Paragon Personal and Auto Finance (No. 3) PLC

Paragon Group
Mixed portfolio of consumer receivables
Country: UK

***PLEASE NOTE:** This pre-sale report addresses the structure and characteristics of the proposed transaction based on the information provided to Moody's as of 20 April 2005. 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 **provisional** ratings set forth in this report. Moody's will disseminate the assignment of definitive ratings through its Client Service Desk.*

CLOSING DATE:
[•] May 2005

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RATINGS

Class	Rating	Amount	% of Total	Legal Final Maturity	Maturity Expected
A1	(P)**Aaa**	£[•]	[72%]	15/04/36	DD/MM/YY
A2	(P)**Aaa**	€[•]	[combined]	15/04/36	DD/MM/YY
B1	(P)**Aa2**	£[•]	[9%]	15/04/36	DD/MM/YY
B2	(P)**Aa2**	€[•]	[combined]	15/04/36	DD/MM/YY
C1	(P)**A2**	£[•]	[9%]	15/04/36	DD/MM/YY
C2	(P)**A2**	€[•]	[combined]	15/04/36	DD/MM/YY
D1	(P)**Baa2**	£[•]	[10%]	15/04/36	DD/MM/YY
D2	(P)**Baa2**	€[•]	[combined]	15/04/36	DD/MM/YY
Total		£[•]	100		

The ratings address the expected loss posed to investors by the legal final maturity. The structure allows for timely payment of interest and ultimate payment of principal at par on or before the rated final legal maturity date. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

OPINION

Strengths of the Transaction

- Moody's assessment of the credit quality of the receivables pool.
- The credit enhancement provided by excess spread, and the First Loss Fund. Paragon has pledged to maintain the gross margin relative to LIBOR at 4% for secured loans. For fixed rate assets, hedging arrangements provide margins relative to LIBOR of 5.5% in year 1, 5.0% in year 2, 4.75% in year three and 4.5% thereafter.
- The subordination of the Class B, C and D Notes;
- The various Performance Conditions associated with the collateral, which act like 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 purchase during the revolving period;
- The benefit of an interest rate hedging arrangement with HSBC Bank plc (**Aa2**, **Prime-1**) which hedges the interest rate risk between the fixed rate interest from all the fixed rate loans comprising approximately half 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;
- The transaction's sound legal structure and tax analysis; and
- The robustness of the back-up servicer arrangements, which incorporate a relatively high state of readiness to take over the servicing function when required.

Weaknesses and Mitigants

- The Issuer is a non-orphan SPV, which may result in some additional risks;
- The transaction does not benefit from a separate liquidity facility. In mitigation the Issuer has a 9% first loss fund and the ability to use principal receipts under the assets to meet its senior expenses obligations and interest due under the Class A Notes;
- There is a limited amount of performance data available on the unsecured retail loan business which has only been originating loans for approximately three years;
- The first loss fund can be depleted without triggering an immediate amortisation, but this is mitigated by the fact that, if this occurs, this will prevent the purchase of new assets which will in time lead to early amortisation; and
- The portfolio includes some delinquent loans (See "Collateral" below).

STRUCTURE SUMMARY

Issuer:	Paragon Personal and Auto Finance (No. 3) PLC
Structure Type:	Notes backed by secured loans, car finance contracts, unsecured personal loans and retail credit loans.
Revolving period:	4 years (ending April 2009)
Seller/Originator:	Paragon Personal Finance Limited ("PPF"), Paragon Car Finance Limited ("PCF"), Paragon Finance PLC ("PFPLC"), Universal Credit Limited ("Universal") and Colonial Finance (UK) Limited ("Colonial")
Servicer:	Paragon Finance PLC (PFPLC)
Back-up Servicer:	GHL Mortgage Services Limited
Interest Payments:	Quarterly, commencing 15 October 2005
Principal Payments:	Quarterly, commencing 15 July 2009, unless the conditions for purchase of assets during the Revolving Period are not met.
Credit Enhancement/Reserves:	First Loss Fund of [9.0]%, and note subordination
Liquidity Facility:	None
Interest Rate Hedging:	Sterling interest rate swap provided by HSBC Bank plc (**Aa2**, **Prime-1**)
Currency Hedging:	Balance guaranteed Sterling / Euro currency basis swaps provided by HSBC Bank plc (**Aa2**, **Prime-1**)
Principal Paying Agent:	Citibank N.A.
Trustee:	Citicorp Trustee Company Limited
Arranger:	Barclays Capital
Lead Managers:	Barclays Capital and HSBC

