably be higher than in the previous year.

INTEREST RATE TRENDS

In 2016 and also into the beginning of the current fiscal year, central banks continued to support the global economy and the financial system with an expansionary monetary policy. This is reflected in the sustained period of historically low interest rates. Uncertainty about the growth in the global economy is gradually dissipating and this could mean that the central banks decide to scale back their monetary policy stimulus. However, the European Central Bank will certainly maintain its policy of low interest rates throughout the whole of 2017. There is now greater uncertainty – mainly caused by Brexit – about when the Bank of England will bring the period of low interest rates in the UK to an end. In the US, the key interest rate was raised by 25 basis points in December 2016 and further rate rises are anticipated during the course of 2017.

MOBILITY CONCEPTS

Social and political factors are increasingly having an impact on many people's individual mobility behavior. New challenges in connection with the design of an intelligent mobility mix comprising public transport combined with motorized and non-motorized personal transport are appearing, primarily in large metropolitan areas. Mobility is being redefined in many respects.

In collaboration with the automotive brands in the Volkswagen Group, Volkswagen Financial Services AG is devoting a great deal of time and effort to pioneering work on the development of new mobility concepts, as has been the case in the conventional automotive business for many years.

New mobility solutions will enhance the traditional idea of owning a vehicle. Based on leasing, long-term and short-term rentals, car and truck hire, and car sharing, Volkswagen Financial Services AG – through its subsidiaries – can now cover an even greater proportion of the mobility needs of its customers.

Simple, transparent, safe, reliable, affordable and flexible – these are the key requirements that our business must satisfy in the future. Volkswagen Financial Services AG continues to closely monitor developments in the mobility market and is already working on new models to support alternative types of marketing and establish new mobility concepts that will safeguard and expand on its existing business model.

In this way, we will continue to make good on the essence of our brand promise in the future and remain "The Key to Mobility" over the long term.

BUSINESS DEVELOPMENT OF VOLKSWAGEN LEASING GMBH

Over the coming fiscal year, Volkswagen Leasing GmbH expects to achieve growth derived from the growth in sales in the Volkswagen Group, although penetration is projected to fall slightly. The Company will continue in its aim to generate growth by expanding the range of products in existing markets. Please refer to the details in the report on opportunities and risks for more information on the trends in credit risk, liquidity risk and residual value risk, including the diesel issue.

Sales activities related to the Volkswagen Group brands will be further intensified, particularly through joint strategic projects.

Furthermore, Volkswagen Leasing GmbH intends to continue enhancing the leveraging of potential along the automotive value chain.

Our aim is to satisfy the wishes and needs of our customers in the most efficient manner in cooperation with the Group brands. Our end customers are looking, in particular, for mobility with predictable fixed costs. In addition, we intend to further expand the digitalization of our business.

The product packages and mobility solutions successfully launched in the last few years will be refined in line with customer needs.

OUTLOOK FOR 2017

The Management of Volkswagen Leasing GmbH expects the global economy to record slightly stronger growth in 2017 than in the previous year, despite some uncertainties. The financial markets continue to be the source of some risk, primarily because of the challenging level of indebtedness in many countries. In addition, growth prospects will be hurt by geopolitical tensions and conflicts. While we expect to see an economic upturn in the major industrialized nations, the rates of expansion will remain moderate.

When the above factors and the market trends are considered, the following overall picture emerges: our earnings expectations assume a slight increase in funding costs, greater levels of cooperation with the individual Group brands, increased cost optimization under our efficiency program, a slight increase in risk costs, higher indirect costs as a result of increased investment in the digitalization of our leasing business, and a continued high degree of uncertainty about macroeconomic conditions in the real economy and the impact of this uncertainty on factors such as risk costs.

In the German market, we anticipate a substantially lower operating profit in accordance with IFRS year-on-year for fiscal year 2017. The diesel issue is not expected to result in any additional effects that would have a negative impact on operating profit in accordance with IFRS for fiscal year 2017.

It is likely that the volume of existing contracts will be slightly above the prior-year level and new contracts will be slightly below the prior-year level. Based on a slight increase in vehicle deliveries, we forecast a marginal decline in 2017 in the penetration rate in the German market and for the Volkswagen Leasing GmbH legal entity.

In Italy, we forecast that there will be a slight year-on-year rise in new contracts and the volume of existing contracts, no change in the penetration rate and a significant reduction in operating profit in accordance with IFRS.

We predict slight year-on-year growth in new contracts and substantial year-on-year growth in the volume of existing contracts in Poland, where operating profit in accordance with IFRS is likely to be well in excess of that achieved in the prior year. A slight increase in the penetration rate is also anticipated in Poland.

