VOLKSWAGEN FINANCIAL SERVICES

THE KEY TO MOBILITY

VOLKSWAGEN LEASING GMBH
ANNUAL REPORT

2017

Volkswagen Leasing GmbH

At a glance

€ million	2017	2016	2015	2014	2013
Lease asset acquisitions	16,040	14,904	13,728	11,951	10,379
Lease assets	26,049	23,753	21,141	19,206	17,940
Total equity and liabilities	32,218	27,767	24,549	21,744	19,354
Leasing income	15,848	14,681	14,001	12,942	11,451

Thousands of vehicles	2017	2016	2015	2014	2013
New leases	615	590	555	517	439
Lease portfolio	1,386	1,281	1,181	1,110	1,014

Fundamental Company Information

Continuous growth confirms Volkswagen Leasing GmbH's business model.

BUSINESS MODEL

The establishment of Volkswagen Leasing GmbH in 1966 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.

Until April 30, 2017, management responsibility at Volkswagen Leasing GmbH was split into Sales Fleet Customers under Mr. Gerhard Künne and Back Office under Mr. Harald Heßke.

As from May 1, 2017, following Mr. Knut Krösche's appointment to the Board of Volkswagen Leasing GmbH, the Company has three Board departments. Mr. Knut Krösche heads the Front Office Sales Fleet Management department, including the sales functions. The Middle Office comprises fleet customer management, rental and leasing models and claims and services management under Mr. Gerhard Künne. The risk management and other back-office activities of Volkswagen Leasing GmbH continue to be combined under the Back Office Board department under Mr. Harald Heßke.

Volkswagen Leasing GmbH was restructured as from September 1, 2017. The areas of marketing, sales management, brand management and sales strategy are now bundled under Corporate Management. Responsibility for this Board department was assigned to Mr. Anthony Bandmann, who was appointed Chairman of the Board of Volkwagen Leasing GmbH as of September 1, 2017. Since September 1, 2017, the internal sales and field sales departments of Volkswagen Leasing GmbH as well as fleet services management and administration have been combined in the Front Office unit in order to give customers a perfectly aligned fleet management and comprehensive service and mobility offering. This Board department has been assigned to Mr. Knut Krösche. Ms. Silke Finger was newly appointed to the Board of Volkswagen Leasing GmbH as of September 1, 2017; her responsibilities as head of the Back Office Board department include risk management, back office and controlling.

In 2016, Volkswagen Financial Services AG initiated a reorganization of its legal entities. A key milestone in the project was reached on September 1, 2017 when Volkswagen Financial Services AG's subsidiary Volkswagen Bank GmbH was transferred to become a direct subsidiary of Volkswagen AG. The aim of the restructuring was to segregate the European lending and deposits business from the other financial services activities and to pool this business under Volkswagen Bank GmbH, structured as a direct subsidiary of Volkswagen AG. The intention of the restructuring is to increase transparency and clarity for supervisory authorities, optimize the use of equity and reduce complexity. A new company, Volkswagen Financial Services Digital Solutions GmbH, will develop and provide system-based services for its parent companies Volkswagen Bank GmbH and Volkswagen Financial Services AG. The other activities will remain in Volkswagen Financial Services AG, which will still be a direct subsidiary of Volkswagen AG.

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:

Reconciliation € million	
Result from ordinary business activities in accordance with the HGB (legal entity)	-525,4
Result from ordinary business activities in accordance with the HGB (branches)	30,9
Variances in operating profit due to classification/measurement differences for leases between HGB and IFRSs	488,6
Additional expense under HGB compared with IFRSs due to ABS funding	171,4
Other factors	-72,3
Operating profit in accordance with IFRSs	93,2

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

There were no changes in equity investments in fiscal year 2017.

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

Although the global economy grew faster in fiscal year 2017 than in the previous year, growth in global demand for vehicles was slower than in the prior-year period. Volkswagen Leasing GmbH's result from ordinary business activities was down on the previous year.

OVERALL ASSESSMENT OF BUSINESS PERFORMANCE

In the opinion of the Management of Volkswagen Leasing GmbH, the business performed well in 2017.

In 2017, Volkswagen Financial Services AG yet again received the award for "best leasing and fleet management company" from the fleet magazine FIRMENAUTO. In addition, Volkswagen Financial Services AG received the special award for financing, leasing and insurance from AUTOMOBILWOCHE magazine.

In 2017, the Company focused on digitalizing its business. For example, for the core brands, the servicing and inspection products are available online. Volkswagen Leasing GmbH thus continues to position itself as a forward-thinking company. In addition, the Company successfully expanded its private leasing business in 2017 to meet the wishes and needs of private customers for mobility, flexibility and independence in the digital age.

As in the previous fiscal year, the commercial segment accounted for the lion's share of overall new registrations in 2017. The story was the same at Volkswagen Leasing GmbH, which saw commercial leasing business grow as a result. There is consistently strong demand for comprehensive, flexible mobility solutions, and this leads to a continuous increase in the services provided. This trend benefited from the individual measures configured for the leasing business in conjunction with the Group brands. As a result, contract numbers continued to increase, both in the private customer and the fleet customer business with both new and low-mileage used vehicles.

Residual value trends for diesel vehicles from all manufacturers are being affected by a variety of factors, including the debate about future driving bans in major cities, which could have an impact on the residual value risk of Volkswagen Leasing GmbH's portfolio. Early indicators, such as longer inventory turnover periods in the dealership organization, could lead to a decline in prices for a limited period. From today's perspective, given the plethora of influencing factors, it is clearly too soon to assess conclusively whether this is a temporary effect or a long-term trend. Based on tight risk control, an adequate provision for risks is recognized for existing contracts on the basis of quarterly portfolio valuations. Residual values in the new vehicle business are calculated realistically, taking into account e.g. vehicle cycles, equipment or industry trends, and regularly adjusted in line with market conditions, thus minimizing the exposure to new risks.

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.

Like Volkswagen Leasing GmbH, carmobility GmbH is a wholly-owned entity within the Volkswagen Financial Services AG group of consolidated entities. In the highly competitive fleet market, Volkswagen Leasing GmbH has expanded its offering of services by cooperating with its sister company carmobility GmbH. Carmobility GmbH's service portfolio covers universal fleet management – irrespective of whether the fleet is bought, leased, or financed in another way. The main emphasis is on a range of customer-oriented products that support fleet operators with their administrative activities and are also used by Volkswagen Leasing GmbH as innovative back-office solutions. In turn, Volkswagen Leasing GmbH performs sales activities for carmobility GmbH in an arrangement that sees Volkswagen Leasing GmbH making a sustained investment in further expanding its customer relationships and providing holistic solutions for its customers. Through the cooperation, Volkswagen Leasing GmbH is optimizing its competitive edge while at the same time minimizing make-or-buy decisions.

Carmobility GmbH is driving innovation in the field of telematics, having launched the "FleetCONNECTED" product in fiscal year 2017. Realtime data gathering in the car and the secure transfer of this data to a protected reporting system open up new potential for optimization, making it easy to identify and eliminate cost drivers while enhancing the safety of company car drivers at the same time.

Another focal area in Volkswagen Leasing GmbH's offering is the provision of innovative mobility services. Volkswagen Leasing GmbH's Charge & Fuel Card and the accompanying Charge & Fuel App greatly simplify the charging process of electric and plug-in hybrid vehicles: customers get a single monthly bill, no matter at which of Germany's publicly accessible charging points they have used their Charge & Fuel Card to charge their vehicles. In addition, fuel (for plug-in hybrid vehicles) and other vehicle-specific services such as car washes can be bought in cashless transactions at over 12,000 service stations in the UTA network. In the process of digitalizing the existing product world of Volkswagen Leasing GmbH, the Charge & Fuel Card was enhanced in 2017 by adding a dedicated website, including an online sales channel.

Volkswagen Leasing GmbH is also systematically expanding its fuel and service card business, 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. In particular, the product range for private and commercial customers has been expanded in a way which conserves resources, offering personalized fleet solutions for sustainable, low-emission mobility.

In 2016, Volkswagen Financial Services AG initiated a reorganization of its structures under company law. The carve-out of Volkswagen Bank GmbH from Volkswagen Financial Services AG as of September 1, 2017 marked an important milestone in this project. As a result of the reorganization, the European lending and deposits business has been segregated from the other financial services activities and assigned to Volkswagen Bank GmbH as a direct subsidiary of Volkswagen AG. The aim of the restructuring is to increase transparency and clarity for supervisory authorities, optimize the use of own funds and reduce complexity. At the same time, the new setup also ensures the Company presents "one face to the customer" without resulting in changes affecting customers, dealers and brands, as all sales activities continue to be provided from a single source while Volkswagen Leasing GmbH takes over sales of automotive banking products as well. A new entity, Volkswagen Financial Services Digital Solutions GmbH, will develop and provide system-based services for its parent companies Volkswagen-Bank GmbH and Volkswagen Financial Services AG. The other activities will remain with Volkswagen Financial Services AG, which is also a direct subsidiary of Volkswagen AG.

