European Structured Finance Presale Report

ABS Consumer – UK

Paragon Personal & Auto Finance (No. 2) PLC

Expected Ratings*

Class	Amount (million)	Final maturity	Rating	CE %
A	GBP146.9	Jan 2022	AAA	53
B	GBP70.9	Jan 2033	A	23
C	GBP26.9	Jan 2049	BBB	12

*Preliminary ratings do not reflect final ratings and are based on information provided by issuers as of 1 November 2001.

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Summary

This transaction is a securitisation of a portfolio of mixed assets comprising unsecured personal and retail credit loans, second and subsequent ranking mortgages and a pool of auto loans originated in the UK by subsidiaries of The Paragon Group of Companies PLC (“PGC”). Fitch has assigned expected ratings to the notes to be issued by Paragon Personal and Auto Finance (No.2) PLC as indicated at left.

The ratings reflect: the available credit enhancement; the prudent origination and underwriting policies of the relevant seller; the servicing capabilities of Paragon Finance PLC; and the integrity of the legal and financial structure. The ratings address the likelihood of the investors receiving interest payments in accordance with the terms of the underlying documents and full repayment of principal by the legal final maturity date falling in January 2022 in respect of the Class A notes, January 2033 in respect of the Class B notes and January 2049 in respect of the Class C notes.

Credit enhancement mainly consists of over-collateralisation of the performing asset base which is expected to total GBP267mln. Accordingly credit enhancement for the Class A notes is expected to equal 53% and is comprised of the 29% subordination of the Class B notes, the 11% subordination of the Class C notes, a reserve fund of 2.9% of the principal outstanding of the notes at closing, 9.1% over-collateralisation and excess spread. There is a level of over-collateralisation required for the life of the transaction. This amount is determined as the difference between the total principal outstanding of performing assets and the total principal outstanding of the rated notes. The minimum amount for this is expected to be GBP22.3mln and this provides 9.1% credit enhancement on the closing of the transaction. Performing assets are defined as receivables less than or equal to twelve months delinquent.

The provisional pool as of 31 August, 2001 consisted of 80,917 loans with an outstanding principal of GBP518,139,584. The pool is subdivided into five product portfolios which were originated by subsidiaries of PGC as follows:

- unsecured personal loans originated by Paragon Personal Finance Ltd, GBP215.3mln
- car finance contracts, GBP54.5mln
- unsecured retail finance loans, GBP17.2mln
- second and subsequent ranking secured loans, GBP30.8mln; and
- unsecured personal loans originated by Universal Credit Ltd, GBP200.4mln

Credit committee highlights

- There was concern over the wide variety of asset classes within the portfolio, which was mitigated by the eligibility criteria and substitution tests.
- There was concern over the level of delinquent accounts, which was mitigated by the required over-collateralisation test.
- A lack of detailed historic data has been mitigated by the adoption of prudent assumptions and stress scenarios.
- Potential Consumer Credit Act issues in relation to the Universal Credit loans have been mitigated by a detailed legal analysis and an adjustment to Fitch’s base case loss estimate.

Structure

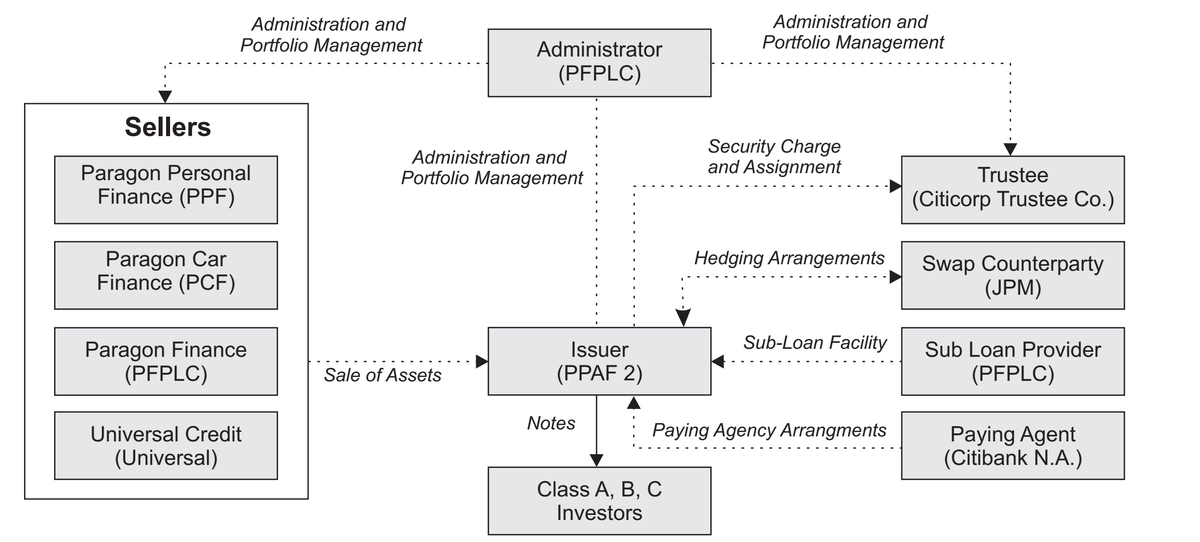
Upon closing the issuer will purchase a portfolio of mixed assets comprising unsecured personal and unsecured retail credit loans, second and subsequent ranking mortgages secured over properties in England, Wales and Scotland and a pool of auto loans. The issuer's interest in the assets will be held on trust for the benefit of the noteholders. The sellers of the assets are Paragon Personal Finance Ltd, Universal Credit Ltd and Paragon Car Finance Ltd who are all wholly owned subsidiaries of PGC.

