

**Rating Action: Moody's downgrades and leaves on review for possible downgrade the ratings of all notes in Paragon Mortgages (No. 7)**

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Global Credit Research - 06 Mar 2014

London, 06 March 2014 -- Moody's Investors Service has today downgraded ratings of all notes in UK buy-to-let residential mortgage-backed securities (RMBS) transaction, Paragon Mortgages (No. 7) PLC (Paragon 7), as a result of the rating agency's detailed analysis of swap counterparty exposure. At the same time, all notes remain on review for possible downgrade pending conclusion of Royal Bank of Scotland plc's (RBS) (A3, Possible Downgrade/P-2) placement on review for downgrade. RBS acts as the currency swap counterparty to the transaction.

Today's rating action follows the placement on review of the ratings in Paragon 7 on the 14th November 2013, in relation to swap counterparty exposure following the introduction of the rating agency's updated approach to assessing swap counterparty linkage in structured finance transactions ([https://www.moodys.com/research/Moodys-reviews-for-downgrade-EMEA-RMBS-and-ABS-transactions-due--PR\\_286515](https://www.moodys.com/research/Moodys-reviews-for-downgrade-EMEA-RMBS-and-ABS-transactions-due--PR_286515))

For a detailed list of affected ratings, refer to the section 'List of affected securities' in this press release.

**RATINGS RATIONALE**

Today's rating action reflects the impact on the transaction of its exposure to its currency swap counterparty, RBS (A3, Possible Downgrade/P-2), following the introduction of the rating agency's updated approach to assessing swap counterparty linkage in structured finance cash flow transactions ("Approach to Assessing Swap Counterparties in Structured Finance Cash Flow Transactions" published on the 12 November 2013).

**-- Swap Counterparty Risks**

RBS (A3, Possible Downgrade/P-2) is the currency swap counterparty to the transaction. The size of exposure to the currency swap counterparty is 78.3% of the total outstanding sterling equivalent note balance. As part of its review, Moody's has incorporated the risk of additional losses on the notes in the event of them becoming unhedged following a default of the currency swap counterparty.

The currency swap agreement in the transaction does not meet Moody's requirements for ISDA schedule and collateral support provisions. In its analysis, Moody's took into account the swap counterparty transfer rating trigger level set at Baa2 and the size of exposure to the currency swap counterparty. Moody's concluded that the credit enhancements are insufficient to protect all tranches against the swap counterparty risks and downgraded all the ratings of all rated tranches.

Moody's maintains all notes in Paragon 7 on review for possible downgrade pending conclusion of RBS's placement on review for downgrade on the 12th Feb 2014. ([https://www.moodys.com/research/Moodys-reviews-Royal-Bank-of-Scotlands-ratings-for-downgrade--PR\\_291987](https://www.moodys.com/research/Moodys-reviews-Royal-Bank-of-Scotlands-ratings-for-downgrade--PR_291987))

**-- Revision of Key Collateral Assumptions**

Moody's conducted a loan by loan analysis of the securitized portfolio. Moody's increased the MILAN assumption from 13% to 14.5% to reflect high borrower concentration, with the concentration to the top 20 borrowers currently representing 13.26% of the remaining outstanding pool.

**Factors that would lead to an upgrade or downgrade of the rating**

Factors or circumstances that could lead to a downgrade of the ratings affected by today's action would be the worse-than-expected performance of the underlying collateral, and deterioration in the credit quality of the counterparties.

Factors or circumstances that could lead to an upgrade of the ratings affected by today's action would be the better-than-expected performance of the underlying assets, and a decline in counterparty risk.

The principal methodology used in this rating was "Moody's Approach to Rating RMBS Using the MILAN Framework" published in November 2013. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

#### LIST OF AFFECTED SECURITIES

Issuer: Paragon Mortgages (No. 7) PLC

...US\$450M Class A1a Notes, Downgraded to Aa3 (sf) and Remains On Review for Possible Downgrade; previously on Nov 14, 2013 Aaa (sf) Placed Under Review for Possible Downgrade

...GBP220M Class A1b Notes, Downgraded to Aa3 (sf) and Remains On Review for Possible Downgrade; previously on Nov 14, 2013 Aaa (sf) Placed Under Review for Possible Downgrade

...EUR500M Class A1c Notes, Downgraded to Aa3 (sf) and Remains On Review for Possible Downgrade; previously on Nov 14, 2013 Aaa (sf) Placed Under Review for Possible Downgrade

...US\$82.5M Class B1a Notes, Downgraded to Baa1 (sf) and Remains On Review for Possible Downgrade; previously on Nov 14, 2013 A2 (sf) Placed Under Review for Possible Downgrade

...EUR65M Class B1b Notes, Downgraded to Baa1 (sf) and Remains On Review for Possible Downgrade; previously on Nov 14, 2013 A2 (sf) Placed Under Review for Possible Downgrade

#### REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

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.

The analysis relies on an assessment of collateral characteristics to determine the collateral loss distribution, that is, the function that correlates to an assumption about the likelihood of occurrence to each level of possible losses in the collateral. As a second step, Moody's evaluates each possible collateral loss scenario using a model that replicates the relevant structural features to derive payments and therefore the ultimate potential losses for each rated instrument. The loss a rated instrument incurs in each collateral loss scenario, weighted by assumptions about the likelihood of events in that scenario occurring, results in the expected loss of the rated instrument.

Moody's did not use any stress scenario simulations in its analysis.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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