

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2020

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-36111

AMERICAN HONDA FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

California

(State or other jurisdiction of incorporation or organization)

1919 Torrance Blvd., Torrance, California

(Address of principal executive offices)

95-3472715

(IRS Employer Identification No.)

90501

(Zip Code)

(310) 972-2555

(Registrant's telephone number, including area code)

20800 Madrona Avenue, Torrance, California 90503

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol(s)	Name of exchange on which registered
1.300% Medium-Term Notes, Series A Due March 21, 2022	N/A	New York Stock Exchange
2.625% Medium-Term Notes, Series A Due October 14, 2022	N/A	New York Stock Exchange
1.375% Medium-Term Notes, Series A Due November 10, 2022	N/A	New York Stock Exchange
0.550% Medium-Term Notes, Series A Due March 17, 2023	N/A	New York Stock Exchange
0.750% Medium-Term Notes, Series A Due January 17, 2024	N/A	New York Stock Exchange
0.350% Medium-Term Notes, Series A Due August 26, 2022	N/A	New York Stock Exchange
1.600% Medium-Term Notes, Series A Due April 20, 2022	N/A	New York Stock Exchange
1.950% Medium-Term Notes, Series A Due October 18, 2024	N/A	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of October 31, 2020, the number of outstanding shares of common stock of the registrant was 13,660,000 all of which shares were held by American Honda Motor Co., Inc. None of the shares are publicly traded.

REDUCED DISCLOSURE FORMAT

American Honda Finance Corporation, a wholly-owned subsidiary of American Honda Motor Co., Inc., which in turn is a wholly-owned subsidiary of Honda Motor Co., Ltd., meets the requirements set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this Form 10-Q with the reduced disclosure format.

AMERICAN HONDA FINANCE CORPORATION
QUARTERLY REPORT ON FORM 10-Q
For the quarter ended September 30, 2020

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Cautionary Statement Regarding Forward-Looking Statements

Certain statements included herein constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties. Certain such forward-looking statements can be identified by the use of forward-looking terminology such as “believes,” “expects,” “may,” “will,” “should,” “seeks,” “scheduled,” or “anticipates” or similar expressions or the negative thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans, or intentions. In addition, all information included herein with respect to projected or future results of operations, cash flows, financial condition, financial performance, or other financial or statistical matters constitute forward-looking statements. Such forward-looking statements are necessarily dependent on assumptions, data, or methods that may be incorrect or imprecise and that may be incapable of being realized. The following factors, among others, could cause actual results and other matters to differ materially from those in such forward-looking statements:

- uncertainties regarding the duration and severity of the COVID-19 pandemic and the measures intended to reduce its spread and the related impact on our operations, liquidity and financial condition;
- declines in the financial condition or performance of Honda Motor Co., Ltd. or the sales of Honda or Acura products;
- changes in economic and general business conditions, both domestically and internationally, including changes in international trade policy;
- fluctuations in interest rates and currency exchange rates;
- the failure of our customers, dealers or counterparties to meet the terms of any contracts with us, or otherwise fail to perform as agreed;
- our inability to recover the estimated residual value of leased vehicles at the end of their lease terms;
- changes or disruption in our funding sources or access to the capital markets;
- changes in our, or Honda Motor Co., Ltd.’s, credit ratings;
- increases in competition from other financial institutions seeking to increase their share of financing of Honda and Acura products;
- changes in laws and regulations, including the result of financial services legislation, and related costs;
- changes in accounting standards;
- a failure or interruption in our operations; and
- a security breach or cyber attack.

Additional information regarding these and other risks and uncertainties to which our business is subject to is contained in our Annual Report on Form 10-K for the fiscal year ended March 31, 2020 filed with the Securities and Exchange Commission on June 22, 2020. Readers of this Quarterly Report should review the information contained in that report, and in any subsequent reports that we file with the Securities and Exchange Commission as such risks and uncertainties may be amended, supplemented or superseded from time to time. We do not intend, and undertake no obligation to, update any forward-looking information to reflect actual results or future events or circumstances, except as required by applicable law.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(U.S. dollars in millions, except share amounts)**

	September 30, 2020	March 31, 2020
Assets		
Cash and cash equivalents	\$ 2,950	\$ 1,503
Finance receivables, net	39,572	39,554
Investment in operating leases, net	34,438	33,843
Due from Parent and affiliated companies	136	93
Income taxes receivable	80	137
Other assets	1,217	1,378
Derivative instruments	1,063	748
Total assets	\$ 79,456	\$ 77,256
Liabilities and Equity		
Debt	\$ 51,290	\$ 50,132
Due to Parent and affiliated companies	111	72
Income taxes payable	207	239
Deferred income taxes	6,809	6,589
Other liabilities	1,770	1,689
Derivative instruments	822	972
Total liabilities	61,009	59,693
Commitments and contingencies (Note 8)		
Shareholder's equity:		
Common stock, \$100 par value. Authorized 15,000,000 shares; issued and outstanding 13,660,000 shares as of September 30, 2020 and March 31, 2020	1,366	1,366
Retained earnings	16,109	15,395
Accumulated other comprehensive loss	(116)	(175)
Total shareholder's equity	17,359	16,586
Noncontrolling interest in subsidiary	1,088	977
Total equity	18,447	17,563
Total liabilities and equity	\$ 79,456	\$ 77,256

The following table presents the assets and liabilities of consolidated variable interest entities. These assets and liabilities are included in the consolidated balance sheets presented above. Refer to Note 9 for additional information.

	September 30, 2020	March 31, 2020
Finance receivables, net	\$ 10,297	\$ 9,645
Investment in operating leases, net	472	493
Other assets	534	598
Total assets	\$ 11,303	\$ 10,736
Secured debt	\$ 10,363	\$ 9,748
Other liabilities	8	9
Total liabilities	\$ 10,371	\$ 9,757

See accompanying *Notes to Consolidated Financial Statements (Unaudited)*.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(U.S. dollars in millions)

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
Revenues:				
Retail	\$ 426	\$ 443	\$ 833	\$ 876
Dealer	25	57	57	122
Operating leases	1,942	1,935	3,847	3,830
Total revenues	2,393	2,435	4,737	4,828
Leased vehicle expenses	1,361	1,409	2,797	2,801
Interest expense	226	318	490	640
Net revenues	806	708	1,450	1,387
Other income, net	17	23	29	43
Total net revenues	823	731	1,479	1,430
Expenses:				
General and administrative expenses	116	124	228	245
Provision for credit losses	(4)	58	(1)	106
Early termination loss on operating leases	(59)	36	(115)	60
(Gain)/Loss on derivative instruments	(232)	174	(325)	205
(Gain)/Loss on foreign currency revaluation of debt	241	(184)	348	(146)
Total expenses	62	208	135	470
Income before income taxes	761	523	1,344	960
Income tax expense	208	135	355	273
Net income	553	388	989	687
Less: Net income attributable to noncontrolling interest	36	33	59	60
Net income attributable to American Honda Finance Corporation	<u>\$ 517</u>	<u>\$ 355</u>	<u>\$ 930</u>	<u>\$ 627</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(U.S. dollars in millions)

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
Net income	\$ 553	\$ 388	\$ 989	\$ 687
Other comprehensive income:				
Foreign currency translation adjustment	40	(23)	113	15
Comprehensive income	593	365	1,102	702
Less: Comprehensive income/(loss) attributable to noncontrolling interest	55	22	113	67
Comprehensive income attributable to American Honda Finance Corporation	<u>\$ 538</u>	<u>\$ 343</u>	<u>\$ 989</u>	<u>\$ 635</u>

See accompanying *Notes to Consolidated Financial Statements (Unaudited)*.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)
(U.S. dollars in millions)

	Total	Retained earnings	Accumulated other comprehensive income/(loss)	Common stock	Noncontrolling interest
Balance at March 31, 2019	\$ 17,268	\$ 15,088	\$ (118)	\$ 1,366	\$ 932
Net income	687	627	—	—	60
Other comprehensive loss	15	—	8	—	7
Dividends declared	(292)	(292)	—	—	—
Balance at September 30, 2019	<u>\$ 17,678</u>	<u>\$ 15,423</u>	<u>\$ (110)</u>	<u>\$ 1,366</u>	<u>\$ 999</u>
Balance at March 31, 2020	\$ 17,563	\$ 15,395	\$ (175)	\$ 1,366	\$ 977
Net income	989	930	—	—	59
Other comprehensive income	113	—	59	—	54
Adoption of accounting standard (Note 1)	(75)	(73)	—	—	(2)
Dividends declared	(143)	(143)	—	—	—
Balance at September 30, 2020	<u>\$ 18,447</u>	<u>\$ 16,109</u>	<u>\$ (116)</u>	<u>\$ 1,366</u>	<u>\$ 1,088</u>

See accompanying *Notes to Consolidated Financial Statements (Unaudited)*.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(U.S. dollars in millions)

	Six months ended September 30,	
	2020	2019
Cash flows from operating activities:		
Net income	\$ 989	\$ 687
Adjustments to reconcile net income to net cash provided by operating activities:		
Debt and derivative instrument valuation adjustments	(122)	24
Provision for credit losses	(1)	106
Early termination loss on operating leases	(115)	60
Depreciation on leased vehicles	2,832	2,827
Accretion of unearned subsidy income	(745)	(849)
Amortization of deferred dealer participation and other deferred costs	181	179
Gain on disposition of leased vehicles	(105)	(96)
Deferred income taxes	227	198
Changes in operating assets and liabilities:		
Income taxes receivable/payable	26	5
Other assets	(2)	16
Accrued interest/discounts on debt	29	23
Other liabilities	73	(9)
Due to/from Parent and affiliated companies	(5)	48
Net cash provided by operating activities	<u>3,262</u>	<u>3,219</u>
Cash flows from investing activities:		
Finance receivables acquired	(10,852)	(9,240)
Principal collected on finance receivables	8,995	8,605
Net change in wholesale loans	1,770	780
Purchase of operating lease vehicles	(7,710)	(9,684)
Disposal of operating lease vehicles	4,980	5,861
Cash received for unearned subsidy income	654	637
Other investing activities, net	(5)	(2)
Net cash used in investing activities	<u>(2,168)</u>	<u>(3,043)</u>

Statement continues on the next page.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(U.S. dollars in millions)

	Six months ended September 30,	
	2020	2019
Cash flows from financing activities:		
Proceeds from issuance of commercial paper	\$ 21,539	\$ 16,053
Paydown of commercial paper	(22,714)	(16,297)
Proceeds from issuance of short-term debt	214	300
Paydown of short-term debt	(433)	(1,100)
Proceeds from issuance of related party debt	734	1,580
Paydown of related party debt	(912)	(1,580)
Proceeds from issuance of medium-term notes and other debt	6,160	4,613
Paydown of medium-term notes and other debt	(4,722)	(3,553)
Proceeds from issuance of secured debt	3,241	2,743
Paydown of secured debt	(2,688)	(2,613)
Dividends paid	(143)	(292)
Net cash provided by/(used in) financing activities	276	(146)
Effect of exchange rate changes on cash and cash equivalents	10	1
Net increase in cash and cash equivalents	1,380	31
Cash and cash equivalents and restricted cash at beginning of period	2,085	1,383
Cash and cash equivalents and restricted cash at end of period	<u>\$ 3,465</u>	<u>\$ 1,414</u>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 309	\$ 448
Income taxes paid	\$ 105	\$ 37

The following table provides a reconciliation of cash and cash equivalents and restricted cash from the Consolidated Balance Sheets to the Consolidated Statements of Cash Flows.

	September 30,	
	2020	2019
Cash and cash equivalents	\$ 2,950	\$ 808
Restricted cash included in other assets ⁽¹⁾	515	606
Total	<u>\$ 3,465</u>	<u>\$ 1,414</u>

(1) Restricted cash balances relate primarily to securitization arrangements (Note 9).

See accompanying *Notes to Consolidated Financial Statements (Unaudited)*.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

Note 1. Summary of Business and Significant Accounting Policies

Organizational Structure

American Honda Finance Corporation (AHFC) is a wholly-owned subsidiary of American Honda Motor Co., Inc. (AHM or the Parent). Honda Canada Finance Inc. (HCFI) is a majority-owned subsidiary of AHFC. Noncontrolling interest in HCFI is held by Honda Canada Inc. (HCI), an affiliate of AHFC. AHM is a wholly-owned subsidiary and HCI is an indirect wholly-owned subsidiary of Honda Motor Co., Ltd. (HMC). AHM and HCI are the sole authorized distributors of Honda and Acura products, including motor vehicles, parts and accessories in the United States and Canada.

Unless otherwise indicated by the context, all references to the “Company”, “we”, “us”, and “our” in this report include AHFC and its consolidated subsidiaries, and references to “AHFC” refer solely to American Honda Finance Corporation (excluding AHFC’s subsidiaries).

Basis of Presentation

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim information, and instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, these unaudited interim financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results of operations, cash flows, and financial condition for the interim periods presented. Results for interim periods should not be considered indicative of results for the full year or for any other interim period. These unaudited interim financial statements should be read in conjunction with the Company’s audited consolidated financial statements, significant accounting policies, and the other notes to the consolidated financial statements for the fiscal year ended March 31, 2020 included in the Company’s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (SEC) on June 22, 2020. All significant intercompany balances and transactions have been eliminated upon consolidation.

Recently Adopted Accounting Standards

Effective April 1, 2020, the Company adopted Accounting Standards Update (ASU) 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, and the related amendments on a modified retrospective basis. The amendments replace the previous incurred loss impairment methodology with a methodology that reflects lifetime expected credit losses. The adoption of ASU 2016-13 resulted in an increase to the allowance for credit loss of \$101 million along with an after-tax cumulative-effect reduction to opening retained earnings and noncontrolling interest of \$75 million. Comparative information has not been restated and continues to be presented under previous accounting standards. Updated significant accounting policies are presented below.

Effective April 1, 2020, the Company adopted ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments modify the disclosure requirements on fair value measurements in Topic 820, based on Financial Accounting Standards Board (FASB) Concepts Statement, *Conceptual Framework for Financial Reporting-Chapter 8: Notes to Financial Statements*. Certain disclosure requirements were removed, modified and added in Topic 820. This standard did not have an impact on the consolidated financial statements.

Recently Issued Accounting Standards

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. The amendments simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The Company is currently assessing the impact of this standard on the consolidated financial statements. The Company plans to adopt the new guidance effective April 1, 2021.

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The guidance provides optional expedients and exceptions for applying GAAP to contracts or other transactions affected by reference rate reform if certain criteria are met. The guidance is effective immediately and may be applied prospectively through December 31, 2022. The Company is evaluating applicable contracts and transactions to determine whether to elect the optional guidance.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

Significant Accounting Policies

Finance Receivables

Finance receivables include retail loan and dealer loan portfolio segments. The retail loan portfolio segment consists of retail installment contracts with consumers. The dealer loan portfolio segment consists of wholesale and commercial loans with dealers. Finance receivables are measured at amortized cost, less the allowance for credit losses. The amortized cost basis includes the unpaid principal balance, unearned origination fees, and deferred origination costs. Origination fees include payments received from AHM and HCI for incentive programs (refer to Note 6 regarding these related party transactions). Origination costs include payments made to dealers for rate participation and other initial direct costs (IDC). Accrued interest receivable balances are presented within other assets.

Revenue on finance receivables includes contractual interest income, accretion of origination fees, and amortization of origination costs. Contractual interest income is accrued using the simple interest method. Origination fees and costs are recognized in revenue using the interest method over the contractual life of the finance receivables. The recognition of finance revenue on retail loans is discontinued when the underlying collateral is repossessed or accounts are charged off. The recognition of finance revenue on dealer loans is discontinued when they are 90 days or more past due or when it has been determined the Company will be unable to collect all principal and interest payments.

Retail loans are charged off when they become 120 days past due or earlier if they have been specifically identified as uncollectible. Dealer loans are charged off when they have been individually identified as uncollectible. Charge-offs of the amortized cost basis are recognized as a reduction to the allowance for credit losses. Subsequent recoveries are credited to the allowance. Charge-offs of accrued interest receivables are reversed against finance revenue.

Allowance for Credit Losses

The allowance for credit losses is management's estimate of lifetime expected credit losses on the amortized cost basis of finance receivables which is deducted from or, in the case of expected net recoveries, added to the amortized cost. The Company has elected not to measure an allowance for credit losses for accrued interest receivable. The allowance is measured on an undiscounted basis. Management evaluates the allowance, at minimum, on a quarterly basis.

The retail loan portfolio segment consists of homogeneous loans with relatively small balances. The allowance for retail loans is measured on a collective basis. The Company's historical experience provides the primary basis for estimating the allowance. The modeling methodology used to estimate the allowance incorporates vintage loss and delinquency migration analysis. Retail loans are segmented into pools with similar risk characteristics. Currently, retail loans are segmented by origination quarter, internal credit grade at origination, product type, and original term. Past economic conditions and other attributes of the pools including loan-to-value ratios at loan inception are also taken into consideration when assessing historical credit loss experience. Current and forecasts of future economic factors such as unemployment rates, bankruptcies and used vehicle prices are applied in the modeling to estimate current expected credit losses. Management will also consider qualitative adjustments given the inherent uncertainty in estimating expected credit losses and the imprecision of any modeling methodology.