COLLATERAL SUMMARY

Receivables:	A mixed portfolio of unsecured personal loans, retail credit loans, various forms of car finance contracts, and secured loans.
Number of Contracts:	75,093
Geographic Diversity:	The Receivables are due from obligors who are geographically spread throughout the United Kingdom, including Northern Ireland.
Weighted average LTV:	88% (secured loans only, LTV is not applicable to other assets)
Weighted average remaining term:	9.18 years
Weighted average seasoning:	24.56 months
Delinquency Status:	Receivables are eligible for inclusion at closing if they are less than 12 months in arrears. 7.3% of the initial portfolio by value is in arrears. 2.0% of the initial portfolio is 3-6 months in arrears. 2.5% of the initial portfolio is 6-12 months in arrears.
Historical Loss Experience:	There is little historic data on losses for retail credit loans. The data on secured loans and car finance contracts suggests expected losses in line with their respective sectors although some of the pools have experienced higher losses in the past.

Overview

Moody's assigns provisional ratings to Paragon Personal and Auto Finance (No. 3) PLC.

Moody's has assigned provisional long term credit ratings of (P)**Aaa** to the Class A1 and A2 Notes, (P)**Aa2** to the Class B1 and B2 Notes, (P)**A2** to the Class C1 and C2 Notes, (P)**Baa2** to the Class D1 and D2 Notes of the Issuer.

Moody's issues provisional ratings in advance of the final sale of securities, and these ratings only represent Moody's preliminary opinion. Upon a conclusive review of the transaction and associated documentation, Moody's will endeavour to assign definitive ratings to the Notes. A final rating may differ from a provisional rating. Please note that Moody's has not yet received full results on the pool data audit.

The ratings of the Class A1 and A2 Notes are based upon an analysis of the characteristics of the loan portfolio backing the Notes, the protection the Notes receive from credit enhancement against defaults and arrears in the portfolio, and the legal and structural integrity of the issue.

The ratings of the various other Notes are based on the above factors, and on an assessment of the extent of their increasing subordinate position within the structure.

The provisional ratings of the Notes address the expected loss posed to investors by the legal final maturity. The structure allows for timely payment of interest and ultimate repayment of principal at par on or before the rated final legal maturity date.

STRUCTURAL AND LEGAL ASPECTS

Transaction Structure

The Issuer is a non-orphan SPV, and may have additional risks.

The Issuer is a special purpose vehicle incorporated in England and owned by The Paragon Group of Companies PLC. Typically, transactions of this nature rated by Moody's have featured an orphan SPV as issuer. The fact that the Issuer is not an orphan company introduces additional risks not typically found in UK ABS transactions:

- as a matter of UK tax law, it is possible that a subsidiary can be fixed with liabilities for tax of another member of its group. In this case, Moody's expects that an extensive range of undertakings will provide assurance that the chance of such secondary liabilities arising is remote.
- a company organised in the UK can be wound up by a shareholders' resolution. Whilst, in the circumstances, there might be little advantage to be gained by a liquidator of the Issuer's parent company by doing this, Moody's stress scenarios envisage such an attempt being made. Moody's is, however, satisfied that the combination of the non-petition covenants given by the parent companies in the Paragon Group, and the share ownership structure of the Issuer, effectively eliminate this risk. The legal opinions confirm this point.

VAT Grouping

The Issuer is grouped with the rest of Paragon Group for VAT purposes, all of which are jointly and severally liable for VAT liabilities of all of the others in that group.

