Paragon Personal and Auto Finance (No. 2) PLC

ABS - UK

EXPECTED CLOSING DATE:
November 2001

AUTHOR:
David Harrison
Analyst
(44-20) 7772 5434
David.Harrison@moodys.com

Neal Shah
AVP-Analyst
(44-20) 7772 5440
Neal.Shah@moodys.com

CONTACTS:

London

Stephen Roughton-Smith
VP/Senior Credit Officer
(44-20) 7772 5441
Stephen.Roughton-Smith@moodys.com

Greg Taylor
VP/Senior Analyst
(44-20) 7772 5570
Greg.Taylor@moodys.com

Frédéric Drevon
Managing Director
(44-20) 7772 5356
Frederic.Drevon@moodys.com

New York

Vernessa Poole
Asset-Backed Securities and Collateralized Debt Obligations
(212) 553-4796
Vernessa.Poole@moodys.com

WEBSITE:
www.moodys.com

This pre-sale report addresses the structure and characteristics of the proposed transaction based on the information provided to Moody's as of 6th November 2001.

Investors should be aware that certain issues concerning this transaction have yet to be finalised. *Upon conclusive review of all documents and legal information as well as any subsequent changes in information, Moody's will endeavour to assign **definitive** ratings to this transaction. The definitive ratings may differ from the **prospective** ratings set forth in this report. Moody's will disseminate the assignment of definitive ratings through its Client Service Desk.*

TRANSACTION IN BRIEF

Class	Rating	Amount	Coupon
A	(P)**Aaa**	£ 146,900,000	3 Month LIBOR + [•] bps to Jan 2008 and [•] bps thereafter
B	(P)**A2**	£ 70,900,000	3 Month LIBOR + [•] bps to Jan 2008 and [•] bps thereafter
C	(P)**Baa2**	£ 26,900,000	3 Month LIBOR + [•] bps to Jan 2008 and [•] bps thereafter

STRUCTURE SUMMARY

Structure Type:	Notes backed by unsecured personal loans, retail credit loans, car finance contracts and secured loans.
Revolving Period:	4 years (up to Determination Date falling in Dec 2005)
Note Payment Dates:	15th day of January, April, July and October, commencing on April 15th, 2002
The Issuer:	Paragon Personal and Auto Finance (No. 2) PLC
Originators/Sellers:	Paragon Personal Finance Limited ("PPF"), Universal Credit Limited ("Universal"), Paragon Car Finance Limited (PCF), Paragon Finance PLC ("PFPLC")
Transaction Account Bank:	National Westminster Bank plc (**Aa1**, **P-1**)
Trustee:	Citicorp Trustee Company Limited
Administrator:	Paragon Finance PLC (PFPLC)
Interest Rate Swap provider:	[Morgan Guaranty Trust Company of New York (**Aa2**/**P-1**)]
Arranger:	J.P. Morgan Securities Limited

CREDIT SUPPORT

Cash Reserve:	2.91% of the Notes at closing
Over-Collateralisation:	9.11% of the Notes throughout the life of the transaction
Subordinated Tranches:	29% Class B, 11% Class C

PROVISIONAL POOL SUMMARY AS AT AUGUST 31ST 2001

Number of Contracts:	80,917
Current Balance:	£518,139,585
Contract Interest Types:	Fixed and floating interest rate

	Universal Unsecured Loans	PPF Personal Loans	PPF Retail Credit Loans
Weighted Average Yield:	19.64%	14.58%	14.85%
Weighted Average Seasoning:	83.52 months	21.92 months	1.0 months
Average Current Balance Outstanding:	£8,731	£7,146	£1,161

	Secured Loans	Car Finance Contracts
Weighted Average Yield:	11.41%	13.36%
Weighted AverageSeasoning:	0.96 months	16.48 months
Weighted Average LTV:	67.0%	N/A
Average Current Balance Outstanding:	£14,482	£4,997

RATING OPINION

Moody's has assigned the following prospective long-term ratings to the debt issuance of Paragon Personal and Auto Finance (No. 2) PLC:

(P)**Aaa** £146,900,000 Class A Floating Rate Notes due 2022;

(P)**A2** £70,900,000 Class B Floating Rate Notes due 2033;

(P)**Baa2** £26,900,000 Class C Floating Rate Notes due 2049.