The allowance for dealer loans is measured at the individual dealer level when they have been specifically identified as impaired. Dealer loans are considered impaired when it is probable that the Company will be unable to collect the amounts due according to the terms of the applicable contracts. The Company's determination of whether dealer loans are impaired is based on evaluations of the dealership's payment history, financial condition, ability to perform under the terms of the loan agreements, and collateral values, as applicable. Expected credit losses on impaired dealer loans are measured based upon the specific circumstances of each dealer considering all expected sources of repayment or the fair value of the collateral if foreclosure is probable. The allowance for dealer loans that have not been specifically identified as impaired is measured collectively primarily using historical loss rates.

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

Note 2. Finance Receivables

Finance receivables consisted of the following:

	September 30, 2020		
	Retail	Dealer	Total
	(U.S. dollars in millions)		
Finance receivables	\$ 36,674	\$ 3,681	\$ 40,355
Allowance for credit losses	(405)	(8)	(413)
Deferred dealer participation and other deferred costs	441	—	441
Unearned subsidy income	(811)	—	(811)
Finance receivables, net	\$ 35,899	\$ 3,673	\$ 39,572

	March 31, 2020		
	Retail	Dealer	Total
	(U.S. dollars in millions)		
Finance receivables	\$ 34,623	\$ 5,606	\$ 40,229
Allowance for credit losses	(364)	(6)	(370)
Deferred dealer participation and other deferred costs	441	—	441
Unearned subsidy income	(746)	—	(746)
Finance receivables, net	\$ 33,954	\$ 5,600	\$ 39,554

Finance receivables include retail loans with a net carrying amount of \$10.3 billion and \$9.6 billion as of September 30, 2020 and March 31, 2020, respectively, which have been transferred to bankruptcy-remote Special Purpose Entities (SPEs) and are considered to be legally isolated but do not qualify for sale accounting treatment. These retail loans are restricted as collateral for the payment of the related secured debt obligations. Refer to Note 9 for additional information.

Allowance for Credit Losses

The following is a summary of the activity in the allowance for credit losses of finance receivables:

**AMERICAN HONDA FINANCE CORPORATION
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (Unaudited)

	Three and six months ended September 30, 2020		
	Retail	Dealer	Total
	(U.S. dollars in millions)		
Beginning balance as of July 1, 2020	\$ 425	\$ 9	\$ 434
Provision	(3)	(1)	(4)
Charge-offs	(47)	(1)	(48)
Recoveries	29	1	30
Effect of translation adjustment	1	—	1
Ending balance as of September 30, 2020	<u>\$ 405</u>	<u>\$ 8</u>	<u>\$ 413</u>
Beginning balance	\$ 364	\$ 6	\$ 370
Cumulative effective of adopting ASU 2016-13	98	3	101
Beginning balance as of April 1, 2020	462	9	471
Provision	—	(1)	(1)
Charge-offs	(113)	(1)	(114)
Recoveries	55	1	56
Effect of translation adjustment	1	—	1
Ending balance as of September 30, 2020	<u>\$ 405</u>	<u>\$ 8</u>	<u>\$ 413</u>
	Three and six months ended September 30, 2019		
	Retail	Dealer	Total
	(U.S. dollars in millions)		
Beginning balance as of July 1, 2019	\$ 193	\$ 11	\$ 204
Provision	60	(2)	58
Charge-offs	(80)	(9)	(89)
Recoveries	24	—	24
Effect of translation adjustment	—	—	—
Ending balance as of September 30, 2019	<u>\$ 197</u>	<u>\$ —</u>	<u>\$ 197</u>
Beginning balance as of April 1, 2019	\$ 193	\$ 8	\$ 201
Provision	97	9	106
Charge-offs	(144)	(17)	(161)
Recoveries	51	—	51
Effect of translation adjustment	—	—	—
Ending balance as of September 30, 2019	<u>\$ 197</u>	<u>\$ —</u>	<u>\$ 197</u>

The adoption of ASC 2016-13 resulted in an increase to the allowance for credit loss of \$101 million, primarily for retail loans. The allowance for retail loans at the beginning of the six months ended September 30, 2020 reflected a significant increase in expected credit losses on retail loans due to the impact of COVID-19. Government measures that were enacted in an effort to slow down and control the spread of COVID-19 have had a severe adverse impact on economic conditions, including a significant increase in unemployment. Forecasts of weaker economic factors were reflected in this estimate, including a sharp rise in unemployment rates. Net charge-offs of retail loans during the six months ended September 30, 2020 were favorable relative to the expected credit losses for the period, which had a positive effect on the provision for credit losses. The forecasted economic factors that were applied in the modeling as of September 30, 2020 were slightly more favorable as compared to those applied at the beginning of the period which contributed to the reduction in the allowance for retail loans. The allowance for retail loans acquired during the six months ended September 30, 2020 is generally lower relative to loans acquired prior to the onset of COVID-19.

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There were no modifications to the terms of dealer loan contracts that constituted troubled debt restructurings during the six months ended September 30, 2020 and 2019. The Company generally does not grant concessions on consumer finance receivables that are considered troubled debt restructurings other than modifications of retail loans in reorganization proceedings pursuant to the U.S. Bankruptcy Code. Retail loans modified under bankruptcy protection were not material to the Company's consolidated financial statements during the six months ended September 30, 2020 and 2019. The Company does allow limited payment deferrals on consumer finance receivables. These payment deferrals are not treated as troubled debt restructurings since the deferrals are deemed insignificant and interest continues to accrue during the deferral period. Payment deferrals were also granted to certain customers impacted by COVID-19 beginning in mid-March 2020. Through the end of September 2020, a cumulative total of approximately 240,000 retail loans were granted payment deferrals. As of September 30, 2020, approximately 15,000 outstanding retail loans were still within their deferral periods. The deferral period is up to a maximum of 3 months in the United States and 4 months in Canada, generally from the date the customer was initially granted the deferral. Customers taking advantage of the deferrals were not considered delinquent during such deferral periods and therefore were not reflected in delinquency measures.

Delinquencies

Collection experience provides an indication of the credit quality of finance receivables. For retail loans, delinquencies are a good predictor of charge-offs in the near term. The likelihood of accounts charging off is significantly higher once an account becomes 60 days delinquent. Retail loans are considered delinquent if more than 10% of a scheduled payment is contractually past due on a cumulative basis. Dealer loans are considered delinquent when any payment is contractually past due. The following is an aging analysis of past due finance receivables:

	30 – 59 days past due	60 – 89 days past due	90 days or greater past due	Total past due	Current or less than 30 days past due	Total finance receivables
(U.S. dollars in millions)						
September 30, 2020						
Retail loans:						
New auto	\$ 166	\$ 50	\$ 13	\$ 229	\$ 29,145	\$ 29,374
Used and certified auto	63	20	5	88	5,370	5,458
Motorcycle and other	12	4	2	18	1,454	1,472
Total retail	<u>241</u>	<u>74</u>	<u>20</u>	<u>335</u>	<u>35,969</u>	<u>36,304</u>
Dealer loans:						
Wholesale flooring	—	—	1	1	2,791	2,792
Commercial loans	—	—	—	—	889	889
Total dealer loans	<u>—</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>3,680</u>	<u>3,681</u>
Total finance receivables	<u>\$ 241</u>	<u>\$ 74</u>	<u>\$ 21</u>	<u>\$ 336</u>	<u>\$ 39,649</u>	<u>\$ 39,985</u>

March 31, 2020

Retail loans:						
New auto	\$ 222	\$ 50	\$ 13	\$ 285	\$ 27,495	\$ 27,780
Used and certified auto	84	20	5	109	5,174	5,283
Motorcycle and other	12	4	2	18	1,237	1,255
Total retail	<u>318</u>	<u>74</u>	<u>20</u>	<u>412</u>	<u>33,906</u>	<u>34,318</u>
Dealer loans:						
Wholesale flooring	1	—	—	1	4,529	4,530
Commercial loans	—	—	—	—	1,076	1,076
Total dealer loans	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>5,605</u>	<u>5,606</u>
Total finance receivables	<u>\$ 319</u>	<u>\$ 74</u>	<u>\$ 20</u>	<u>\$ 413</u>	<u>\$ 39,511</u>	<u>\$ 39,924</u>

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Credit Quality Indicators

Credit losses are an expected cost of extending credit. The majority of our credit risk is with consumer financing and to a lesser extent with dealer financing. Exposure to credit risk in retail loans is managed through regular monitoring and adjusting of underwriting standards, pricing of contracts for expected losses, and focusing collection efforts to minimize losses. Exposure to credit risk for dealers is managed through ongoing reviews of their financial condition.

Retail Loan Segment

The Company utilizes proprietary credit scoring systems to evaluate the credit risk of applicants and assign internal credit grades at origination. Factors used to develop a customer's credit grade include the terms of the contract, the loan-to-value ratio, the customer's debt ratios, and credit bureau attributes such as the number of trade lines, utilization ratio, and number of credit inquiries. Different scorecards are utilized depending on the type of product financed. The Company regularly reviews and analyzes the performance of the consumer-financing portfolio to ensure the effectiveness of underwriting guidelines, purchasing criteria and scorecard predictability of customers. Internal credit grades are determined only at the time of origination and are not reassessed during the life of the contract. The following describes the internal credit grade ratings.

A - Borrowers classified as very low credit risks. Based on their application and credit bureau report, they have the ability to pay and have shown a willingness to pay. Generally, A credit borrowers have an extensive credit history, an excellent payment record and extensive financial resources.

B - Borrowers classified as relatively low credit risks. Based on their application and credit bureau report, they have the ability to pay and have shown a willingness to pay. Generally, B credit borrowers may have one or more conditions, that could reduce the internal credit score, such as a shorter credit history or a minor credit weakness.

C - Borrowers classified as moderate credit risks. Based on their application and credit bureau report, they may have limited financial resources, limited credit history, or a weakness in credit history.

D - Borrowers classified as relatively higher credit risks. Based on their application and credit bureau report, they may have very limited financial resources, very limited or no credit history, or a poor credit history.

Others - Borrowers, including businesses, without credit bureau reports.

The following table summarizes the amortized cost of retail loans by internal credit grade:

	Retail loans by vintage fiscal year							Total
	2021	2020	2019	2018	2017	Prior		
	(U.S. dollars in millions)							
Credit grade A	\$ 6,281	\$ 6,750	\$ 5,303	\$ 2,834	\$ 1,289	\$ 316	\$ 22,773	
Credit grade B	1,624	1,835	1,286	863	399	136	6,143	
Credit grade C	1,145	1,538	999	685	311	109	4,787	
Credit grade D	342	741	452	287	131	54	2,007	
Others	127	190	134	80	48	15	594	
Total retail loans	<u>\$ 9,519</u>	<u>\$ 11,054</u>	<u>\$ 8,174</u>	<u>\$ 4,749</u>	<u>\$ 2,178</u>	<u>\$ 630</u>	<u>\$ 36,304</u>	

Dealer Loan Segment

The Company utilizes an internal risk rating system to evaluate dealer credit risk. Dealerships are assigned an internal risk rating based on an assessment of their financial condition and other factors. Factors including liquidity, financial strength, management effectiveness, and operating efficiency, are evaluated when assessing their financial condition. Financing limits and interest rates are based upon these risk ratings. Monitoring activities including financial reviews and inventory inspections are performed more frequently for dealerships with weaker risk ratings. The financial conditions of dealerships are reviewed and their risk ratings are updated at least annually.

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Dealerships have been divided into the following groups:

- Group I - Dealerships in the strongest internal risk rating tier
- Group II - Dealerships with internal risk ratings below the strongest tier
- Group III - Dealerships with impaired loans

The following table summarizes the amortized cost of dealer loans by risk rating groups:

	Commercial loans by vintage fiscal year						Revolving loans	Wholesale Flooring	Total
	2021	2020	2019	2018	2017	Prior			
	(U.S. dollars in millions)								
Group I	\$ 144	\$ 66	\$ 7	\$ 44	\$ 46	\$ 88	\$ 284	\$ 1,341	\$ 2,020
Group II	40	35	34	31	33	37	—	1,450	1,660
Group III	—	—	—	—	—	—	—	1	1
Total dealer loans	<u>\$ 184</u>	<u>\$ 101</u>	<u>\$ 41</u>	<u>\$ 75</u>	<u>\$ 79</u>	<u>\$ 125</u>	<u>\$ 284</u>	<u>\$ 2,792</u>	<u>\$ 3,681</u>

Note 3. Investment in Operating Leases

Investment in operating leases consisted of the following:

	September 30, 2020	March 31, 2020
	(U.S. dollars in millions)	
Operating lease vehicles	\$ 44,199	\$ 43,624
Accumulated depreciation	(8,480)	(8,219)
Deferred dealer participation and initial direct costs	130	131
Unearned subsidy income	(1,245)	(1,376)
Estimated early termination losses	(166)	(317)
Investment in operating leases, net	<u>\$ 34,438</u>	<u>\$ 33,843</u>

Operating lease revenue consisted of the following:

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
	(U.S. dollars in millions)			
Lease payments	\$ 1,687	\$ 1,669	\$ 3,362	\$ 3,306
Subsidy income and dealer rate participation, net	232	245	452	491
Reimbursed lessor costs	23	21	33	33
Total operating lease revenue, net	<u>\$ 1,942</u>	<u>\$ 1,935</u>	<u>\$ 3,847</u>	<u>\$ 3,830</u>

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Leased vehicle expenses consisted of the following:

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
	(U.S. dollars in millions)			
Depreciation expense	\$ 1,416	\$ 1,421	\$ 2,832	\$ 2,827
Initial direct costs and other lessor costs	42	41	70	70
Gain on disposition of leased vehicles ⁽¹⁾	(97)	(53)	(105)	(96)
Total leased vehicle expenses, net	\$ 1,361	\$ 1,409	\$ 2,797	\$ 2,801

(1) Included in the gain on disposition of leased vehicles are end of term charges of \$14 million and \$18 million for the three months ended September 30, 2020 and 2019, respectively, and \$33 million and \$46 million for the six months ended September 30, 2020 and 2019, respectively.

Investment in operating leases includes lease assets with a net carrying amount of \$472 million and \$493 million as of September 30, 2020 and March 31, 2020, respectively, which have been transferred to SPEs and are considered to be legally isolated but do not qualify for sale accounting treatment. These investments in operating leases are restricted as collateral for the payment of the related secured debt obligations. Refer to Note 9 for additional information.

Contractual operating lease payments due as of September 30, 2020 are summarized below. Based on the Company's experience, it is expected that a portion of the Company's operating leases will terminate prior to the scheduled lease term. The summary below should not be regarded as a forecast of future cash collections.

Twelve month periods ending September 30,	(U.S. dollars in millions)
2021	\$ 5,829
2022	3,940
2023	1,529
2024	254
2025	54
Total	\$ 11,606

The Company recognized a reversal of early termination losses on operating leases of \$59 million and \$115 million during the three and six months ended September 30, 2020, respectively, and recognized early termination losses of \$36 million and \$60 million during the three and six months ended September 30, 2019, respectively. Actual net losses realized totaled \$3 million and \$32 million for the three months ended September 30, 2020 and 2019, respectively, and \$36 million and \$56 million for the six months ended September 30, 2020 and 2019, respectively.

The general allowance for uncollectible operating lease receivables was recorded through a reduction to revenue of \$7 million for both the three months ended September 30, 2020 and 2019, and \$21 million and \$13 million during the six months ended September 30, 2020 and 2019, respectively.

During the six months ended September 30, 2020, the Company considered the impact of COVID-19 on estimated residual values and determined that impairment conditions were not met. No impairment losses due to declines in estimated residual values were recognized during the three and six months ended September 30, 2020 and 2019.

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Note 4. Debt

The Company issues debt in various currencies with both floating and fixed interest rates. Outstanding debt net of discounts and fees, weighted average contractual interest rates and range of contractual interest rates were as follows:

	September 30, 2020	March 31, 2020	Weighted average contractual interest rate		Contractual interest rate ranges	
			September 30, 2020	March 31, 2020	September 30, 2020	March 31, 2020
(U.S. dollars in millions)						
Unsecured debt:						
Commercial paper	\$ 4,353	\$ 5,490	0.47 %	1.81 %	0.23 - 1.13%	1.01 - 2.31%
Related party debt	375	533	0.54 %	1.76 %	0.51 - 0.56%	1.45 - 2.06%
Bank loans	4,980	4,938	1.08 %	2.16 %	0.86 - 1.44%	1.44 - 2.55%
Private MTN program	500	999	3.80 %	3.84 %	3.80 - 3.80%	3.80 - 3.88%
Public MTN program	27,056	25,130	1.66 %	2.07 %	0.35 - 3.63%	0.35 - 3.63%
Euro MTN programme	28	28	2.23 %	2.23 %	2.23 - 2.23%	2.23 - 2.23%
Other debt	3,635	3,266	2.18 %	2.47 %	0.79 - 3.44%	1.73 - 3.44%
Total unsecured debt	40,927	40,384				
Secured debt	10,363	9,748	1.62 %	2.25 %	0.19 - 3.30%	1.36 - 3.30%
Total debt	\$ 51,290	\$ 50,132				

As of September 30, 2020, the outstanding principal balance of long-term debt with floating interest rates totaled \$11.5 billion, long-term debt with fixed interest rates totaled \$34.0 billion, and short-term debt with floating and fixed interest rates totaled \$5.8 billion. As of March 31, 2020, the outstanding principal balance of long-term debt with floating interest rates totaled \$13.0 billion, long-term debt with fixed interest rates totaled \$30.0 billion, and short-term debt with floating and fixed interest rates totaled \$7.3 billion.

