

## **Rating Action: Moody's concludes review on European captive auto finance institutions**

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### **Actions conclude reviews initiated on 17 July 2012 and on 19 October 2012**

London, 18 January 2013 -- Moody's Investors Service has today announced rating actions affecting four European auto captive finance groups and their subsidiaries, concluding the reviews for downgrade of several institutions' bank financial strength ratings (BFSR) and debt and deposit ratings.

The actions announced today are as follows:

(1) Banque PSA Finance's (BPF) long-term debt and deposit ratings were confirmed at Baa3 and its short-term ratings at Prime-3 whilst the bank's BFSR was confirmed at D+ equivalent to a standalone credit assessment of ba1. BPF's provisional (P)Ba2 and (P)Ba3 subordinated and junior subordinated debt programs have also been confirmed. The BFSR and all ratings carry a negative outlook.

(2) RCI Banque's (RCI) long-term debt and deposit ratings were downgraded to Baa3 from Baa2 and its short-term ratings to Prime-3 from Prime-2 whilst RCI's BFSR was lowered to D+, equivalent to a standalone credit assessment of baa3, from C-/baa2. RCI's subordinated debt rating was downgraded to Ba1 from Baa3. The BFSR and all ratings carry a stable outlook.

(3) Volkswagen Bank GmbH's (VW Bank) BFSR was confirmed at C- with a stable outlook, but the equivalent standalone credit assessment was lowered to baa2 from baa1. The A3 long-term deposit ratings with their positive outlook and the Prime-2 short-term ratings were unaffected by today's action.

(4) FGA Capital S.A.'s (FGA Capital) long-term issuer rating was confirmed at Baa3. The rating outlook was changed to negative.

Today's rating actions conclude the reviews initiated on 17 July 2012 and on 19 October 2012. The reviews were prompted by four rating drivers: (1) the general adverse impact of the deterioration in macroeconomic conditions in Europe, in particular on the auto manufacturing industry; (2) concentrated exposures to car dealers, which are highly correlated with the manufacturers; (3) high reliance on market funding, which can be subject to sudden changes in investor confidence; and (4) some reliance on bank credit lines, the availability and terms of which could be compromised by funding pressure on the banking industry and the prospect of regulatory changes.

### **RATINGS RATIONALE**

European auto captive financial institutions support the sales of their industrial parents by offering auto loans and related services to retail and corporate customers, as well as loans to car dealers to help them finance their inventories. On the funding side, both BPF and RCI are heavily dependent on access to senior unsecured and asset-backed securitisation markets, as well as credit lines provided by larger banks. The ratings of all auto captives are constrained by their lack of business diversification, large exposures to car dealers, their reliance on confidence-sensitive wholesale funding and in some cases by their inherent credit linkages with their lower-rated industrial parents. These are characteristics more commonly associated with non-investment-grade ratings, as shown by the rating levels of certain other non-bank auto finance companies with similar business models.

However, Moody's takes into consideration certain mitigating factors, including good capitalisation levels, sound profitability and a greater degree of asset and liability matching than those of traditional retail and commercial banks. Moreover, Moody's notes that unlike many other vendor finance companies, all of these institutions have banking licenses or equivalents, and for this reason they are subject to similar regulatory standards as other credit institutions and to ongoing supervision. This oversight, together with access to central bank refinancing facilities, provides a certain level of protection to creditors.

### **ISSUER SPECIFIC CONSIDERATIONS - BPF**

The confirmation of BPF's BFSR of D+/ba1 reflects Moody's assessment of the four rating drivers assessed in the

wider review of European auto captive finance groups for this institution, as follows:

-- Deteriorating macroeconomic fundamentals

BPF has thus far demonstrated strong resilience to the current deteriorating operating environment for European banks: the bank has maintained stable earning streams through the cycle and to date, there has been limited correlation between its own revenues and those of its parent, which have experienced high volatility. Credit losses have thus far been limited in both market segments in which the firm operates, namely end-user and dealer financing. Notwithstanding this performance, Moody's believes that BPF's strategic role within the PSA group (Ba3, negative) means that its standalone creditworthiness is ultimately closely tied to the credit strength of its parent, which is itself vulnerable to further macroeconomic pressures through its exposure to the cyclical car market.