Other activities will continue in the coming years in local companies of the European Economic Area with the aim of achieving the planned structure.

Volkswagen Leasing GmbH, as a subsidiary of Volkswagen Financial Services AG, launched the used-car platform HeyCar jointly with its sister company Mobility Trader GmbH in the reporting period. The platform, which provides marketing support for the used-car business, will be expanded in stages. From summer 2018, all dealers throughout Germany will be able to connect to the platform. HeyCar boasts a portfolio of high-quality vehicles offered by premium dealers of all brands, high-quality, prequalified customer inquiries, as well as ease of use and peace of mind for customers.

In 2018, Volkswagen Leasing GmbH will get ready for a new structure in Fleet Customer Sales, which will place even greater focus on the customer.

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 2017 COMPARED WITH PRIOR-YEAR FORECASTS

In the German market, we anticipated a substantially lower operating profit in accordance with IFRS for fiscal year 2017. The IFRS operating profit generated by Volkswagen Leasing GmbH in the German market was worse than forecast, with a significant decline to €93.2 million, from €242.2 million in the previous year.

The volume of new contracts had been expected to decline slightly and that of existing contracts had been forecast to increase slightly in 2017 compared with the previous year. Both new contracts and the volume of existing contracts increased substantially year-on-year – contrary to expectations – 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 60.5% 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 45.4%.

In Italy, we had expected the volume of new and existing contracts to rise slightly. Moreover, we had anticipated that the penetration rate would remain steady and that the IFRS operating profit would fall significantly. In contrast to our forecast, both new business and the volume of existing contracts increased further, compared with the previous year. The penetration rate also improved slightly. Driven by special items, the IFRS operating profit in Italy rose significantly faster than expected in 2017, from €21.6 million in the previous year to €35.0 million.

For our branch in Poland, we had forecast that, given a slight increase in the penetration rate, the IFRS operating profit would be significantly up on the previous year. The volume of new contracts had been expected to be slightly higher and that of existing contracts significantly higher than the prior-year level. Actual results show an IFRS operating profit of €5.8 million for 2017, well up on the prior-year operating loss of €6.6 million. Also as expected, the penetration rate is slightly above the previous year's level. The volume of new and existing contracts performed significantly better than expected.

GLOBAL ECONOMY

Global Economic Development

Global gross domestic product (GDP) rose by 3.2 (2.5)% in 2017. Economic momentum accelerated in both advanced economies and emerging markets year-on-year. Consumer prices increased at a slower pace worldwide than in the previous year, with persistently low interest rates and rising energy and commodity prices.

Europe

GDP growth in Western Europe edged up slightly during the year to 2.3 (1.8)%, with the majority of the countries in this region seeing higher growth rates. The start of the Brexit negotiations between the United Kingdom and the European Union generated uncertainty, as did the question of what form this relationship would take in the future. The unemployment rate in the eurozone continued to decrease, falling to an average of 9.6 (10.6)%.

The Central and Eastern Europe region recorded a relatively strong increase in GDP in the reporting period with an increase of 3.8 (1.8)%. In Central Europe the general uptrend gained traction, and in Eastern Europe the economy also grew at a considerably stronger pace than in the previous year. Higher energy prices led to a stabilization of the economic situation in the countries from this region that export raw materials.

Germany

The German economy continued to profit from optimistic consumer sentiment and a good labor market, which led to a sharper year-on-year increase in GDP to 2.5 (1.9) % in 2017.

TRENDS IN THE MARKETS FOR FINANCIAL SERVICES

Demand for automotive financial services was high once again in 2017, due above all to the expansion of the overall market for passenger cars and low key interest rates in the main currency areas. Particularly insurance and service products such as maintenance and servicing agreements were especially popular, as customers in more advanced automotive financial services markets are putting greater focus on optimizing overall running costs. In the fleet segment, some customers consulted automotive financial service providers in order to optimize their entire mobility management beyond mere fleet operation. There was also increased demand from both private and business customers for mobility services centered on vehicle usage rather than ownership.

In Europe, sales of financial services climbed further in the reporting period, strengthened by higher vehicle sales and demand for after-sales products such as servicing, maintenance and spare parts agreements as well as automotive-related insurance. Demand developed positively in most countries; in the United Kingdom, France, Spain and Italy in particular, automotive financial services products continued to enjoy rising popularity. The UK's decision to leave the EU has not yet had a negative impact on local demand for financial services.

In Germany, the share of loan-financed or leased vehicles remained stable at a high level in 2017. Alongside traditional products, mobility services and after-sales products were particularly popular.

In the commercial vehicles segment, the European market for financial services again performed positively.

TRENDS IN THE PASSENGER CAR MARKETS

In fiscal year 2017, the global market volume of passenger cars rose by 2.9% to 83.5 million vehicles, achieving a record figure for the seventh time in a row. While demand rose in the Asia-Pacific, South America, Western Europe and Central and Eastern Europe regions, the market volume in North America, the Middle East and Africa fell short of the prior-year figures.

Sector-Specific Environment

The sector-specific environment was influenced significantly by fiscal policy measures, which contributed substantially to the mixed trends in sales volumes in the markets last year. The instruments used were tax cuts or increases, incentive programs and sales incentives, as well as import duties.

In addition, non-tariff trade barriers to protect the respective domestic automotive industry made the movement of vehicles, parts and components more difficult.

Europe

In Western Europe, new passenger car registrations rose by 2.5% to 14.3 million vehicles, the highest level in the past ten years. The positive performance was underpinned in particular by the strong macroeconomic environment, consumer confidence and low interest rates. In Italy (+8.1%), the level of demand benefited from demand for replacement vehicles and particularly from significant growth in sales to commercial customers. The number of diesel vehicles (passenger cars) in Western Europe slipped to 44.4 (49.5)% in the reporting year.

The passenger car market volume in the Central and Eastern European region in fiscal year 2017 was up considerably on the prior-year figure, with an increase of 12.6% to 3.0 million vehicles. New passenger car registrations in the EU member states of Central Europe increased by 12.5% to

1.3 million units. Passenger car sales in Eastern Europe also achieved a double-digit growth rate (+12.6%), starting from a very low level. The main growth driver in the region was the Russian market, which, with an increase of 12.3% to 1.5 million vehicles, saw demand increase again for the first time after four years of decline.

Germany

In fiscal year 2017, demand for passenger cars in Germany exceeded the prior-year figure by 2.7% at 3.4 million units. The fact that this was the highest level since 2009 was attributable not only to the buoyant macroeconomic environment but also to manufacturer discounts in the form of a trade-in bonus for older diesel models as well as to an environmental bonus for electric-powered vehicles (all-electric and plug-in hybrid drives). New registrations for both retail customers (+4.4%) and business customers (+1.7%) increased as a result.

However, domestic production and exports fell short of the comparable prior-year figures in 2017. Passenger car production declined by 1.7% to 5.6 million vehicles. Passenger car exports fell by 0.9% to 4.4 million vehicles; this was mainly due to the fact that the volume of exports to North America was significantly lower because of shifts in production, accompanied by a weakening of the North American market.

TRENDS IN THE MARKETS FOR COMMERCIAL VEHICLES

Overall demand for light commercial vehicles in fiscal year 2017 was slightly lower than in the previous year. A total of 9.1 (9.3) million vehicles were registered worldwide.

In Western Europe, the number of new vehicle registrations rose by 4.7% during the year to 1.9 million units, driven by the region's continued positive economic performance. The markets in Italy, France and Spain recorded moderate to high growth rates, while the United Kingdom registered a decline.

In Germany, the comparative figure for 2016 was exceeded by 3.6%.

Central and Eastern European markets recorded perceptible growth on the whole with 326 (306) thousand vehicle registrations.

RESULTS OF OPERATIONS

In the reporting period, leasing income rose by €1.1 billion to €15.8 billion. Of this rise in income, €0.8 billion was attributable to increased proceeds from the disposal of former lease vehicles (which accounted for €8.7 billion of the total leasing income) and €0.5 billion to ongoing lease installments. Although subsidies received made a positive contribution to the increase in revenue, the figure for income from services declined by €0.3 billion year-on-year due to a change in reporting. The larger portfolio of leases will lift revenue in the coming years.

