

## **Fitch Affirms Icelandic Banks on Sovereign Rating Downgrade**

Fitch Ratings-London/Frankfurt-15 March 2007: Fitch has today affirmed the ratings of the four Icelandic banks it rates, as listed below. The agency states that despite significant macro-imbalances and signs that restoring these might lead to pressures on the banks' domestic operating environment, it has maintained a Stable Outlook on the Issuer Default Rating of these banks.

Glinir Banki ("Glitnir"): Issuer Default 'A' with a Stable Outlook, Short-term 'F1', Individual 'B/C', and Support '2'

Kaupthing Bank ("Kaupthing"): Issuer Default 'A' with a Stable Outlook, Short-term 'F1', Individual 'B/C', and Support '2'

Landsbanki Islands ("Landsbanki"): Issuer Default 'A' with a Stable Outlook, Short-term 'F1', Individual 'B/C', and Support '2'

Straumur-Burdaras Investment Bank ("Straumur"): Issuer Default 'BBB-' with a Stable Outlook, Short-term 'F3', Individual 'C/D', and Support '3'

The rating affirmations follow the downgrade today of Iceland's Long-term foreign currency Issuer Default rating to 'A+' with a Stable Outlook, from 'AA-' (AA minus) (see separate announcement on the agency's public website, [www.fitchratings.com](http://www.fitchratings.com)). "During the past year, the banks have experienced a series of stress tests and shocks to which management have reacted quickly" says Alexandre Birry, Associate Director at Fitch's Financial Institutions group. In a special report released today, the agency highlights the measures taken and the challenges that remain. The ratings are supported by the banks' good capitalisation, the growing diversification of their activities and the resulting stronger sustainable revenue generation capacity. Straumur, having been granted an investment banking licence in 2004, has a different risk profile than its three peers.

These four banks have managed to maintain good performance levels in 2006 while acting on a number of their specific risks. Their access to funding, although at a higher price than in the past, has been strengthened through geographical diversification. Their funding maturity profile has been lengthened. The banks have enhanced their liquidity to be able to generally meet their maturing debt during the next 12 months without having to access the capital markets. Their profit streams have been diversified through the consolidation of the newly acquired businesses. In addition, the banks have reduced their equity exposures, although these remain above 20% of the banks' capital.

The Icelandic banks have shown strong resilience to shocks in 2006, having benefited from the still good domestic environment and rapid business expansion, in particular in the strong-performing Scandinavian markets. "The diversification of their businesses, both in terms of product and geography, has strengthened their position," says Olivia Perney Guillot, Senior Director at Fitch. "However, the banks' activities are increasingly geared towards corporate and investment banking and capital markets business, where they have expanded rapidly, both organically and through acquisitions; these represent an increasingly important feature of their risk profile. This differentiates the Icelandic banks from a number of their Nordic peers, where activities are generally more balanced between the retail and corporate businesses," adds Ms Perney Guillot.

Given the structure of the Icelandic economy, and in particular the Icelandic business model that has been built on extensive external borrowing (mainly by banks), it will take time to resolve the macro-imbalances. The large Icelandic banks will remain heavily reliant on wholesale funding and, while customer deposit taking initiatives have been taken to address this, it will take time to build up a stable deposit base, especially given that in many cases these initiatives target corporate deposits, which can prove volatile. The banks also remain exposed to specific risks, including their very volatile domestic currency and stock exchange. In addition, a slow down of the Icelandic economy, combined with high inflation and interest rates, would put pressures on households and corporates and lead to increases in arrears. Fitch is of the opinion that the banks' underlying profitability should be sufficient to absorb loan impairment charges increases.

The report, entitled 'Icelandic Banks – Holding Out In Volatile Times', is available on the agency's subscription website, [www.fitchresearch.com](http://www.fitchresearch.com).

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