

Rating Action: Moody's upgrades notes in 3 UK RMBS Paragon transactions

Global Credit Research - 02 Jul 2015

London, 02 July 2015 -- Moody's Investors Service has today upgraded the ratings of 12 notes in Paragon Mortgages (No.7) plc, Paragon Mortgages (No.9) plc and Paragon Mortgages (No.11) plc. Additionally Moody's Investors Service has upgraded the Counterparty Instrument Rating (CIR) associated with Class Cb cross currency swap in Paragon Mortgages (No.9) plc. Today's rating actions primarily reflect the assignment of counterparty risk assessments (CR Assessments) to various FX swap counterparties and an update in collateral assumptions. At the same time, Moody's confirmed the ratings of all remaining 6 tranches in these three transactions.

See towards the end of the ratings rationale section of this press release for a detailed list of affected ratings.

RATINGS RATIONALE

Today's upgrades reflect (1) the assignment of the CR Assessments to the Swap Counterparties, and (2) update in collateral assumptions, whereas the rating confirmations are driven by sufficient credit enhancement.

--- ASSIGNMENT OF NEW COUNTERPARTY RISK (CR) ASSESSMENT

The assignment of the CR Assessments, which is higher than the corresponding senior unsecured rating for Barclays Bank PLC and also an upgrade from the previous unsecured rating used for The Royal Bank of Scotland plc (RBS), have resulted in a decrease in the probability of losing the benefit of hedging provided by the Swap Counterparties.

A CR Assessment reflects the probability that a bank will default on certain senior operating obligations and other contractual commitments. Moody's uses CR Assessments to measure the risk of default for various bank exposures faced by structured finance transactions, including exposures to swap counterparties.

-- REVISION OF KEY COLLATERAL ASSUMPTIONS

Moody's has reduced the MILAN CE as follows:

- i) Paragon Mortgages (No.7) plc to 12.50% from 14.50%
- ii) Paragon Mortgages (No.9) plc to 14% from 17.77%
- iii) Paragon Mortgages (No.11) plc to 14% from 17.50%

And has maintained the Expected Loss assumptions for all three transactions.

--- COUNTERPARTY INSTRUMENT RATING (CIR)

CIR measures the risk posed to a counterparty arising from a special purpose vehicle's (SPV) inability to honor its obligations under the referenced financial contract. The rating does not address potential losses in relation to any market risk associated with the transaction.

Following the CIR methodology, "Moody's Approach to Counterparty Instrument Ratings" published in June 2015 (http://www.moody's.com/viewresearchdoc.aspx?docid=PBS_SF406099), the CIR is determined in 2 steps; the first step, the expected loss assuming no counterparty default, and the second step, counterparty linkage analysis.

The expected loss for the counterparty will usually match that of the pari passu-ranking notes without considering the linkage to the swap counterparty; in this case, Class Cb.

The second step, counterparty linkage analysis, determines whether the rating from the first step should be further adjusted due to linkage to the counterparty itself, RBS. The analysis incorporates a probability uplift and a severity modifier.

Moody's now gives a 3-notch probability uplift. Probability uplift assesses whether the swap will be transferred to a different counterparty before current counterparty defaults. It also assesses the likelihood of the swap being out-the-money at counterparty default and the termination payment being subordinated in the payment priority.

Principal methodologies:

The principal methodology used in these ratings was "Moody's Approach to Rating RMBS Using the MILAN Framework" published in January 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

The analysis undertaken by Moody's at the initial assignment of ratings for RMBS securities may focus on aspects that become less relevant or typically remain unchanged during the surveillance stage. Please see Moody's Approach to Rating RMBS Using the MILAN Framework for further information on Moody's analysis at the initial rating assignment and the on-going surveillance in RMBS.

The methodology used in rating 'Cross currency swap for class Cb' for Paragon Mortgages (No. 9) PLC was "Moody's Approach to Counterparty Instrument Ratings" published in June 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

Factors that could lead to an upgrade or downgrade of the ratings:

Factors or circumstances that could lead to an upgrade of the ratings include (1) better-than-expected performance of the underlying collateral; (2) deleveraging of the capital structure; and (3) improvements in the credit quality of the transaction counterparties (4) a decline in counterparty risk.