Leasing expenses went up by €1.1 billion to €9.3 billion year-on-year. The increase was attributable in particular to higher net carrying amounts of vehicles disposed of, which rose by €0.8 billion to €7.9 billion as a result of volume growth, and to expenses from service leases, which increased by €0.3 billion to €1.1 billion, also largely due to volume growth.

The restructuring measures implemented at Volkswagen Financial Services AG have led to functions and tasks being assumed by Volkswagen Leasing GmbH. In this context, general and administrative expenses increased by €50 million to €396 million, mainly as a consequence of higher IT costs, staffing costs and charges for services provided by third parties.

Depreciation and write-downs of lease assets amounted to €6.0 billion (previous year: €5.2 billion). This figure includes write-downs of €0.5 billion (previous year: €0.3 billion).

Volkswagen Leasing GmbH's funding costs rose year-on-year from €359 million in 2016 to €454 million in 2017. This is attributable firstly to a growth-related change in the required funding and secondly to the continuing strong emphasis on asset-backed securities (ABS) programs in the funding process.

Write-downs of and valuation allowances on receivables and additions to provisions in the leasing business came to €452 million (previous year: €714 million). The year-on-year change was primarily a result of the change in the presentation of future expenses for servicing and wear-and-tear products applied since the previous year.

Income from the reversal of write-downs and of valuation allowances on receivables and from the reversal of provisions in the leasing business increased significantly to €562 million (previous year: €138 million). The rise is primarily due to the reversal of provisions in the leasing business, which increased significantly – compared with the previous year –, and an increase in income from the reversal of valuation allowances in the leasing business.

Net other operating income rose by €23 million year-on-year to €295 million in 2017. The figure also includes support payments in the amount of €44 million from Volkswagen Financial Services AG to compensate for higher funding costs and realized residual value losses. Other operating expenses in the reporting period increased by €57 million to €100 million. The rise is mainly due to expenses from currency translation incurred in connection with the branch in Poland and higher issuance costs.

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. Although the result from ordinary business activities in accordance with the HGB was again significantly worse than the prior-year figure at €–525.3 million (previous year: €–260.8 million), Volkswagen Leasing GmbH generated a positive IFRS operating profit of €93.2 million in the German market (previous year: €242.2 million). The year-on-year decline is primarily attributable to a rise in expenses for servicing and wear-and-tear products, higher risk costs and an increase in overheads. 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 €13.4 million, amounting to €35.0 million for the reporting period (previous year: €21.6 million). In Poland, the Company generated an IFRS operating profit of €5.8 million, a significant improvement on the previous year's operating loss of €6.6 million.

NET ASSETS AND FINANCIAL POSITION

Total assets rose by €4.4 billion to €32.2 billion. Lease assets, which represent the core business of Volkswagen Leasing GmbH, amounted to a total of €26.0 billion and therefore accounted for approximately 80.7% of total assets.

Acquisitions of lease assets rose by €1.1 billion to €16.0 billion. The gross carrying amount of lease assets increased from €32.1 billion to €35.5 billion. The net carrying amount as of the reporting date was €26.0 billion (previous year: €23.8 billion), equating to a rise of €2.2 billion or 9.2%.

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 1,386,000 units compared with approximately 1,281,000 as of the prior year reporting date. Of this figure, the Italian branches accounted for approximately 29,000 vehicles (previous year: 25,000) and the Polish branch for 76,000 vehicles (previous year: 55,000). The increase in the portfolio was due to the net effect from the addition of approximately 615,000 new units and the disposal of around 510,000 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)

2017		2016		2015		2014		2013	
Additions	Balance	Additions	Balance	Additions	Balance	Additions	Balance	Additions	Balance
615	1,386	590	1,281	555	1,181	517	1,110	439	1,014

In terms of capital structure, the main liability items are the liabilities to customers of €13.5 billion (previous year: €12.7 billion) and the notes and commercial paper issued amounting to €10.5 billion (previous year: €7.2 billion).

Equity

Volkswagen Leasing GmbH's subscribed capital remained unchanged at €76 million in fiscal year 2017. Based on the total assets of €32.2 billion, the equity ratio was 0.7% (previous year: 0.8%).

Liquidity Analysis

Volkswagen Leasing GmbH is funded primarily through capital market and ABS programs as well as lines of credit provided by external banks and Volkswagen AG. Unexpected fluctuations are compensated by Volkswagen Financial Services AG.

To ensure there is appropriate liquidity management, Treasury prepares liquidity maturity balances, carries out cash flow forecasts and takes action as required. In these calculations, the legally determined cash flows are assumed for funding instruments, whereas estimated cash flows are used for other factors that affect liquidity. The requirement under the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements Risk Management) for 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

In July, Volkswagen Leasing GmbH returned to the euro capital markets with an issue of unsecured bonds. The issue comprised three bonds with a volume of €3.5 billion. In October, two further bonds were placed with a volume of €2.25 billion.

Volkswagen Leasing GmbH was also active in the market with its ABS program.

German lease receivables were securitized in October 2017 as part of the “Volkswagen Car Lease 25” (VCL 25) transaction. The transaction had a volume of €1.6 billion.

This package of measures ensured that Volkswagen Leasing GmbH had adequate liquidity at all times during 2017.

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

The management of Volkswagen Leasing GmbH expects that with further economic growth in the vast majority of markets, there will be a moderate increase in deliveries to customers of the Volkswagen Group. 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, 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. 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. Our aim is to ensure that all key products worldwide are also available online by 2020. 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 leasing transactions turn out to be lower than the prior calculations of expected losses and the associated provisions recognized on this basis. A situation in which the incurred losses are lower than the expected losses can occur particularly at times when economic uncertainty dictates a conservative risk approach but in which the economic circumstances subsequently stabilize, resulting in an improvement in the credit quality of the lessees concerned.

OPPORTUNITIES FROM RESIDUAL VALUE RISK

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 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 (Group) 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, treasury, risk management and controlling 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. The tasks of the compliance unit are managed by Volkswagen Bank GmbH on the basis of an outsourcing agreement.
- 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).
- The fact that all transactions are accurately recognized in the accounts, processed and evaluated, and then properly reported ensures that the areas of responsibility are clearly delineated and various monitoring and review mechanisms are implemented.
- 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.
- Internal audit in the Volkswagen Financial Services AG subgroup is a key component of Volkswagen Leasing GmbH's monitoring and control system. It carries out regular audits of accounting-related processes in Germany and abroad as part of its risk-oriented auditing activities and reports on these audits directly to the 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, 2017 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, (hereinafter: Volkswagen Leasing GmbH) is exposed to a large number of risks typical of the financial services sector as part of its primary operating activities. The Company takes on these risks responsibly 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, Volkswagen Leasing GmbH's Risk Management continuously monitors the system. Secondly, the individual elements in the system are regularly reviewed on a risk-oriented basis by Internal Audit.

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.

Volkswagen Leasing GmbH's Risk Management is divided into Strategic and Operational Risk Management in Germany (subsequently collectively referred to as "Risk Management") and the branches in Italy and Poland (local risk management). Risk Management in Germany sets out the framework for the organization of risk management and also performs the local risk management tasks for the German market.

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. Risk Management is therefore responsible for identifying possible risks, analyzing, quantifying and assessing risks, and for determining the resulting measures to manage the risks. Risk Management is a neutral, independent unit and reports directly to the Management of Volkswagen Leasing GmbH.

Local risk management in the Italian and Polish branches ensures the risk management system is implemented and its requirements complied with; Risk Management in Germany does the same for the German market.

For Italy and Poland, 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; Risk Management in Germany performs the corresponding function in its local market. There is a direct line of reporting from local risk management to Risk Management in Germany.

To summarize, continuous monitoring of risks, transparent and direct communication with the Management and the integration of all information obtained into the 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 high-level ROUTE2025 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. Moreover, on this basis, the business strategy 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 with the Management and 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, 2016 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% and a time horizon of one year. In addition to the going concern approach, risk-bearing capacity is analyzed using the gone concern approach.

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 credit risk arising from internal corporate funding, 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.

DISTRIBUTION OF RISKS BY TYPE OF RISK
as of September 30, 2017

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

As of September 30, 2017, the overall economic risk of Volkswagen Leasing GmbH amounted to €956 million. The apportionment of this total risk by individual risk category was as follows:

CHANGES IN RISK, BY RISK CATEGORY

	30.09.2017		31.12.2016	
	€ million	Percent	€ million	Percent
Risk category				
Credit risk	379	40	354	38
Shareholder, issuer and counterparty risk	3	0	1	0
Residual value risk	320	34	278	30
Earnings risk	143	15	162	18
Market risk	12	1	22	2
Liquidity risk	0	0	0	0
(funding risk)	51	5	60	7
Operational risk[1]	48	5	46	5
Total	**956**	**100**	**923**	**100**

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

The risk-taking potential of €2.6 billion as of September 30, 2017 primarily comprised reported equity. As of the reporting date, 37% of the risk-taking potential was utilized for the risks outlined above. In the period January 1, 2017 to September 30, 2017 the maximum utilization of the risk-taking potential in accordance with MaRisk was 38%.