In common with other Paragon transactions rated by Moody's (see the previous "Paragon Personal and Auto Finance", "Paragon Mortgages" and "Finance For People" deals), but unlike the vast majority of UK ABS 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 to mitigate this risk:

1. A Trust Account, held in the name of Citicorp Trustee Company Limited as trustee with National Westminster Bank Plc (**Aa1**, **Prime-1**), can be used by any member of the VAT group to meet group VAT liabilities should PFPLC (which, as representative member, is primarily liable for group VAT) fail to do so. PFPLC must maintain a minimum balance in the Trust Account equal to the greater of (1) GBP120,000, (2) 1.2 times the actual VAT liability for the Paragon VAT Group in the last two accounting periods, or (3) 1.2 times the sum of the estimated VAT liabilities of the Paragon VAT Group for the current and next succeeding accounting periods.
2. If PFPLC fails to pay VAT due by it, or fails to maintain the minimum balance in the Trust Account, the Issuer will automatically be de-grouped; on a de-grouping, the Issuer will become liable for VAT on the servicing fees paid to the Servicer, but will not be liable for any VAT of any other group company. The Customs & Excise, who administer VAT, cannot prevent a company from de-grouping, but it must be given 90 days' prior notice.

CREDIT ENHANCEMENT

Excess Spread

The minimum margin is set by asset type

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 from the assets (after interest rate hedging as appropriate); and
2. the amounts of interest due by the Issuer on account of its various ongoing costs and expenses and under the Notes.

Excess spread is to be applied by the Issuer first in replacing any principal amount lost on the assets as a result of write-offs (loans which are more than 12 months in arrears are written off). Shortfalls in principal are measured by a quarterly test which compares the aggregate principal of performing assets (those no more than 12 months in arrears) plus cash held after deduction of senior expenses against the aggregate principal of Notes. Excess spread is then applied in increasing the First Loss Fund to the required amount.

The transaction benefits from a covenant of the Issuer to maintain a minimum margin over 3-month Sterling LIBOR on secured loans of 4.00%. For fixed rate assets, hedging arrangements provide margins relative to LIBOR of 5.5% in year 1, 5.0% in year 2, 4.75% in year three and 4.5% thereafter.

The minimum margin covenant on secured loans and the hedging arrangements provides some guarantee as to the amount of excess spread that will be available.

The credit enhancement value of excess spread also depends on the timing of principal losses. It should be assumed that excess spread that arises before any losses have occurred will be distributed to the Originator via the Subordinated Loan and other profit extraction mechanisms. If principal losses are concentrated in a narrow time period (for example during a sharp recession) there is no claw-back of excess spread from prior periods. However, excess spread cannot be distributed if there is any existing principal shortfall or any shortfall on the First Loss Fund.

First Loss Fund

The second layer of protection for investors in the Notes is the First Loss Fund (equal to [9]% of the aggregate principal balance of the notes at closing (see below)). This fund will be fully funded at close and is available to pay interest and senior cost obligations of the Issuer and to make up any principal losses should there be insufficient excess spread on the assets to meet these obligations.

Subordination of the Notes

The third layer of protection for investors is the subordination of the principal balance of the Class B Notes, Class C Notes and Class D Notes to the Class A Notes equal to 28% of the original aggregate principal balance of the Notes.

Redemption of the Notes

The notes will amortise sequentially starting with the Class A1 and A2 Notes pro-rata.

The Notes will begin to amortise pro rata, but only if the following conditions are satisfied:

1. The Interest Payment Date is after April 2010
2. There is no deficiency of principal of assets relative to principal of liabilities
3. There has been no deferral of interest on any Class of the Notes;
4. The First Loss Fund is fully funded;
5. Class A subordination provided by subordinate notes exceeds two times the initial amount; and
6. The aggregate GBP Equivalent Principal Amount Outstanding of the Notes subordinated to the Class A Notes exceeds 6.75% of the original aggregate principal balance of the Notes.

If any of these conditions are not fulfilled, amortisation will be sequential, commencing with the Class A Notes.

Interest/Interest Subordination

Further protection is provided via the subordination of interest due under the Notes; on each interest payment date, all income (after paying certain senior costs and expenses) is allocated first to pay Class A interest, then Class B interest, then Class C interest and lastly Class D interest. If there is insufficient cash available, it is possible that interest on the Notes could be deferred, starting with the Class D Notes and working backwards in reverse order of subordination.