Braunschweig, February 14, 2017

The Management

Gerhard Künne

Harald Heßke

Balance Sheet

of Volkswagen Leasing GmbH, Braunschweig, as of December 31, 2016

€ thousand		Dec. 31, 2016	Dec. 31, 2015
Assets			
1. Receivables from banks			
a) Repayable on demand	5,381		22,258
b) Other receivables	88,895		78,567
		94,276	100,825
2. Receivables from customers			
a) Repayable on demand	572,573		286,810
b) Other receivables	1,194,927		1,086,084
		1,767,500	1,372,894
3. Shares in affiliated companies		0	8,651
4. Lease assets		23,753,366	21,141,405
5. Intangible fixed assets			
a) Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets	3,113		3,616
b) Prepayments	24		35
		3,137	3,651
6. Property and equipment			
a) Land and buildings	38,627		39,598
b) Operating and office equipment	1,218		1,433
		39,845	41,031
7. Other assets		1,129,834	1,240,088
8. Prepaid expenses		978,613	641,263
Total assets		**27,766,571**	**24,549,808**

€ thousand		Dec. 31, 2016	Dec. 31, 2015
Equity and liabilities			
1. Liabilities to banks			
a) Repayable on demand	321,887		423,005
b) With agreed maturity or notice period	1,193,699		586,828
		1,515,586	1,009,833
2. Liabilities to customers			
a) Repayable on demand	7,344,708		4,722,688
b) With agreed maturity or notice period	5,360,052		5,973,165
		12,704,760	10,695,853
3. Notes, commercial paper issued			
a) Bonds issued	6,070,837		7,010,661
b) Commercial paper	1,101,699		275,945
		7,172,536	7,286,606
4. Other liabilities		21,607	18,185
5. Deferred income		5,217,604	4,505,360
6. Provisions			
a) Provisions for taxes	9,813		14,090
b) Other provisions	901,071		787,531
		910,884	801,621
7. Special tax-allowable reserve		1,235	1,341
8. Equity			
a) Subscribed capital	76,004		76,004
b) Capital reserves	145,706		154,356
c) Net retained profits	649		649
		222,359	231,009
Total equity and liabilities		**27,766,571**	**24,549,808**
1. Contingent liabilities			
Liability arising from the provision of collateral for third-party liabilities		169,898	211,685
2. Other obligations			
Irrevocable leasing commitments		1,943,035	1,872,295

Income Statement

of Volkswagen Leasing GmbH, Braunschweig, for the period January 1 to December 31, 2016

€ thousand				Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
1.	Leasing income		14,680,504		14,001,494
2.	Leasing expenses		8,181,816		7,946,158
				6,498,688	6,055,336
3.	Interest income from lending and money market transactions		22,316		24,965
4.	Interest expense		359,113		281,690
	of which: Unwinding of discount on provisions		2,017		2,718
				–336,797	–256,725
5.	Income from profit-and-loss transfer agreements			0	8,719
6.	Fee and commission income		521		452
7.	Fee and commission expenses		543,420		476,227
				–542,899	–475,775
8.	Other operating income			271,569	250,890
9.	Income from the reversal of special tax-allowable reserve			106	105
10.	General and administrative expenses				
	a) Personnel expenses				
	aa) Wages and salaries	4,306			4,193
	ab) Social security, post-employment and other employee benefit costs	1,423			1,404
			5,729		5,597
	b) Other administrative expenses		340,379		382,823
				346,108	388,420
11.	Depreciation, amortization and writedowns				
	a) Depreciation and writedowns of lease assets		5,182,126		4,737,879
	b) Amortization and writedowns of intangible fixed assets, and depreciation and writedowns of property and equipment		3,636		2,929
				5,185,762	4,740,808
12.	Other operating expenses			43,366	36,226
13.	Writedowns of and valuation allowances on receivables and additions to provisions in the leasing business			714,391	630,783
14.	Income from the reversal of writedowns of and valuation allowances on receivables and from the reversal of provisions in the leasing business			138,183	180,193
15.	Expenses from transfer and absorption of losses			0	3,180
16.	**Result from ordinary business activities**			**–260,777**	**–36,674**
17.	Income tax expense			43,626	38,315
18.	Income from transfer and absorption of losses			304,403	74,989
19.	**Net income for the year**			**0**	**0**
20.	Retained profits brought forward			649	649
21.	Assets reduction due to spin-off			–8,651	0
22.	Withdrawal from capital reserves			8,651	0
23.	**Net retained profits**			**649**	**649**

Cash Flow Statement

of Volkswagen Leasing GmbH, Braunschweig, for the period January 1 to December 31, 2016