The *prospective* rating of the Class A Notes are based upon the following positive and less favourable features:

Positive Features:

- Moody's assessment of the credit quality of the receivables pool;
- The credit enhancement provided by excess spread, over-collateralisation, and the First Loss Fund;
- The subordination of the Class B and C Notes;
- The various Performance Conditions associated with the collateral, which act as early amortisation triggers during the revolving period;
- The eligibility criteria and portfolio tests selected for the four types of loan contracts, both at closing and for substitution;
- The benefit of an interest rate hedging arrangements with Morgan Guaranty Trust Company of New York (**Aa2**, **P-1**) which hedges the interest rate risk between the fixed rate interest from the majority of the loans in the asset pool and the floating rate coupons on the Notes;
- Moody's assessment of the Administrator's operations, controls, and procedures for both underwriting and subsequent servicing of the asset pool; and
- The sound transaction's legal structure and tax analysis.

Less Favourable Features:

- The limited amount of performance data available on some of the asset classes included in the pool, due to the fact that the secured loan business has only been originating loans since July of 1999;
- The presence of delinquent and non-performing loans in the portfolio (See "*Collateral*" below).

Moody's *prospective* rating of the Class B and Class C Notes is based on the same as that set out above for the A Notes, except for taking into account the subordinated positions in the transaction of each of the Class B and Class C Notes. The *prospective* ratings on the Notes reflect the timely payment of interest and the ultimate payment of principal on the Notes on or before the legal final maturity.

RATING SUMMARY

The Issuer is a special purpose vehicle incorporated under the laws of England and Wales and is a wholly owned subsidiary of the Paragon Group of Companies PLC. The activities of the Issuer are restricted to ensure that it is bankruptcy remote. The Issuer will fund the purchase of the assets by issuing the Class A, Class B, and Class C Notes.

The Notes pay quarterly coupons at a fixed spread over LIBOR, which adjusts after January, 2008, with the first payment being made on April 15th 2002.

The Issuer's beneficial interest in the English receivables will be an equitable interest only. No notification of the assignment and transfer of the receivables shall be made to the receivables' debtors. In the case of, *inter alia*, an insolvency of Paragon, the Trustee will, pursuant to the Power of Attorney granted in its favour by the Issuer, be able to give notice to the borrowers to perfect the transfer of the legal title to the receivables to the Issuer and to require the borrowers to make payments directly to the Trustee's account.

In relation to the Scottish auto and unsecured receivables the transfer of the receivables must be done using a declaration of trust over assets in favour of the Issuer, which is potentially subject to Stamp Duty. Paragon will apply for adjudication from Stamp Duty, seeking a Section 42 Finance Act 1930 intra group exemption. Paragon has received an adjudicated "Stamped without Duty" on its prior two consumer loan transactions and has obtained an adjudication "in principle" to the same effect in relation to such assets in this transaction. Moody's believes that no stamp duty liability will arise as a result of this transaction and therefore no specific reserve has been funded related to Stamp Duty.

COLLATERAL

The mixed loan pool consists of:

1. ***Unsecured Personal Loans*** originated by Universal and PPF. Universal originated loans will only be purchased at closing, whereas personal loans originated by Paragon will be substituted during the revolving period, in addition to being purchased at closing.
2. ***Unsecured Retail Loans*** originated by PPF and made to individuals to fund the purchase of consumer products such as furniture and electrical goods.
3. ***Secured Loans*** originated by PPF. The assets included in the portfolio will comprise the benefit of loans to individuals in the United Kingdom secured by second or subsequent-ranking charges over residential property in England, Wales and Scotland, together with all security relating to those loans.
4. ***Car Finance Contracts*** originated by PCF and made to individuals, partnerships and corporate bodies. The assets include the benefit of motor vehicle contract purchase agreements and motor vehicle leasing agreements and the beneficial ownership of the vehicles that are concerned.

Moody's believes that the Universal section of the portfolio, which is currently "owned" by the 'Finance For People 3' transaction, is of a relatively poor quality. Approximately 83% of the Universal loans in the Provisional Pool were more than 1 month in arrears, including approximately 76% where the loans are more than 12 months in arrears. However, as all loans greater than 12 months in arrears are classified as non-performing Portfolio Assets, Moody's has assigned only moderate value to the worth of these assets to the transaction. Also, since the proportion of Paragon originated assets will increase as the transaction revolves, (see "*Substitution*" below) Moody's analysis assumes some improvement in the quality of the asset portfolio over time.