Up to December 31, 2017 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

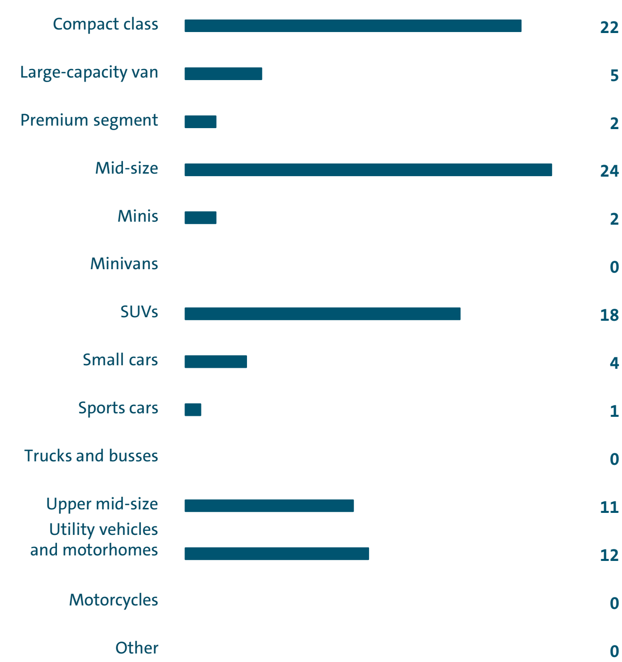
- just a few lessees/contracts account for a large proportion of the leases (counterparty concentrations)
- a small number of sectors account for a large proportion of the leases (sector concentrations)
- many of the leases are with businesses within a defined geographical area (regional concentrations)
- 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 is concentrated on the German market, but is focusing on broad diversification across regions. The fact that customers come from different sectors enhances diversification.

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, 2017
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, 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, the new product process must be completed. 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 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 and, if applicable, the Board of Management of Volkswagen Financial Services AG. If activities are planned in new markets, the new market process of Volkswagen Financial Services AG has to be completed.

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 write-downs 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, 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 and commercial 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.

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 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 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.

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.

Depreciation, amortization and write-downs

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) 3.6% (previous year: 3.5%); loss given default (LGD) 34.8% (previous year: 34.9%); and total volume of receivables based on the active portfolio €26.3 billion (previous year: €23.4 billion).

Risk monitoring and control

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.

Trends

Further growth in the volume of receivables within Volkswagen Leasing GmbH was achieved in fiscal year 2017. As in the previous year, the German portfolio was instrumental in driving growth based on favorable economic conditions. Overall, the credit risk of Volkswagen Leasing GmbH remained stable.

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. Under an outsourcing agreement, the Treasury Back Office unit of Volkswagen Bank GmbH 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.

On the basis of an outsourcing agreement, the Risk Management unit of Volkswagen Bank GmbH evaluates counterparty risk on a monthly basis. If limits are exceeded, the situation is escalated to the Management of Volkswagen Leasing GmbH. Counterparty risks are reported to the Management and Risk Management of Volkswagen Leasing GmbH 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.

There is no shareholder risk at present, because Volkswagen Leasing GmbH did not hold any equity investments as of December 2017.

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 investment 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 Risk Management of Volkswagen Bank GmbH escalates the situation on an ad hoc basis to the Management of Volkswagen Leasing GmbH 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
Under an outsourcing agreement, the Treasury unit of Volkswagen Bank GmbH 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. On the basis of an outsourcing agreement, the Risk Management of Volkswagen Bank GmbH is responsible for monitoring and reporting on interest rate risk.

A report on the latest position regarding interest rate risk is submitted to the Management and Risk Management of Volkswagen Leasing GmbH once a 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. Operationally, liquidity risk management is performed by Volkswagen Bank GmbH's Risk Management function on the basis of an outsourcing agreement.

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 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 on the basis of an outsourcing agreement.

The Risk Management of Volkswagen Bank GmbH is responsible for identifying and recording liquidity risk, also on the basis of an outsourcing agreement. 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. 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.

Risk monitoring and control

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

The Risk Management unit of Volkswagen Bank GmbH 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 and Risk Management of Volkswagen Leasing GmbH are given an up-to-date report on the liquidity position on a monthly basis.

Development of liquidity risk

The effect of the diesel issue, which was uncovered in September 2015, on liquidity risk has almost fully dissipated. The ability to access the capital market was restored in August 2016, and liquidity risk at the level of Volkswagen Leasing GmbH has been stable since then.

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 write-down 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 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 write-downs.

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, 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. Trends in the used vehicle market, and thus changes in the residual value portfolio, were affected in 2017 by the debate about possible future driving bans for diesel vehicles in major cities.

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 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 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 €154 million as of December 31, 2017.
Training and awareness campaigns were carried out in order to further highlight 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 Leasing GmbH, 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 Leasing GmbH is taking account of both categories of risk by setting up a local compliance unit and this unit is working toward specifying and implementing risk-mitigating measures. The tasks of the compliance unit are managed by Volkswagen Bank GmbH on the basis of an outsourcing arrangement.

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

As part of the compliance unit, 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 unit 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 unit 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 Institution:

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

The compliance requirements at the Institution are specified centrally and must be implemented autonomously in the local branches. 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 Institution's compliance officer.

The compliance officer receives regular reports and carries 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 unit, 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, employee 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 2017. 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 2017, 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.

Human Resources Report

Promoting a culture of open feedback and discussion

Staffing numbers

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, 2017, Volkswagen Leasing GmbH had 750 staff members (previous year: 959) in Germany.

The branches in Milan and Verona (Italy) had 249 employees (previous year: 90) as of December 31, 2017 and these individuals held employment contracts with Volkswagen Leasing GmbH. The branch in Warsaw had 179 employees (previous year: 3) as of December 31, 2017.

The significant changes in the number of employees compared with fiscal year 2016 are the result of the reorganization of the structure of the Volkswagen Financial Services Group under company law.

Employees

We consider it the duty of Volkswagen Financial Services AG to be a top employer for our employees. For us, this includes above all attractive and varied job descriptions, ample opportunities for professional and personal development as well as international career opportunities, while allowing for a good work-life balance. Moreover, we offer remuneration commensurate with the work performed, profit-sharing arrangements and a number of social benefits.

We expect our top employees to have a high level of expertise, provide excellent performance, embrace change and flexible working arrangements, be willing to gain new qualifications (in particular with regard to future (digital) customer requirements), be willing to continuously increase the productivity of their work and to dedicate themselves to their profession with commitment and passion. The sustained success of our Company is only made possible through the excellent work of our employees, who use innovative methods and find agile ways to cooperate .

Human Resources Strategy

The Human Resources unit of Volkswagen Financial Services AG has overarching responsibility for human resources in all the German subsidiaries of Volkswagen Financial Services AG, including therefore Volkswagen Leasing GmbH.

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 other strategic cornerstones of customers, volume, profitability and operational excellence. Based on specific activities to develop and retain staff, 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 top employer, take our excellent globally recognized reputation to yet another level.

The strategic focus in the reporting period was again on promoting a culture of open feedback and discussion as well as on customer- and service-oriented cooperation, both internally and with customers.

We assess the extent to which we have achieved our objective of being a top employer by regularly taking part in external employer competitions. The aim is to enhance working conditions and develop appropriate measures, so that Volkswagen Financial Services AG is among the top 20 employers in the Great Place to Work employer ranking by 2025, not only in Europe, but worldwide. Due to the Europe-wide reorganization of Volkswagen Financial Services AG, the company’s participation in Great Place to Work in Europe was suspended during the reporting period; the company is planning to take part again in 2019.

However, we received a number of other employer awards. For example, Volkswagen Financial Services AG was yet again rated “top company” in Germany by Focus magazine and the employer evaluation platform kununu.

The satisfaction of our customers with the work of our employees is given top priority at Volkswagen Financial Services AG. 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.

Staff Development

The employees' need for further skills and qualifications is determined at annual employee appraisals and suitable professional development measures are agreed. 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.

The skills development needs of the various departments are determined annually at the strategic skills development conferences. This is then used as the basis for a forward-looking expansion of skills development activities.

Because of the growing significance of both digital and environmentally compatible mobility concepts within the Volkswagen Group, the skills development portfolio of the FS Academy in regard to e-mobility and digitalization is continually being expanded. In this way, the FS Academy is making a considerable contribution to the digital transformation within the Company.