€ thousand	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
Net loss (before loss transfer)	–304,403	–74,989
Depreciation and writedowns of fixed assets	5,185,763	4,740,809
Change in provisions	109,263	9,934
Gain on disposal of lease assets	–763,987	–569,052
Net interest income/expense	336,797	256,726
Other adjustments	24,749	54,589
Change in receivables from banks	6,549	–53,598
Change in receivables from customers	133,585	16,897
Change in other assets related to operating activities	–534,593	–842,857
Change in liabilities to banks	505,753	268,674
Change in liabilities to customers	2,008,908	3,081,592
Change in notes, commercial paper issued	–114,070	–892,609
Change in other liabilities related to operating activities	706,909	338,279
Interest and dividends received	31,035	27,686
Interest paid	–359,113	–281,690
Income taxes paid	–24,749	–54,589
I. Cash flows from operating activities	**6,948,396**	**6,025,802**
Proceeds from disposal of lease assets	7,883,218	7,624,597
Payments to acquire lease assets	–14,904,083	–13,728,102
Payments to acquire property and equipment/intangible fixed assets used by the Company itself	–2,520	–10,371
II. Cash flows from investing activities	**–7,023,385**	**–6,113,876**
Proceeds from transfer and absorption of losses by Volkswagen Financial Services AG	74,989	88,074
III. Cash flows from financing activities	**74,989**	**88,074**
Net change in cash funds (total of I., II. and III.)	0	0
Cash funds at beginning of period	0	0
Cash funds at end of period	0	0

The balance sheet and income statement have been prepared in accordance with the Verordnung über die Rechnungslegung der Kreditinstitute (RechKredV – German Bank Accounting Regulation). The cash funds equate to cash-in-hand in accordance with GAS 21.

Statement of Changes in Equity

of Volkswagen Leasing GmbH, Braunschweig

€ thousand	Subscribed capital	Capital reserves	Net retained profits	Equity
Balance as of December 31, 2015	76,004	154,356	649	231,009
Assets reduction due to spin-off	–	–8,650	–	–8,650
Balance as of December 31, 2016	76,004	145,706	649	222,359

Notes

to the Annual Financial Statements of Volkswagen Leasing GmbH, Braunschweig, for the period ended December 31, 2016

1. General Information

The annual financial statements of Volkswagen Leasing GmbH have been prepared in accordance with the requirements of the Handelsgesetzbuch (HGB – German Commercial Code) and the Verordnung über die Rechnungslegung der Kreditinstitute (RechKredV – German Bank Accounting Regulation).

Volkswagen Leasing GmbH provides IT and other internal services for companies in the Volkswagen Financial Services AG Group. A system of internal cost allocation is used to charge these services on to the German Group companies on the basis of usage.

The income derived from the allocation of these costs is reported under net other operating income/expenses.

2. Accounting Policies

Volkswagen Leasing GmbH has retained the accounting policies applied in the prior year without change.

Long-term financial assets are recognized at cost.

Intangible fixed assets, property and equipment, and lease assets are carried at cost less depreciation and less impairment losses, if the impairment is expected to be permanent, taking existing collateral into account.

The office buildings (useful life of 50 years for old buildings and 25 years for new buildings) are depreciated on a straight-line basis.

Differences between the carrying amounts required by the HGB and those permitted in the tax base continue to be reported under the special tax-allowable reserve in exercise of the grandfather rights provided for in article 67(3) sentence 1 of the EGHGB; these differences are recognized at their nominal amounts.

Receivables and other assets are recognized at their principal amounts. Appropriate valuation allowances are recognized to take into account any default risk.

Prepaid expenses are expenses incurred before the reporting date but attributable to a period or periods after this date; the item is reversed and taken to the income statement on a straight-line basis over the relevant period of time.

Discernible risks and uncertain liabilities are accounted for by recognizing adequate provisions in the amount required to settle the liability determined in accordance with prudent business judgment. Provisions with a maturity of more than one year are discounted using the average market discount rate for the previous seven fiscal years. This discount rate is published monthly by Deutsche Bundesbank. Liabilities are recognized at the settlement amount.

On the basis of an existing profit-and-loss transfer agreement, deferred taxes are generally recognized by Volkswagen AG, Wolfsburg, the controlling entity in the tax group. Deferred taxes are recognized for all temporary differences between the carrying amounts in accordance with the HGB and those in the tax base using the specific company tax rate of 29.9%. No deferred tax liabilities were separately recognized in fiscal year 2016 after utilization of the option to offset deferred tax assets and deferred tax liabilities. The deferred tax liabilities on lease assets arising in the Italy branch, which is taxable separately, are netted with the deferred tax assets relating to provisions. The deferred tax liabilities on receivables arising in the Poland branch, which is also separately taxable, are netted with the deferred tax assets relating to lease assets. In addition, no deferred tax assets are recognized in exercise of the option available under section 274 of the HGB.