-- Concentrated exposures to car dealers

These exposures, which are short-term and secured on vehicles, in aggregate represent around 27% of the bank's loan book. Although this portfolio is spread across many borrowers, Moody's considers that these exposures represent substantial aggregate risks due to their inherent correlation, for example in the event of a substantial worsening of the credit standing of the bank's parent. Nevertheless, Moody's believes that BPF's capital is sufficiently strong to absorb the losses in a highly adverse scenario of widespread dealer defaults and a significant increase in retail loan losses.

-- High reliance on market funding

BPF's funding profile is entirely wholesale funded, making it vulnerable to sudden changes in investors' confidence. Restricted market access could lead to a shortening of the bank's maturity profile and higher funding costs, which would constrain loan origination. This would in turn affect the strength of BPF's franchise and ultimately reduce its earnings generation, particularly if any funding constraints coincided with higher loan impairments. However, Moody's recognises that BPF (1) aims to match its assets and liabilities thereby limiting maturity transformation ; and (2) that it has access to considerable liquidity, principally in the form of committed bank credit lines to bridge any mismatches or temporary market access restrictions. Moody's also notes that the bank has announced that it would start collecting retail deposits in 2013 to increase the stability of its funding profile. The rating agency believes that it will take time for the bank to grow its retail deposit book to an extent that would reduce the bank's reliance on market funds; as such, the impact of this initiative is currently negligible.

-- Reliance on bank credit lines

As noted above, credit facilities provided by other banks represent the majority of BPF's funding and liquidity reserves. However, Moody's believes that both the current deleveraging efforts of European banks and forthcoming Basel-led liquidity and funding rules reduce banks' incentives to provide committed bank credit lines, a trend which would be exacerbated were lenders to begin to question the credit strength of the bank or its parent. This would likely result in a reduction in the availability of these facilities, an increase in their cost, or both.

The assessment of these pressure points has led Moody's to confirm the standalone credit assessment, which had already been lowered to D+/ba1 during the course of 2012 because of the weakening credit fundamentals of the parent. However, the negative outlook assigned to the bank's credit assessment reflects the negative outlook on PSA.

The Baa3 long-term debt and deposit ratings of BPF include one notch of systemic support as a result of the support plan announced by PSA on 24 October 2012 and approved by the French parliament at the end of last year, which, amongst others, comprises EUR7 billion refinancing guarantees provided by the French government for the period 2013-2016. While the size and relatively simple nature of BPF's business model do not suggest any meaningful systemic importance, in Moody's view the support plan demonstrates some willingness on the part of the French authorities to support BPF as a means of stabilising the franchise of PSA, given the latter's economic relevance as a major car manufacturer and employer in France. The plan is still subject to approval from the European Commission (EC), which could impose restrictions or conditions on PSA, or indeed BPF. However, Moody's believes that there would inevitably be limits on the willingness of the authorities to support bondholders of a small financial institution. The negative outlook on the long-term debt rating thus reflects (1) the fact that a downgrade of the standalone credit assessment could trigger a downgrade of the long-term rating; and (2) the uncertainties around the outcome of the EC review.

WHAT COULD MOVE THE RATINGS UP/DOWN

Moody's believes that there is little likelihood of any upwards rating pressure on BPF, given the current rating level and the outlook on PSA.

The long-term debt and deposit ratings of BPF could be downgraded in the event of (1) deterioration in the bank's credit fundamentals; (2) a downgrade of PSA; (3) a negative development in relation to the EC review of the support plan for the bank; and/or (4) any elements that would lead Moody's to reduce its assessment of systemic support available to the bank.