Interest/Principal Subordination

In addition, Class B, C or D Note interest may be subordinated to payment of principal under the Class A Notes. This occurs when outstanding principal losses, which cannot be remedied after taking into account replenishment of the First Loss Fund, exceed the outstanding balance of the Class D Notes. In this circumstance, making good the principal loss occurs higher in the waterfall than Class D Interest. Further deterioration, could cause the total principal loss to exceed Class C and D, and ultimately higher than Class B interest. In these circumstances, payment of interest on the respective subordinated Class of Notes is subordinated to the reduction of the principal shortfall, and to the topping-up of the First Loss Fund. Interest on all such subordinated Classes of Note can be deferred until later interest payment dates if there are insufficient available funds (but includes interest roll-up).

Liquidity

The Issuer does not have the benefit of a separate Liquidity Facility.

The Issuer does not have the benefit of a separate liquidity facility. However there are several layers of liquidity support available to Noteholders to counter temporary cashflow shortfalls. These shortfalls could arise from delinquencies in the pool or interruptions in the servicing or cash collection functions.

Principal Paying Interest to meet senior expenses and Class A interest due only.

If there is insufficient interest received from the assets to pay interest due on the Class A Notes and certain senior ranking expenses of the Issuer, then the Issuer can pay these items out of principal received from the assets. This provides substantial protection for investors in the Class A Notes against a deterioration in the arrears performance of the portfolio. This structural feature does however result in further subordination of the Notes subordinate to Class A. Moody's believes, however, that this risk has been appropriately reflected in the ratings of these Classes. However, the fact that the Issuer is unable to use all receipts to pay interest on the Class B, Class C or Class D Notes exposes these classes to greater liquidity risk.

First Loss Fund.

As described above, the First Loss Fund is available to cover interest shortfalls under the Notes.

The value of the liquidity support provided by the First Loss Fund is reduced by the fact that the First Loss Fund is topped-up out of excess spread after such excess spread has been used to replenish any principal shortfall that has arisen. (See "*Interest/Principal Subordination*" above.)

Hedging

The Issuer separately hedges interest rates and currency.

In order to mitigate sterling fixed interest rate exposure, the Issuer hedges interest rate risk as described below by entering into a hedge agreement with HSBC Bank plc (**Aa2**, **Prime-1**)].

The currency exposure relating to the Class A2 Notes, B2 Notes, C2 Notes and D2 Notes, all of which are denominated in Euros, is hedged with a currency swap entered into with HSBC Bank plc.

In each case, the swap counterparties are obliged to enter into suitable arrangements with respect to the collateralisation of the Issuer's exposures to them, and ultimately to permit their replacement as swap counterparties. This follows Moody's usual practises.

All fixed rate assets are hedged with interest rate swaps.

For assets which are floating rate (most of the Secured Loans), the Administrator must set the rate on these assets at least as high as the required margin, unless Paragon subsidises the rate by making a subordinated loan for any shortfall.

In relation to all fixed rate assets, the Issuer will on the Closing Date enter into a single balance guaranteed interest rate swap with HSBC Bank plc. Under the terms of this swap, the Issuer pays the counterparty the weighted average of all performing fixed rate assets and receives LIBOR plus 5.5% in the first year, 5% in the second year, 4.75% in the third year and 4.5% thereafter.

Exchange rate hedging provided by a currency swap.

The Issuer will enter into cross currency swaps exchanging Sterling for Euros with HSBC Bank plc to hedge against interest rate risk and foreign exchange risk on the Class A2, Class B2, Class C2 and Class D2 Notes.

Payments of interest on the Class B2, Class C2 and Class D2 Notes may be deferred if the performance of the transaction deteriorates. Arrangements are in place such that, if the Issuer is unable to pay the full Sterling amount due on the currency swap, the swap counterparty will only pay a proportional Euro amount. This will result in proportional interest deferral of the Sterling and Euro denominated Notes of each Class.