Commercial Paper

As of September 30, 2020 and March 31, 2020, the Company had commercial paper programs that provide the Company with available funds of up to \$8.9 billion and \$8.8 billion, respectively, at prevailing market interest rates for terms up to one year. The commercial paper programs are supported by the Keep Well Agreements with HMC described in Note 6.

Outstanding commercial paper averaged \$4.9 billion and \$5.5 billion during the six months ended September 30, 2020 and 2019, respectively. The maximum balance outstanding at any month-end during the six months ended September 30, 2020 and 2019 was \$5.9 billion and \$6.2 billion, respectively.

Related Party Debt

HCFI issues fixed rate short-term notes to HCI to help fund HCFI's general corporate operations. HCFI incurred interest expense on these notes totaling \$1 million and \$4 million for the three months ended September 30, 2020 and 2019, respectively, and \$2 million and \$8 million for the six months ended September 30, 2020, and 2019, respectively.

Bank Loans

Outstanding bank loans at September 30, 2020 were either short-term or long-term, with floating or fixed interest rates, and denominated in U.S. dollars or Canadian dollars. Outstanding bank loans have prepayment options. No outstanding bank loans as of September 30, 2020 were supported by the Keep Well Agreements with HMC described in Note 6. Outstanding bank loans contain certain covenants, including limitations on liens, mergers, consolidations and asset sales.

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Medium-Term Note (MTN) Programs

Private MTN Program

AHFC no longer issues MTNs under its Rule 144A Private MTN Program. AHFC has one note outstanding under the Private MTN Program as of September 30, 2020. The note is long-term, with a fixed interest rate, and denominated in U.S. dollars. Notes under this program were issued pursuant to the terms of an issuing and paying agency agreement which contains certain covenants, including negative pledge provisions.

Public MTN Program

In August 2019, AHFC renewed its Public MTN program by filing a registration statement with the SEC under which it may issue from time to time up to \$30.0 billion aggregate principal amount of Public MTNs pursuant to the Public MTN program. The aggregate principal amount of MTNs offered under this program may be increased from time to time. Notes outstanding under the Public MTN program as of September 30, 2020 were long-term, with either fixed or floating interest rates, and denominated in U.S. dollars, Euro or Sterling. Notes under this program are issued pursuant to an indenture which contains certain covenants, including negative pledge provisions and limitations on mergers, consolidations and asset sales.

Euro MTN Programme

The Euro MTN Programme was retired in August 2014. AHFC has one note outstanding under this program as of September 30, 2020. The note has a maturity date of February 21, 2023, a fixed interest rate and is not listed on the Luxembourg Stock Exchange. The note was issued pursuant to the terms of an agency agreement which contains certain covenants, including negative pledge provisions.

The MTN programs are supported by the Keep Well Agreement with HMC described in Note 6.

Other Debt

The outstanding balances as of September 30, 2020 consisted of private placement debt issued by HCFI which are long-term, with either fixed or floating interest rates, and denominated in Canadian dollars. Private placement debt is supported by the Keep Well Agreement with HMC described in Note 6. The notes are issued pursuant to the terms of an indenture which contain certain covenants, including negative pledge provisions.

Secured Debt

The Company issues notes through financing transactions that are secured by assets held by issuing SPEs. Notes outstanding as of September 30, 2020 were long-term and short-term with either fixed or floating interest rates, and denominated in U.S. dollars or Canadian dollars. Repayment of the notes is dependent on the performance of the underlying retail loans and operating leases. Refer to Note 9 for additional information on the Company's secured financing transactions.

Credit Agreements

Syndicated Bank Credit Facilities

AHFC maintains a \$7.0 billion syndicated bank credit facility that includes a \$3.5 billion credit agreement, which expires on February 26, 2021, a \$2.1 billion credit agreement, which expires on February 28, 2023, and a \$1.4 billion credit agreement, which expires on February 28, 2025. As of September 30, 2020, no amounts were drawn upon under the AHFC credit agreements. AHFC intends to renew or replace these credit agreements prior to or on their respective expiration dates.

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HCFI maintains a \$1.5 billion syndicated bank credit facility which provides that HCFI may borrow up to \$751 million on a one-year revolving basis and up to \$751 million on a five-year revolving basis. The one-year tranche of the credit agreement expires on March 25, 2021 and the five-year tranche of the credit agreement expires on March 25, 2025. As of September 30, 2020, no amounts were drawn upon under the HCFI credit agreement. HCFI intends to renew or replace the credit agreement prior to or on the expiration date of each respective tranche.

The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales and affiliate transactions. Loans, if any, under the credit agreements will be supported by the Keep Well Agreement described in Note 6.

Other Credit Agreements

AHFC maintains other committed lines of credit that allow the Company access to an additional \$1.0 billion in unsecured funding with two banks. The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales. As of September 30, 2020, no amounts were drawn upon under these agreements. These agreements expire in September 2021. The Company intends to renew or replace these credit agreements prior to or on their respective expiration dates.

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Note 5. Derivative Instruments

The notional balances and fair values of the Company's derivatives are presented below. The derivative instruments are presented on a gross basis in the Company's consolidated balance sheets. Refer to Note 13 regarding the valuation of derivative instruments.

	September 30, 2020			March 31, 2020		
	Notional balances	Assets	Liabilities	Notional balances	Assets	Liabilities
	(U.S. dollars in millions)					
Interest rate swaps	\$ 60,730	\$ 714	\$ 764	\$ 57,379	\$ 704	\$ 830
Cross currency swaps	5,638	349	58	4,001	44	142
Gross derivative assets/liabilities		1,063	822		748	972
Collateral posted/held		45	11		45	9
Counterparty netting adjustment		(752)	(752)		(764)	(764)
Net derivative assets/liabilities		<u>\$ 356</u>	<u>\$ 81</u>		<u>\$ 29</u>	<u>\$ 217</u>

The income statement impact of derivative instruments is presented below. There were no derivative instruments designated as part of a hedge accounting relationship during the periods presented.

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
	(U.S. dollars in millions)			
Interest rate swaps	\$ (6)	\$ 31	\$ (15)	\$ (45)
Cross currency swaps	238	(205)	340	(160)
Total gain/(loss) on derivative instruments	<u>\$ 232</u>	<u>\$ (174)</u>	<u>\$ 325</u>	<u>\$ (205)</u>

The fair value of derivative instruments is subject to the fluctuations in market interest rates and foreign currency exchange rates. Since the Company has elected not to apply hedge accounting, the volatility in the changes in fair value of these derivative instruments is recognized in earnings. All settlements of derivative instruments are presented within cash flows from operating activities in the consolidated statements of cash flows.

These derivative instruments also contain an element of credit risk in the event the counterparties are unable to meet the terms of the agreements. However, the Company minimizes the risk exposure by limiting the counterparties to major financial institutions that meet established credit guidelines. In the event of default, all counterparties are subject to legally enforceable master netting agreements. In Canada, HCFI is a party to reciprocal credit support agreements that require posting of cash collateral to mitigate counterparty credit risk on derivative positions. Posted collateral is recognized in other assets and held collateral is recognized in other liabilities.

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Note 6. Transactions Involving Related Parties

The following tables summarize the income statement and balance sheet impact of transactions with the Parent and affiliated companies:

Income Statement	<u>Three months ended September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(U.S. dollars in millions)			
Revenue:				
Subsidy income	\$ 381	\$ 418	\$ 740	\$ 845
Interest expense:				
Related party debt	1	4	2	8
Other income, net:				
VSC administration fees	27	28	53	55
Support Service Fee	(12)	(9)	(23)	(18)
General and administrative expenses:				
Support Compensation Agreement fees	18	17	35	34
Benefit plan expenses	2	3	4	5
Shared services	17	19	35	35

Balance Sheet	<u>September 30, 2020</u>	<u>March 31, 2020</u>
		(U.S. dollars in millions)
Assets:		
Finance receivables, net:		
Unearned subsidy income	\$ (801)	\$ (738)
Investment in operating leases, net:		
Unearned subsidy income	(1,242)	(1,372)
Due from Parent and affiliated companies	136	93
Liabilities:		
Debt:		
Related party debt	\$ 375	\$ 533
Due to Parent and affiliated companies	111	72
Accrued interest expense:		
Related party debt	—	1
Other liabilities:		
Unearned VSC administrative fees	347	363
Accrued benefit expenses	72	69

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Support Agreements

HMC and AHFC are parties to a Keep Well Agreement, effective as of September 9, 2005. This Keep Well Agreement provides that HMC will (1) maintain (directly or indirectly) at least 80% ownership in AHFC's voting stock and not pledge (directly or indirectly), or in any way encumber or otherwise dispose of, any such stock of AHFC that it is required to hold (or permit any of HMC's subsidiaries to do so), (2) cause AHFC to have a positive consolidated tangible net worth with tangible net worth defined as (a) stockholder's equity less (b) any intangible assets, determined on a consolidated basis in accordance with GAAP, and (3) ensure that AHFC has sufficient liquidity to meet its payment obligations for debt HMC has confirmed in writing is covered by this Keep Well Agreement, in accordance with its terms, or where necessary make available to AHFC, or HMC shall procure for AHFC, sufficient funds to enable AHFC to meet such obligations in accordance with such terms. This Keep Well Agreement is not a guarantee by HMC.

HMC and HCFI are parties to a Keep Well Agreement effective as of September 26, 2005. This Keep Well Agreement provides that HMC will (1) maintain (directly or indirectly) at least 80% ownership in HCFI's voting stock and not pledge (directly or indirectly), or in any way encumber or otherwise dispose of, any such stock of HCFI that it is required to hold (or permit any of HMC's subsidiaries to do so), (2) cause HCFI to have a positive consolidated tangible net worth with tangible net worth defined as (a) stockholder's equity less (b) any intangible assets, determined on a consolidated basis in accordance with generally accepted accounting principles in Canada, and (3) ensure that HCFI has sufficient liquidity to meet its payment obligations for debt HMC has confirmed in writing is covered by this Keep Well Agreement, in accordance with its terms, or where necessary make available to HCFI, or HMC shall procure for HCFI, sufficient funds to enable HCFI to meet such obligations in accordance with such terms. This Keep Well Agreement is not a guarantee by HMC.

Debt programs supported by the Keep Well Agreements consist of the Company's commercial paper programs, Private MTN Program, Public MTN Program, Euro MTN Programme, and HCFI's private placement debt and loans, if any, under AHFC's syndicated bank credit facilities. In connection with the above agreements, AHFC and HCFI have entered into separate Support Compensation Agreements, where each has agreed to pay HMC a quarterly fee based on the amount of outstanding debt that benefit from the Keep Well Agreements. Support Compensation Agreement fees are recognized in general and administrative expenses.

Incentive Financing Programs

The Company receives subsidy payments from AHM and HCI, which supplement the revenues on financing products offered under incentive programs. Subsidy payments received on retail loans and leases are deferred and recognized as revenue over the term of the related contracts. The unearned balance is recognized as reductions to the carrying value of finance receivables and investment in operating leases. Subsidy payments on dealer loans are received as earned.

Related Party Debt

HCFI issues short-term notes to HCI to fund HCFI's general corporate operations. Interest rates are based on prevailing rates of debt with comparable terms. Refer to Note 4 for additional information.

Vehicle Service Contract (VSC) Administration

AHFC performs administrative services for VSCs issued by certain subsidiaries of AHM. AHFC's performance obligations for the services are satisfied over the term of the underlying contracts and revenue is recognized proportionate to the anticipated amount of services to be performed. Contract terms range between two and nine years with the majority of contracts having original terms between four and eight years. The majority of the administrative service revenue is recognized during the latter years of the underlying contracts as this is the period in which the majority of VSC claims are processed. AHFC receives fees for performing the administrative services when the contracts are acquired.

Unearned VSC administration fees represent AHFC's contract liabilities and are included in other liabilities (Note 11). VSC administration income is recognized in other income, net (Note 12). HCFI receives fees for marketing VSCs issued by HCI. These fees are also recognized in other income, net.

AHFC pays fees to AHM for services provided in support of AHFC's performance of VSC administrative services. The support fees are recognized as an expense within other income, net (Note 12).

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Shared Services

The Company shares certain common expenditures with AHM, HCI, and other related parties including information technology services and facilities. The allocated costs for shared services are included in general and administrative expenses.

Benefit Plans

The Company participates in various employee benefit plans that are sponsored by AHM and HCI. The allocated benefit plan expenses are included in general and administrative expenses.

Income taxes

The Company's U.S. income taxes are recognized on a modified separate return basis pursuant to an intercompany income tax allocation agreement with AHM. Income tax related items are not included in the tables above. Refer to Note 7 for additional information.

Other

AHM periodically sponsors programs that allow lessees to terminate their lease contracts prior to the contractual maturity date. AHM compensates the Company for rental payments that were waived under these programs. During the three months ended September 30, 2020 and 2019, the Company recognized \$2 million and \$3 million, respectively, and during the six months ended September 30, 2020 and 2019, the Company recognized \$5 million and \$6 million, respectively, under these programs which were reflected as proceeds on the disposition of the returned lease vehicles.

The majority of the amounts due from the Parent and affiliated companies at September 30, 2020 and March 31, 2019 related to incentive financing program subsidies. The majority of the amounts due to the Parent and affiliated companies at September 30, 2020 and March 31, 2019 related to wholesale flooring payable to the Parent. These receivable and payable accounts are non-interest-bearing and short-term in nature and are expected to be settled in the normal course of business.

In July 2020 and August 2019, AHFC declared and paid cash dividends of \$143 million and \$292 million, respectively, to its parent, AHM.

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Note 7. Income Taxes

The Company's effective tax rate was 27.3% and 25.8%, for the three months ended September 30, 2020 and 2019, respectively, and 26.4% and 28.4% for the six months ended September 30, 2020 and 2019, respectively. The increase in the comparable effective tax rate for the three months ended September 30, 2020 was primarily due to U.S. state taxes. The reduction in the effective tax rate for the six months ended September 30, 2020 was primarily due to changes in unrecognized tax benefits in the six months ended September 30, 2019, offset in part by an increase in state taxes.

The Company does not provide for income taxes on its share of the undistributed earnings of HCFI which are intended to be indefinitely reinvested outside the United States. At September 30, 2020, \$976 million of accumulated undistributed earnings of HCFI were intended to be so reinvested. If the undistributed earnings as of September 30, 2020 were distributed, the tax liability associated with these earnings would be \$47 million, inclusive of currency translation adjustments.

On March 27, 2020, the U.S. government enacted the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) which provides economic relief in response to the coronavirus pandemic. The CARES Act, among other things, includes provisions to allow certain net operating losses to be carried-back up to five years, to increase interest deduction limitations, and to make technical corrections to tax depreciation methods for qualified improvement property. During the six months ended September 30, 2020, several U.S. states enacted legislation to respond to various provisions of the CARES Act. The Company evaluated the impact of new tax laws according to the Company's modified separate return basis pursuant to an intercompany income tax allocation agreement with the Parent, and concluded there was no material impact on the Company's September 30, 2020 income tax accounts.

As of September 30, 2020, the Company is subject to examination in various U.S. tax jurisdictions for returns filed for the taxable years ended March 31, 2008 through 2020. The Company's Canadian subsidiary, HCFI, is subject to examination for returns filed for the taxable years ended March 31, 2013 through 2020 federally, and returns filed for the taxable years ended March 31, 2008 through 2020, except for 2011 and 2012, provincially. The Company believes appropriate provisions have been made for all outstanding issues for all open years and does not expect any material changes in the amounts of unrecognized tax benefits during the fiscal year ending March 31, 2021.

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Note 8. Commitments and Contingencies

Operating Leases

The Company leases certain premises and equipment through operating leases. AHFC leases its premises and equipment from third parties and HCFI leases its premises from HCI. Effective October 1, 2020, AHFC leases certain premises from its parent, AHM. The lease has a total of \$24 million in undiscounted future payments over the eight year lease term.

Many of the Company's leases contain renewal options, and generally have no residual value guarantees or material covenants. When it is reasonably certain that the Company will exercise the option to renew a lease, the Company will include the renewal option in the evaluation of the lease term. The Company has elected not to recognize right-of-use assets or lease liabilities for leases with a lease term of less than one year. As most of the Company's leases do not provide an implicit rate, the incremental borrowing rate is used in determining the present value of lease payments. The right-of-use assets in operating lease arrangements are reported in other assets on the Company's consolidated balance sheets.

Operating lease liabilities are reported in other liabilities on the Company's consolidated balance sheets. At September 30, 2020, maturities of operating lease liabilities were as follows:

Twelve month periods ending September 30,	(U.S. dollars in millions)
2021	\$ 10
2022	9
2023	8
2024	8
2025	6
Thereafter	15
Total undiscounted future lease obligations	56
Less: imputed interest	(5)
Operating lease liabilities	\$ 51

Rent expense under operating leases was \$3 million and \$2 million for the three months ended September 30, 2020 and 2019, respectively, and \$5 million for both the six months ended September 30, 2020 and 2019. Rent expense is included within general and administrative expenses.