#### ISSUER SPECIFIC CONSIDERATIONS - RCI

The lowering of RCI's standalone credit profile to D+/baa3 from C-/baa2 also reflects Moody's assessment of the significance of the four rating drivers assessed in the wider review of European auto captive finance groups rating drivers for this institution:

##### -- Deteriorating macroeconomic fundamentals

RCI has also demonstrated strong resilience to the current deteriorating operating environment for European banks, having maintained high revenues and a good profitability level in the current difficult operating environment. Moody's says that RCI's asset quality has shown little deterioration to date, demonstrating a high degree of resilience to a weakening economic environment. However, the rating agency believes that RCI's strategic role within the Renault / Nissan alliance means that its standalone creditworthiness is ultimately closely tied to the strength of its immediate parent, Renault S.A. (Ba1, stable). So far, Renault and Nissan Motor Co., Ltd. (A3, stable) have demonstrated a high degree of resilience to macroeconomic pressures despite the cyclical nature of the car market, and this in turn affords a degree of protection to RCI.

##### -- Concentrated exposures to car dealers

RCI's exposures to car dealers are short-term and secured on vehicles, representing in aggregate 26% of the bank's loan book. Although this portfolio is well diversified in terms of borrowers and geographies, Moody's considers that these exposures represent substantial aggregate risks due to their inherent correlation, for example in the event of a substantial worsening of the credit standing of the bank's parent. Nevertheless, Moody's believes that RCI is sufficiently strong to absorb losses resulting from these exposures in a highly adverse scenario of widespread dealer defaults and a significant increase in retail loan losses.

##### -- High reliance on market funding

RCI is heavily reliant on wholesale funding, which means that it can lose market access if investors' confidence diminishes, leading to a shortening of the bank's maturity profile and higher funding costs, which would constrain loan origination. This would, in turn, affect RCI's franchise with a negative impact on earnings, particularly if any funding constraints coincided with higher loan impairments. RCI's largely matched book mitigates refinancing risk as it finances its assets with longer-dated liabilities. In addition, it has considerable liquidity, principally in the form of committed bank credit lines to bridge any mismatches or temporary market access restrictions. Moody's also notes that RCI started to collect retail deposits in 2012 but it is likely to be some years before its retail deposits book is sufficiently large to provide any material diversification benefit in its overall funding profile.

##### -- Reliance on bank credit lines

Credit facilities provided by larger banks represent an important portion of RCI's funding and liquidity reserves. However, Moody's believes that both the current deleveraging efforts of European banks and forthcoming Basel-led liquidity and funding rules reduce banks' incentive to provide these lines in the future, a trend that would be exacerbated if lenders to begin to question the credit strength of the bank or its parent. This has the potential to reduce the availability of these facilities, increase their cost, or both.

Moody's assessment of these pressure points has led to a one-notch reduction in the bank's standalone credit assessment to D+/baa3. The assignment of a stable outlook reflects Moody's view that these pressures are now fully captured at the D+/baa3 BFSR level.

Following the announcement of the French government's funding assistance for BPF, Moody's considers that there is a similar probability of systemic support for RCI, in the event of need. However, the probability Moody's assigns to support being provided is insufficient to translate into uplift for the long-term ratings, given RCI's current D+/baa3 standalone credit profile.

#### WHAT COULD MOVE THE RATINGS UP/DOWN

The bank's monoline business model and its captive status inherently limit any upwards pressure on the ratings that could develop following (1) a material reduction in the reliance on wholesale funding; or (2) any other material improvement in the bank's credit fundamentals.

A downgrade of RCI's ratings could materialise if (1) the parent's credit profile weakens; or (2) the bank's credit fundamentals deteriorate. However, systemic support considerations could limit the magnitude of such a downgrade, whereby RCI's long-term ratings could remain at Baa3 in the event of only mild downwards pressure on the bank's standalone credit profile.