Such deferral under the currency swap will not give the counterparty to this swap the right to terminate the currency swap.

COLLATERAL – REFERENCE PORTFOLIO

Eligibility criteria and Provisional Pool

The collateral consists of a mixed loan pool

Unsecured personal loans originated by Universal, Colonial and PPF. The Universal and Colonial unsecured personal loans are the remains of portfolios that were purchased in 1998 and 2000 respectively. All unsecured loans originated since that time have been originated by PPF, and PPF ceased origination of these loans in 2003. Moody's therefore expects few unsecured personal loans to be purchased after closing, and this sub-portfolio may therefore run off. This enhances the credit quality of the assets. The Issuer cannot purchase further unsecured personal loans such that their percentage in the portfolio would be over 15%.

Retail credit loans are unsecured personal loans originated by PPF and Colonial following introduction by a retailer. Moody's understands that by focusing on certain retail sectors (for example furniture and floor coverings) PPF is able to select a borrower universe that has more stable domestic circumstances. (Note that Colonial no longer originates retail credit loans.) The Issuer cannot purchase retail credit loans such that the combined percentage of unsecured personal loans and retail credit loans in the portfolio would be over 25%.

Car finance contracts have been originated by PCF and made to individuals, partnerships and corporate bodies. The assets include the benefit of motor vehicle contract purchase agreements, motor vehicle conditional sale agreements and motor vehicle hire purchase agreements, and the beneficial ownership of the vehicles that are concerned. The Issuer cannot purchase car finance contracts such that the combined percentage of unsecured personal loans, retail credit loans and car finance contracts in the portfolio would be over 60%.

Secured loans have been 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. There is a limit of 80% on the percentage of secured loans in the portfolio.

At close, the Issuer is permitted to purchase assets up to 12 months in arrears

Sub-portfolio	Provisional Pool balance	Number of loans	% over 1 month in arrears	% 6 – 12 months in arrears
Unsecured personal loans	£69,520,565	14,031	18.7%	9.9%
Retail credit loans	£21,490,125	28,778	8.1%	4.4%
Car finance contracts	£128,823,095	23,483	2.1%	0.4%
Secured loans	£209,804,917	8,801	6.6%	1.1%
Total	**£429,638.702**	**75,093**	**7.3%**	**2.5%**

None of the loans will be more than 12 months in arrears upon purchase at closing and for subsequent purchases, loans may not be more than one month in arrears. All loans are fully written-off as soon as they become greater than 12 months in arrears. Also, since unsecured personal loans are the worst-performing sub-portfolio and these are no longer being originated by the group, Moody's expects that the proportion of this sub-portfolio could decrease as the transaction revolves (see Substitution below). However, since this is not certain, Moody's analysis assumes that the portfolio will be split among the four sub-classes in such a way as to maximise the percentages of the worst performing sub-portfolios.

Further asset purchases

The Issuer may purchase assets representing each of the four sub-portfolios described above at any time up to April 2009. At any time that further assets are purchased, all of the eligibility criteria described above must be satisfied. These include the maximum percentages that apply to all loan types. They also include the minimum margin criteria for secured loans and the need to have in place hedging arrangements for any fixed rate assets purchased.

In addition to this, additional criteria relating to the overall performance of the assets already owned by the Issuer must also be met for substitution of further assets to occur. These criteria 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. The first loss fund is fully funded; and
4. The Issuer will not be able to purchase assets of a particular sub-portfolio if the arrears in the existing sub-portfolio fail the following trigger test:
   a) ***Unsecured personal loans*** more than 3 months in arrears are greater than 15%, and total payments received on unsecured personal loans during the previous three months were less than 100% of payments due during that period.
   b) ***Retail credit loans*** more than 3 months in arrears are greater than 6%, and total payments received on retail credit loans during the previous three months were less than 100% of payments due during that period.
   c) ***Car finance contracts*** more than 3 months in arrears are greater than 4%, and total payments received on car finance contracts during the previous three months were less than 100% of payments due during that period.
   d) ***Secured loans*** more than 3 months in arrears are greater than 10%, and total payments received on secured loans during the previous three months were less than 100% of payments due during that period.