Another focus of the FS Academy was on extending the skills development offering to enhance the skills in traditional and agile project management methods in order to turn them into a strength for the Company. The offering also includes the option to acquire certified product owner and scrum master qualifications and thus take the lead in agile projects.

Report on Expected Developments

The global economy is expected to grow somewhat less strongly in 2018 than in the previous year. We assume that trends in global demand for vehicles will be mixed and that demand will increase at a slightly slower rate than in the reporting period.

The main opportunities and risks arising from the operating activities having been set out in the report on opportunities and risks, the section below now outlines the expected future developments. These developments give rise to opportunities and potential benefits that are included in 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.

DEVELOPMENTS IN THE GLOBAL ECONOMY

In our forecasts, we assume that global economic growth will weaken slightly in 2018. 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 therefore expect somewhat weaker momentum than in 2017 in both the advanced economies and the emerging markets. We expect the strongest rates of expansion in Asia's emerging economies.

Furthermore, we anticipate that the global economy will also continue to grow in the period from 2019 to 2022.

Europe

In Western Europe, economic growth is expected to slow down in 2018 compared with the reporting period. Resolving structural problems poses a major challenge, as do the uncertain results and impacts of the Brexit negotiations between the EU and the United Kingdom.

For Central Europe, we estimate that growth rates in 2018 will be lower than those of the past fiscal year. In Eastern Europe, the economic situation should stabilize further, providing that the smoldering conflict between Russia and Ukraine does not worsen. Following the increase in the past fiscal year, Russia's economic output is likely to grow further.

Germany

In Germany, gross domestic product (GDP) is likely to increase less strongly in 2018 than in the reporting period. However, the situation in the labor market is expected to remain stable and bolster consumer spending.

TRENDS IN THE MARKETS FOR FINANCIAL SERVICES

We believe that automotive financial services will be very important for vehicle sales worldwide in 2018. We expect demand to continue rising in emerging markets where market penetration has so far been low, such as China. Regions with already developed automotive financial services markets will see a continuation of the trend towards enabling mobility at the lowest possible total costs. Integrated end-to-end solutions, comprising mobility-related service modules such as insurance and innovative packages of services, will become increasingly important to this. Additionally, we expect demand to increase for new forms of mobility, such as carsharing, and for integrated mobility services including parking, refueling and charging. We anticipate that this trend will also continue in the period from 2019 to 2022.

In the mid-sized and heavy commercial vehicles category, we expect rising demand for financial services products in emerging markets. There in particular, financing solutions support vehicle sales and are thus an essential component of the sales process. In the mature markets, we foresee increased demand for telematics services and services aimed at reducing total operating costs in 2018. This trend is also expected to continue in the period 2019 to 2022.

TRENDS IN THE PASSENGER CAR MARKETS

We expect trends in the passenger car markets in the individual regions to be mixed in 2018. Overall, growth in global demand for new vehicles will probably be slower than in the reporting period.

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

We expect that the growth in demand for passenger cars worldwide will continue in the years 2019 to 2022.

Europe

For 2018, we anticipate that unit sales volumes in Western Europe will fall slightly short of those seen in the reporting period. The level recorded before the financial and debt crisis is unlikely to be achieved again in the medium term. The uncertain outcome of the exit negotiations between the EU and United Kingdom is likely to further exacerbate the continuing uncertainty among consumers precipitated by the financial and debt crisis, putting a damper on demand. In Italy and Spain, the recovery will probably continue in 2018 but at a considerably slower pace; in the French market, we expect growth to be only slightly positive. In the United Kingdom, we expect the market volume to fall moderately short of the previous year's high level.

Passenger car demand in 2018 is expected to significantly exceed the prior-year figures in markets in Central and Eastern Europe. In Russia, the volume of demand will probably rise somewhat more strongly after the considerable recovery over the past fiscal year.

Germany

Following the positive trend of recent years, we forecast that the market volume of the German passenger car market will remain on a level with the previous year in 2018.

TRENDS IN THE MARKETS FOR COMMERCIAL VEHICLES

We expect trends in the markets for light commercial vehicles in the individual regions to be mixed again in 2018. Overall, we expect a slight fall in demand in 2018, and a return to the growth trajectory for the years 2019 to 2022.

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 2018 will be slightly below the previous year's level. The United Kingdom and Italy are expected to record a decline. 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 2018 will probably be perceptibly higher than in the previous year. In Russia, too, we expect the market volume to rise compared with 2017.

INTEREST RATE TRENDS

In 2017 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, although the central banks in the US and the UK have already introduced initial interest rate hikes. The level of interest rates still remains close to the historic low. In terms of the economic outlook, the clouds are lifting however, so much so that the central banks in the US and UK are likely to announce further gradual increases in interest rates. This will be reflected in a modest rise in interest denominated in GBP and USD.

However, the ECB will certainly maintain its policy of low interest rates throughout the whole of 2018. An initial rise in interest rates is not anticipated before 2019. Interest rates will therefore probably remain stable in the Eurozone for the time being.

MOBILITY CONCEPTS

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

In collaboration with the automotive brands in the Volkswagen Group, Volkswagen Financial Services AG is extensively working 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 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.

The Company has taken a huge step toward becoming a mobility service provider with the expansion of vehicle-related mobility services. Volkswagen Financial Services AG already offers its customers an attractive portfolio of services covering the customer desire for convenience and flexibility. Efforts are focusing on the global expansion of innovative payment solutions for digital business models in the Volkswagen Group, the further expansion of cashless and mobile settlement of parking charges in North America and Europe and the further development of the range of services relating to fuel and electric vehicle charging cards in Europe. In this context, Volkswagen Financial Services AG intends to continue to serve as a one-stop shop for its customers. In addition, the Europe-wide processing of toll business will be integrated into the services for business customers and other activities will focus on driving forward the further expansion of the fleet business.

Simple, convenient, transparent, safe, reliable 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 concepts 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.

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.

Volkswagen Leasing GmbH's position in the global competitive environment will be strengthened not only through market-related activities, but also through strategic investment in structural initiatives as well as process optimization and productivity improvements.

FORECAST OF MATERIAL RISKS

Credit Risk Forecast

A stable risk position is predicted for 2018 overall, aided by the positive macroeconomic situation in Germany.

Market Risk Forecast

We are expecting a generally stable market risk situation for fiscal year 2018, based on the expected relatively stable interest rate environment.

Liquidity Risk Forecast

In general, the liquidity situation is expected to be stable. However, the future risk trend also depends on uncertain factors, such as the Brexit negotiations and rising political tensions around the world, and these may affect the availability and prices of funding instruments.

Residual Value Risk Forecast

We expect the volume of contracts to continue to grow in fiscal year 2018. The main drivers behind this are the implemented growth program, the continuing positive economic environment and further expansion in the fleet business. The current debate about the use of diesel vehicles being potentially prohibited in major cities in the future could affect the residual value portfolio in 2018.

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.

OUTLOOK FOR 2018

The Management of Volkswagen Leasing GmbH expects the global economy to record slightly weaker growth in 2018 than in the previous year. 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. We expect to see slightly weaker momentum in the major industrialized nations than in 2017.

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 decrease in risk costs, higher indirect costs as a result of increased investment in the digitalization of our leasing business, and a continued 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 slightly higher operating profit in accordance with IFRS year-on-year for fiscal year 2018.

Both new contracts and the volume of existing contracts are expected to be slightly up on the previous year in 2018. Based on a slight increase in vehicle deliveries, we forecast a marginal decline in the penetration rate in the German market and for Volkswagen Leasing GmbH.

In Italy, we forecast that there will be a slight year-on-year decline in new leases and a slight rise in the lease portfolio. The decrease in new leases will lead to a slight decline in the penetration rate. IFRS operating profit is expected to be significantly down on the figure for 2017.

In Poland, the volume of new contracts is expected to be slightly higher and that of existing contracts significantly higher than the prior-year level. Operating profit in accordance with IFRS is expected to be significantly in excess of the prior-year figure. A slight increase in the penetration rate is also anticipated in Poland.