Substitution

In addition to the eligibility criteria that have to be met prior to any assets entering the pool at closing, the criteria that must also be met for substitution of further assets during the four year substitution period include:

1. The seller, PGC and/or PFPLC are financially solvent;
2. The rating agencies have not notified the Issuer of an adverse effect on the ratings;
3. Satisfactory hedging arrangements are in place so that the spread between the interest rate payable by the Issuer on the Notes and the interest rate received on the asset equals at least (i) 7% for unsecured personal loans, (ii), 5% for unsecured retail loans (iii) 6% for car finance contracts and (iv) 5% for secured loans unless, in the case of secured loans, adequate funds are available in the Shortfall Fund.
4. The following concentration and arrears limitations by loan types:
   a. ***Unsecured Personal Loans*** may be purchased only if (i) personal loans will not exceed 15% of the total pool, (ii) personal loans more than 3 months in arrears are less than 10% of total personal loan balances or interest payments received on personal loans during the previous three months were at least 95% of the interest due on personal loans during that period. Note that, at closing, these assets are expected to constitute approximately 81% of the pool.
   b. ***Unsecured Retail Loans*** are not subject to any limitation as a percentage of the portfolio but (i) for those loans with deferral periods no deferral period will exceed 12 month, (ii) the balance of retail loans whose deferred period is then current will not exceed 25% of the total balance of retail loans, (iii) retail loans more than 3 months in arrears are less than 4% of total retail loan balances, or interest payments received on retail loans during the previous three months were at least 96% of the interest due on retail loans during that period.
   c. ***Car Finance Contracts*** may be purchased only if (i) car finance contracts will not exceed 30% of the total pool, (ii) car finance contracts more than 3 months in arrears are less than 4% of car finance contract balances or interest payments received on car finance contracts during the previous three months were at least 96% of the interest due on car finance contracts during that period, and (iii) the total amount of car finance contracts with residual risk is less than £3 million.
   d. ***Secured Loans*** may be purchased only if (i) secured loans will not exceed 30% of the total pool, (ii) secured loans more than 3 months in arrears are less than 10% of total secured loan balances or interest payments received on secured loans during the previous three months were at least 95% of the interest due on secured loans during that period, and (iii) the product of the weighted average foreclosure frequency and the weighted average loss severity does not exceed by more than 0.25% the same calculation as at closing.

These criteria assist in mitigating the risk that the volatility of the pool may worsen due to substitution. If such deterioration is detected, then the substitution period will end and the transaction will amortise.

In addition to these eligibility criteria, a performance test that utilises an Over Collateralisation Required Amount (the “OCRA”) will act as an early amortisation trigger. Also, the Performance Conditions provide that the Actual Principal Funds available in the transaction are at least equal to the Required Principal Funds. The Required Principal Funds are defined as the amount of Notes outstanding plus the OCRA less the balance of performing assets.

Principal Paying Interest

The structure allows the deferment of interest payment on the Class C and B Notes to repay Class A principal. If the Required Principal Funds less the Issuer Funds, senior costs, Notes interest and amounts required for replenishment of the First Loss Fund equals an amount less than the outstanding Subordinated Notes, then amounts due to pay interest on the Class C (and Class B) Notes will be used to repay Class A principal. This provides substantial protection for investors in the Class A Notes against a gradual deterioration in the arrears performance of the portfolio. Moody’s believes, however, that the fact that the Issuer is unable to use all receipts to pay interest on the Class B or Class C Notes exposes the Class B and Class C Notes to greater liquidity risk.

HEDGING

Interest Rate Risk

At closing, the Issuer will enter into hedging arrangements with Morgan Guaranty Trust Company of New York (**Aa2**/**P-1**), as Hedge Counterparty to hedge any loans which are fixed, capped or collared rate. These asset pool cashflows (other than the secured loans) are at fixed rates of interest, whereas the Notes will pay fixed spreads over three month LIBOR. The fixed/floating interest rate mismatch is hedged by the Issuer entering into hedging arrangements, which may consist of swaps, caps or floors with eligible Hedge Counterparty.

CREDIT ENHANCEMENT

Investors in the Notes are protected from the effect of credit losses on the pool in a number of ways.

Excess Spread

The first layer of protection for investors in the Notes is the Excess Spread in the transaction, which is the difference between:

1. The income receivable by the Issuer under the portfolio assets, and its other investments and hedge arrangements; and
2. The amounts of interest due by the Issuer on account of its various ongoing costs and expenses and under the Notes.

The credit enhancement value of excess spread also depends on the timing of principal losses. Excess Spread is available on a “use it or lose it” basis and so, if not used to top up the First Loss Fund or to reduce the Debtor Ledger, it is paid back to Paragon via the Subordinated Loan and other profit extraction mechanisms. This might occur before losses on the portfolio have shown through. Moody’s assessed the value of the excess spread under a variety of adverse conditions, including high pre-payment scenarios.