Deferred income comprises income before the reporting date that represents income or other operating income from the leasing business that is attributable to future periods.

Equity is recognized at the nominal amount.

Irrevocable credit commitments are recognized at present value.

Interest rate derivatives entered into by Volkswagen Leasing GmbH are used as part of general economic hedges. The Company does not make use of the option to apply specific hedge accounting arrangements.

In accordance with section 256a sentence 1 of the HGB, foreign currency assets and liabilities are translated at the middle spot rate at the reporting date and in compliance with the historical cost convention and the principle of imparity (whereby unrealized losses are recognized but unrealized gains are not recognized). In the case of maturities of one year or less, currency translation gains and losses are recognized in their entirety in the income statement in accordance with section 256a sentence 2 of the HGB.

Leasing income is recognized insofar as the goods or services due have been provided and an entitlement to the due consideration has been created. Income from goods supplied (sales revenue) is reported as soon as beneficial ownership has passed to the customer (transfer of possession, the right to use and sell, charges and the risk of loss and accidental loss). The transfer of beneficial ownership is determined in accordance with the agreed terms of delivery and/or general terms and conditions. Income from services is recognized as soon as the service has been provided. The amount of income reported corresponds to the agreed consideration minus the applicable sales tax and income deductions such as bonuses, discounts and rebates.

3. Balance Sheet Disclosures

The breakdown of the fixed assets aggregated in the balance sheet and the changes in these assets in the reporting period are shown in the statement of changes in fixed assets.

The breakdown of receivables from banks is as follows:

€ thousand	Dec. 31, 2016	Dec. 31, 2015
1. Receivables from banks	94,276	100,825
(of which from affiliated companies €93,813 thousand; previous year: €97,258 thousand)		
Total	**94,276**	**100,825**

The breakdown of receivables from customers is as follows:

€ thousand	Dec. 31, 2016	Dec. 31, 2015
1. Trade receivables	581,951	439,142
2. Receivables from affiliated companies	1,175,561	924,058
(of which from the shareholder €1,085,689 thousand; previous year: €841,938 thousand)		
(of which trade receivables €92,772 thousand; previous year: €75,594 thousand)		
3. Other receivables	9,988	9,694
Total	**1,767,500**	**1,372,894**

The following table shows the maturity analysis for the receivables:

€ thousand	Dec. 31, 2016	Dec. 31, 2015
1. Receivables from banks	94,276	100,825
of which due in 0 – 3 months	94,276	100,825
2. Trade receivables	581,951	439,142
of which due in 0 – 3 months	136,305	101,243
of which due in > 3 – 12 months	164,501	144,222
of which due in > 12 – 60 months	281,145	193,677
3. Receivables from affiliated companies	1,175,561	924,058
of which due in 0 – 3 months	425,561	174,058
of which due in > 3 – 12 months	350,000	0
of which due in > 12 – 60 months	0	350,000
of which due in > 60 months	400,000	400,000
4. Other receivables	9,988	9,694
of which due in 0 – 3 months	9,988	9,694
Total	**1,861,776**	**1,473,719**

The main components of other assets are available-for-sale lease returns amounting to €646,962 thousand (previous year: €681,596 thousand), receivables from the processing of ABS transactions amounting to €271,416 thousand (previous year: €366,894 thousand) and accrued swap interest of €72,423 thousand (previous year: €86,416 thousand).

Prepaid expenses include discounts on purchased bonds and ABS transactions amounting to €919,133 thousand (previous year: €594,396 thousand); these discounts are amortized over the relevant maturity. Prepaid vehicle taxes of €13,162 thousand (previous year: €11,673 thousand), insurance payments in connection with service leases in the amount of €46,121 thousand (previous year: €35,070 thousand) and other prepaid expenses are also recognized under this item.

Assets amounting to €910,285 thousand were held in foreign currency through the branch in Poland.

The breakdown of liabilities is as follows:

€ thousand	Dec. 31, 2016	Dec. 31, 2015
1. Liabilities to banks	1,515,586	1,009,833
(of which to affiliated companies €781,496 thousand; previous year: €558,021 thousand)		
2. Liabilities to customers	12,704,760	10,695,853
(of which to affiliated companies €5,988,496 thousand; previous year: €6,516,254 thousand)		
(of which to the shareholder €736,835 thousand; previous year: €532,178 thousand)		
(of which trade payables €671,581 thousand; previous year: €583,410 thousand)		
3. Notes, commercial paper issued	7,172,536	7,286,606
4. Other liabilities	21,607	18,185
Total	**21,414,489**	**19,010,477**