As of September 30, 2020, the weighted average remaining lease term for operating leases was 6.6 years and the weighted average remaining discount rate for operating leases was 3.06%.

Revolving Lines of Credit to Dealerships

The Company extends commercial revolving lines of credit to dealerships to support their business activities including facilities refurbishment and general working capital requirements. The amounts borrowed are generally secured by the assets of the borrowing entity. The unused balance of commercial revolving lines of credit was \$562 million as of September 30, 2020. The Company also has commitments to finance the construction of auto dealership facilities. The remaining unfunded balance for these construction loans was \$5 million as of September 30, 2020.

Legal Proceedings and Regulatory Matters

The Company establishes accruals for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. When able, the Company will determine estimates of reasonably possible loss or range of loss, whether in excess of any related accrued liability or where there is no accrued liability. Given the inherent uncertainty associated with legal matters, the actual costs of resolving legal claims and associated costs of defense may be substantially higher or lower than the amounts for which accruals have been established.

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The Company is involved, in the ordinary course of business, in various legal proceedings including claims of individual customers and purported class action lawsuits. Certain of these actions are similar to suits filed against other financial institutions and captive finance companies. Most of these proceedings concern customer allegations of wrongful repossession or defamation of credit. The Company is also subject to governmental reviews and inquiries from time to time. The Company has received two Civil Investigative Demands from the U.S. Department of Justice (DOJ) relating to the financing of motor vehicles by servicemembers under the Servicemembers Civil Relief Act. The Company is cooperating with the DOJ and is responding to their information requests. Based on available information and established accruals, management does not believe it is reasonably possible that the results of these proceedings, in the aggregate, will have a material adverse effect on the Company's consolidated financial statements.

Note 9. Securitizations and Variable Interest Entities (VIE)

The Company utilizes SPEs for its asset-backed securitizations and these SPEs are considered VIEs, which are required to be consolidated by their primary beneficiary. The Company is considered to be the primary beneficiary of these SPEs due to (i) the power to direct the activities of the SPEs that most significantly impact the SPEs' economic performance through the Company's role as servicer, and (ii) the obligation to absorb losses or the right to receive residual returns that could potentially be significant to the SPEs through the subordinated certificates and residual interest retained. The debt securities issued by the SPEs to third-party investors along with the assets of the SPEs are included in the Company's consolidated financial statements.

During the six months ended September 30, 2020 and 2019, the Company issued notes through asset-backed securitizations, which were accounted for as secured financing transactions totaling \$3.3 billion and \$2.8 billion, respectively. The notes were secured by assets with an initial balance of \$3.5 billion and \$3.0 billion, respectively.

The table below presents the carrying amounts of assets and liabilities of consolidated SPEs as they are reported in the Company's consolidated balance sheets. All amounts exclude intercompany balances, which have been eliminated upon consolidation. Investors in notes issued by a SPE only have recourse to the assets of such SPE and do not have recourse to the assets of AHFC, HCFI, or its other subsidiaries or to other SPEs. The assets of SPEs are the only source of funds for repayment on the notes.

	September 30, 2020				
	Assets			Liabilities	
	(U.S. dollars in millions)				
	Securitized assets	Restricted cash ⁽¹⁾	Other	Secured debt	Other
Retail loan securitizations	\$ 10,297	\$ 514	\$ 17	\$ 9,981	\$ 6
Operating lease securitizations	472	1	2	382	2
Total	\$ 10,769	\$ 515	\$ 19	\$ 10,363	\$ 8

	March 31, 2020				
	Assets			Liabilities	
	(U.S. dollars in millions)				
	Securitized assets	Restricted cash ⁽¹⁾	Other	Secured debt	Other
Retail loan securitizations	\$ 9,645	\$ 581	\$ 16	\$ 9,345	\$ 7
Operating lease securitizations	493	1	—	403	2
Total	\$ 10,138	\$ 582	\$ 16	\$ 9,748	\$ 9

(1) Included with other assets in the Company's consolidated balance sheets (Note 10).

In their role as servicers, AHFC and HCFI collect payments on the underlying securitized assets on behalf of the SPEs. Cash collected during a calendar month is required to be remitted to the SPEs in the following month. AHFC and HCFI are not restricted from using the cash collected for their general purposes prior to the remittance to the SPEs. As of September 30, 2020 and March 31, 2020, AHFC and HCFI had combined cash collections of \$561 million and \$468 million, respectively, which were required to be remitted to the SPEs.

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Note 10. Other Assets

Other assets consisted of the following:

	<u>September 30, 2020</u>	<u>March 31, 2020</u>
	(U.S. dollars in millions)	
Interest receivable and other assets	\$ 101	\$ 107
Vehicles held for disposition	113	228
Other receivables	239	172
Deferred expense	99	105
Software, net of accumulated amortization of \$162 and \$156 as of September 30, 2020 and March 31, 2020, respectively	24	23
Property and equipment, net of accumulated depreciation of \$24 and \$23 as of September 30, 2020 and March 31, 2020, respectively	4	4
Restricted cash	515	582
Operating lease assets	44	48
Like-kind exchange assets	66	91
Other miscellaneous assets	12	18
Total	<u>\$ 1,217</u>	<u>\$ 1,378</u>

Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets, which range from three to five years. General and administrative expenses include depreciation and amortization expense of \$2 million and \$3 million for the three months ended September 30, 2020 and 2019, respectively, and \$5 million and \$6 million for the six months ended September 30, 2020 and 2019, respectively.

Note 11. Other Liabilities

Other liabilities consisted of the following:

	<u>September 30, 2020</u>	<u>March 31, 2020</u>
	(U.S. dollars in millions)	
Dealer payables	\$ 152	\$ 68
Accrued interest expense	152	138
Accounts payable and accrued expenses	442	408
Lease security deposits	82	84
Unearned VSC administrative fees (Note 6)	347	363
Unearned income, operating leases	332	358
Operating lease liabilities	51	55
Uncertain tax positions	192	195
Other liabilities	20	20
Total	<u>\$ 1,770</u>	<u>\$ 1,689</u>

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Note 12. Other Income, net

Other income consisted of the following:

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
	(U.S. dollars in millions)			
VSC administration fees (Note 6)	\$ 27	\$ 28	\$ 53	\$ 55
Other, net	(10)	(5)	(24)	(12)
Total	\$ 17	\$ 23	\$ 29	\$ 43

Note 13. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are those other than quoted prices included within Level 1 that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Nonperformance risk is also required to be reflected in the fair value measurement, including an entity's own credit standing when measuring the fair value of a liability.

Recurring Fair Value Measurements

The following tables summarize the fair value hierarchy of assets and liabilities measured at fair value on a recurring basis:

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Notes to Consolidated Financial Statements (Unaudited)

	September 30, 2020			
	Level 1	Level 2	Level 3	Total
	(U.S. dollars in millions)			
Assets:				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 714	\$ —	\$ 714
Cross currency swaps	—	349	—	349
Total assets	\$ —	\$ 1,063	\$ —	\$ 1,063
Liabilities:				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 764	\$ —	\$ 764
Cross currency swaps	—	58	—	58
Total liabilities	\$ —	\$ 822	\$ —	\$ 822

	March 31, 2020			
	Level 1	Level 2	Level 3	Total
	(U.S. dollars in millions)			
Assets:				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 704	\$ —	\$ 704
Cross currency swaps	—	44	—	44
Total assets	\$ —	\$ 748	\$ —	\$ 748
Liabilities:				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 830	\$ —	\$ 830
Cross currency swaps	—	142	—	142
Total liabilities	\$ —	\$ 972	\$ —	\$ 972

The valuation techniques used in measuring assets and liabilities at fair value on a recurring basis are described below:

Derivative Instruments

The Company's derivatives are transacted in over-the-counter markets and quoted market prices are not readily available. The Company uses third-party developed valuation models to value derivative instruments. These models estimate fair values using discounted cash flow modeling techniques, which utilize the contractual terms of the derivative instruments and market-based inputs, including interest rates and foreign exchange rates. Discount rates incorporate counterparty and HMC specific credit default spreads to reflect nonperformance risk.

The Company's derivative instruments are classified as Level 2 since all significant inputs are observable and do not require management judgment. There were no transfers between fair value hierarchy levels during the six months ended September 30, 2020 and 2019. Refer to Note 5 for additional information on derivative instruments.

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Nonrecurring Fair Value Measurements

The following tables summarize nonrecurring fair value measurements recognized for assets still held at the end of the reporting periods presented:

	Level 1	Level 2	Level 3	Total	Lower-of-cost or fair value adjustment
(U.S. dollars in millions)					
<u>September 30, 2020</u>					
Vehicles held for disposition	\$ —	\$ —	\$ 55	\$ 55	\$ 14
<u>September 30, 2019</u>					
Vehicles held for disposition	\$ —	\$ —	\$ 121	\$ 121	\$ 27

The following describes the methodologies and assumptions used in nonrecurring fair value measurements, which relate to the application of lower of cost or fair value accounting on long-lived assets.

Vehicles Held for Disposition

Vehicles held for disposition consist of returned and repossessed vehicles. They are valued at the lower of their carrying value or estimated fair value, less estimated disposition costs. The fair value is based on current average selling prices of like vehicles at wholesale used vehicle auctions.

Fair Value of Financial Instruments

The following tables summarize the carrying values and fair values of the Company's financial instruments except for those measured at fair value on a recurring basis. Certain financial instruments and all nonfinancial assets and liabilities are excluded from fair value disclosure requirements including the Company's investment in operating leases.

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	September 30, 2020				
	Carrying value	Fair value			Total
		Level 1	Level 2	Level 3	
(U.S. dollars in millions)					
Assets:					
Cash and cash equivalents	\$ 2,950	\$ 2,950	\$ —	\$ —	\$ 2,950
Dealer loans, net	3,673	—	—	3,454	3,454
Retail loans, net	35,899	—	—	37,258	37,258
Restricted cash	515	515	—	—	515
Liabilities:					
Commercial paper	\$ 4,353	\$ —	\$ 4,354	\$ —	\$ 4,354
Related party debt	375	—	375	—	375
Bank loans	4,980	—	5,016	—	5,016
Medium-term note programs	27,584	—	28,426	—	28,426
Other debt	3,635	—	3,756	—	3,756
Secured debt	10,363	—	10,494	—	10,494

	March 31, 2020				
	Carrying value	Fair value			Total
		Level 1	Level 2	Level 3	
(U.S. dollars in millions)					
Assets:					
Cash and cash equivalents	\$ 1,503	\$ 1,503	\$ —	\$ —	\$ 1,503
Dealer loans, net	5,600	—	—	5,136	5,136
Retail loans, net	33,954	—	—	34,441	34,441
Restricted cash	582	582	—	—	582
Liabilities:					
Commercial paper	\$ 5,490	\$ —	\$ 5,488	\$ —	\$ 5,488
Related party debt	533	—	533	—	533
Bank loans	4,938	—	4,780	—	4,780
Medium-term note programs	26,157	—	25,740	—	25,740
Other debt	3,266	—	3,232	—	3,232
Secured debt	9,748	—	9,794	—	9,794

Fair value information presented in the tables above is based on information available at September 30, 2020 and March 31, 2020. Although the Company is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been updated since those dates, and therefore, the current estimates of fair value at dates subsequent to those dates may differ significantly from the amounts presented herein.

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Note 14. Segment Information

The Company's reportable segments are based on the two geographic regions where operating results are measured and evaluated by management: the United States and Canada.

Segment performance is evaluated using an internal measurement basis, which differs from the Company's consolidated results prepared in accordance with GAAP. Segment performance is evaluated on a pre-tax basis before the effect of valuation adjustments on derivative instruments and revaluations of foreign currency denominated debt. Since the Company does not elect to apply hedge accounting, the impact to earnings resulting from these valuation adjustments as reported under GAAP is not representative of segment performance as evaluated by management. Realized gains and losses on derivative instruments, net of realized gains and losses on foreign currency denominated debt, are included in the measure of net revenues when evaluating segment performance.

No adjustments are made to segment performance to allocate any revenues or expenses. Financing products offered throughout the United States and Canada are substantially similar. Segment revenues from the various financing products are reported on the same basis as GAAP consolidated results.

Financial information for the three and six months ended September 30, 2020 and 2019 is summarized in the following tables:

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	United States	Canada	Valuation adjustments and reclassifications	Consolidated Total
	(U.S. dollars in millions)			
Three months ended September 30, 2020				
Revenues:				
Retail	\$ 377	\$ 49	\$ —	\$ 426
Dealer	22	3	—	25
Operating leases	1,607	335	—	1,942
Total revenues	2,006	387	—	2,393
Leased vehicle expenses	1,108	253	—	1,361
Interest expenses	197	29	—	226
Realized (gains)/losses on derivatives and foreign currency denominated debt	72	11	(83)	—
Net revenues	629	94	83	806
Other income, net	12	5	—	17
Total net revenues	641	99	83	823
Expenses:				
General and administrative expenses	104	12	—	116
Provision for credit losses	(2)	(2)	—	(4)
Early termination loss on operating leases	(56)	(3)	—	(59)
(Gain)/Loss on derivative instruments	—	—	(232)	(232)
(Gain)/Loss on foreign currency revaluation of debt	—	—	241	241
Income before income taxes	\$ 595	\$ 92	\$ 74	\$ 761
Six months ended September 30, 2020				
Revenues:				
Retail	\$ 740	\$ 93	\$ —	\$ 833
Dealer	50	7	—	57
Operating leases	3,194	653	—	3,847
Total revenues	3,984	753	—	4,737
Leased vehicle expenses	2,298	499	—	2,797
Interest expenses	427	63	—	490
Realized (gains)/losses on derivatives and foreign currency denominated debt	125	20	(145)	—
Net revenues	1,134	171	145	1,450
Other income, net	22	7	—	29
Total net revenues	1,156	178	145	1,479
Expenses:				
General and administrative expenses	202	26	—	228
Provision for credit losses	2	(3)	—	(1)
Early termination loss on operating leases	(117)	2	—	(115)
(Gain)/Loss on derivative instruments	—	—	(325)	(325)
(Gain)/Loss on foreign currency revaluation of debt	—	—	348	348
Income before income taxes	\$ 1,069	\$ 153	\$ 122	\$ 1,344
September 30, 2020				
Finance receivables, net	\$ 35,275	\$ 4,297	\$ —	\$ 39,572
Investment in operating leases, net	29,267	5,171	—	34,438
Total assets	69,496	9,960	—	79,456

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	United States	Canada	Valuation adjustments and reclassifications	Consolidated Total
	(U.S. dollars in millions)			
Three months ended September 30, 2019				
Revenues:				
Retail	\$ 390	\$ 53	\$ —	\$ 443
Dealer	51	6	—	57
Operating leases	1,595	340	—	1,935
Total revenues	2,036	399	—	2,435
Leased vehicle expenses	1,152	257	—	1,409
Interest expense	273	45	—	318
Realized (gains)/losses on derivatives and foreign currency denominated debt	23	(1)	(22)	—
Net revenues	588	98	22	708
Other income, net	20	3	—	23
Total net revenues	608	101	22	731
Expenses:				
General and administrative expenses	109	15	—	124
Provision for credit losses	56	2	—	58
Early termination loss on operating leases	36	—	—	36
(Gain)/Loss on derivative instruments	—	—	174	174
(Gain)/Loss on foreign currency revaluation of debt	—	—	(184)	(184)
Income before income taxes	\$ 407	\$ 84	\$ 32	\$ 523
Six months ended September 30, 2019				
Revenues:				
Retail	\$ 772	\$ 104	\$ —	\$ 876
Dealer	110	12	—	122
Operating leases	3,160	670	—	3,830
Total revenues	4,042	786	—	4,828
Leased vehicle expenses	2,294	507	—	2,801
Interest expense	550	90	—	640
Realized (gains)/losses on derivatives and foreign currency denominated debt	38	(3)	(35)	—
Net revenues	1,160	192	35	1,387
Other income, net	37	6	—	43
Total net revenues	1,197	198	35	1,430
Expenses:				
General and administrative expenses	215	30	—	245
Provision for credit losses	104	2	—	106
Early termination loss on operating leases	59	1	—	60
(Gain)/Loss on derivative instruments	—	—	205	205
(Gain)/Loss on foreign currency revaluation of debt	—	—	(146)	(146)
Income before income taxes	\$ 819	\$ 165	\$ (24)	\$ 960
September 30, 2019				
Finance receivables, net	\$ 35,737	\$ 4,486	\$ —	\$ 40,223
Investment in operating leases, net	28,407	5,363	—	33,770
Total assets	66,960	10,020	—	76,980

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Our primary focus, in collaboration with AHM and HCI, is to provide support for the sale of Honda and Acura products and maintain customer and dealer satisfaction and loyalty. To deliver this support effectively, we seek to maintain competitive cost of funds, efficient operations, and effective risk and compliance management. The primary factors influencing our results of operations, cash flows, and financial condition include the volume of Honda and Acura sales and the portion of those sales that we finance, our cost of funds, competition from other financial institutions, consumer credit defaults, and used motor vehicle prices.