Braunschweig, February 12, 2018

The Management

Anthony Bandmann

Silke Finger

Knut Krösche

Balance Sheet

of Volkswagen Leasing GmbH, Braunschweig, as of December 31, 2017

€ thousand		Dec. 31, 2017	Dec. 31, 2016
Assets			
1. Receivables from banks			
a) Repayable on demand	10,910		5,381
b) Other receivables	160,938		88,895
		171,848	94,276
2. Receivables from customers		3,832,061	1,767,500
3. Lease assets		26,048,897	23,753,366
4. Intangible fixed assets			
a) Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets	2,953		3,113
b) Prepayments	182		24
		3,135	3,137
5. Property and equipment			
a) Land and buildings	35,319		38,627
b) Operating and office equipment	3,249		1,218
		38,568	39,845
6. Other assets		1,119,167	1,129,834
7. Prepaid expenses		1,004,673	978,613
Total assets		**32,218,349**	**27,766,571**

€ thousand		Dec. 31, 2017	Dec. 31, 2016
Equity and liabilities			
1. Liabilities to banks			
a) Repayable on demand	96,187		321,887
b) With agreed maturity or notice period	1,108,115		1,193,699
		1,204,302	1,515,586
2. Liabilities to customers		13,482,960	12,704,760
3. Notes, commercial paper issued			
a) Bonds issued	10,329,687		6,070,837
b) Commercial paper	159,002		1,101,699
		10,488,689	7,172,536
4. Other liabilities		504,104	21,607
5. Deferred income		5,696,536	5,217,604
6. Provisions			
a) Provisions for pensions and other post-employment benefits	2,440		0
b) Provisions for taxes	4,450		9,813
c) Other provisions	611,380		901,071
		618,270	910,884
7. Special tax-allowable reserve		1,129	1,235
8. Equity			
a) Subscribed capital	76,004		76,004
b) Capital reserves	145,706		145,706
c) Net retained profits	649		649
		222,359	222,359
Total equity and liabilities		**32,218,349**	**27,766,571**
1. Contingent liabilities			
Liability arising from the provision of collateral for third-party liabilities		187,498	169,898
2. Other obligations			
Irrevocable leasing commitments		2,347,736	1,943,035

Income Statement

of Volkswagen Leasing GmbH, Braunschweig, for the period January 1 to December 31, 2017

€ thousand				Jan. 1 – Dec. 31, 2017	Jan. 1 – Dec. 31, 2016
1.	Leasing income		15,848,481		14,680,504
2.	Leasing expenses		9,326,472		8,181,816
				6,522,009	6,498,688
3.	Interest income from lending and money market transactions		27,681		22,316
4.	Interest expense		454,202		359,113
	of which: Unwinding of discount on provisions		1,337		2,017
				–426,521	–336,797
5.	Fee and commission income		568		521
6.	Fee and commission expenses		562,567		543,420
				–561,999	–542,899
7.	Other operating income			294,748	271,569
8.	Income from the reversal of special tax-allowable reserve			106	106
9.	General and administrative expenses				
	a) Personnel expenses				
	aa) Wages and salaries	11,815			4,306
	ab) Social security, post-employment and other employee benefit costs of which: for post-employment benefits €2,440 thousand	3,002			1,423
			14,817		5,729
	b) Other administrative expenses		380,876		340,379
				395,693	346,108
10.	Depreciation, amortization and writedowns				
	a) Depreciation and writedowns of lease assets		5,961,815		5,182,126
	b) Amortization and writedowns of intangible fixed assets, and depreciation and writedowns of property and equipment		6,075		3,636
				5,967,890	5,185,762
11.	Other operating expenses			100,333	43,366
12.	Writedowns of and valuation allowances on receivables and additions to provisions in the leasing business			452,053	714,391
13.	Income from the reversal of writedowns of and valuation allowances on receivables and from the reversal of provisions in the leasing business			562,272	138,183
14.	**Result from ordinary business activities**			**–525,354**	**–260,777**
15.	Income tax expense			–2,021	43,626
16.	Income from transfer and absorption of losses			523,333	304,403
17.	**Net income for the year**			**0**	**0**
18.	Retained profits brought forward			649	649
19.	Assets reduction due to spin-off			0	–8,651
20.	Withdrawal from capital reserves			0	8,651
21.	**Net retained profits**			**649**	**649**

Cash Flow Statement

of Volkswagen Leasing GmbH, Braunschweig, for the period January 1 to December 31, 2017

€ thousand	Jan. 1 – Dec. 31, 2017	Jan. 1 – Dec. 31, 2016
Net loss (before loss transfer)	–523,333	–304,403
Depreciation and writedowns of fixed assets	5,967,889	5,185,763
Change in provisions	–292,614	109,263
Gain on disposal of lease assets	–939,530	–763,987
Net interest income/expense	426,522	336,797
Other adjustments	24,653	24,749
Change in receivables from banks	–77,572	6,549
Change in receivables from customers	–1,322,297	133,585
Change in other assets related to operating activities	–538,727	–534,593
Change in liabilities to banks	–311,284	505,753
Change in liabilities to customers	778,199	2,008,908
Change in notes, commercial paper issued	3,316,154	–114,070
Change in other liabilities related to operating activities	961,323	706,909
Interest and dividends received	27,681	31,035
Interest paid	–454,202	–359,113
Income taxes refunded	–24,653	–24,749
I. Cash flows from operating activities	**7,018,209**	**6,948,396**
Proceeds from disposal of lease assets	8,725,033	7,883,218
Payments to acquire lease assets	–16,042,441	–14,904,083
Payments to acquire property and equipment/intangible fixed assets used by the Company itself	–5,204	–2,520
II. Cash flows from investing activities	**–7,322,612**	**–7,023,385**
Proceeds from transfer and absorption of losses by Volkswagen Financial Services AG	304,403	74,989
III. Cash flows from financing activities	**304,403**	**74,989**
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 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, 2016	76,004	145,706	649	222,359
Change	–	–	–	0
Balance as of December 31, 2017	76,004	145,706	649	222,359

Notes

to the Annual Financial Statements of Volkswagen Leasing GmbH, Braunschweig, for the period ended December 31, 2017

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 to the German Group companies according to the costs-by-cause principle.

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

2. Accounting Policies

Volkswagen Leasing GmbH has changed the accounting policies applied in the prior year in relation to accounting for service agreements. The provision previously recognized for outstanding charges under service agreements for wear-and-tear relating to leasing expenses was reversed, and an entry for leasing income was recognized under the item other liabilities. Realized income including a margin now takes account of expenses incurred in connection with the obligation to take over maintenance and wear-and-tear services.

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. Lease assets are depreciated on a straight-line basis over their typical useful life. For a passenger car the useful life is six years, for a truck nine years, and for other leased items, which mainly comprise movable lease assets at dealerships (workshop equipment), three to 13 years. Intangible assets are amortized on a straight-line basis over three years.

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 – Introductory Act to the German Commercial Code.

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 29.87%. No deferred tax liabilities were separately recognized in fiscal year 2017 after utilization of the option to offset deferred tax assets and deferred tax liabilities. The Italy branch, which is taxable separately, mainly recognizes 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 for the branch in question. 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, representing income or other operating income from the leasing business that is attributable to future periods.

Equity is recognized at the nominal amount. Irrevocable lease commitments are reported 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. The interest rate portfolio of Volkswagen Leasing GmbH was reviewed in accordance with IDW AcP BFA 3 to assess whether there was any need to recognize a provision for expected losses. The discounted cash flow method was used for the evaluation. The discount rate used to discount the cash flows included a component to cover risk costs still expected to be incurred together with a risk costs premium and administrative expenses. The present value determined in this way was then compared against the carrying amounts recognized in the HGB financial statements for the assets in the interest rate portfolio. There were no indications that the recognition of a provision for expected losses was required.

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, principally from sales of used vehicles (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 receivables from banks is as follows:

€ thousand	Dec. 31, 2017	Dec. 31, 2016
1. Receivables from banks	171,848	94,276
(of which from affiliated companies €170,995 thousand; previous year: €93,813 thousand)		
Total	**171,848**	**94,276**

The breakdown of receivables from customers is as follows:

€ thousand	Dec. 31, 2017	Dec. 31, 2016
1. Trade receivables	805,204	581,951
2. Receivables from affiliated companies	3,015,009	1,175,561
(of which from the shareholder €2,103,256 thousand; previous year: €1,085,689 thousand)		
(of which trade receivables €61,853 thousand; previous year: €92,772 thousand)		
3. Other receivables	11,848	9,988
Total	**3,832,061**	**1,767,500**

The following table shows the maturity analysis for the receivables:

€ thousand	Dec. 31, 2017	Dec. 31, 2016
1. Receivables from banks	171,848	94,276
of which due in 0 – 3 months	171,848	94,276
2. Trade receivables	805,204	581,951
of which due in 0 – 3 months	149,291	136,305
of which due in 3 – 12 months	266,583	164,501
of which due in 12 – 60 months	389,330	281,145
3. Receivables from affiliated companies	3,015,009	1,175,561
of which due in 0 – 3 months	2,615,009	425,561
of which due in 3 – 12 months	0	350,000
of which due in 12 – 60 months	400,000	0
of which due in > 60 months	0	400,000
4. Other receivables	11,848	9,988
of which due in 0 – 3 months	11,848	9,988
Total	**4,003,909**	**1,861,776**

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 main components of other assets are available-for-sale lease returns amounting to €534,305 thousand (previous year: €646,962 thousand), receivables from the processing of ABS transactions amounting to €309,711 thousand (previous year: €271,416 thousand) and accrued swap interest of €85,637 thousand (previous year: €72,423 thousand).