The following table shows the maturity analysis for the liabilities:

€ thousand	Dec. 31, 2016	Dec. 31, 2015
1. Liabilities to banks	1,515,586	1,009,833
of which due in 0 – 3 months	815,213	610,371
of which due in > 3 – 12 months	649,373	364,462
of which due in > 12 – 60 months	51,000	35,000
2. Liabilities to customers	12,704,760	10,695,853
of which due in 0 – 3 months	2,220,156	1,502,586
of which due in > 3 – 12 months	1,867,137	1,423,822
of which due in > 12 – 60 months	8,617,467	7,769,445
of which due in > 60 months	0	0
3. Notes, commercial paper issued	7,172,536	7,286,606
of which due in 0 – 3 months	681,175	331,668
of which due in > 3 – 12 months	1,991,361	954,938
of which due in > 12 – 60 months	1,500,000	3,000,000
of which due in > 60 months	3,000,000	3,000,000
4. Other liabilities	21,607	18,185
of which due in 0 – 3 months	16,261	12,105
of which due in > 3 – 12 months	2,312	359
of which due in > 12 – 60 months	3,034	2,210
of which due in > 60 months	0	3,511
Total	**21,414,489**	**19,010,477**

A total of €1.5 billion (previous year: €0.9 billion) of the notes and commercial paper issued are due in the next fiscal year.

Volkswagen Leasing GmbH has not furnished any collateral in connection with the liabilities.

The other liabilities include swap interest liabilities amounting to €8,022 thousand (previous year: €10,799 thousand).

The provisions comprise tax provisions of €9,813 thousand (previous year: €14,090 thousand) and other provisions of €901,071 thousand (previous year: €787,531 thousand).

The other provisions include provisions for the risks arising in connection with existing leases. The provisions for residual value risks amount to €7,049 thousand (previous year: €9,845 thousand). Further notable recognized items include expenses from service leases and expenses for outstanding invoices in an amount of €112,565 thousand (previous year: €92,477 thousand). Provisions totaling €159,687 thousand (previous year: €174,815 thousand) have also been recognized for dealer bonuses and other bonus payments.

The provision recognized for outstanding repair invoices under servicing and wear-and-tear agreements amounts to €354,134 thousand (previous year: €265,453 thousand).

The provision recognized for risks arising from the terms and conditions of leases amounts to €125,600 thousand before discounting (previous year: €120,200 thousand). The discount amount is €1,552 thousand (previous year: €2,122 thousand).

The tax writedowns for the office building in accordance with section 3 of the Zonenrandförderungsgesetz (ZRFG – German Border Zone Development Act) are recognized in the special tax-allowable reserve. The reported net income is not materially increased by the reversal of the special tax-allowable reserve and the resulting change in the tax expense. This measurement for tax purposes will not have a significant impact on future net income either.

The upstream merger of the equity investments to Volkswagen Financial Services AG reduced capital reserves by €8,650 thousand. Equity consequently declined from € 231,009 thousand to € 222,359 thousand in the reporting period.

Liabilities amounting to €910,285 thousand were held in foreign currency through the branch in Poland.

Statement of changes in fixed assets:

€ thousand	GROSS CARRYING AMOUNTS Brought forward January 1, 2016	Additions	Disposals	Re-classifications	Currency translation differences	Balance December 31, 2016	
I. Intangible fixed assets							
Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets	5,977	1,197	0	0	–92	7,082	
Prepayments	35	27	38	0	0	24	
	6,012	1,224	38	0	–92	7,106	
II. Property and equipment							
Land and buildings	50,514	632	105	0	–50	50,991	
Operating and office equipment	2,706	638	673	0	–75	2,596	
Assets under construction	73	26	0	0	0	99	
	53,293	1,296	778	0	–125	53,686	
III. Lease assets							
Vehicles, technical equipment and machinery	28,769,006	14,805,852	11,686,383	66,952	–716	31,954,711	
Prepayments	66,994	97,868	42	–66,952	0	97,868	
	28,836,000	14,903,720	11,686,425	0	–716	32,052,579	
IV. Shares in affiliated companies	8,651	0	8,651	0	0	0	
Total fixed assets	**28,903,956**	**14,906,240**	**11,695,892**	**0**	**–933**	**32,113,371**	