A first loss reserve will be funded at closing from part of the proceeds of the subordinated loan. The reserve fund will be available to meet certain items in the priority of payments. The initial reserve amount will be GBP7,125,000 equivalent to 2.91% of the principal amount outstanding of the notes at closing. The reserve fund may step down to GBP3,562,500 equivalent to 1.46% of the principal outstanding of the notes at closing subject to a five-year lock out period, no Class A notes remaining outstanding and an asset test being satisfied.

Payment of interest on the three classes of notes is quarterly in arrears. The rate payable will be based on three month LIBOR plus a margin which steps up in 2008. The structure has a mechanism whereby if an asset/liability test fails interest on the junior notes may be deferred in order to pay senior expenses and principal on the senior notes.

Whilst the Class A notes are outstanding they will be redeemed in priority to the Class B and Class C notes until January 2007. At this point the notes may be redeemed pro rata, subject to the ratio of the Class B and Class C notes to the total notes outstanding, equalling or exceeding 2.25 times the initial subordination levels. In addition whilst the Class A notes are outstanding the principal outstanding of the Class B and Class C notes will have a floor of 6.75% of the total notes at closing. Once the Class A notes have been redeemed in full, redemption of the Class B and then the Class C notes will be sequential. If a withholding tax is imposed all of the notes may be redeemed at the principal amount outstanding plus accrued interest. The issuer also has the option to redeem the notes in full from 2005.

Transaction Structure



* Paragon Finance PLC is the administrator. The structure allows for substitution of receivables originated in the future by Paragon Finance PLC, although none of the receivables in the provisional pool have been originated by Paragon Finance PLC.

Key Information

Portfolio characteristics

Type of loans: Unsecured personal and retail credit loans, auto loans and second and subsequent ranking mortgages secured over properties in England, Wales and Scotland

Provisional Pool Balance: GBP 518,139,584 (as at 31 August 2001)

Weighted Average Yield: 16.23%

Weighted Average Seasoning: 43 months

Transaction Parties

Originators: Paragon Personal Finance Ltd (PPF), Universal Credit Ltd (UCL), Paragon Car Finance Ltd (PCF), Paragon Finance PLC

Administrator: Paragon Finance PLC

Arranger: JP Morgan Securities Ltd

Transaction Account Provider: National Westminster Bank plc

Hedge Counterparty: JPMorgan Chase Bank (JPM) (AA/F1+)

The structure allows for substitutions during the first four years of the transaction subject to certain tests being met which include concentration limits on the different asset types which may be substituted and certain delinquency and solvency tests being met. Discretionary further advances under the secured loans may be made during the life of the deal subject to funds being available to the issuer and certain conditions being met as detailed in the underlying documentation which are designed to maintain the credit quality of the pool.

Monies from the borrowers will be paid directly into the transaction account of the issuer or alternatively into collection accounts in the names of the transferors. In the latter case monies will be transferred on the next business day into the transaction account thereby limiting the commingling risk.