Prepaid expenses include discounts on purchased bonds and ABS transactions amounting to €928,585 thousand (previous year: €919,133 thousand); these discounts are amortized over the relevant maturity. Prepaid vehicle taxes of €17,268 thousand (previous year: €13,162 thousand), insurance payments in connection with service leases in the amount of €58,507 thousand (previous year: €46,121 thousand) and other prepaid expenses are also recognized under this item.

Assets amounting to €886.5 million were held in foreign currency through the branch in Poland.

The breakdown of liabilities is as follows:

€ thousand	Dec. 31, 2017	Dec. 31, 2016
1. Liabilities to banks	1,204,302	1,515,586
(of which to affiliated companies €51,793 thousand; previous year: €781,496 thousand)		
2. Liabilities to customers	13,482,960	12,704,760
(of which to affiliated companies €6,402,988 thousand; previous year: €5,988,496 thousand)		
(of which to the shareholder €779,253 thousand; previous year: €736,835 thousand)		
(of which trade payables €601,588 thousand; previous year: €671,581 thousand)		
3. Notes, commercial paper issued	10,488,689	7,172,536
4. Other liabilities	504,104	21,607
Total	**25,680,055**	**21,414,489**

The following table shows the maturity analysis for the liabilities:

€ thousand	Dec. 31, 2017	Dec. 31, 2016
1. Liabilities to banks	1,204,302	1,515,586
of which due in 0 – 3 months	268,212	815,213
of which due in 3 – 12 months	300,276	649,373
of which due in 12 – 60 months	635,814	51,000
2. Liabilities to customers	13,482,960	12,704,760
of which due in 0 – 3 months	704,279	2,220,156
of which due in 3 – 12 months	3,323,629	1,867,137
of which due in 12 – 60 months	8,767,372	8,617,467
of which due in > 60 months	687,680	0
3. Notes, commercial paper issued	10,488,689	7,172,536
of which due in 0 – 3 months	214,699	681,175
of which due in 3 – 12 months	773,990	1,991,361
of which due in 12 – 60 months	6,250,000	1,500,000
of which due in > 60 months	3,250,000	3,000,000
4. Other liabilities	504,104	21,607
of which due in 0 – 3 months	106,627	16,261
of which due in 3 – 12 months	262,742	2,312
of which due in 12 – 60 months	134,735	3,034
Total	**25,680,055**	**21,414,489**

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

A total nominal amount of €1.0 billion (previous year: €2.6 billion) of the notes and commercial paper issued is due in the next fiscal year.

The other liabilities include swap interest liabilities amounting to €11,019 thousand (previous year: €8,022 thousand). Due to a change in reporting, the provision recognized in previous years for outstanding repair invoices under servicing and wear-and-tear agreements in an amount of €479,329 thousand (previous year: €354,134 thousand) is now reported under other liabilities.

The provisions comprise pension provisions for the Italy branch amounting to €2,440 thousand, tax provisions of €4,450 thousand (previous year: €9,813) and other provisions of €611,380 thousand (previous year: €901,071 thousand).

The other provisions include provisions for the risks arising in connection with existing leases. The provisions for residual value risks amount to €8,568 thousand (previous year: €7,049 thousand). Further notable recognized items include expenses from service leases and expenses for outstanding invoices in an amount of €120,423 thousand (previous year: €112,565 thousand). Provisions totaling €153,735 thousand (previous year: €159,687 thousand) have also been recognized for dealer bonuses and other bonus payments.

The provision recognized for risks arising from the terms and conditions of leases amounts to €141,000 thousand before discounting (previous year: €125,600 thousand). The discount amount is €1,582 thousand (previous year: €1,552 thousand).

The tax write-downs 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.

Liabilities amounting to €1,240.5 million were held in foreign currency through the branch in Poland.

Statement of changes in fixed assets:

€ thousand	Gross carrying amounts					
	Brought forward January 1, 2017	Additions	Disposals	Re-classifications	Currency translation differences	Balance December 31, 2017
I. Intangible fixed assets						
Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets	7,082	1,718	490	0	138	8,448
Prepayments	24	156	0	0	2	182
	7,106	1,874	490	0	140	8,630
II. Property and equipment						
Land and buildings	50,991	228	0	17	82	51,318
Operating and office equipment	2,596	3,001	985	0	227	4,839
Assets under construction	99	102	0	–17	0	184
	53,686	3,331	985	0	309	56,341
III. Lease assets						
Vehicles, technical equipment and machinery	31,954,711	15,943,211	12,569,744	97,864	6,267	35,432,309
Prepayments	97,868	97,228	152	–97,716	0	97,228
	32,052,579	16,040,439	12,569,896	0	6,267	35,529,389
Total fixed assets	**32,113,371**	**16,045,644**	**12,571,371**	**0**	**6,716**	**35,594,360**

	Depreciation, amortization and write-downs					Net carrying amounts	
	Brought forward January 1, 2017	Additions	Disposals	Currency translation differences	Balance December 31, 2017	Balance December 31, 2017	Balance December 31, 2016
	3,969	1,861	452	117	5,495	2,953	3,113
	0	0	0	0	0	182	24
	3,969	1,861	452	117	5,495	3,135	3,137
	12,463	3,670	0	50	16,183	35,135	38,528
	1,378	543	397	66	1,590	3,249	1,218
	0	0	0	0	0	184	99
	13,841	4,213	397	116	17,773	38,568	39,845
	8,299,213	5,961,815	4,785,018	4,482	9,480,492	25,951,817	23,655,498
	0	0	0	0	0	97,228	97,868
	8,299,213	5,961,815	4,785,018	4,482	9,480,492	26,048,897	23,753,366
	8,317,023	**5,967,889**	**4,785,867**	**4,715**	**9,503,760**	**26,090,600**	**23,796,348**

4. Income Statement Disclosures

Leasing income amounts to €15,848,481 thousand. The leasing expense amounts to €9,326,472 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 expenses from the services business. Net leasing income is €6,522,009 thousand.

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

€ thousand	Jan. 1 – Dec. 31, 2017	Jan. 1 – Dec. 31, 2016
1. Interest income from lending and money market transactions (of which from affiliated companies €6,300 thousand; previous year: €6,049 thousand)	27,681	22,316
2. Interest expense (of which to affiliated companies €31,966 thousand; previous year: €28,714 thousand)	454,202	359,113
Total	**–426,521**	**–336,797**

Net other operating income is €294,748 thousand, of which €248,010 thousand is attributable to the leasing business and €46,738 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 €107,309 thousand (previous year: €88,440 thousand) and income from currency translation amounting to €44,212 thousand. Also included is an income related to prior periods of €3,354 thousand (previous year: €1,800 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 €14,817 thousand, of which €11,816 thousand relates to wages and salaries and €3,001 thousand to social security costs.

Other administrative expenses amount to €380,876 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 write-downs on lease assets are reported separately, the recognized amount for this item being €5,961,815 thousand. This figure includes write-downs to fair value amounting to €465,296 thousand (previous year: €289,790 thousand). Lease assets have been written down by an additional amount of €6,483 thousand (previous year: €5,388 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 €100,333 thousand in the reporting period. This figure includes issuance and rating expenses of €12,950 thousand and expenses from currency translation of €60,212 thousand.

Expenses for write-downs of, and valuation allowances on, receivables and additions to provisions in the leasing business amounting to €452,053 thousand are offset by corresponding income of €562,272 thousand. Due to a change in the reporting of provisions, additions to provisions decreased and income from the reversal of valuation allowances increased.

The above figures resulted in a loss before tax for the reporting period of €525.4 million (previous year: €260.8 million).

Income tax expense includes tax allocations amounting to €–54,254 thousand (previous year: €–14,559 thousand).

Under the existing profit-and-loss transfer agreement, the loss after tax of €523,333 thousand is transferred to and absorbed by Volkswagen Financial Services AG.