A substantial portion of our consumer financing business is acquired through incentive financing programs sponsored by AHM and HCI. The volume of these incentive financing programs and the allocation of those programs between retail loans and leases may vary from fiscal period to fiscal period depending upon the respective marketing strategies of AHM and HCI. AHM and HCI's marketing strategies are based in part on their business planning and control, in which we do not participate. Therefore, we cannot predict the level of incentive financing programs AHM and HCI may sponsor in the future. Our consumer financing acquisition volumes are substantially dependent on the extent to which incentive financing programs are offered. Increases in incentive financing programs generally increase our financing penetration rates, which typically results in increased financing acquisition volumes for us. The amount of subsidy payments we receive from AHM and HCI is dependent on the terms of the incentive financing programs and the interest rate environment. Subsidy payments are received upon acquisition and recognized in revenue throughout the life of the loan or lease; therefore, a significant change in the level of incentive financing programs in a fiscal period typically only has a limited impact on our results of operations for that period. The amount of subsidy income we recognize in a fiscal period is dependent on the cumulative level of subsidized contracts outstanding that were acquired through incentive financing programs.

We seek to maintain high quality consumer and dealer account portfolios, which we support with strong underwriting standards, risk-based pricing, and effective collection practices. Our cost of funds is facilitated by the diversity of our funding sources, and effective interest rate and foreign currency exchange risk management. We manage expenses to support our profitability, including adjusting staffing needs based upon our business volumes and centralizing certain functions. Additionally, we use risk and compliance management practices to optimize credit and residual value risk levels and maintain compliance with our pricing, underwriting and servicing policies at the United States, Canadian, state and provincial levels.

In our business operations, we incur costs related to funding, credit loss, residual value loss, and general and administrative expenses, among other expenses.

We analyze our operations in two business segments defined by geography: the United States and Canada. We measure the performance of our United States and Canada segments on a pre-tax basis before the effect of valuation adjustments on derivative instruments and revaluations of foreign currency denominated debt. For additional information regarding our segments, see Note 14—Segment Information of *Notes to Consolidated Financial Statements (Unaudited)*. The following tables and the related discussion are presented based on our geographically segmented consolidated financial statements.

References in this report to our “fiscal year 2021” and “fiscal year 2020” refer to our fiscal year ending March 31, 2021 and our fiscal year ended March 31, 2020, respectively.

COVID-19 Pandemic

In March 2020, the World Health Organization declared COVID-19 a global pandemic. Extraordinary governmental measures were enacted in efforts to slow down and control the spread of COVID-19 including travel bans and border closings, shelter-in-place orders, closures of non-essential businesses and social distancing requirements. These restrictions, some of which have been and may continue to be reinstated, along with the related changes in consumer behaviors, have resulted and may continue to result in an economic slowdown and a significant increase in unemployment in the United States and Canada.

We have modified certain business practices, including remote work arrangements, and we may take further action as may be required by government authorities, or that we determine are in the best interest of our employees, customers and dealers. As of the date of this report, our remote work arrangements have not caused material adverse disruptions to our business operations or financial reporting functions. In an effort to reduce expenses, we also implemented temporary furloughs and salary reductions, which were lifted during May 2020 and September 2020, respectively.

To assist our existing retail loan and lease customers who may have been impacted by COVID-19, payment deferrals were granted to those customers who requested assistance beginning in mid-March 2020. Through the end of September 2020, a cumulative total of approximately 240,000 retail loans and 190,000 retail leases were granted payment deferrals, which represented approximately 10% and 12% of outstanding retail loans and retail leases as of September 30, 2020, respectively. By the end of September 2020, approximately 94% of these customers were required to resume making their payments. The deferral periods were up to a maximum of 3 months in the United States and 4 months in Canada, generally from the date the customer was initially granted the deferral. Customers taking advantage of the deferrals were not considered delinquent during such deferral periods and therefore were not reflected in our delinquency measures. In the United States, approximately 20% of the customers that were required to resume making their payments after the expiration of their deferral period were delinquent as of October 31, 2020, of which approximately 5% were 30 days or more past due and approximately 2% were repossessed or charged-off.

Many Honda and Acura dealerships temporarily suspended their sales operations beginning in mid-March. To help support the dealers during this period of disruption to their operations, beginning in March 2020, we granted deferrals of interest payments on floorplans and principal payments on commercial loans generally for a period of 3 months. Interest continued to accrue during the deferral period.

The suspension of sales operations at Honda and Acura dealerships and the decline in consumer demand had an impact on the sale of Honda and Acura vehicles. As a result, our consumer financing acquisition volumes also declined. Most dealerships resumed their sales operations beginning in May 2020 and with the support of incentive financing programs, our consumer financing acquisition volumes have recovered to pre-COVID-19 levels by June 2020.

Sales of returned vehicles were limited during April 2020 as most physical auctions temporarily suspended operations. Used vehicle prices were negatively impacted during the suspension of auctions but have since recovered to pre-COVID-19 levels by June 2020.

The COVID-19 pandemic initially led to disruptions and volatility in the global capital markets. To improve our liquidity position for potential disruptions in funding sources, we increased our cash balances in part through additional medium-term note issuances. Our overall ability to access funding sources has not been negatively impacted.

The near-and-long term impact of COVID-19 to our business remains highly uncertain and cannot be accurately predicted at this time. Although some of the initial governmental measures that were enacted to control the spread of COVID-19 have begun to be scaled back, recent surges in the spread of COVID-19 have resulted and may continue to result in the reimplementing of certain restrictions, which could adversely impact our business.

Results of Operations

The following table presents our income before income taxes:

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
(U.S. dollars in millions)				
Income before income taxes:				
United States segment	\$ 661	\$ 433	\$ 1,178	\$ 792
Canada segment	100	90	166	168
Total income before income taxes	<u>\$ 761</u>	<u>\$ 523</u>	<u>\$ 1,344</u>	<u>\$ 960</u>

Comparison of the Three Months Ended September 30, 2020 and 2019

Our consolidated income before income taxes was \$761 million during the second quarter of fiscal year 2021 compared to \$523 million during the same period in fiscal year 2020. This increase of \$238 million, or 46%, was due to the following differences:

	Three months ended September 30,		Difference	% Change
	2020	2019		
(U.S. dollars in millions)				
Net revenues:				
Retail	\$ 426	\$ 443	\$ (17)	(4)%
Dealer	25	57	(32)	(56)%
Operating lease, net of leased vehicle expenses	581	526	55	10 %
Interest expense	(226)	(318)	92	(29)%
Other income, net	17	23	(6)	(26)%
Total net revenues	<u>823</u>	<u>731</u>	<u>92</u>	<u>13 %</u>
Expenses:				
General and administrative expenses	116	124	(8)	(6)%
Provision for credit losses	(4)	58	(62)	(107)%
Early termination loss on operating leases	(59)	36	(95)	n/m
(Gain)/Loss on derivative instruments	(232)	174	(406)	n/m
(Gain)/Loss on foreign currency revaluation of debt	241	(184)	425	n/m
Total expenses	<u>62</u>	<u>208</u>	<u>(146)</u>	<u>(70)%</u>
Total income before income taxes	<u>\$ 761</u>	<u>\$ 523</u>	<u>\$ 238</u>	<u>46 %</u>

n/m = not meaningful

Comparison of the Six Months Ended September 30, 2020 and 2019

Our consolidated income before income taxes was \$1,344 million during the first six months of fiscal year 2021 compared to \$960 million during the same period in fiscal year 2020. This increase of \$384 million, or 40%, was due to the following differences:

	Six months ended September 30,			
	2020	2019	Difference	% Change
(U.S. dollars in millions)				
Net revenues:				
Retail	\$ 833	\$ 876	\$ (43)	(5)%
Dealer	57	122	(65)	(53)%
Operating lease, net of leased vehicle expenses	1,050	1,029	21	2 %
Interest expense	(490)	(640)	150	(23)%
Other income, net	29	43	(14)	(33)%
Total net revenues	<u>1,479</u>	<u>1,430</u>	<u>49</u>	<u>3 %</u>
Expenses:				
General and administrative expenses	228	245	(17)	(7)%
Provision for credit losses	(1)	106	(107)	(101)%
Early termination loss on operating leases	(115)	60	(175)	n/m
(Gain)/Loss on derivative instruments	(325)	205	(530)	n/m
(Gain)/Loss on foreign currency revaluation of debt	348	(146)	494	n/m
Total expenses	<u>135</u>	<u>470</u>	<u>(335)</u>	<u>(71)%</u>
Total income before income taxes	<u>\$ 1,344</u>	<u>\$ 960</u>	<u>\$ 384</u>	<u>40 %</u>

n/m = not meaningful

Segment Results—Comparison of the Three Months Ended September 30, 2020 and 2019

Results of operations for the United States segment and the Canada segment are summarized below:

	United States Segment		Canada Segment		Consolidated	
	Three months ended September 30,		Three months ended September 30,		Three months ended September 30,	
	2020	2019	2020	2019	2020	2019
(U.S. dollars in millions)						
Revenues:						
Retail	\$ 377	\$ 390	\$ 49	\$ 53	\$ 426	\$ 443
Dealer	22	51	3	6	25	57
Operating leases	1,607	1,595	335	340	1,942	1,935
Total revenues	2,006	2,036	387	399	2,393	2,435
Leased vehicle expenses	1,108	1,152	253	257	1,361	1,409
Interest expense	197	273	29	45	226	318
Net revenues	701	611	105	97	806	708
Other income, net	12	20	5	3	17	23
Total net revenues	713	631	110	100	823	731
Expenses:						
General and administrative expenses	104	109	12	15	116	124
Provision for credit losses	(2)	56	(2)	2	(4)	58
Early termination loss on operating leases	(56)	36	(3)	—	(59)	36
(Gain)/Loss on derivative instruments	(235)	181	3	(7)	(232)	174
(Gain)/Loss on foreign currency revaluation of debt	241	(184)	—	—	241	(184)
Income before income taxes	\$ 661	\$ 433	\$ 100	\$ 90	\$ 761	\$ 523

Revenues

Revenue from retail loans in the United States segment decreased by \$13 million, or 3%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was primarily attributable to lower yields due to the declining interest rate environment. Revenue from retail loans in the Canada segment decreased by \$4 million, or 8%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was attributable to lower average outstanding balances and lower yields.

Operating lease revenue in the United States segment increased by \$12 million, or 1%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The increase was primarily attributable to higher average outstanding operating leases. Operating lease revenue in the Canada segment decreased by \$5 million, or 1%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was attributable to lower average outstanding operating leases and the effect of foreign currency translation adjustments.

Revenue from dealer loans in the United States segment decreased by \$29 million, or 57%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was attributable to lower yields due to the declining interest rate environment and lower average outstanding balances. Revenue from dealer loans in the Canada segment decreased by \$3 million, or 50%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was attributable to lower yields due to the declining interest rate environment and lower average outstanding balances.

Consolidated subsidy income from AHM and HCI sponsored incentive programs decreased by \$37 million, or 9%, to \$381 million during the second quarter of fiscal year 2021 compared to \$418 million during the same period in fiscal year 2020 primarily due to lower average outstanding incentive leases and incentive retail loans which resulted in the decrease in average subsidy payments received.

Leased vehicle expenses

Leased vehicle expenses in the United States segment decreased by \$44 million, or 4%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was attributable to higher gains on disposition of leased vehicles due to strong used vehicle prices during the second quarter of fiscal year 2021. Leased vehicle expenses in the Canada segment decreased by \$4 million, or 2%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was due to the decrease in depreciation on operating leases due to lower average outstanding operating leases and the effect of foreign currency translation adjustments.

Interest expense

Interest expense in the United States segment decreased by \$76 million, or 28%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020 primarily due to lower average interest rates. Interest expense in the Canada segment decreased by \$16 million, or 36%, during the second quarter of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was attributable to lower average interest rates and lower average outstanding debt. See “—*Liquidity and Capital Resources*” below for more information.

Provision for credit losses

In the United States segment, we recognized a negative provision for credit losses of \$2 million, during the second quarter of fiscal year 2021 compared to provision for credit losses of \$56 million during the same period in fiscal year 2020. The negative provision for credit losses was primarily attributable to lower than expected net charge-offs of retail loans during the second quarter of fiscal year 2021. In the Canada segment, we recognized a negative provision for credit losses of \$2 million during the second quarter of fiscal year 2021 compared to provision for credit losses of \$2 million during the same period in fiscal year 2020. The negative provision for credit losses is attributable to lower than expected net charge-offs during the second quarter of fiscal year 2021. See “—*COVID-19 Pandemic*” above and “—*Financial Condition—Credit Risk*” below for more information.

Early termination loss on operating leases

In the United States segment, we recognized a reversal of early termination losses on operating leases of \$56 million, during the second quarter of fiscal year 2021 compared to early termination losses of \$36 million during the same period in fiscal year 2020. The reversal of early termination losses was the result of lower than expected realized losses during the second quarter of fiscal year 2021 and a reduction in the estimated impact that COVID-19 will have on lessee default rates. In the Canada segment, we recognized a reversal of early termination losses on operating leases of \$3 million during the second quarter of fiscal year 2021 compared to early termination losses of less than \$1 million during the same period in fiscal year 2020. The reversal of early termination losses was the result of lower than expected realized losses during the second quarter of fiscal year 2021. See “—*COVID-19 Pandemic*” above and “—*Financial Condition—Credit Risk*” below for more information.

Gain/loss on derivative instruments

In the United States segment, we recognized a gain on derivative instruments of \$235 million during the second quarter of fiscal year 2021 compared to a loss of \$181 million during the same period in fiscal year 2020. The gain in the second quarter of fiscal year 2021 was attributable to a gain on cross currency swaps of \$238 million and a gain on pay float interest rate swaps of \$1 million, partially offset by a loss on pay fixed interest rate swaps of \$4 million. The gain on cross currency swaps during the second quarter of fiscal year 2021 was primarily attributable to the U.S. dollar weakening against the Euro and Sterling during the period. In the Canada segment, we recognized a loss on derivative instruments of \$3 million during the second quarter of fiscal year 2021 compared to a gain of \$7 million during the same period in fiscal year 2020. The loss in the second quarter of fiscal year 2021 was due to a decline in applicable swap rates during the period. See “—*Derivatives*” below for more information.

Gain/loss on foreign currency revaluation of debt

In the United States segment, we recognized a loss on the revaluation of foreign currency denominated debt of \$241 million during the second quarter of fiscal year 2021 compared to a gain of \$184 million during the same period in fiscal year 2020. The loss in the second quarter of fiscal year 2021 was primarily due to the U.S. dollar weakening against the Euro and Sterling during the period.

Income tax expense

The consolidated effective tax rate was 27.3% for the second quarter of fiscal year 2021 and 25.8% for the same period in fiscal year 2020. The increase in the comparable period effective tax rate was primarily due to U.S. state taxes. For additional information regarding income taxes, see Note 7—Income Taxes of *Notes to Consolidated Financial Statements (Unaudited)*.

Segment Results—Comparison of the Six Months Ended September 30, 2020 and 2019

Results of operations for the United States segment and the Canada segment are summarized below:

	United States Segment		Canada Segment		Consolidated	
	Six months ended September 30,		Six months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019	2020	2019
	(U.S. dollars in millions)					
Revenues:						
Retail	\$ 740	\$ 772	\$ 93	\$ 104	\$ 833	\$ 876
Dealer	50	110	7	12	57	122
Operating leases	3,194	3,160	653	670	3,847	3,830
Total revenues	3,984	4,042	753	786	4,737	4,828
Leased vehicle expenses	2,298	2,294	499	507	2,797	2,801
Interest expense	427	550	63	90	490	640
Net revenues	1,259	1,198	191	189	1,450	1,387
Other income, net	22	37	7	6	29	43
Total net revenues	1,281	1,235	198	195	1,479	1,430
Expenses:						
General and administrative expenses	202	215	26	30	228	245
Provision for credit losses	2	104	(3)	2	(1)	106
Early termination loss on operating leases	(117)	59	2	1	(115)	60
(Gain)/Loss on derivative instruments	(332)	211	7	(6)	(325)	205
(Gain)/Loss on foreign currency revaluation of debt	348	(146)	—	—	348	(146)
Income before income taxes	\$ 1,178	\$ 792	\$ 166	\$ 168	\$ 1,344	\$ 960

Revenues

Revenue from retail loans in the United States segment decreased by \$32 million, or 4%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was primarily attributable to lower yields due to the declining interest rate environment. Revenue from retail loans in the Canada segment decreased by \$11 million, or 11%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was attributable to lower average outstanding balances and lower yields due to the declining interest rate environment.

Operating lease revenue in the United States segment increased by \$34 million, or 1%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The increase was primarily attributable to higher average outstanding operating leases. Operating lease revenue in the Canada segment decreased by \$17 million, or 3%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was attributable to lower average outstanding operating leases, lower net revenue on more recently acquired operating leases and the effect of foreign currency translation adjustments.

Revenue from dealer loans in the United States segment decreased by \$60 million, or 55%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was attributable to lower yields due to the declining interest rate environment and lower average outstanding balances. Revenue from dealer loans in the Canada segment decreased by \$5 million, or 42%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in revenue was primarily due to lower yields due to the declining interest rate environment.