	DEPRECIATION, AMORTIZATION AND WRITEDOWNS					NET CARRYING AMOUNTS	
	Brought forward January 1, 2016	Additions	Disposals	Currency translation differences	Balance December 31, 2016	Balance December 31, 2016	Balance December 31, 2015
	2,361	1,659	0	–51	3,969	3,113	3,616
	0	0	0	0	0	24	35
	2,361	1,659	0	–51	3,969	3,137	3,651
	10,989	1,584	84	–26	12,463	38,528	39,525
	1,273	393	249	–39	1,378	1,218	1,433
	0	0	0	0	0	99	73
	12,262	1,977	333	–65	13,841	39,845	41,031
	7,694,595	5,182,126	4,576,328	–1,180	8,299,213	23,655,498	21,074,411
	0	0	0	0	0	97,868	66,994
	7,694,595	5,182,126	4,576,328	–1,180	8,299,213	23,753,366	21,141,405
	0	0	0	0	0	0	8,651
	7,709,218	**5,185,762**	**4,576,661**	**–1,296**	**8,317,023**	**23,796,348**	**21,194,738**

4. Income Statement Disclosures

Leasing income amounts to €14,680,504 thousand. The leasing expense amounts to €8,181,816 thousand and includes the expenses necessary to generate the income. These expenses largely comprise the net carrying amounts of lease assets for which the leases have expired and service lease expenses. Net leasing income is €6,498,688 thousand.

The breakdown of net interest income/expense is as follows:

€ thousand	Jan. 1 – Dec. 31, 2016	Jan. 1 – Dec. 31, 2015
1. Interest income from lending and money market transactions (of which from affiliated companies €6,049 thousand; previous year: €7,254 thousand)	22,316	24,965
2. Interest expense (of which to affiliated companies €28,714 thousand; previous year: €40,196 thousand)	359,113	281,690
Total	**–336,797**	**–256,725**

Net other operating income is €271,569 thousand, of which €230,887 thousand is attributable to the leasing business and €40,682 thousand to the allocation of overheads to other entities. Net other operating income/expenses includes income from administration and broking services provided for third parties amounting to €88,440 thousand (previous year: €63,145 thousand) and income from currency translation amounting to €24,909 thousand. Also included is an income related to prior periods of €1,800 thousand (previous year: €0 thousand). Income from the reversal of special tax-allowable reserve amounts to €106 thousand.

The personnel expenses for employees at the branches in Milan, Verona and Poland come to €5,729 thousand, of which €4,306 thousand relates to wages and salaries and €1,423 thousand to social security costs.

Other administrative expenses amount to €340,379 thousand. These relate, in particular, to internal charges from other Group companies in connection with workplace costs, staff leasing and IT services, and to charges for services provided by third parties.

Depreciation and writedowns on lease assets are reported separately, the recognized amount for this item being €5,182,127 thousand. This figure includes writedowns to fair value amounting to €289,790 thousand (previous year: €274,243 thousand). Lease assets have been written down by an additional amount of €5,388 thousand (previous year: €4,050 thousand) to account for risks arising from the early remarketing of vehicles following the default of a lessee (latent credit risk).

Other operating expenses amounted to €43,366 thousand in the reporting period. This figure includes issuance and rating expenses of €2,721 thousand and expenses from currency translation of €19,655 thousand.

Some of the expenses for writedowns of, and valuation allowances on, receivables and additions to provisions in the leasing business amounting to €714,391 thousand are offset by corresponding income of €138,183 thousand.

The above figures resulted in a loss before tax for the reporting period of €260.8 million (previous year: €36.7 million).

Under the existing profit-and-loss transfer agreement, the loss after tax of €304,403 thousand is transferred to and absorbed by Volkswagen Financial Services AG.

Breakdown of income by region:

€ thousand

		Germany	Italy	Poland	Jan. 1 – Dec. 31, 2016 Total	Jan. 1 – Dec. 31, 2015 Total
1.	Leasing income					
	Lease payments	4,852,554	124,831	40,392	5,017,777	4,830,979
	Maintenance and service income	1,001,638	97,227	16,628	1,115,493	1,043,339
	Used vehicle sales	7,732,309	141,787	9,122	7,883,218	7,624,596
	Other	619,392	16,420	28,204	664,016	502,580
		14,205,893	380,265	94,346	14,680,504	14,001,494
3.	Interest income from lending and money market transactions	5,582	242	16,492	22,316	24,965
6.	Fee and commission income	515	0	6	521	452
8.	Other operating income	242,083	1,333	28,153	271,569	250,890
9.	Income from the reversal of special tax-allowable reserve	106	0	0	106	105
14.	Income from the reversal of writedowns of and valuation allowances on receivables and from the reversal of provisions in the leasing business	106,604	27,133	4,446	138,183	180,193
Total		**14,560,783**	**408,973**	**143,443**	**15,113,199**	**14,458,099**

5. Other Disclosures

Interest rate risk has been hedged by interest rate swaps with a total notional value of €22.6 billion. As of the reporting date, the positive values were €387.9 million and the negative fair values €63.4 million. The fair values are determined using market information as of the reporting date and with the help of suitable IT-based valuation techniques. In connection with these derivatives, accrued interest of €72.4 million is included in other assets and of €8.0 million in other liabilities.