#### ISSUER SPECIFIC CONSIDERATIONS - VW Bank

The confirmation of VW Bank's C- BFSR, now equivalent to a baa2 standalone credit assessment, captures Moody's assessment of the following rating drivers assessed in the wider review of European auto captive finance groups:

##### -- Deteriorating macroeconomic fundamentals

Despite a weakening trend in asset quality over the last years, VW Bank's profitability has held up well, demonstrating a fair degree of resilience to a weakening economic environment. Going forward, Moody's believes that VW Bank' standalone credit profile is exposed to (1) earnings pressure, as the low interest-rate environment and fierce competition in the German market imply multiple challenges; and (2) the prospect of rising risk charges as the credit cycle in Germany has turned. VW Bank's strategic role within the wider Volkswagen group closely links its standalone creditworthiness to the strength of its ultimate parent, Volkswagen AG (VW AG, A3 positive). The group has thus far demonstrated a high degree of resilience to macroeconomic pressures despite the cyclical nature of the car market, which in turn affords a degree of protection to VW Bank.

##### -- Concentrated exposures to car dealers

VW Bank's exposures to car dealers represent 24% of its loan book. The portfolio is well diversified in terms of borrowers, but highly concentrated with a majority of the dealer loan book domiciled in Germany. Moody's considers that these exposures represent significant aggregate risks due to their inherent correlation, given that the performance of the dealer loan book is to a large extent related to the well-being of the related car manufacturer and its brands. However, VW Bank displays a good loss-absorption capacity in Moody's highly adverse macroeconomic scenario; this scenario captures rising dealer defaults and a significant increase in retail loan losses that are more closely linked to the German credit cycle.

##### -- Limited reliance on market funding and bank credit lines

VW Bank benefits from well diversified funding sources across instruments, investors, and tenors. The bank has a sizeable deposit base which, as at 30 June 2012, amounted to EUR23.5 billion (or 60% of total liabilities) and is sourced primarily from individual customers in Germany. This affords an additional degree of funding stability compared with other automotive banks and financial services providers. This is despite the fact that the collection of deposits through the internet potentially entails some volatility, particularly in times of higher uncertainty, or if the parent's credit standing were to deteriorate.

Nonetheless, there remains a certain degree of market-funding reliance, which amounts to about 20% relative to total assets, as of 30 June 2012. The bank's funding via group companies remains modest and primarily consists of a back-up line from VW Group, reflecting management's attempt to largely maintain financial independence for the bank. Furthermore, VW Bank displays a significant liquidity buffer comprising some committed bank credit facilities, the back-up line from VW Group, as well as liquid and highly-rated ECB-eligible government securities. Moody's thus regards the bank's liquidity profile as adequate, also in view of the relative short duration of largely matched assets and liabilities.

Moody's assessment of these pressure points resulted in a one-notch reduction in the bank's standalone credit assessment to C-/baa2. The assignment of a stable outlook captures Moody's view that these pressures are now fully captured at the current BFSR level.

VW Bank's A3 long-term deposit ratings were unaffected by today's rating action and incorporate a very high probability of receiving support from its ultimate owner VW AG, in the event of need.

#### WHAT COULD MOVE THE RATINGS UP/DOWN

There is currently limited upwards pressure on the BFSR as expressed by the stable outlook on VW Bank's standalone credit strength. The bank's business model displays a number of characteristics commonly associated with non-investment-grade standalone ratings, consistent with the rating levels of a number of non-bank auto finance companies with similar business models. Even if the operating environment improves, the bank's narrow business focus would suggest a standalone credit assessment no higher than the 'baa' category.

A weakening in the bank's credit fundamentals could trigger a downgrade of VW Bank's BFSR. Furthermore, Moody's would reassess VW Bank's standalone risk profile if VW Group acquired the remaining indirect 50% stake in LeasePlan (Baa2/Prime-2 deposits, stable; BFSR C-/BCA baa2, stable).

Upwards or downwards rating pressures on VW AG are likely to translate into similar ratings pressures for VW Bank's long-term deposit ratings, unless Moody's changes its parental support assumptions for the bank.