Consolidated subsidy income from AHM and HCI sponsored incentive programs decreased by \$105 million, or 12%, to \$740 million during the first six months of fiscal year 2021 compared to \$845 million during the same period in fiscal year 2020 primarily due to lower average outstanding incentive leases and incentive retail loans which resulted in the decrease in average subsidy payments received.

Leased vehicle expenses

Leased vehicle expenses in the United States segment increased by \$4 million during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The increase was attributable to the increase in depreciation due to higher average outstanding operating leases partially offset by higher gains on disposition of leased vehicles due to strong used vehicle prices during the first six months of fiscal year 2021. Leased vehicle expenses in the Canada segment decreased by \$8 million, or 2%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was primarily due to the decrease in depreciation on operating leases due to lower average outstanding operating leases and the effect of foreign currency translation adjustments.

Interest expense

Interest expense in the United States segment decreased by \$123 million, or 22%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020 primarily due to lower average interest rates. Interest expense in the Canada segment decreased by \$27 million, or 30%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease was attributable to lower average interest rates and lower average outstanding debt. See “—*Liquidity and Capital Resources*” below for more information.

Provision for credit losses

The provision for credit losses in the United States segment decreased by \$102 million, or 98%, during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. The decrease in the provision for credit losses was primarily attributable to lower than expected net charge-offs of retail loans during the first six months of fiscal year 2021. In the Canada segment, we recognized a negative provision for credit losses of \$3 million during the first six months of fiscal year 2020 compared to provision for credit losses of \$2 million in the same period in fiscal year 2020. The negative provision for credit losses was primarily attributable to lower than expected net charge-offs during the first six months of fiscal year 2021. See “—*COVID-19 Pandemic*” above and “—*Financial Condition—Credit Risk*” below for more information.

Early termination loss on operating leases

In the United States segment, we recognized a reversal of early termination losses on operating leases of \$117 million during the first six months of fiscal year 2021 compared to early termination losses of \$59 million during the same period in fiscal year 2020. The reversal of early termination losses was the result of lower than expected realized losses during the first six months of fiscal year 2021 and a reduction in the estimated impact that COVID-19 will have on lessee default rates. Early termination losses on operating leases in the Canada segment increased by \$1 million during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020. See “—*COVID-19 Pandemic*” above and “—*Financial Condition—Credit Risk*” below for more information.

Gain/loss on derivative instruments

In the United States segment, we recognized a gain on derivative instruments of \$332 million during the first six months of fiscal year 2021 compared to a loss of \$211 million during the same period in fiscal year 2020. The gain in the first six months of fiscal year 2021 was attributable to a gain on cross currency swaps of \$340 million and a gain on pay float interest rate swaps of \$65 million, partially offset by a loss on pay fixed interest rate swaps of \$73 million. The gain on cross currency swaps during the first quarter of fiscal year 2021 was primarily attributable to the U.S. dollar weakening against the Euro and Sterling during the period. The loss on pay fixed interest rate swaps and gain on pay float interest rate swaps during the first six months of fiscal year 2021 were primarily due to the decline in applicable swap rates during the period. In the Canada segment, we recognized a loss on derivative instruments of \$7 million during the first six months of fiscal year 2021 compared to a gain of \$6 million during the same period in fiscal year 2020. The loss in the first six months of fiscal year 2021 was due to a decline in applicable swap rates during the period. See “—*Derivatives*” below for more information.

Gain/loss on foreign currency revaluation of debt

In the United States segment, we recognized a loss on the revaluation of foreign currency denominated debt of \$348 million during the first six months of fiscal year 2021 compared to a gain of \$146 million during the same period in fiscal year 2020. The loss in the first six months of fiscal year 2021 was primarily due to the U.S. dollar weakening against the Euro and Sterling during the period.

Income tax expense

The consolidated effective tax rate was 26.4% for the first six months of fiscal year 2021 and 28.4% for the same period in fiscal year 2020. The reduction in the comparable period effective tax rate was primarily due to changes in unrecognized tax benefits in the six months ended September 30, 2019, offset in part by an increase in state taxes. For additional information regarding income taxes, see Note 7—Income Taxes of *Notes to Consolidated Financial Statements (Unaudited)*.

Financial Condition

Consumer Financing

Consumer Financing Acquisition Volumes

The following table summarizes the number of retail loans and leases we acquired and the number of such loans and leases acquired through incentive financing programs sponsored by AHM and HCI:

	Three months ended September 30,				Six months ended September 30,			
	2020		2019		2020		2019	
	Acquired	Sponsored ⁽²⁾	Acquired	Sponsored ⁽²⁾	Acquired	Sponsored ⁽²⁾	Acquired	Sponsored ⁽²⁾
(Units ⁽¹⁾ in thousands)								
United States Segment								
Retail loans:								
New auto	159	133	120	71	268	224	222	128
Used auto	36	14	31	2	59	23	69	10
Motorcycle and other	21	1	17	—	53	1	40	1
Total retail loans	216	148	168	73	380	248	331	139
Leases	136	119	157	128	232	202	298	239
Canada Segment								
Retail loans:								
New auto	20	18	18	16	29	26	35	32
Used auto	4	—	1	—	6	—	2	—
Motorcycle and other	4	3	2	2	7	6	5	5
Total retail loans	28	21	21	18	42	32	42	37
Leases	23	23	25	24	34	33	52	50
Consolidated								
Retail loans:								
New auto	179	151	138	87	297	250	257	160
Used auto	40	14	32	2	65	23	71	10
Motorcycle and other	25	4	19	2	60	7	45	6
Total retail loans	244	169	189	91	422	280	373	176
Leases	159	142	182	152	266	235	350	289

- (1) A unit represents one retail loan or lease contract, as noted, that was originated in the United States and acquired by AHFC or its subsidiaries, or that was originated in Canada and acquired by HCFI, in each case during the period shown.
- (2) Represents the number of retail loans and leases acquired through incentive financing programs sponsored by AHM and/or HCI and only those contracts with subsidy payments. Excludes contracts where contractual rates met or exceeded AHFC's yield requirements and subsidy payments were not required.

Consumer Financing Penetration Rates

The following table summarizes the percentage of AHM and/or HCI sales of new automobiles and motorcycles that were financed with either retail loans or leases that we acquired:

	<u>Three months ended September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
<u>United States Segment</u>				
New auto	76%	64%	73%	62%
Motorcycle	33%	32%	33%	33%
<u>Canada Segment</u>				
New auto	93%	81%	82%	81%
Motorcycle	39%	31%	30%	30%
<u>Consolidated</u>				
New auto	78%	66%	74%	64%
Motorcycle	34%	32%	33%	33%

Consumer Financing Asset Balances

The following table summarizes our outstanding retail loan and lease asset balances and units:

	September 30, 2020	March 31, 2020	September 30, 2020	March 31, 2020
	(U.S. dollars in millions)		(Units ⁽¹⁾ in thousands)	
United States Segment				
Retail loans:				
New auto	\$ 25,660	\$ 24,353	1,544	1,510
Used auto	5,118	4,999	367	356
Motorcycle and other	1,328	1,145	202	192
Total retail loans	<u>\$ 32,106</u>	<u>\$ 30,497</u>	<u>2,113</u>	<u>2,058</u>
Investment in operating leases	\$ 29,267	\$ 28,809	1,309	1,318
Securitized retail loans ⁽²⁾	\$ 9,740	\$ 8,977	759	703
Canada Segment				
Retail loans:				
New auto	\$ 3,445	\$ 3,195	253	258
Used auto	232	178	25	24
Motorcycle and other	116	84	22	20
Total retail loans	<u>\$ 3,793</u>	<u>\$ 3,457</u>	<u>300</u>	<u>302</u>
Investment in operating leases	\$ 5,171	\$ 5,034	285	296
Securitized retail loans ⁽²⁾	\$ 557	\$ 668	52	58
Securitized investments in operating leases ⁽²⁾	\$ 472	\$ 493	24	24
Consolidated				
Retail loans:				
New auto	\$ 29,105	\$ 27,548	1,797	1,768
Used auto	5,350	5,177	392	380
Motorcycle and other	1,444	1,229	224	212
Total retail loans	<u>\$ 35,899</u>	<u>\$ 33,954</u>	<u>2,413</u>	<u>2,360</u>
Investment in operating leases	\$ 34,438	\$ 33,843	1,594	1,614
Securitized retail loans ⁽²⁾	\$ 10,297	\$ 9,645	811	761
Securitized investments in operating leases ⁽²⁾	\$ 472	\$ 493	24	24

(1) A unit represents one retail loan or lease contract, as noted, that was outstanding as of the date shown.

(2) Securitized retail loans and investments in operating leases represent the portion of total managed assets that have been sold in securitization transactions but continue to be recognized on our balance sheet.

In the United States segment, retail loan acquisition volumes increased by 15% during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020 primarily due to the increase in sponsored new auto loan acquisition volumes. Lease acquisition volumes decreased by 22% during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020 due to the decrease in both sponsored and non-sponsored program volumes. In the Canada segment, retail loan acquisition volumes during the first six months of fiscal year 2021 were flat compared to the same period in fiscal year 2020. Lease acquisition volumes decreased by 35% during the first six months of fiscal year 2021 compared to the same period in fiscal year 2020 due to the decrease in sponsored program volumes.

Dealer Financing

Wholesale Flooring Financing Penetration Rates

The following table summarizes the number of dealerships with wholesale flooring financing agreements as a percentage of total Honda and Acura dealerships in the United States and/or Canada, as applicable:

	<u>September 30, 2020</u>	<u>March 31, 2020</u>
<u>United States Segment</u>		
Automobile	29 %	29 %
Motorcycle	97 %	97 %
Other	17 %	16 %
<u>Canada Segment</u>		
Automobile	35 %	36 %
Motorcycle	94 %	96 %
Other	92 %	93 %
<u>Consolidated</u>		
Automobile	30 %	30 %
Motorcycle	97 %	97 %
Other	19 %	19 %

Wholesale Flooring Financing Percentage of Sales

The following table summarizes the percentage of AHM unit sales in the United States and/or HCI unit sales in Canada, as applicable, that we financed through wholesale flooring loans with dealerships:

	<u>Three months ended September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
<u>United States Segment</u>				
Automobile	24%	26%	23%	27%
Motorcycle	98%	98%	98%	97%
Other	9%	9%	9%	9%
<u>Canada Segment</u>				
Automobile	32%	33%	32%	33%
Motorcycle	85%	95%	87%	92%
Other	97%	96%	97%	96%
<u>Consolidated</u>				
Automobile	25%	27%	24%	27%
Motorcycle	96%	97%	97%	97%
Other	11%	11%	13%	13%

Dealer Financing Asset Balances

The following table summarizes our outstanding dealer financing asset balances and units:

	September 30, 2020	March 31, 2020	September 30, 2020	March 31, 2020
	(U.S. dollars in millions)		(Units ⁽¹⁾ in thousands)	
United States Segment				
Wholesale flooring loans:				
Automobile	\$ 2,040	\$ 3,049	71	109
Motorcycle	260	760	32	96
Other	44	55	36	56
Total wholesale flooring loans	<u>\$ 2,344</u>	<u>\$ 3,864</u>	<u>139</u>	<u>261</u>
Commercial loans	\$ 826	\$ 1,020		
Canada Segment				
Wholesale flooring loans:				
Automobile	\$ 391	\$ 547	15	21
Motorcycle	36	91	5	13
Other	19	24	16	27
Total wholesale flooring loans	<u>\$ 446</u>	<u>\$ 662</u>	<u>36</u>	<u>61</u>
Commercial loans	\$ 57	\$ 54		
Consolidated				
Wholesale flooring loans:				
Automobile	\$ 2,431	\$ 3,596	86	130
Motorcycle	296	851	37	109
Other	63	79	52	83
Total wholesale flooring loans	<u>\$ 2,790</u>	<u>\$ 4,526</u>	<u>175</u>	<u>322</u>
Commercial loans	\$ 883	\$ 1,074		

(1) A unit represents one automobile, power equipment, or marine engine, as applicable, financed through a wholesale flooring loan that was outstanding as of the date shown.

Credit Risk

Credit losses are an expected cost of extending credit. The majority of our credit risk is in consumer financing and to a lesser extent in dealer financing. Credit risk of our portfolio of consumer finance receivables can be affected by general economic conditions. Adverse changes, such as a rise in unemployment, can increase the likelihood of defaults. Declines in used vehicle prices can reduce the amount of recoveries on repossessed collateral. We manage our exposure to credit risk in retail loans by monitoring and adjusting our underwriting standards, which affect the level of credit risk that we assume, pricing contracts for expected losses and focusing collection efforts to minimize losses. We manage our exposure to credit risk for dealers through ongoing reviews of their financial condition.

We are also exposed to credit risk on our portfolio of operating lease assets. We expect a portion of our operating leases to terminate prior to their scheduled maturities when lessees default on their contractual obligations. Losses are generally realized upon the disposition of the repossessed operating lease vehicles. The factors affecting credit risk on our operating leases and our management of the risk are similar to that of our consumer finance receivables.

Credit risk on dealer loans is affected primarily by the financial strength of the dealers within the portfolio, the value of collateral securing the financings, and economic and market factors that could affect the creditworthiness of dealers. We manage our exposure to credit risk in dealer financing by performing comprehensive reviews of dealers prior to establishing financing arrangements and monitoring the payment performance and creditworthiness of these dealers on an ongoing basis. In the event of default by a dealer, we seek all available legal remedies pursuant to related dealer agreements, guarantees, security interests on collateral, or liens on dealership assets. Additionally, we have agreements with AHM and HCI that provide for their repurchase of new, unused, undamaged and unregistered vehicles or equipment that have been repossessed from dealers who defaulted under the terms of their respective wholesale flooring agreements.

With the adoption of ASC 2016-13, the allowance for credit losses is management's estimate of lifetime expected credit losses on the amortized cost basis of finance receivables. Additional information regarding credit losses is provided in the discussion of "*Critical Accounting Policies—Credit Losses*" below.

The following table presents information with respect to our allowance for credit losses and credit loss experience of our finance receivables and losses related to lessee defaults on our operating leases:

	As of or for the three months ended September 30,		As of or for the six months ended September 30,	
	2020	2019	2020	2019
(U.S. dollars in millions)				
United States Segment				
Finance receivables:				
Allowance for credit losses at beginning of period ⁽⁴⁾	\$ 421	\$ 198	\$ 456	\$ 194
Provision for credit losses	(2)	56	2	104
Charge-offs, net of recoveries	(17)	(64)	(56)	(108)
Allowance for credit losses at end of period	<u>\$ 402</u>	<u>\$ 190</u>	<u>\$ 402</u>	<u>\$ 190</u>
Allowance as a percentage of ending receivable balance ⁽¹⁾			1.12 %	0.53 %
Charge-offs as a percentage of average receivable balance ^{(1), (3)}	0.19 %	0.70 %	0.32 %	0.59 %
Delinquencies (60 or more days past due):				
Delinquent amount ⁽²⁾			\$ 90	\$ 107
As a percentage of ending receivable balance ^{(1), (2)}			0.25 %	0.29 %
Operating leases:				
Early termination loss on operating leases	\$ (56)	\$ 36	\$ (117)	\$ 59
Canada Segment				
Finance receivables:				
Allowance for credit losses at beginning of period ⁽⁴⁾	13	6	15	7
Provision for credit losses	(2)	2	(3)	2
Charge-offs, net of recoveries	(1)	(1)	(2)	(2)
Effect of translation adjustment	1	—	1	—
Allowance for credit losses at end of period	<u>\$ 11</u>	<u>\$ 7</u>	<u>\$ 11</u>	<u>\$ 7</u>
Allowance as a percentage of ending receivable balance ⁽¹⁾			0.26 %	0.13 %
Charge-offs as a percentage of average receivable balance ^{(1), (3)}	— %	0.11 %	0.07 %	0.09 %
Delinquencies (60 or more days past due):				
Delinquent amount ⁽²⁾			\$ 3	\$ 5
As a percentage of ending receivable balance ^{(1), (2)}			0.07 %	0.12 %
Operating leases:				
Early termination loss on operating leases	\$ (3)	\$ —	\$ 2	\$ 1
Consolidated				
Finance receivables:				
Allowance for credit losses at beginning of period ⁽⁴⁾	\$ 434	\$ 204	\$ 471	\$ 201
Provision for credit losses	(4)	58	(1)	106
Charge-offs, net of recoveries	(18)	(65)	(58)	(110)
Effect of translation adjustment	1	—	1	—
Allowance for credit losses at end of period	<u>\$ 413</u>	<u>\$ 197</u>	<u>\$ 413</u>	<u>\$ 197</u>
Allowance as a percentage of ending receivable balance ⁽¹⁾			1.03 %	0.48 %
Charge-offs as a percentage of average receivable balance ^{(1), (3)}	0.17 %	0.63 %	0.29 %	0.54 %
Delinquencies (60 or more days past due):				
Delinquent amount ⁽²⁾			\$ 93	\$ 112
As a percentage of ending receivable balance ^{(1), (2)}			0.23 %	0.27 %
Operating leases:				
Early termination loss on operating leases	\$ (59)	\$ 36	\$ (115)	\$ 60

- (1) Ending and average receivable balances exclude the allowance for credit losses, unearned subvention income related to our incentive financing programs and deferred origination costs. Average receivable balances are calculated based on the average of each month's ending receivables balance for each respective period.
- (2) For the purposes of determining whether a contract is delinquent, payment is generally considered to have been made, in the case of (i) dealer loans, upon receipt of 100% of the payment when due and (ii) consumer finance receivables, upon receipt of 90% of the sum of the current monthly payment plus any overdue monthly payments. Delinquent amounts presented are the aggregated principal balances of delinquent finance receivables. Payments that were granted deferrals are not considered delinquent during the deferral period. See above under "—COVID-19 Pandemic" for additional information.
- (3) Percentages for the three and six months ended September 30, 2020 and September 30, 2019 have been annualized.
- (4) Beginning allowance for the six months ended September 30, 2020 includes the cumulative effect of adopting ASU 2016-13.