These criteria assist in mitigating the risk that the overall performance of the pool may deteriorate due to a changing portfolio mix.

Amortisation

If the Issuer is unable to purchase further assets of a particular sub-portfolio, either because they have failed the arrears trigger for that sub-portfolio, they exceed the maximum percentage of that sub-portfolio, or because there are no assets available to purchase that satisfy the eligibility criteria, the Issuer will cease to purchase assets of that sub-portfolio. Ultimately, a combination of such restrictions across all the sub-portfolios could result in the Issuer being unable to reinvest all the available principal receipts resulting from amortisation and prepayment in purchasing further assets. In these circumstances the Issuer can retain cash up to an amount equal to 27% of the aggregate principal balance of the Notes before they will need to apply this money to amortisation as described above.

In addition, if the total assets of the transaction are less than the aggregate Note principal, then the Issuer will be required to cease purchase of further assets and to pay down notes to the extent that cash held exceeds 27% of the Notes. In this context, total assets means aggregate portfolio principal plus cash, but excluding the First Loss Fund.

ORIGINATOR, SERVICER AND DUE DILIGENCE

PPF, PCF, PFPLC, Universal and Colonial (the originators of the assets) and Paragon Finance PLC, the administrator of the assets, are all wholly owned subsidiaries of the Paragon Group of Companies.

Moody's believes that Paragon has a well developed servicing business with a track record of successful collections and arrears management in the United Kingdom. In addition, GHL Mortgage Services Limited is the substitute administrator of the assets.

Moody's conducts regular periodic due diligence of originators and servicers to review origination processes and company strategies and in order to assess the risk of a securitisation being affected through servicing interruptions.

MOODY'S ANALYSIS

To determine the provisional ratings on the tranches of Notes, Moody's has used the following methodology, which is comparable to that applied to most European consumer finance asset backed securities transactions.

Loss Distribution

Moody's analysis focused broadly on:

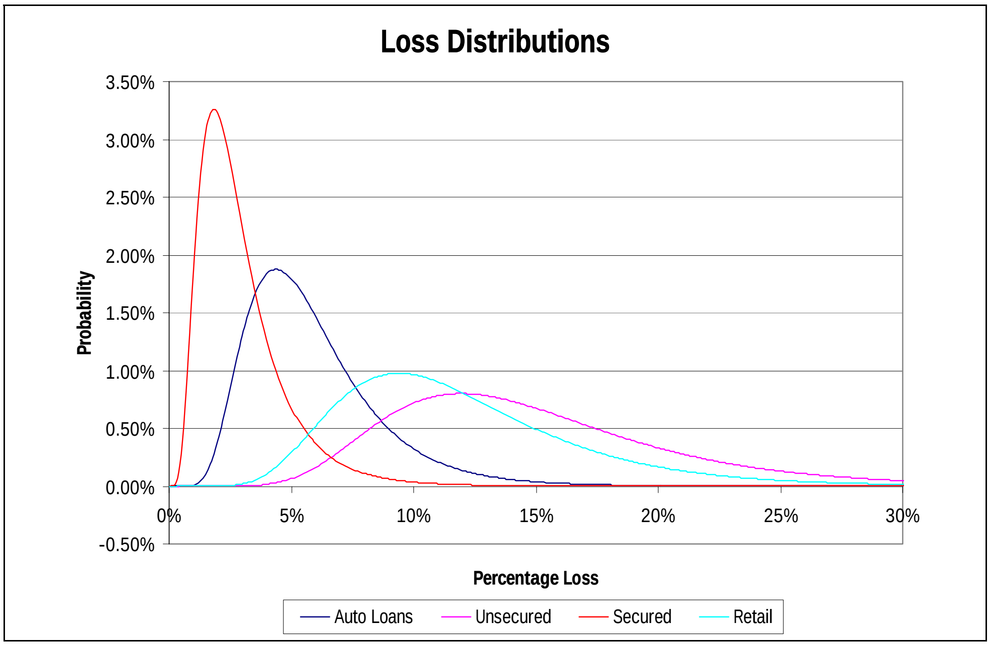
- ***the collateral***
- ***the market sector***
- ***the originator***
- ***the historic performance***
- ***the structure used for the transaction.***

The first step in the analysis is to determine a loss distribution of the pool of assets to be securitised. Because of the large number of loans and supporting historical data, Moody's uses a continuous distribution to approximate the loss distribution: the lognormal distribution.