The annual financial statements of Volkswagen Leasing GmbH are included in the consolidated financial statements of Volkswagen AG, Wolfsburg, (largest basis of consolidation) which are prepared in accordance with the International Financial Reporting Standards and published in the German Federal Gazette.

The annual financial statements of Volkswagen Leasing GmbH are also included in the consolidated financial statements of Volkswagen Financial Services AG, Braunschweig, which are prepared in accordance with the International Financial Reporting Standards and published in the German Federal Gazette.

To fund the lease assets, Volkswagen Leasing GmbH has placed asset-backed securities transactions (ABS transactions) in the market. Three such transactions were carried out in fiscal year 2016. In 2016, Volkswagen Leasing GmbH generated cash inflows totaling €5,312,276 thousand from the sale of future lease receivables and residual values under these leases. Five further transactions are in place, dating back to prior years. Other than the one-time inflows from each of these transactions, there is no other material impact on the present or future liquidity and financial position of Volkswagen Leasing GmbH.

Volkswagen Leasing GmbH held 100% of the shares in Vehicle Trading International (VTI) GmbH, Braunschweig, carmobility GmbH, Braunschweig and Euromobil Autovermietung GmbH, Isernhagen, at the beginning of the reporting period. These three companies were transferred to Volkswagen Financial Services AG, Braunschweig, in an upstream merger.

The land and buildings belonging to Volkswagen Leasing GmbH are largely used by the other companies in the FS subgroup based in Braunschweig.

The irrevocable leasing commitments relate to confirmed leases for which the vehicle had not yet been delivered as of the reporting date and the committed credit limit had thus not yet been utilized. It is expected that the credit will be drawn down, as the commitments relate to concluded leasing agreements. The Company has other financial obligations in the form of purchase order commitments, although the amount involved is immaterial as far as the assessment of the financial position of the Company is concerned.

As of the reporting date, there were some contingent liabilities in connection with the ABS transactions that are not reported in the balance sheet. These contingent liabilities and obligations arise from the fact that the vehicles underlying the future lease receivables that have been sold have in some cases been assigned as collateral to the special purpose entities issuing the bonds (up to and including ABS transaction VCL 21). It is expected that this collateral will not be called upon, as it is assumed that the risk will not materialize. A market risk reserve serving as collateral for certain risks was paid to investors in connection with ABS transactions VCL 22, VCL 23, VCL 24, PVCL1 and VCL Master RV C2. It is expected that this collateral will not be called upon, as it is assumed that the risk will not materialize.

Depending on the impact of the diesel issue on Volkswagen Leasing GmbH, support will be provided in the German market by the Volkswagen Group. Cash inflows are also not expected to decline as a result in the coming years.

Volkswagen Leasing GmbH does not enter into transactions with related parties that are not on an arm's length basis.

The fees paid to the independent auditors are disclosed in the notes to the consolidated financial statements of Volkswagen AG, Wolfsburg.

Volkswagen Leasing GmbH does not use any of its own personnel to carry out its operating activities in Germany. The employees are provided by Volkswagen Financial Services AG in return for a consideration. In addition, on average during the year, the Company had 81 (previous year: 78) salaried employees at its branches in Milan and Verona, and 3 (3) salaried employees at its branch in Poland.

The members of the Management do not receive any remuneration from the Company.

The Management of Volkswagen Leasing GmbH proposes that the net retained profits of €648,680.82 be carried forward to the new fiscal year.

6. Report on Post-Balance Sheet Date Events

There were no significant events affecting Volkswagen Leasing GmbH after the end of fiscal year 2016.

7. Company Information

Company name: Volkswagen Leasing Gesellschaft mit beschränkter Haftung
Location of registered office: Braunschweig
Registry court: Amtsgericht Braunschweig, Commercial Register B
Commercial register number: HRB 1858

8. Governing Bodies of Volkswagen Leasing GmbH

Management as of December 31, 2016

GERHARD KÜNNE
Management chairman
Sales Fleet Customers

HARALD HEẞKE (FROM FEBRUARY 1, 2016)
Back Office Leasing

THOMAS RENNEBAUM (UNTIL MARCH 31, 2016)
Middle Office Leasing (until March 31, 2016)

DR. HEIDRUN ZIRFAS (UNTIL MARCH 31, 2016)
Back Office Leasing (until January 1, 2016)

Audit Committee of Volkswagen Leasing GmbH

The members of the Audit Committee of Volkswagen Leasing GmbH are as follows:

DR. JÖRG BOCHE
Chairman
Executive Vice President of Volkswagen AG
Head of Group Treasury

