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**Research Update:**

# Glitnir Bank Downgraded To 'CCC'; On Watch Neg On Increased Systemic Concerns

**Primary Credit Analyst:**

Miguel Pintado, Stockholm (46) 8-440-5904; miguel\_pintado@standardandpoors.com

**Secondary Credit Analyst:**

Louise Lundberg, Stockholm (46) 8-440-5938; louise\_lundberg@standardandpoors.com

## Table Of Contents

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Rationale

Ratings List

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## Rationale

On Oct. 7, 2008, Standard & Poor's Ratings Services lowered its long-term counterparty credit rating on Iceland-based Glitnir Bank to 'CCC' from 'BBB' and placed it on CreditWatch with negative implications. At the same time, it lowered its short-term counterparty credit rating on the bank to 'C' from 'A-3'. Furthermore, the ratings on the hybrid capital instruments of the bank were lowered to 'CC', two notches below those on the counterparty credit ratings.

The rating actions reflect our increased concerns about the implications for Glitnir's asset quality and liquidity position following the passage of a bill yesterday by the Icelandic government enabling the government, in certain conditions, to take over commercial banks. The government stated that given the increasing refinancing difficulties faced by Icelandic banks, the government is authorizing the Icelandic Financial Supervisory Authority to take over commercial banks under certain conditions. In a speech to the Icelandic public, Prime Minister Geir Haarde implied that depositors and creditors of overseas subsidiaries of Icelandic banks must rely on the financial resources of the overseas subsidiaries themselves and warned that the Icelandic banks may "become to some extent non-operational". This announcement resulted in the lowering of the sovereign ratings on the Republic of Iceland (see "Republic of Iceland Ratings Lowered And Removed From CreditWatch Negative," published Oct. 6, 2008 on RatingsDirect).

As the unwinding of the Icelandic banking sector takes place in the coming weeks, the repercussions on the economy and on the banks themselves will be significant. The implications for Glitnir's asset quality and that of the other banks could be transformational as major Icelandic holding companies with interests in foreign countries and in many cases current large borrowers (and shareholders) of the banks themselves are likely to be significantly hit in the event of government takeovers. Glitnir Bank issued a profit warning last week following a 70% drop in its share price that followed the government's takeover of 75% of the shares in the bank.

In addition, the major depreciation of the Icelandic krona in the past few weeks will put significant pressure on domestic borrowers, which have increasingly taken out foreign currency loans that are only partly naturally hedged by foreign exchange revenues. Furthermore, asset quality is likely to be negatively affected by high inflation, which in turn will increase the debt service burden on the bulk of households that have inflation-indexed loans.

Because of the wholesale nature of Icelandic banks' funding and their rapid expansion into Internet deposits in the U.K. and the Nordic countries, yesterday's announcement is likely to prompt massive withdrawals in the days ahead, which in turn is likely to exacerbate funding and liquidity pressure.

Although we consider Glitnir to be of high systemic importance within the

Icelandic banking system, the announcement by Mr. Haarde makes it clear that depositors and investors cannot depend on government support for Glitnir's foreign operations.

## Ratings List

Glitnir Bank

Downgraded; CreditWatch/Outlook Action

	To	From
Long-term counterparty credit rating	CCC/Watch Neg	BBB/Negative
Short-term counterparty credit rating	C	A-3

Downgraded

	To	From
Senior Unsecured (2 issues)	CCC	BBB
Subordinated (1 issue)	CCC-	BBB-
Junior Subordinated (1 issue)	CC	BB
Commercial Paper (1 issue)	C	A-3

N.B. This list does not include all ratings affected.

### Additional Contact:

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com

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