In the United States segment, the provision for credit losses on our finance receivables was \$2 million during the first six months of fiscal year 2021 compared to \$104 million during the same period in fiscal year 2020. The decrease in the provision for credit losses was primarily attributable to the decrease in the provision for retail loans of \$92 million. Net charge-offs during the first six months of fiscal year 2021 were favorable relative to the expected credit losses for the period, which had a positive effect on the provision for credit losses on retail loans. Delinquencies and net charge-offs of retail loans during the first six months of fiscal year 2021 were lower compared to the same period in fiscal year 2020 due in part to payment deferrals that were granted to requesting customers as a result of COVID-19. It is expected however that some customers will not be able to make the contractual payments after the deferral period and will ultimately default. We recognized a reversal of early termination losses on operating leases of \$117 million during the first six months of fiscal year 2021 compared to losses of \$59 million during the same period in fiscal year 2020. The reversal of early termination losses was the result of lower than expected realized losses during the first six months of fiscal year 2021 and a reduction in the estimated impact that COVID-19 will have on lessee default rates. The effect of higher unemployment rates was reduced in the modeling of estimated early termination losses. See above under “—COVID-19 Pandemic” for additional information.

In the Canada segment, we recognized a negative provision for credit losses of \$3 million on our finance receivables during the first six months of fiscal year 2021 compared to a provision for credit losses of \$2 million during the same period in fiscal year 2020. The negative provision for credit losses is primarily attributable to lower than expected net charge-offs of retail loans during the first six months of fiscal year 2021. Early termination losses on operating lease assets was \$2 million during the first six months of fiscal year 2021 compared to \$1 million during the same period in fiscal year 2020.

Lease Residual Value Risk

Contractual residual values of lease vehicles are determined at lease inception based on expectations of future used vehicle values, taking into consideration external industry data and our own historical experience. Lease customers have the option at the end of the lease term to return the vehicle to the dealer or to buy the vehicle at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance). Returned lease vehicles can be purchased by the grounding dealer at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance) or for a market based price. Returned lease vehicles that are not purchased by the grounding dealers are sold through online and physical auctions. We are exposed to risk of loss on the disposition of returned lease vehicles when the proceeds from the sale of the vehicles are less than the contractual residual values.

We assess our estimates for end of lease term market values of leased vehicles, at minimum, on a quarterly basis. The primary factors affecting the estimates are the percentage of leased vehicles that we expect to be returned by the lessee at the end of lease term and expected loss severities. Factors considered in this evaluation include, among other factors, economic conditions, historical trends, and market information on new and used vehicles. Our leasing volumes and those across the automotive industry have increased significantly in recent years. As a result, the supply of off-lease vehicles will continue to increase over the next several years, which could negatively impact used vehicle prices. Adjustments to estimated residual values are made on a straight-line basis over the remaining term of the lease and recognized as depreciation expense. Additional information regarding lease residual values is provided in the discussion of “—Critical Accounting Policies—Determination of Lease Residual Values” below.

We also review our investment in operating leases for impairment whenever events or changes in circumstances indicate that the carrying values may not be recoverable. If impairment conditions are met, impairment losses are measured by the amount the carrying values exceed their fair values. We did not recognize impairment losses due to declines in estimated residual values during the first six months of fiscal year 2021 or the same period in fiscal year 2020.

The following table summarizes our number of lease terminations and the method of disposition:

	Three months ended September 30,		Six months ended September 30,	
	2020	2019	2020	2019
(Units ⁽¹⁾ in thousands)				
United States Segment				
Termination units:				
Sales at outstanding contractual balances ⁽²⁾	116	95	180	196
Sales through auctions and dealer direct programs ⁽³⁾	21	40	59	94
Total termination units	137	135	239	290
Canada Segment				
Termination units:				
Sales at outstanding contractual balances ⁽²⁾	25	22	40	45
Sales through auctions and dealer direct programs ⁽³⁾	1	2	4	4
Total termination units	26	24	44	49
Consolidated				
Termination units:				
Sales at outstanding contractual balances ⁽²⁾	141	117	220	241
Sales through auctions and dealer direct programs ⁽³⁾	22	42	63	98
Total termination units	163	159	283	339

- (1) A unit represents one terminated lease by their method of disposition during the period shown. Unit counts do not include leases that were terminated due to lessee defaults.
- (2) Includes vehicles purchased by lessees or dealers for the contractual residual value at lease maturity or the outstanding contractual balance if purchased prior to lease maturity.
- (3) Includes vehicles sold through online auctions and market based pricing options under our dealer direct programs or through physical auctions.

Liquidity and Capital Resources

Our liquidity strategy is to fund current and future obligations through our cash flows from operations and our diversified funding programs in a cost and risk effective manner. Our cash flows are generally impacted by cash requirements related to the volume of finance receivable and operating lease acquisitions and various operating and funding costs incurred, which are largely funded through payments received on our assets and our funding sources outlined below. As noted, the levels of incentive financing sponsored by AHM and HCI can impact our financial results and liquidity from period to period. Increases or decreases in incentive financing programs typically increase or decrease our financing penetration rates, respectively, which result in increased or decreased acquisition volumes and increased or decreased liquidity needs, respectively. At acquisition, we receive the subsidy payments, which reduce the cost of consumer loan and lease contracts acquired, and we recognize such payments as revenue over the term of the loan or lease.

In an effort to minimize liquidity risk and interest rate risk and the resulting negative effects on our margins, results of operations and cash flows, our funding strategy incorporates investor diversification and the utilization of multiple funding sources including commercial paper, medium-term notes, bank loans and asset-backed securities. We incorporate a funding strategy that takes into consideration factors such as the interest rate environment, domestic and foreign capital market conditions, maturity profiles, and economic conditions. See above under “—COVID-19 Pandemic” for additional information. We believe that our funding sources, combined with cash provided by operating and investing activities, will provide sufficient liquidity for us to meet our debt service and working capital requirements over the next twelve months.

The summary of outstanding debt presented in the tables and discussion below in this section “—*Liquidity and Capital Resources*” as of September 30, 2020 and March 31, 2020 includes foreign currency denominated debt, which was translated into U.S. dollars using the relevant exchange rates as of September 30, 2020 and March 31, 2020, as applicable. Additionally, the amounts in this section that are presented in “C\$” (Canadian dollar), “€” (Euro), “£” (Sterling) and “¥” (Yen) were converted into U.S. dollars solely for the convenience based on the exchange rate on September 30, 2020 of 1.3319, 1.1718, 1.2902 and 105.47, respectively, per U.S. dollar. These translations should not be construed as representations that the converted amounts actually represent such U.S. dollar amounts or that they could be converted into U.S. dollars at the rates indicated.

Summary of Outstanding Debt

The table below presents a summary of our outstanding debt by various funding sources:

			Weighted average contractual interest rate	
	September 30, 2020	March 31, 2020	September 30, 2020	March 31, 2020
(U.S. dollars in millions)				
United States Segment				
Unsecured debt:				
Commercial paper	\$ 3,498	\$ 4,486	0.44 %	1.83 %
Bank loans	3,798	3,797	1.04 %	2.21 %
Private MTN program	500	999	3.80 %	3.84 %
Public MTN program	27,056	25,130	1.66 %	2.07 %
Euro MTN programme	28	28	2.23 %	2.23 %
Total unsecured debt	34,880	34,440		
Secured debt	9,454	8,710	1.68 %	2.26 %
Total debt	\$ 44,334	\$ 43,150		
Canada Segment				
Unsecured debt:				
Commercial paper	\$ 855	\$ 1,004	0.57 %	1.73 %
Related party debt	375	533	0.54 %	1.76 %
Bank loans	1,182	1,141	1.22 %	2.01 %
Other debt	3,635	3,266	2.18 %	2.47 %
Total unsecured debt	6,047	5,944		
Secured debt	909	1,038	1.01 %	2.13 %
Total debt	\$ 6,956	\$ 6,982		
Consolidated				
Unsecured debt:				
Commercial paper	\$ 4,353	\$ 5,490	0.47 %	1.81 %
Related party debt	375	533	0.54 %	1.76 %
Bank loans	4,980	4,938	1.08 %	2.16 %
Private MTN program	500	999	3.80 %	3.84 %
Public MTN program	27,056	25,130	1.66 %	2.07 %
Euro MTN programme	28	28	2.23 %	2.23 %
Other debt	3,635	3,266	2.18 %	2.47 %
Total unsecured debt	40,927	40,384		
Secured debt	10,363	9,748	1.62 %	2.25 %
Total debt	\$ 51,290	\$ 50,132		

Commercial Paper

As of September 30, 2020, we had commercial paper programs in the United States of \$7.0 billion and in Canada of C\$2.5 billion (\$1.9 billion). Interest rates on the commercial paper are fixed at the time of issuance. During the six months ended September 30, 2020, consolidated commercial paper month-end outstanding principal balances ranged from \$3.7 billion to \$5.9 billion.

Related Party Debt

HCFI issues fixed rate notes to HCI to help fund HCFI's general corporate operations. Interest rates are based on prevailing rates of debt with comparable terms. Generally, the term of these notes is less than 120 days.

Bank Loans

During the six months ended September 30, 2020, AHFC did not enter into any term loan agreements. HCFI entered into two floating rate term loan agreements for a total of C\$600 million (\$450 million). As of September 30, 2020, we had bank loans denominated in U.S. dollars and Canadian dollars with floating and fixed interest rates, in principal amounts ranging from \$38 million to \$600 million. As of September 30, 2020, the remaining maturities of all bank loans outstanding ranged from 79 days to approximately 4.5 years. The weighted average remaining maturity on all bank loans was 1.5 years as of September 30, 2020.

Our bank loans contain customary restrictive covenants, including limitations on liens, mergers, consolidations and asset sales, and a financial covenant that requires us to maintain positive consolidated tangible net worth. In addition to other customary events of default, the bank loans include cross-default provisions and provisions for default if HMC does not maintain ownership, whether directly or indirectly, of at least 80% of the outstanding capital stock of AHFC or HCFI, as applicable. All of these covenants and events of default are subject to important limitations and exceptions under the agreements governing the bank loans. As of September 30, 2020, management believes that AHFC and HCFI were in compliance with all covenants contained in our bank loans.

Medium-Term Note (MTN) Programs

Private MTN Program

AHFC no longer issues MTNs under its Rule 144A Private MTN Program. As of September 30, 2020, AHFC has one note outstanding under the Private MTN program with a remaining maturity that does not exceed 1.0 year. The note was issued pursuant to the terms of an issuing and paying agency agreement, which requires AHFC to comply with certain covenants, including negative pledge provisions, and includes customary events of defaults. As of September 30, 2020, management believes that AHFC was in compliance with all covenants contained in the Private MTN.

Public MTN Program

AHFC is a well-known seasoned issuer under SEC rules and issues Public MTNs pursuant to a registration statement on Form S-3 filed with the SEC. In August 2019, AHFC renewed its Public MTN program by filing a registration statement with the SEC under which it may issue from time to time up to \$30.0 billion aggregate principal amount of Public MTNs, which includes the issuance of foreign currency denominated notes into international markets. The aggregate principal amount of MTNs offered under this program may be increased from time to time.

The Public MTNs may have original maturities of 9 months or more from the date of issue, may be interest bearing with either fixed or floating interest rates, or may be discounted notes. During the six months ended September 30, 2020, AHFC issued €1.5 billion aggregate principal amount of Euro denominated fixed rate MTNs, with an original maturity range from 2.0 years to 4.5 years, \$3.5 billion fixed rate notes with an original maturity range from 3.0 to 5.0 years, and \$300 million floating rate notes, which an original maturity of 3.0 years. The weighted average remaining maturities of all Public MTNs was 2.4 years as of September 30, 2020.

The Public MTNs are issued pursuant to an indenture, which requires AHFC to comply with certain covenants, including negative pledge provisions and restrictions on AHFC's ability to merge, consolidate or transfer substantially all of its assets or the assets of its subsidiaries, and includes customary events of default. As of September 30, 2020, management believes that AHFC was in compliance with all covenants under the indenture.

Euro MTN Programme

The Euro MTN Programme was retired in August 2014. AHFC has one note outstanding under this program. The note has a maturity date of February 21, 2023, a fixed interest rate and is not listed on the Luxembourg Stock Exchange. The note was issued pursuant to the terms of an agency agreement which requires AHFC to comply with certain covenants, including negative pledge provisions, and includes customary events of default. As of September 30, 2020, management believes that AHFC was in compliance with all covenants contained in the Euro MTNs.

The table below presents a summary of outstanding debt issued under our MTN Programs by currency:

	<u>September 30, 2020</u>	<u>March 31, 2020</u>
	(U.S. dollars in millions)	
U.S. dollar	\$ 21,756	\$ 22,309
Euro	5,026	3,076
Sterling	773	744
Japanese yen	29	28
Total	<u>\$ 27,584</u>	<u>\$ 26,157</u>

Other Debt

HCFI issues privately placed Canadian dollar denominated notes, with either fixed or floating interest rates. During the six months ended September 30, 2020, HCFI entered into two private placement transactions for C\$700 million (\$526 million). As of September 30, 2020, the remaining maturities of all of HCFI's Canadian notes outstanding ranged from 79 days to approximately 5.5 years. The weighted average remaining maturities of these notes was 2.6 years as of September 30, 2020.

The notes are issued pursuant to the terms of an indenture, which requires HCFI to comply with certain covenants, including negative pledge provisions, and includes customary events of default. As of September 30, 2020, management believes that HCFI was in compliance with all covenants contained in the privately placed notes.

Secured Debt

Asset-Backed Securities

We enter into securitization transactions for funding purposes. Our securitization transactions involve transferring pools of retail loans and operating leases to bankruptcy-remote special purpose entities (SPEs). The SPEs are established to accommodate securitization structures, which have the limited purpose of acquiring assets, issuing asset-backed securities, and making payments on the securities. Assets transferred to SPEs are considered legally isolated from us and the claims of our creditors. We continue to service the retail loans and operating leases transferred to the SPEs. Investors in the notes issued by a SPE only have recourse to the assets of such SPE and do not have recourse to the assets of AHFC, HCFI, or our other subsidiaries or to other SPEs. The assets of SPEs are the only source of funds for repayment on the notes

Our securitizations are structured to provide credit enhancements to investors in the notes issued by the SPEs. Credit enhancements can include the following:

- *Subordinated certificates*— securities issued by SPEs that are retained by us and are subordinated in priority of payment to the notes.
- *Overcollateralization*— securitized asset balances that exceed the balance of securities issued by SPEs.
- *Excess interest*— excess interest collections to be used to cover losses on defaulted loans.
- *Reserve funds*— restricted cash accounts held by the SPEs to cover shortfalls in payments of interest and principal required to be paid on the notes.
- *Yield supplement accounts*— restricted cash accounts held by SPEs to supplement interest payments on notes.

The risk retention regulations in Regulation RR of the Securities Exchange Act of 1934, as amended (Exchange Act), require the sponsor to retain an economic interest in the credit risk of the securitized assets, either directly or through one or more majority-owned affiliates. Standard risk retention options allow the sponsor to retain either an eligible vertical interest, an eligible horizontal residual interest, or a combination of both. AHFC has satisfied this obligation by retaining an eligible vertical interest of an amount equal to at least 5% of the principal amount of each class of note and certificate issued for the securitization transaction that was subject to this rule but may choose to use other structures in the future.

We are required to consolidate the SPEs in our financial statements, which results in the securitizations being accounted for as on-balance sheet secured financings. The securitized assets remain on our consolidated balance sheet along with the notes issued by the SPEs.

During the six months ended September 30, 2020, we issued notes through asset-backed securitizations totaling \$3.3 billion, which were secured by assets with an initial balance of \$3.5 billion.

Credit Agreements

Syndicated Bank Credit Facilities

AHFC maintains a \$3.5 billion 364-day credit agreement, which expires on February 26, 2021, a \$2.1 billion credit agreement, which expires on February 28, 2023, and a \$1.4 billion credit agreement, which expires on February 28, 2025. As of September 30, 2020, no amounts were drawn upon under the AHFC credit agreements. AHFC intends to renew or replace these credit agreements prior to or on their respective expiration dates.

