

## **Fitch Puts Three Icelandic Banks on Rating Watch Negative**

Fitch Ratings-London- 1 April 2008: Fitch Ratings has today placed Glitnir Banki hf.'s, Kaupthing Bank hf.'s and Landsbanki Islands' (the three banks) Long- and Short-term Issuer Default ratings (IDRs), senior and subordinated debt ratings and Individual ratings on Rating Watch Negative (RWN). The Support ratings of '2' and Support Rating Floors of 'BBB' have been affirmed. While Fitch believes that the three banks' liquidity is currently sufficient, diminishing confidence in the sector has increased the risk of unanticipated calls on liquidity while severely restricting funding options. Moreover, the recent sharp depreciation of the ISK and the heightened risk of a 'hard landing' for the Icelandic economy are likely to adversely impact asset quality and performance.

Fitch expects to resolve the RWNs on all three banks over the coming weeks, following a more thorough review of the banks' financial and risk profiles. Fitch has also put the Long- and Short-term IDRs of Heritable Bank, the UK-based subsidiary of Landsbanki Islands on RWN and the Long- and Short-term IDRs and Individual rating of Kaupthing Singer & Friedlander, the UK-based subsidiary of Kaupthing Bank hf, on RWN. Fitch expects to resolve the RWN on the ratings of the subsidiaries at the same time as those of their parents.

Fitch has been monitoring the sector closely since the financial markets turmoil increased in H207. From its discussions with management, Fitch believes that the banks remain liquid, and have benefited from efforts made to diversify funding following an Icelandic banking crisis in early 2006. Fitch's review of the banks over the coming weeks will focus on the extent to which they are coping with the effects of a weakening external environment and their ability to withstand a deterioration in the domestic environment. Today's rating action considers the banks' increasingly restricted access to funding and potential for additional pressures on liquidity given the current negative market sentiment towards the sector, which has been compounded by the wider problems in the global financial markets.

Fitch notes that the three Icelandic banks' underlying performance appears likely to weaken in 2008 from the impact on business volumes and asset quality due to the downturn in the Icelandic economy and continued global uncertainty, as well as sharply higher new funding costs. At a time when the ISK has been rapidly devaluing, this concern is heightened by the fact that many Icelandic corporates have foreign currency-denominated loan exposures, despite hedges against this risk in most cases. However, Fitch expects reported performance to be supported by FX and translation gains as a result of the fall of the ISK in Q108, offsetting to some extent potential losses on equity exposures. The agency also notes the exposure of the banks to Icelandic investment companies, where the loans are collateralised by shares in corporates, which have also fallen in value in recent months. Finally, expected weaker capital markets and investment banking activities are set to result in significantly lower earnings in 2008, with this business line having expanded sharply in recent years and accounting for up to 40% of operating profits in 2007.

Nevertheless, Fitch notes that the business fundamentals of the three banks currently remain sound. Liquidity appears comfortable and the banks are currently able to operate without recourse to the capital markets for some months to come. Capitalisation is also good and has been strengthened by recent efforts, such as share and convertible bond issuance. Furthermore, the banks have made significant progress in diversifying their funding bases, both by funding type and geographical location in recent years, whilst lending has also become more diversified with the geographical expansion of the banks.

The ratings of the three banks and two subsidiaries are as follows:

Glitnir Banki hf.:

Long-term IDR and senior debt: affirmed at 'A'; placed on Rating Watch Negative

Short-term IDR: affirmed at 'F1'; placed on Rating Watch Negative

Support rating: affirmed at '2'

Support rating floor: affirmed at 'BBB'

Individual rating: affirmed at 'B/C'; placed on Rating Watch Negative

Subordinated debt: affirmed at 'A-' ; placed on Rating Watch Negative

Kaupthing Bank hf.:

Long-term IDR and senior debt: affirmed at 'A'; placed on Rating Watch Negative

Short-term IDR: affirmed at 'F1'; placed on Rating Watch Negative

Support rating: affirmed at '2'

Support rating floor: affirmed at 'BBB'

Individual rating: affirmed at 'B/C'; placed on Rating Watch Negative

Subordinated debt: affirmed at 'A-' ; placed on Rating Watch Negative

Kaupthing Singer & Friedlander Ltd:

Long-term IDR: affirmed at 'A'; placed on Rating Watch Negative

Short-term IDR: affirmed at 'F1'; placed on Rating Watch Negative

Support rating: affirmed at '2'

Individual rating: affirmed at 'B/C'; placed on Rating Watch Negative

Landsbanki Islands:

Long-term IDR and senior debt: affirmed at 'A'; placed on Rating Watch Negative

Short-term IDR: affirmed at 'F1'; placed on Rating Watch Negative

Support rating: affirmed at '2'

Support rating floor: affirmed at 'BBB'

Individual rating: affirmed at 'B/C'; placed on Rating Watch Negative

Subordinated debt: affirmed at 'A-' ; placed on Rating Watch Negative

Heritable Bank Ltd:

Long-term IDR: affirmed at 'A'; placed on Rating Watch Negative

Short-term IDR: affirmed at 'F1'; placed on Rating Watch Negative

Support rating: affirmed at '1'

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