The issuer will enter into hedging arrangements with the hedge counterparty which are intended to hedge the mismatch between the floating interest payable on the notes and fixed interest received on the majority of the assets. The hedging will be by way of a combination of an interest rate swap agreement and cap agreements. The swap will follow a pre-set amortisation (CPR) curve calculated over and above the scheduled repayment of the performing assets. The notional of the caps is set as the difference betweeen the swap schedule and the scheduled amortisation of the assets. If the CPR exceeds the pre-set curve the issuer will be over-swapped. In this case the issuer would typically partially terminate the excess swap notional which may lead to a termination payment payable by the issuer, or otherwise it would have the option of paying on a higher notional than it is receiving on. Fitch considers that increased prepayment rates may be driven by certain market or other conditions irrespective of the stress scenario. Fitch analysed the potential costs to the issuer under prepayment levels above the pre-set curve and in Fitch's view credit enhancement is sufficient to mitigate this risk - see Credit Analysis for further details. Fitch has not relied on prepayment penalties which may be payable by the borrower, although the transaction will receive the benefit of these and they would be a further mitigant with respect to additional costs incurred by the issuer as described above. The provisions of the hedge agreement will provide for replacement/ collateralisation in the event of a downgrade of the counterparty.

There is a remote risk of non-enforceability of a small percentage of the loans in the Universal pool due to non-compliance with the Consumer Credit Act ("CCA") and this has been factored into Fitch's base case charge-off assumptions. Many of the loans within the pool constitute debtor/creditor/supplier ("DCS") agreements for the purposes of the CCA whereby a creditor provides finance specifically for the purchase of goods or services from a supplier. In the event of breach of contract by the supplier the debtor may claim directly against the creditor or may set off any payments due under a loan against the amount of their claim. Any right of set off that a borrower has is limited to the amount owed by the borrower under the credit agreement. Fitch has considered the likelihood of borrowers exercising a right of set off and has factored this into its analysis.

Credit Analysis

Fitch applied its standard methodology when rating this transaction. For further information please see Fitch's criteria paper *"Rating Unsecured Consumer Finance ABS in Europe"*, published in June 2001.

Fitch recognises the relative complexity of the asset composition in this portfolio, both in terms of the several different consumer loan product pools in the portfolio, and the fact that there are both fully performing and delinquent loans in some pools. Furthermore, for the delinquent loans, there is wide variation in the stage of delinquency of the accounts. Therefore, in line with its standard criteria, Fitch evaluated each asset pool to determine a base case estimate of the expected performances for each pool. Where a particular pool contained accounts at any stage of delinquency, Fitch only gave credit for collections from such accounts where specific past performance data demonstrated a consistent flow of collections. For these pools Fitch adapted its criteria to reflect specific aspects of either the underlying product or the nature of the performance information available. To break the portfolio down into its component parts, Fitch grouped the loans into five categories:

1) Unsecured personal loans originated by PPF;
2) Auto loans, leases and associated finance contracts;
3) Unsecured retail finance loans;
4) Secured personal loans (2nd charge residential mortgages); and
5) Unsecured personal loans originated by UCL.

For pools 1) and 2), in line with its standard criteria, Fitch reviewed static pool cumulative charge-off history to establish a base case performance. Fitch reviewed net charge-off data which incorporated recovery data. Fitch also reviewed prepayment and delinquency data to support its assumptions for the products. Fitch also used current seasoning and yield characteristics of the expected purchase pool to form its base case performance projections. For pool 1), Fitch also split the pool into loans originated prior to September 1998 and after that date and analysed their expected performance separately. This was because, due to changes to underwriting criteria, the performance for the later pool demonstrates marked improvement. For pool 2), Fitch observed a number of balloon loans and contracts with residual or turn-in risk and factored this into its base case charge-off.

Fitch also considered the eligibility criteria and delinquency tests, which allow substitution of further loans into the portfolio, which may alter the characteristics of each pool. However, Fitch considered that the worst case scenario for the whole portfolio is no substitutions and amortisation immediately after closing. Therefore, Fitch evaluated base case performance from the characteristics of the initial portfolio.

The following table sets out the assumption which Fitch made for pools 1) and 2). Note that for the pre-September 1998 unsecured loans, Fitch disregarded the current seasoning of the loans and reset expected performance according to the average remaining term of the loans.

Base Case – pools 1 & 2

	Unsecured Loans Pre 09/98	Unsecured Loans Post 09/98	Auto Loans
Cumulative net charge-off	10%	18%	7.5%
Prepayment	7%	7%	7%
W.a. yield	14.5%	14%	13.7%
W.a. remaining maturity	60m	78m	40m
Seasoning	0m	12m	12m

For pools 1) and 2), Fitch then stressed the above assumptions and modelled the performance of the pools for each rating scenario. The following stresses were applied. (Yield compression reflects the impact of prepayment of higher yielding loans and delayed receipt of interest due to delinquency.)