Over-Collateralisation

The transaction provides credit enhancement for the Notes through over-collateralisation, i.e. the principal value of the performing assets is greater than that of the Notes. The level of over-collateralisation is expected to be 9.11% at closing and is maintained at this constant level during the life of the transaction in normal conditions.

First Loss Fund

The third layer of protection which is available for Investors in the Notes is the First Loss Fund. On closing, Paragon will make a Subordinated Loan to the Issuer of an amount equal to 2.91% of the aggregate initial principal amount outstanding of the Notes to be issued.

This loan will be paid into a designated account to be used to provide on-going liquidity support, to meet senior expenses and to provide credit support to the transaction. Any amounts utilised will be replenished from future excess spread in the transaction.

On each Interest Payment Date, revenue of the Issuer in excess of the amounts required to pay or provide for priority payments will be applied to replenish the First Loss Fund to the Required Amount. After the latter of the January 2007 interest payment date and the moment when the Class A Notes are fully redeemed, the Required Amount reduces to half of its level at closing to 1.45% providing that the Actual Principal Funds are equal to Required Principal Funds.

Principal and Interest Subordination

The Class A Notes rank first in priority. The Class B Notes and the Class C Notes will be subordinated to the Class A Notes. The Class C Notes will be subordinated to the Class B Notes in priority. Accordingly, upon enforcement of the security and after utilising the transaction’s Over-Collateralisation and the transaction First Loss Fund, losses will be borne first by the Class C Noteholders then by the Class B Noteholders and then by the Class A Noteholders.

Pro Rata B and C Note Amortisation

So long as Class A Notes are outstanding, all redemptions will be applied to Class A principal until January, 2007. Thereafter, the pro-rata paydown of the Class B and Class C Notes will be subject to the relative percentage of the Class B and C Notes to the total Notes being at least 2.25x the initial subordination. In addition, the outstanding amount of Class B plus Class C Notes must equal at least 6.75% of the total Notes outstanding so long as Class A Notes remain outstanding.

VAT Grouping

In common with other Paragon transactions rated by Moody's, but unlike the vast majority of UK transactions, the Issuer is grouped with the rest of the Paragon Group for VAT purposes. The VAT grouping means that services or goods provided between members of the VAT group are not subject to VAT (which would otherwise be payable on servicing fees); but, as a consequence, each member of the VAT group is jointly and severally liable for VAT liabilities of all other members of that group. A long-standing arrangement is in place with Morgan Guaranty Trust Company of New York (**Aa3**, **Prime-1**) to mitigate this risk.

Administrator

Moody's believes that Paragon Finance PLC, being a servicer on a number of Paragon securitisations, has a well-developed servicing business with a track record of successful collections and arrears management in the United Kingdom. There is no stand-by servicer in place, however the level of credit enhancement and liquidity provisions present in the transaction gives Moody's comfort that this risk is sufficiently mitigated.

Moody's Rating Methodology

Moody's structured finance rating methodology is based upon an "expected loss" approach, which is based upon the probability of default of assets in the pool and the severity of loss in the event of default, (i.e. the level of subsequent recoveries, if any).[1,2] Moody's calculated the expected loss for the transaction by analysis of historical data provided by the originator together with Moody's expectation of the future. The expected loss and its likely volatility were then used by Moody's to model the transaction assuming a lognormal distribution of that loss.[3] This analysis took account of structural features such as the revolving period, early amortisation triggers, over-collateralisation and the mechanism for capture of excess spread. The loss for each Note tranche by the model was then converted into a rating using Moody's idealised default probability tables.

Based on the above analysis, Moody's believes that the Credit Enhancement available for the transaction is consistent with the ratings on the Notes.

Monitoring

Moody's will monitor the transaction and the ratings of the Notes on an ongoing basis until the Notes mature. The monitoring will include the review of the monthly servicing reports and other performance data including supporting ratings, together with discussions with the servicer and other parties, as Moody's considers appropriate.

1 "Rating Mezzanine Securities in Structured Finance Transactions: The impact of an Expected Value Approach", *Moody's International Structured Finance Special Report* (February 1999).
2 "Subordination, Diversification and the Expected-Loss Approach to Credit Risk", *Moody's International Structured Finance Special Report* (February 1997).
3 "The Lognormal Method Applied to ABS Analysis", *Moody's International Structured Finance Special Report* (July 2000).

Doc ID# SF11469isf