WALDEMAR DROSDZIOK
Deputy Chairman
Chairman of the Joint Works Council of Volkswagen Financial Services AG,
Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

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

GABOR POLONYI
Head of Fleet Customer Management, Volkswagen Leasing GmbH

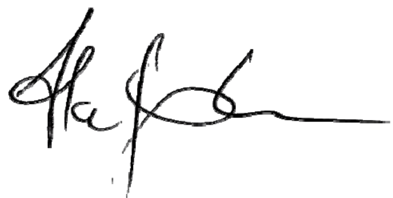
9. Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the annual financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of Volkswagen Leasing GmbH, and the management report includes a fair review of the development and performance of the business and the position of Volkswagen Leasing GmbH, together with a description of the material opportunities and risks associated with the expected development of Volkswagen Leasing GmbH.

Braunschweig, February 14, 2017

The Management

Gerhard Künne



Harald Heßke

Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, income statement, notes, cash flow statement and statement of changes in equity, including the bookkeeping system, together with the management report prepared by Volkswagen Leasing Gesellschaft mit beschränkter Haftung, Braunschweig, for the fiscal year from January 1 to December 31, 2016. The bookkeeping system and the preparation of the annual financial statements and management report in accordance with the requirements of German commercial law are the responsibility of the Company's Management. Our responsibility is to express an opinion on the annual financial statements, including the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with section 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW – Institute of Public Auditors in Germany). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with the generally accepted accounting principles and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the bookkeeping system, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Management, as well as evaluating the overall presentation of the annual financial statements and the management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with generally accepted accounting principles. The management report is consistent with the annual financial statements, complies with the legal requirements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Hanover, February 14, 2017

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Frank Hübner	Prof. Mathias Schellhorn
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Report of the Audit Committee

of Volkswagen Leasing GmbH

Volkswagen Leasing GmbH is a publicly traded corporation within the meaning of section 264d of the HGB. In accordance with the provisions in section 324 of the HGB, the Company has established an Audit Committee, which concerns itself in particular with the tasks described in section 107(3) sentence 2 of the Aktiengesetz (AktG – German Stock Corporation Act). The Audit Committee has four members. There were no changes in the composition of the Audit Committee compared with the prior year.

The Audit Committee held two regular meetings in the reporting period. There were no extraordinary meetings. During the reporting period, there were no urgent transactions that would have required a decision by circulation of written resolution for approval. All members of the Audit Committee were present at all the meetings.

At the meeting held on February 19, 2016, the Audit Committee reviewed the annual financial statements and the management report of Volkswagen Leasing GmbH for the year ended December 31, 2015 together with the proposal for the appropriation of profit. As part of this review, the Audit Committee discussed with the external auditors the reports on the audit of the annual financial statements and the management report of Volkswagen Leasing GmbH as well as material transactions and issues related to financial reporting. The Audit Committee reported on its review to the sole shareholder. It also received reports on the diesel issue, the business and risk strategy and the funding and liquidity position and on internal and external audit activities, together with the related findings. The Committee also gathered details to establish the extent to which there were relationships of a professional, financial or other nature between the external auditors and the Company and/or its governing bodies with a view to assessing the independence of the external auditors. In this regard, the Audit Committee obtained information on the services that the external auditors had provided for the Company in addition to the auditing activities and on whether there were any grounds for disqualification or partiality. Following a detailed evaluation of the independence of the external auditors, the Audit Committee submitted a recommendation to the sole shareholder regarding the election of the external auditors and drew up the resolution covering the issue of the audit engagement in preparation for the Annual General Meeting.

At its meeting on October 27, 2016, the Audit Committee focused in particular on the risk management system at Volkswagen Leasing GmbH. The committee also received detailed reports on IT issues of current importance and from the compliance officer. In addition, it held discussions with the external auditor regarding audit planning, key points of the audit and the auditor’s information requirements.

Braunschweig, March 1, 2017

Dr. Jörg Boche
Chairman

Waldemar Drosdziok
Deputy Chairman

Dr. Arno Antlitz
Member

Gabor Polonyi
Member

NOTE ON FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements on the future business development of Volkswagen Leasing GmbH. These statements are based on assumptions relating to the development of the global economy and of the financial and automotive markets, which Volkswagen Leasing GmbH has made on the basis of the information available to it and which it considers to be realistic at the time of going to press. The estimates given entail a degree of risk, and the actual developments may differ from those forecast.

Should actual developments turn out to be different, contrary to expectations and assumptions, or unforeseen events occur that have an impact on the business of Volkswagen Leasing GmbH, this will have a corresponding effect on the business development of the Company.

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VOLKSWAGEN LEASING GMBH

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