Stress scenarios – pool 1

	AAA	A	BBB
Charge-off multiplier	4x	2.5x	1.75x
Prepayment multiplier	3x/0x	2x	1.5x
Yield compression	-4%	-3%	-2%

Stress scenarios – pool 2

	AAA	A	BBB
Charge-off multiplier	5x	3x	2x
Prepayment multiplier	3x/0x	2x	1.5x
Yield compression	-4%	-3%	-2%

For pool 3), Fitch reviewed historic portfolio delinquency roll rates and dynamic charge-off rates for loans greater than 12 months delinquent. Fitch also observed historic dynamic collection, or payment, rates for the portfolio, and the historic yield of the portfolio. Accordingly, Fitch modelled these characteristics similarly to Fitch's standard methodology for modelling the amortisation of a pool of revolving retail credit receivables. Fitch made the base case assumptions set out in the table overleaf.

Base Case – pool 3	
Annualised yield	15.0%
Annualised charge-off rate	4.5%
Monthly payment rate	10.0%

Fitch then applied the following stress scenarios and modelled expected losses after amortisation of the collateral for each scenario.

Stress Scenarios – pool 3

	AAA	A	BBB
Yield decline	30%	25%	20%
Charge-off multiplier	5.5x	3.5x	2.25x
Payment rate decline	50%	35%	25%

For pool 4), Fitch applied its UK RMBS methodology. This involved a loan-by-loan analysis of the pool, estimating the weighted average foreclosure frequency ("WAFF") and weighted average loss severity ("WALS") based upon loan and borrower characteristics and geographic location of the secured property. Fitch stressed the base case default probability and regionally adjusted market value declines ("MVD") to establish the required credit enhancement under each rating scenario. For further information on how Fitch approaches analysis of residential mortgage loan portfolios, please see Fitch's criteria paper "*UK Residential Mortgage Default Model II*".

For pool 5), Fitch assessed the composition of this pool by sub-pools of performing, delinquent and more than 12 months delinquent accounts. Fitch noted the very high proportion of the pool which is more than 12 months delinquent. Fitch adapted its methodology to estimate the projected collections of principal and interest from the portfolio. To perform this analysis, Fitch reviewed historic data, by delinquency status, which showed the amounts of interest and principal (whether prepaid or redeemed) which had been collected on a quarterly basis. Fitch also reviewed portfolio delinquency roll rates to establish the rate at which the portfolio would be expected to deteriorate. Fitch modelled the expected delinquency and expected collections of the portfolio, over the remaining life of the loans, to determine a base case cash flow. Fitch then stressed the delinquency and collection determinants, in line with its standard consumer asset stresses, to evaluate the expected cash flow under each rating scenario. Fitch then utilised the cash flow projection to determine the appropriate credit enhancement for the pool.

To establish credit enhancement requirements for the aggregate portfolio, Fitch took the performance assumptions for each pool, as outlined above, at each rating level, and determined the required credit enhancement for each pool, assuming it would be purchased at face value. Then, on the basis of the composition by pool of the expected initial portfolio, Fitch assessed the weighted average credit enhancement at each rating level for the aggregate portfolio.

Fitch also determined an additional level of credit enhancement at 'AAA' and 'A' level to mitigate the partial hedging of interest rate risk, described above. Fitch evaluated the loss that the issuer might suffer in the event of prepayments rising to 40% and 30% for the 'AAA' and 'A' scenarios respectively. These additional prepayment stresses were modelled separately to the combined charge-off, yield and prepayment stresses, to assess the maximum cost the issuer may potentially face. In Fitch's view credit enhancement available is sufficient to mitigate this additional stress.

The credit enhancement requirement for the 'BBB' rating determined the total amount of rated notes which could be issued. To determine the level of over-collateralisation of the notes by loans less than 12 months delinquent, Fitch assessed the difference between the amount of such loans in the initial purchase portfolio and the total notes amount. This level of over-collateralisation must be maintained throughout the revolving period of the transaction. In Fitch's view, the eligibility criteria and delinquency tests for substitution ensure that the aggregate delinquency characteristics of the portfolio do not deteriorate. Also, although through substitution the yield level of the receivables may decline, in Fitch's view this would be adequately compensated by improvement in the composition between pools or improvement in the overall delinquency profile of the portfolio.

In conclusion, Fitch determined that the worst case stress scenario was under amortisation after closing and set credit enhancement levels accordingly to ensure the notes are protected from any shortfall in principal or interest collections.

■ Surveillance

Fitch will monitor the transaction on a regular basis and as warranted by events. Fitch's structured finance surveillance team ensures that the assigned ratings remain, in Fitch's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is available at www.fitchratings.com.

Please call the Fitch analysts mentioned on the first page of this report for any queries regarding the initial analysis or the ongoing surveillance.

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