To determine the shape of the curve, two parameters are needed: the expected loss and the volatility around this expected loss number. These parameters are found by looking at two important data sources: historical loss data and the loan by loan model.

Moody's has been provided with loss data with respect to the Originators' asset book, and this is used in addition to other applicable and relevant data in order to extrapolate expected losses for the loan pool. Examples of data include market and sector wide performance data, the performance of other securitisations, and other originators' data.

The following loss distribution curves are those that Moody's used in rating the transaction. Each of the curves is based upon historic data, with the exception of Retail Credit Loans. For this asset-class, we stressed the historic loss experience of Paragon due to the short history of origination. This brought the loss curve more in line with the sector, based upon our experience with similar portfolios elsewhere in the market.



To obtain the volatility under "stress" scenarios, Moody's will also take into account historical data, however, observed historical volatility may not be significant (given insufficient datapoints, or incomplete data), and in addition may not be representative for the future as it is based on the previous economic environments experienced.

Moody's determines a number representing the enhancement which would be required for a pool of assets to obtain a rating consistent with **Aaa** under highly stressed conditions. This number (the "Aaa CE" number) is produced by using a loan-by-loan model, which looks at each loan in the pool individually and based on its individual characteristics such as loan to value or other identified drives of risk, will produce a benchmark CE number. This assumes stressed recovery rates, time to recovery, interest rates and costs to foreclosure. The weighted average benchmark CE number will then be adjusted according to positive and negative characteristics of each loan or of the pool as a whole to produce the Aaa CE number.

The Aaa CE number and the expected loss number are the basis of committee discussions and are used to derive the lognormal distribution of losses of the pool.

The standard deviation of the distribution is found by setting the probability of a loss greater than the expected loss compliant with the idealised expected loss target of the Aaa CE number.

Tranching and Rating of Notes

Having obtained the loss distribution of the pool, a cash flow model is used to assess the impact of structural features of the transaction, including the priorities of interest and principal, liquidity and the value of excess spread.

The sum of the loss experience per note class weighted by the probability of such loss scenario determines the expected loss on each tranche and hence the rating, which is consistent with Moody's target losses for each rating category.

The provisional rating of the Class A Notes is therefore based on an analysis of:

- The characteristics of the assets backing the Notes;
- The relative roll-rate levels and arrears in this type of lending compared to conventional lending;
- Sector-wide and originator specific performance data;
- Protection provided by credit enhancement and liquidity support against defaults and arrears of the assets;
- The legal and structural integrity of the Issue.

The provisional ratings of the Classes of Notes subordinated to the Class A Notes are based on the above factors, and also on an assessment of the extent of their subordinate position within the structure.

RATING SENSITIVITIES AND MONITORING

Moody's will monitor the transaction on an ongoing basis to ensure that the transaction continues to perform in the manner expected, including checking all supporting ratings and reviewing periodic servicing reports. Any subsequent changes in the ratings will be publicly announced and disseminated through Moody's Client Service Desk.

Moody's will also publish a quarterly Performance Overview for this transaction, which will contain summarised information about the asset and note performance, as well as any other material changes affecting the Notes.

RELATED RESEARCH

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Performance Overviews are currently available for all the previous transactions of the Paragon Mortgages series, Paragon Personal and Auto Finance (No. 1) PLC and Paragon Personal and Auto Finance (No. 2) PLC. The market for consumer finance in the UK is dominated by credit card and mortgage transaction, with only limited issuance in personal loans. However, the following reports available on Moodys.com may give further information regarding the performance of the UK consumer finance sector generally:

- Moody's Approach to Rating UK Residential Mortgage-Backed Securities – 6th May 1998
- The UK Credit Card Indices is published quarterly.

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