

Rating Action: Landsbanki Islands hf

Moody's downgrades Landsbanki Islands hf to A2/C-

London, 28 February 2008 -- Moody's Investors Service has today downgraded the bank financial strength rating ("BFSR") of Landsbanki Islands hf ("Landsbanki") to C- from C and its long-term foreign and local currency deposit ratings to A2 from Aa3. The bank's Prime-1 short-term rating was affirmed. The outlook on all ratings is stable. These rating actions conclude the review for possible downgrade initiated on 30 January 2008.

Moody's review focused on: (i) the sustainability of the bank's earnings in light of the more challenging credit environment, both in Iceland and in the other countries where Landsbanki has sizeable operations; (ii) the prospects for asset quality given the slowdown in the Icelandic economy, the current volatility of the Icelandic stock market and the seasoning of the loan portfolio after several years of torrid growth; and (iii) the development of the bank's liquidity profile given the current global market conditions and its growing reliance on short-term internet-based deposits from overseas sources for funding.

"After carrying out comprehensive stress tests, Moody's has concluded that Landsbanki's liquidity profile is sound. This is supported both by on-balance-sheet liquidity and by the favourable term structure of the bank's debt in spite of the potential risks posed by its internet deposit funding," said Kimmo Rama, lead analyst for Landsbanki at Moody's.

In recent years, Icelandic banks have experienced substantially stronger asset growth than their Nordic peers -- both within Iceland and overseas. Moody's believes that the current turmoil in the global financial markets is likely to curtail this growth and poses greater challenges for the asset quality of Icelandic banks.

Moody's downgrade reflects its concerns in respect of Landsbanki's asset quality and profitability, despite the 2007 results still showing a reasonably good performance in these areas. These concerns relate to the bank's high single-name and sectoral exposures in light of the weakened Icelandic and global credit environment.

Moody's stress tests on Landsbanki's loan portfolio subjected it to different default, asset growth and revenue assumptions as well as scenarios in which problem loans increased sharply. "These stress tests showed that Landsbanki can withstand significant downward pressure. However, given the concentrated nature of its largest exposures, Moody's believes that its ability to withstand a deterioration in its loan book has been reduced to a level more consistent with a BSFR of C-," Mr Rama explained.

In respect of the sustainability of the bank's earnings, Moody's stated that Landsbanki's business model remains to some extent dependent on investment banking, which Moody's expects to prove challenging over the coming years. This adverse change in market conditions is likely to create volatility in recurring earnings power and thereby put pressure on the bank's capital adequacy assuming moderate asset growth. In 2007, investment banking generated nearly 30% of pre-tax profits.

Landsbanki is the second largest bank in Iceland in terms of total assets and has a market share of loans and deposits of more than 25%. In Moody's opinion, a default of Landsbanki would pose a substantial risk to the Icelandic payment system and it therefore assesses the probability of systemic support for the bank in the event of a stress situation as very high. Moody's therefore imputes a three-notch uplift from the Landsbanki's baseline credit assessment of Baa2 (which maps from its new BFSR of C-), bringing the long-term deposit rating to A2

Commenting on the future rating drivers, Moody's notes that, as the ratings have just been downgraded, an upgrade is unlikely in the medium term. However, the BFSR could enjoy positive pressure in the event of a significant decrease in credit risk concentration, a further decrease in the contribution from potentially volatile earnings and/or a decrease in the bank's risk appetite, provided good profitability and liquidity are also maintained.

Conversely, further downward pressure on Landsbanki's BFSR could be caused by a change in strategy towards higher risk acceptance. The maintenance of solid asset quality and a sound liquidity and funding profile also remain fundamental rating considerations.

The following ratings were downgraded:

Bank Deposits: to A2 from Aa3

Bank Financial Strength: to C- from C

Issuer Rating: to A2 from Aa3

Senior Unsecured: to A2 from Aa3

Subordinate: to A3 from A1

Jr Subordinate MTN: to Baa1 from A2

Preferred Stock: to Baa1 from A2

The following ratings were affirmed:

Commercial Paper: P-1

Other Short-Term: P-1

Landsbanki is headquartered in Reykjavik, Iceland. At the end of December 2007, Landsbanki had total assets of ISK3,058 billion (EUR33.4 billion).

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