Factors or circumstances that could lead to a downgrade of the ratings include (1) a worse than expected performance of the underlying collateral (2) deterioration in the notes' available credit enhancement (3) deterioration in the credit quality of the transaction counterparties (4) an increase in counterparty risk.

LIST OF AFFECTED RATINGS

Issuer: Paragon Mortgages (No. 7) PLC

...US\$450M A1a Notes, Confirmed at A1 (sf); previously on Mar 20, 2015 A1 (sf) Placed Under Review for Possible Upgrade

...GBP220M A1b Notes, Confirmed at A1 (sf); previously on Mar 20, 2015 A1 (sf) Placed Under Review for Possible Upgrade

...EUR500M A1c Notes, Confirmed at A1 (sf); previously on Mar 20, 2015 A1 (sf) Placed Under Review for Possible Upgrade

...EUR65M B1b Notes, Upgraded to Baa1 (sf); previously on Mar 20, 2015 Baa3 (sf) Placed Under Review for Possible Upgrade

...US\$82.5M B1a Notes, Upgraded to Baa1 (sf); previously on Mar 20, 2015 Baa3 (sf) Placed Under Review for Possible Upgrade

Issuer: Paragon Mortgages (No. 9) PLC

...GBP346M Aa Notes, Upgraded to Aa1 (sf); previously on Mar 20, 2015 Aa2 (sf) Placed Under Review for Possible Upgrade

...EUR355M Ab Notes, Upgraded to Aa1 (sf); previously on Mar 20, 2015 Aa2 (sf) Placed Under Review for Possible Upgrade

...US\$60M Ac Notes, Upgraded to Aa1 (sf); previously on Mar 20, 2015 Aa2 (sf) Placed Under Review for Possible Upgrade

...GBP7M Ba Notes, Upgraded to A1 (sf); previously on Mar 20, 2015 Baa2 (sf) Placed Under Review for Possible Upgrade

...EUR29.5M Bb Notes, Upgraded to A1 (sf); previously on Mar 20, 2015 Baa2 (sf) Placed Under Review for Possible Upgrade

...GBP3M Ca Notes, Upgraded to A3 (sf); previously on Mar 20, 2015 Baa3 (sf) Placed Under Review for Possible Upgrade

...EUR66M Cb Notes, Upgraded to A3 (sf); previously on Mar 20, 2015 Baa3 (sf) Placed Under Review for Possible Upgrade

...Cross Currency Swap for Class Cb Notes, Upgraded to A3 (sf); previously on Mar 20, 2015 Baa2 (sf) Placed Under Review for Possible Upgrade

Issuer: Paragon Mortgages (No. 11) PLC

...US\$985M A1 Notes, Confirmed at Aa1 (sf); previously on Mar 20, 2015 Aa1 (sf) Placed Under Review for Possible Upgrade

...GBP149.5M A2a Notes, Confirmed at Aa1 (sf); previously on Mar 20, 2015 Aa1 (sf) Placed Under Review for Possible Upgrade

...EUR219.7M A2b Notes, Confirmed at Aa1 (sf); previously on Mar 20, 2015 Aa1 (sf) Placed Under Review for Possible Upgrade

...GBP16M B1a Notes, Upgraded to Aa2 (sf); previously on Mar 20, 2015 Aa3 (sf) Placed Under Review for Possible Upgrade

...EUR82.4M B1b Notes, Upgraded to Aa2 (sf); previously on Mar 20, 2015 Aa3 (sf) Placed Under Review for Possible Upgrade

...EUR87.5M C1b Notes, Upgraded to A2 (sf); previously on Dec 23, 2014 Downgraded to A3 (sf)

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.

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 quantitative analysis entails an evaluation of scenarios that stress factors contributing to sensitivity of ratings and take into account the likelihood of severe collateral losses or impaired cash flows. Moody's weights the impact on the rated instruments based on its assumptions of the likelihood of the events in such scenarios occurring.

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