Breakdown of income by region:

€ thousand

		Germany	Italy	Poland	Jan. 1 – Dec. 31, 2017 Total	Jan. 1 – Dec. 31, 2016 Total
1.	Leasing income					
	Lease payments	5,294,268	132,111	78,914	5,505,293	5,017,777
	Maintenance and service income	649,522	99,437	21,865	770,824	1,115,493
	Used vehicle sales	8,598,714	112,090	14,229	8,725,033	7,883,218
	Other	772,775	19,982	54,574	847,331	664,016
		15,315,279	363,620	169,582	15,848,481	14,680,504
3.	Interest income from lending and money market transactions	6,062	648	20,971	27,681	22,316
5.	Fee and commission income	487	0	81	568	521
7.	Other operating income	234,215	6,252	54,281	294,748	271,569
8.	Income from the reversal of special tax-allowable reserve	106	0	0	106	106
13.	Income from the reversal of writedowns of and valuation allowances on receivables and from the reversal of provisions in the leasing business	485,744	68,297	8,231	562,272	138,183
Total		**16,041,893**	**438,817**	**253,146**	**16,733,856**	**15,113,199**

5. Other Disclosures

Interest rate risk has been hedged by interest rate swaps with a total notional value of €29.1 billion. As of the reporting date, the positive fair values were €300.1 million and the negative fair values €45.0 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 €85.6 million is included in other assets and €11.0 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. One such transaction was carried out in fiscal year 2017. In 2017, Volkswagen Leasing GmbH generated cash inflows totaling €4,379,698 thousand from the sale of future lease receivables and residual values under these leases. Six 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 has undertaken to assign an amount of €1.4 billion from future lease receivables to Volkswagen Bank GmbH as collateral for lines of credit. The lines of credit relate to Volkswagen Leasing GmbH and other subsidiaries/investees of Volkswagen Financial Services AG.

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. 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 ABS transactions VCL 22, VCL 23, VCL 24, VCL 25, PVCL1 and VCL Master RV C2. A market risk reserve serving as collateral for certain risks was paid to investors in connection with these transactions. 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 was provided in the German market by the Volkswagen Group.

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, and in the consolidated financial statements of Volkswagen Financial Services AG, Braunschweig.

In 2017, the fees attributable to Volkswagen Leasing GmbH for audit-related services concerned the audit of the annual financial statements and reviews of interim financial statements prepared during the year.

Other attestation services mainly involved comfort letters and miscellaneous attestation services in connection with ABS transactions.

Other services performed by the independent auditors mainly consisted of services relating to banking regulations in the reporting year.

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, the Company had an annual average of 163 salaried employees including three senior executives at its branches in Milan and Verona (previous year: 81 salaried employees with no senior executives), and 92 salaried employees with no senior executives at its branch in Poland (previous year: three salaried employees with no senior executives). The increased staff resources result from the reorganization of the Volkswagen Financial Services AG Group.

Senior managers do not receive any remuneration from the Company. The expenses borne by the Company for the Management amounted to €1,185 thousand.

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 2017.

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, 2017

ANTHONY BANDMANN (AS OF SEPTEMBER 1, 2017)
Chairman of the Management (as of September 1, 2017)
Corporate Management Volkswagen Leasing GmbH (as of September 1, 2017)

GERHARD KÜNNE (UNTIL AUGUST 31, 2017)
Chairman of the Management (until August 31, 2017)
Fleet Customer Sales (until April 30, 2017)
Middle Office Fleet Management (from May 1, 2017 until August 31, 2017)

SILKE FINGER (AS OF SEPTEMBER 1, 2017)
Back Office Volkswagen Leasing GmbH (as of September 1, 2017)

HARALD HEßKE (UNTIL AUGUST 31, 2017)
Back Office Leasing (until August 31, 2017)

KNUT KRÖSCHE (AS OF MAY 1, 2017)
Front Office Fleet Management Sales (as of May 1, 2017)
Front Office Volkswagen Leasing GmbH (as of September 1, 2017)

Audit Committee of Volkswagen Leasing GmbH

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

DR. JÖRG BOCHE (UNTIL SEPTEMBER 20, 2017)
Chairman
Executive Vice President of Volkswagen AG
Head of Group Treasury

WERNER FLÜGGE (AS OF SEPTEMBER 21, 2017)
Chairman

WALDEMAR DROSDZIOK (UNTIL SEPTEMBER 20, 2017)
Deputy Chairman
Chairman of the Joint Works Council of Volkswagen Financial Services AG,
Volkswagen Bank GmbH and Euromobil Autovermietung GmbH

HELMUT STREIFF (AS OF SEPTEMBER 21, 2017)
Deputy Chairman

DR. ARNO ANTLITZ (UNTIL SEPTEMBER 20, 2017)
Member of the Volkswagen Brand Board of Management
Controlling and Accounting

FRANK FIEDLER (AS OF SEPTEMBER 21, 2017)
Member of the Board of Management of Volkswagen Financial Services AG
Finance and Purchasing division

GABOR POLONYI (UNTIL SEPTEMBER 20, 2017)
Head of Fleet Customer Management of 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 12, 2018

Volkswagen Leasing GmbH
The Management

Anthony Bandmann

Silke Finger

Knut Krösche

INDEPENDENT AUDITOR'S REPORT

To Volkswagen Leasing GmbH, Braunschweig

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

Audit Opinions

We have audited the annual financial statements of Volkswagen Leasing GmbH, Braunschweig, which comprise the balance sheet as at December 31, 2017, and the statement of profit and loss, statement of cash flows and statement of changes in equity for the financial year from January 1 to December 31, 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report of Volkswagen Leasing GmbH for the financial year from January 1 to December 31, 2017.

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

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law and give a true and fair view of the assets, liabilities and financial position of the Company as at December 31, 2017 and of its financial performance for the financial year from January 1 to December 31, 2017 in compliance with German Legally Required Accounting Principles, and
- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development.

Pursuant to § [Article] 322 Abs. [paragraph] 3 Satz [sentence] 1 HGB [Handelsgesetzbuch: German Commercial Code], we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

Basis for the Audit Opinions

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

Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from January 1 to December 31, 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matter of most significance in our audit was as follows:

❶ Recoverability of lease assets from current and terminated leases

Our presentation of this key audit matter has been structured as follows:

① Matter and issue

② Audit approach and findings

③ Reference to further information

Hereinafter we present the key audit matter:

❶ Recoverability of lease assets from current and terminated leases

① Vehicles from current leases amounting to EUR 26,048.9 million (80.9% of total assets) are reported under the balance sheet item "Lease assets" and from terminated leases amounting to EUR 534.3 million (1.7% of total assets) under the balance sheet item "Other assets" in the annual financial statements of Volkswagen Leasing GmbH as of December 31, 2017. In accordance with commercial law, lease assets classified as fixed assets are measured on the basis of the lower of cost less amortization and fair value, while other assets classified as current assets are measured at the lower of cost and fair value. Volkswagen Leasing GmbH performs a quarterly impairment test of lease assets from current and terminated leases using internal and external marketing results. The amortized carrying amount of the relevant asset is compared with the corresponding lower fair value in the context of the impairment test. The results of internal and external marketing and the executive directors' estimate of the development of market prices for vehicles are taken into account for this purpose. Write-downs in respect of lease assets amounting in total to EUR 465.3 million were recognized for the two balance sheet items concerned in the fiscal year on the basis of this valuation.

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

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

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

③ The Company's disclosures relating to lease assets and to other assets are contained in sections 2 "Accounting Policies" and 3 "Balance Sheet Disclosures" in the notes to the financial statements.

Other Information

The executive directors are responsible for the other information. The annual report is expected to be made available to us after the date of this auditor's report.

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

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

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

Responsibilities of the Executive Directors and the Audit Committee for the Annual Financial Statements and the Management Report

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the executive directors are responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

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

The audit committee is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

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

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

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

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

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit of the annual financial statements and of the policies and procedures relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of those systems of the Company.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.
- Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

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

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

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as auditor by the annual general meeting on March 6, 2017. We were engaged by the supervisory board on October 23, 2017. We have been the auditor of Volkswagen Leasing GmbH, Braunschweig, without interruption since financial year 1966.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Frank Hübner.

Hanover, February 13, 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Frank Hübner	Prof. Dr. 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 three members. Changes in the reporting period are disclosed in the information on governing bodies.

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 March 1, 2017, the Audit Committee reviewed the annual financial statements and the management report of Volkswagen Leasing GmbH for the year ended December 31, 2016 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 risk management, the business and risk strategy, the status of the separation of the lending business supervised by the European Central Bank from the other business areas of Volkswagen Financial Services AG (project Panda) as well as on internal and external audit procedures and the resulting 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 November 27, 2017, the Audit Committee focused in particular on the business performance of Volkswagen Leasing GmbH and the impact of the implementation of project Panda. In addition, it concerned itself with the audit planning, key audit matters and the auditor’s information obligations. It also dealt with the selection process for the audit of the financial statements for fiscal year 2020 and the annual review of the guidelines for audit-related services.

Braunschweig, February 26, 2018

Werner Flügge
Chairman

Helmut Streiff
Deputy Chairman

Frank Fiedler
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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