#### ISSUER SPECIFIC CONSIDERATIONS - FGA Capital

The confirmation of FGA Capital's issuer rating at Baa3 reflects (1) Moody's assessment of the significance for this firm of the four rating drivers assessed in the wider review of European auto captive finance groups; and (2) unchanged external support assumptions, given the 50/50 ownership by Fiat S.p.a. (Fiat; Ba3, negative) and Credit Agricole S.A. (CASA; A2/Prime-1 deposits; BFSR D/BCA ba2, negative) :

##### -- Deteriorating macroeconomic fundamentals

FGA Capital has maintained stable earning streams through the cycle, and thus far there has been limited correlation between its own revenues and those of Fiat, which has experienced volatility. However, due to the macroeconomic stresses in FGA Capital's core markets, Moody's believes that profitability is likely to come under pressure from a combination of higher provisions, lower lending volumes and higher re-financing costs. Moody's notes that FGA Capital's business is evidently linked to Fiat's performance through the significant commercial dependence on the brand name and business success of the car manufacturer.

##### -- Concentrated exposures to car dealers

These exposures, which are mainly short-term and secured on vehicles, in aggregate represent around 26% of the firm's loan book. Although this portfolio is spread across many borrowers, Moody's considers that these exposures represent substantial aggregate risks due to their inherent correlation, for example in the event of a substantial worsening of the credit standing of FGA Capital's auto parent. Nevertheless, Moody's believes that FGA's capital is sufficiently strong to absorb the losses in a highly adverse scenario of widespread dealer defaults and a significant increase in retail loan losses.

##### -- High reliance on market funding and bank credit lines

While FGA Capital is entirely wholesale funded, under the joint-venture agreement it benefits from significant funding support from CASA which is particularly valuable in the currently challenging and more expensive wholesale market conditions. CASA's funding contribution peaked in 2009 and has progressively decreased over the last three years, as a consequence of lower lending volumes. Moody's considers the available liquidity reserves under those commitments as appropriate, given the largely matched asset and liability profile. Despite FGA Capital's funding dependence on CASA, Moody's acknowledges the proven commitment and ability of its banking shareholder to support FGA Capital.

The assessment of these pressure points has led Moody's to confirm the firm's Baa3 long-term issuer rating, which continues to incorporate a moderate probability of support from CASA, in case of need.

The negative outlook on FGA Capital's rating reflects the adverse trends of the challenging operating environment on financials and business model, as well as the negative outlook on the ratings of Fiat and CASA. Furthermore, Moody's will monitor the joint-venture agreement, which can be terminated by either CASA or Fiat, from end-2014 onwards.

#### WHAT COULD CHANGE THE RATINGS UP/DOWN

Moody's believes that there is little likelihood of any upwards rating pressure on FGA Capital, given the current rating level and the outlook on both parents' ratings.

Any weakening of funding and ultimate support from CASA or a material change in the joint-venture agreement -- which in Moody's view would be detrimental to FGA Capital's risk profile -- could have a negative impact on FGA

Capital's rating. Furthermore, the materialisation of a more severe stress scenario resulting in a material weakening of FGA Capital's financial fundamentals and/or a significant deterioration affecting Fiat Spa and its rating could exert negative pressure on FGA Capital's rating.

#### RATINGS OF SUBSIDIARIES

The Baa3 backed senior unsecured rating of Peugeot Finance International NV and the Prime-3 backed commercial paper rating of SOFIRA SNC were confirmed at Baa3 with negative outlook.

The senior unsecured medium-term notes (MTN) ratings of RCI's subsidiary DIAC have been downgraded to (P)Baa3 from (P)Baa2 and its short-term rating lowered to Prime-3 from Prime-2.

The rating agency affirmed the A3/Prime-2 backed long and short-term ratings of Volkswagen Financial Services Australia Ltd., Volkswagen Leasing GmbH, Volkswagen Financial Services Japan Ltd and Volkswagen Financial Services N.V. At the same time, Moody's changed the outlooks on these ratings to positive from stable, in alignment with the outlook on their respective ultimate parent, Volkswagen AG.

Moody's confirmed the ratings of FGA Capital Ireland PLC's backed, senior unsecured medium-term notes (MTNs) at Baa3 with a negative outlook. FGA Capital Ireland is a subsidiary of FGA Capital.

The methodology used in these ratings was Moody's Consolidated Global Bank Rating Methodology published in June 2012. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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