

Rating Action: Moody's upgrades ratings in Paragon Personal and Auto Finance (No.3) PLC transaction

Global Credit Research - 21 Nov 2013

Paris, November 21, 2013 -- Moody's Investors Service has today upgraded to Aa1 (sf) from Aa2 (sf) the ratings on Class B1 and B2 notes, to Aa2 (sf) from A2 (sf) the ratings on Class C1 and C2 notes, and to A3 (sf) from Baa2 (sf) the ratings on Class D1 and D2 notes in the transaction Paragon Personal and Auto Finance (No.3) PLC. At the same time, Moody's affirmed the Aa1 (sf) ratings on Class A1 and A2 notes. This transaction is a UK consumer loan transaction. All affected ratings are listed below.

Issuer: Paragon Personal and Auto Finance (No. 3) PLC

...GBP146M A1 Notes, Affirmed Aa1 (sf); previously on Feb 21, 2013 Downgraded to Aa1 (sf)

...EUR259.5M A2 Notes, Affirmed Aa1 (sf); previously on Feb 21, 2013 Downgraded to Aa1 (sf)

...GBP16M B1 Notes, Upgraded to Aa1 (sf); previously on May 19, 2005 Definitive Rating Assigned Aa2 (sf)

...EUR35.5M B2 Notes, Upgraded to Aa1 (sf); previously on May 19, 2005 Definitive Rating Assigned Aa2 (sf)

...GBP18M C1 Notes, Upgraded to Aa2 (sf); previously on May 19, 2005 Definitive Rating Assigned A2 (sf)

...EUR33M C2 Notes, Upgraded to Aa2 (sf); previously on May 19, 2005 Definitive Rating Assigned A2 (sf)

...GBP24.5M D1 Notes, Upgraded to A3 (sf); previously on May 19, 2005 Definitive Rating Assigned Baa2 (sf)

...EUR30M D2 Notes, Upgraded to A3 (sf); previously on May 19, 2005 Definitive Rating Assigned Baa2 (sf)

RATINGS RATIONALE

Today's rating action primarily reflects the availability of high credit enhancement levels in the transaction Paragon Personal and Auto Finance (No.3) PLC.

UPGRADES REFLECT HIGH CREDIT ENHANCEMENT LEVELS

The transaction benefits from high credit enhancement in the form of subordination as well as a reserve fund amounting to GBP40.5 million. Credit enhancement is 31% below the Class D notes, 51% below the Class C notes, 69% below the Class B notes and 87% below the Class A notes. The reserve is currently funded at its target level and is a cash reserve held with the issuer account bank at Barclays Bank Plc (A2/P-1). The reserve could be reduced to GBP20.25 million upon certain conditions, among which all class A notes should have been repaid, no interest payment should have been deferred and no PDL should have been on any class of notes.

UPDATED KEY COLLATERAL ASSUMPTIONS TO REFLECT DETERIORATING POOL PERFORMANCE

The notes are backed by a portfolio of secured loans (97.6%), car finance contracts (0.8%), unsecured personal loans (1.3%) and retail credit loans (0.3%) originated by several wholly owned subsidiaries of the Paragon Group of Companies. The pool factor in this transaction is currently at approximately 29%.

This transaction suffers high delinquency levels with 90+ delinquencies at 8.88% in September 2013, a level much higher than the EMEA consumer loan index at around 1.50% for this same period. Cumulative losses observed since closing of the transaction in 2005 are at 7.27% (as a percentage of the original balance plus replenishments). Moody's took into account these deteriorating performances by updating its key collateral assumptions for this transaction. The rating agency increased its current default assumption to 13% from 11% of the current portfolio and maintained the recovery rate assumption at 20%. Moody's also decreased the coefficient of variation to 38.06% from 55%, which, combined with the revised key collateral assumptions, results in a portfolio credit enhancement of 45%.

The high credit enhancement present in the structure addresses the credit risk posed by deteriorating

performance.

MOODY'S HAS CONSIDERED EXPOSURE TO COUNTERPARTY RISK

In this transaction, Paragon Finance Plc acts as servicer and transfers collections every day to the issuer account that resides at Barclays Bank Plc. Moody's has incorporated into its analysis the potential default of Paragon Finance Plc, which could expose the transaction to a commingling loss on the collections.

HSBC Bank Plc (Aa3/P-1) acts as swap counterparty, for both the fixed floating swap and the cross currency swap present in this transaction. Today's action takes into account the impact of the exposure to the swap counterparty following the introduction of the rating agency's updated approach to assessing swap counterparty linkage in structured finance transactions. The application of this updated approach has had no impact on the rating levels at this stage.

CONTINUED EXPOSURE TO PAYMENT DISRUPTION RISK

Homeloan Management Limited (HML), which is part of Skipton Building Society (Ba1/NP), acts as back-up servicer and back-up cash manager in the transaction. Paragon Finance Plc (NR) acts as servicer and cash manager. Despite the "warm" back-up arrangement, the absence of a party with an investment-grade sponsor weakens the efficiency of the back-up arrangement in mitigating payment disruption risk.

As explained in the press release related to the downgrade of the senior notes of this transaction and published on 21 February 2013 (see https://www.moody's.com/research/Moodys-confirms-ratings-in-eight-Paragon-transactions-on-restructuring--PR_266570), the continued payment disruption risk is capping the rating of the senior notes at Aa1 (sf).

METHODOLOGIES

The methodologies used in this rating action were Moody's Approach to Rating Consumer Loan ABS Transactions, published in May 2013 and Global Structured Finance Operational Risk Guidelines published in June 2013. Please see the Credit Policy page on www.moody's.com for a copy of these methodologies.

In reviewing this transaction, Moody's used ABSROM to model the cash flows and determine the loss for each tranche. The cash flow model evaluates all default scenarios that are then weighted considering the probabilities of the lognormal distribution assumed for the portfolio default rate. In each default scenario, Moody's calculates the corresponding loss for each class of notes given the incoming cash flows from the assets and the outgoing payments to third parties and noteholders. Therefore, the expected loss for each tranche is the sum product of the probability of occurrence of each default scenario and the loss derived from the cash flow model in each default scenario for each tranche.

As such, Moody's analysis encompasses the assessment of stressed scenarios.

As the euro area crisis continues, the ratings of structured finance notes remain exposed to the uncertainties of credit conditions in the general economy. The deteriorating creditworthiness of euro area sovereigns as well as the weakening credit profile of the global banking sector could negatively affect the ratings of the notes.

REGULATORY DISCLOSURES

Moody's did not receive or take into account a third-party assessment on the due diligence performed regarding the underlying assets or financial instruments related to the monitoring of this transaction in the past six months.

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