HCFI maintains a C\$2.0 billion (\$1.5 billion) credit agreement which provides that HCFI may borrow up to C\$1.0 billion (\$751 million) on a one-year revolving basis and up to C\$1.0 billion (\$751 million) on a five-year revolving basis. The one-year tranche of the credit agreement expires on March 25, 2021 and the five-year tranche of the credit agreement expires on March 25, 2025. As of September 30, 2020, no amounts were drawn upon under the HCFI credit agreement. HCFI intends to renew or replace the credit agreement prior to or on the expiration date of each respective tranche.

The credit agreements contain customary conditions to borrowing and customary restrictive covenants, including limitations on liens and limitations on mergers, consolidations and asset sales, and limitations on affiliate transactions. The credit agreements also require AHFC and HCFI to maintain a positive consolidated tangible net worth as defined in their respective credit agreements. The credit agreements, in addition to other customary events of default, include cross-default provisions and provisions for default if HMC does not maintain ownership, whether directly or indirectly, of at least 80% of the outstanding capital stock of AHFC or HCFI, as applicable. In addition, the AHFC and HCFI credit agreements contain provisions for default if HMC's obligations under the HMC-AHFC Keep Well Agreement or the HMC-HCFI Keep Well Agreement, as applicable, become invalid, voidable, or unenforceable. All of these conditions, covenants and events of default are subject to important limitations and exceptions under the agreements governing the credit agreements. As of September 30, 2020, management believes that AHFC and HCFI were in compliance with all covenants contained in the respective credit agreements.

Other Credit Agreements

AHFC maintains other committed lines of credit that allow the Company access to an additional \$1.0 billion in unsecured funding with two banks. The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales and a requirement for AHFC to maintain a positive consolidated tangible net worth. As of September 30, 2020, no amounts were drawn upon under these agreements. These agreements expire in September 2021. The Company intends to renew or replace these credit agreements prior to or on their respective expiration dates.

Keep Well Agreements

HMC has entered into separate Keep Well Agreements with AHFC and HCFI. Pursuant to the Keep Well Agreements, HMC has agreed to, among other things:

- own and hold, at all times, directly or indirectly, at least 80% of each of AHFC's and HCFI's issued and outstanding shares of voting stock and not pledge, directly or indirectly, encumber, or otherwise dispose of any such shares or permit any of HMC's subsidiaries to do so, except to HMC or wholly-owned subsidiaries of HMC;

- cause each of AHFC and HCFI to, on the last day of each of AHFC’s and HCFI’s respective fiscal years, have a positive consolidated tangible net worth (with “tangible net worth” meaning (a) shareholders’ equity less (b) any intangible assets, as determined in accordance with GAAP with respect to AHFC and generally accepted accounting principles in Canada with respect to HCFI); and
- ensure that, at all times, each of AHFC and HCFI has sufficient liquidity and funds to meet their payment obligations under any Debt (with “Debt” defined as AHFC’s or HCFI’s debt, as applicable, for borrowed money that HMC has confirmed in writing is covered by the respective Keep Well Agreement) in accordance with the terms of such Debt, or where necessary, HMC will make available to AHFC or HCFI, as applicable, or HMC will procure for AHFC or HCFI, as applicable, sufficient funds to enable AHFC or HCFI, as applicable, to pay its Debt in accordance with its terms. AHFC or HCFI Debt does not include the notes issued by SPEs in connection with AHFC’s or HCFI’s secured financing transactions, any related party debt or any indebtedness outstanding as of September 30, 2020 under AHFC’s and HCFI’s bank loan agreements.

As consideration for HMC’s obligations under the Keep Well Agreements, we have agreed to pay HMC a quarterly fee based on the amount of outstanding Debt pursuant to Support Compensation Agreements, dated April 1, 2019. We incurred expenses of \$18 million and \$17 million during the three months ended September 30, 2020 and 2019, respectively, and \$35 million and \$34 million for the six months ended September 30, 2020 and 2019, respectively, pursuant to these Support Compensation Agreements.

Indebtedness of Consolidated Subsidiaries

As of September 30, 2020, AHFC and its consolidated subsidiaries had \$61.0 billion of outstanding indebtedness and other liabilities, including current liabilities, of which \$18.0 billion consisted of indebtedness and liabilities of our consolidated subsidiaries. None of AHFC’s consolidated subsidiaries had any outstanding preferred equity.

Derivatives

We utilize derivative instruments to mitigate exposures to fluctuations in interest rates and foreign currency exchange rates. The types of derivative instruments include interest rate swaps, basis swaps, and cross currency swaps. Interest rate and basis swap agreements are used to mitigate the effects of interest rate fluctuations of our floating rate debt relative to our fixed rate finance receivables and operating lease assets. Cross currency swap agreements are used to manage currency and interest rate risk exposure on foreign currency denominated debt. The derivative instruments contain an element of credit risk in the event the counterparties are unable to meet the terms of the agreements.

All derivative financial instruments are recorded on our consolidated balance sheet as assets or liabilities, and carried at fair value. Changes in the fair value of derivatives are recognized in our consolidated statements of income in the period of the change. Since we do not elect to apply hedge accounting, the impact to earnings resulting from these valuation adjustments as reported under GAAP is not representative of our results of operations as evaluated by management. Realized gains and losses on derivative instruments, net of realized gains and losses on foreign currency denominated debt, are included in the measure of net revenues when we evaluate segment performance. Refer to Note 14—Segment Information of *Notes to Consolidated Financial Statements (Unaudited)* for additional information about segment information and Note 5—Derivative Instruments of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on derivative instruments.

Off-Balance Sheet Arrangements

We are not a party to off-balance sheet arrangements.

Contractual Obligations

The following table summarizes our contractual obligations, excluding lending commitments to dealers and derivative obligations, for the periods indicated:

	Payments due for the twelve month periods ending September 30,						
	Total	2021	2022	2023	2024	2025	Thereafter
	(U.S. dollars in millions)						
Unsecured debt obligations ⁽¹⁾	\$ 40,997	\$ 13,345	\$ 9,184	\$ 8,759	\$ 4,386	\$ 3,447	\$ 1,876
Secured debt obligations ⁽¹⁾	10,379	5,460	3,122	1,621	176	—	—
Interest payments on debt ⁽²⁾	1,861	684	487	336	179	100	75
Operating lease obligations	56	10	9	8	8	6	15
Total	<u>\$ 53,293</u>	<u>\$ 19,499</u>	<u>\$ 12,802</u>	<u>\$ 10,724</u>	<u>\$ 4,749</u>	<u>\$ 3,553</u>	<u>\$ 1,966</u>

- (1) Debt obligations reflect the remaining principal obligations of our outstanding debt and do not reflect unamortized debt discounts and fees. Repayment schedule of secured debt reflects payment performance assumptions on underlying receivables. Foreign currency denominated debt principal is based on exchange rates as of September 30, 2020.
- (2) Interest payments on floating rate and foreign currency denominated debt based on the applicable floating rates and/or exchange rates as of September 30, 2020.

The obligations in the above table do not include certain lending commitments to dealers since the amount and timing of future payments is uncertain. Refer to Note 8—Commitments and Contingencies of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on these commitments.

Our contractual obligations on derivative instruments are also excluded from the table above because our future cash obligations under these contracts are inherently uncertain. We recognize all derivative instruments on our consolidated balance sheet at fair value. The amounts recognized as fair value do not represent the amounts that will be ultimately paid or received upon settlement under these contracts. Refer to Note 5—Derivative Instruments of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on derivative instruments.

New Accounting Standards

Refer to Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*.

Critical Accounting Policies

Critical accounting policies are those accounting policies that require the application of our most difficult, subjective, or complex judgments, often requiring us to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods, or for which the use of different estimates that could have reasonably been used in the current period would have had a material impact on the presentation of our financial condition, cash flows, and results of operations. The impact and any associated risks related to these estimates on our financial condition, cash flows, and results of operations are discussed throughout “*Management’s Discussion and Analysis of Financial Condition and Results of Operation*” where such estimates affect reported and expected financial results. Different assumptions or changes in economic circumstances could result in additional changes to the determination of the allowance for credit losses and the determination of lease residual values.

Credit Losses

With the adoption of ASC 2016-13, the allowance for credit losses is management’s estimate of lifetime expected credit losses on the amortized cost basis of finance receivables. We have elected not to measure an allowance for credit losses for accrued interest receivables. The allowance is measured on an undiscounted basis. Management evaluates the allowance, at minimum, on a quarterly basis.

The allowance for retail loans is measured on a collective basis. Our historical experience provides the primary basis for estimating the allowance. The modeling methodology used to estimate the allowance incorporates vintage loss and delinquency migration analysis. Retail loans are segmented into pools with similar risk characteristics. Currently, retail loans are segmented by origination quarter, internal credit grade, product type, and original term. Past economic conditions and other attributes of the pools including loan-to-value ratios at loan inception are also taken into consideration when assessing historical credit loss experience. Current and forecasts of future economic factors such as unemployment rates, bankruptcies and used vehicle prices are applied in the modeling to estimate current expected credit losses. Management will also consider qualitative adjustments given the inherent uncertainty in estimating expected credit losses and the imprecision of any modeling methodology.

The allowance for dealer loans is measured at the individual dealer level when they have been specifically identified as impaired. Dealer loans are considered impaired when it is probable that we will be unable to collect the amounts due according to the terms of the applicable contract. Our determination of whether dealer loans are impaired is based on evaluations of the dealership's payment history, financial condition, ability to perform under the terms of the loan agreements, and collateral values as applicable. Expected credit losses on impaired dealer loans is measured based upon the specific circumstances of each dealer considering all expected sources of repayment or the fair value of the collateral if foreclosure is probable. The allowance for dealer loans that have not been specifically identified as impaired is measured collectively primarily using historical loss rates.

Estimated losses on operating leases expected to terminate early due to lessee defaults are also determined collectively using modeling methodologies consistent with those used for retail loans.

Refer to Note 2—Finance Receivables of *Notes to Consolidated Financial Statements (Unaudited)* for additional information regarding credit losses on retail and dealer loans. Refer to Note 3—Investment in Operating Leases of *Notes to Consolidated Financial Statements (Unaudited)* for additional information regarding early termination losses on operating leases.

Sensitivity Analysis

Our allowance for credit losses and early termination losses on operating leases requires significant judgment about inherently uncertain factors. The estimates are based on management's evaluation of many factors, including our historical credit loss experience, the value of the underlying collateral, delinquency trends, and economic conditions. The estimates are based on information available as of each reporting date. Actual losses may differ from the original estimates due to actual results varying from those assumed in our estimates. 10% and 20% increases in estimated incurred losses on our consumer finance receivables would have resulted in increases to the allowance for credit losses as of September 30, 2020 of \$41 million and \$81 million, respectively. Similarly, 10% and 20% increases in estimated incurred losses due to defaults on operating leases would have resulted in increases to estimated early termination losses as of September 30, 2020 of \$17 million and \$33 million, respectively.

Determination of Lease Residual Values

Contractual residual values of lease vehicles are determined at lease inception based on expectations of future used vehicle values, taking into consideration external industry data and our own historical experience. Lease customers have the option at the end of the lease term to return the vehicle to the dealer or to buy the vehicle at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance). Returned lease vehicles can be purchased by the grounding dealer at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance) or a market based price. Returned lease vehicles that are not purchased by the grounding dealer are sold through online and physical auctions. We are exposed to risk of loss on the disposition of returned lease vehicles when the proceeds from the sale of the vehicles are less than the contractual residual values at the end of lease term. We assess our estimates for end of term market values of the leased vehicles, at minimum, on a quarterly basis. The primary factors affecting the estimates are the percentage of leased vehicles that we expect to be returned by the lessee at the end of lease term and expected loss severities. Factors considered in this evaluation include, among other factors, economic conditions, historical trends and market information on new and used vehicles. Our leasing volumes and those across the automotive industry have increased significantly in recent years. As a result, the supply of off-lease vehicles will continue to increase over the next several years which could negatively impact used vehicle prices.

For operating leases, adjustments to estimated residual values are made on a straight-line basis over the remaining term of each lease and recognized as depreciation expense.

Sensitivity Analysis

If future estimated auction values for all outstanding operating leases as of September 30, 2020 were to decrease by \$100 per unit from our current estimates, the total impact would be an increase of approximately \$73 million in depreciation expense, which would be recognized over the remaining lease terms. If future return rates for all operating leases were to increase by one percentage point from our current estimates, the total impact would be an increase of approximately \$13 million in depreciation expense, which would be recognized over the remaining lease terms. This sensitivity analysis may be asymmetric and is specific to the conditions in effect as of September 30, 2020. Additionally, any declines in auction values are likely to have a negative effect on return rates which could affect the severity of the impact on our results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Principal Executive Officer and Principal Financial Officer have performed an evaluation of our disclosure controls and procedures, as that term is defined in Rule 13a-15(e) of the Exchange Act, as of September 30, 2020, and each has concluded that such disclosure controls and procedures are effective, at the reasonable assurance level, to ensure that information required to be disclosed in our periodic reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and such information is accumulated and communicated to management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control over Financial Reporting

There were no changes in the internal control over financial reporting during the quarter ended September 30, 2020, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

For information on our legal proceedings, see Note 8—Commitments and Contingencies—Legal Proceedings and Regulatory Matters of *Notes to Consolidated Financial Statements (Unaudited)*, which is incorporated by reference herein.

Item 1A. Risk Factors

There are no material changes to the risk factors set forth under “*Item 1A. Risk Factors*” in our Annual Report on Form 10-K for the fiscal year ended March 31, 2020, which was filed with the SEC on June 22, 2020.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

Item 3. Defaults Upon Senior Securities

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description
3.1 ⁽¹⁾	Articles of Incorporation of American Honda Finance Corporation, dated February 6, 1980, and Certificates of Amendment to the Articles of Incorporation, dated March 29, 1984, November 13, 1988, December 4, 1989, July 2, 1991, April 3, 1997, November 30, 1999, and December 17, 2003.
3.2 ⁽¹⁾	Amended and Restated Bylaws of American Honda Finance Corporation, dated April 27, 2010.
4.1 ⁽¹⁾	Form of Specimen Common Stock of American Honda Finance Corporation.
4.2	American Honda Finance Corporation agrees to furnish to the Securities and Exchange Commission upon request a copy of each instrument with respect to issues of long-term debt of American Honda Finance Corporation and its subsidiaries, the authorized principal amount of which does not exceed 10% of the consolidated assets of the American Honda Finance Corporation and its subsidiaries.
4.3 ⁽²⁾	Amended and Restated Issuing and Paying Agency Agreement between American Honda Finance Corporation and The Bank of New York Mellon, dated as of August 27, 2012.
4.4	Trust Indenture between Honda Canada Finance Inc., as issuer, and BNY Trust Company of Canada (as successor to CIBC Mellon Trust Company), as trustee, dated as of September 26, 2005(3), as supplemented by supplemental indentures from time to time, and the Form of Debenture(4).
4.5 ⁽⁵⁾	Indenture, dated September 5, 2013, between American Honda Finance Corporation and Deutsche Bank Trust Company Americas, as trustee.
4.6 ⁽⁶⁾	First Supplemental Indenture, dated February 8, 2018, between American Honda Finance Corporation and Deutsche Bank Trust Company Americas, as trustee.
4.7	Form of Fixed Rate Medium-Term Note, Series A(7) and Form of Floating Rate Medium-Term Note, Series A (8).
31.1 ⁽⁹⁾	Certification of Principal Executive Officer
31.2 ⁽⁹⁾	Certification of Principal Financial Officer
32.1 ⁽¹⁰⁾	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350
32.2 ⁽¹⁰⁾	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350
101.INS ⁽⁹⁾	XBRL Instance Document
101.SCH ⁽⁹⁾	XBRL Taxonomy Extension Schema Document
101.CAL ⁽⁹⁾	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB ⁽⁹⁾	XBRL Taxonomy Extension Label Linkbase Document
101.PRE ⁽⁹⁾	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF ⁽⁹⁾	XBRL Taxonomy Extension Definition Linkbase Document

1. Incorporated herein by reference to the same numbered Exhibit filed with our registration statement on Form 10, dated June 28, 2013.
2. Incorporated herein by reference to the same numbered Exhibit filed with our registration statement on Form 10, amendment No. 1, dated August 7, 2013.
3. Incorporated herein by reference to Exhibit number 4.5 filed with our registration statement on Form 10, amendment No. 1, dated August 7, 2013.
4. Incorporated herein by reference to the same numbered Exhibit filed with our quarterly report on Form 10-Q, dated February 12, 2015.
5. Incorporated herein by reference to Exhibit number 4.1 filed with our registration statement on Form S-3, dated September 5, 2013.
6. Incorporated herein by reference to Exhibit number 4.6 filed with our quarterly report on Form 10-Q, dated February 8, 2018.
7. Incorporated herein by reference to Exhibit number 4.1 filed with our current report on Form 8-K, dated August 8, 2019.
8. Incorporated herein by reference to Exhibit number 4.2 filed with our current report on Form 8-K, dated August 8, 2019.
9. Filed herewith.
10. Furnished herewith.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 10, 2020

AMERICAN HONDA FINANCE CORPORATION

By: /s/ Paul C. Honda

Paul C. Honda

Vice President and Assistant Secretary
(Principal Accounting Officer)