

Research Update:

Ratings On The Republic Of Iceland Placed On Watch Negative After The Electorate Rejects Icesave Agreement A Second Time

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Research Update:

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Overview

- On April 9, 2011, the Icelandic electorate rejected, in a referendum, the so-called Icesave agreement.
- We see potentially higher economic risks to Iceland associated with a prolonged period of uncertainty.
- We are placing the 'BBB-/A-3' foreign currency and 'BBB/A-3' local currency sovereign credit ratings on Iceland on CreditWatch with negative implications.
- The CreditWatch will remain while we analyze the consequences of the vote on the economic, financial, and political outlook for Iceland.

Rating Action

On April 13, 2011, Standard & Poor's Ratings Services placed the 'BBB-/A-3' foreign currency and 'BBB/A-3' local currency sovereign credit ratings on Iceland on CreditWatch with negative implications. The CreditWatch will remain while we analyze the consequences of the rejection of the Icesave agreement on Iceland's economic, financial, and political outlook.

Rationale

The CreditWatch placement comes after the Icelandic electorate rejected for a second time the government-negotiated Icesave agreement with the U.K. and the Netherlands, at a referendum on April 9, 2011.

We understand that under this agreement the Icelandic state would guarantee that the Depositors' and Investors' Guarantee Fund of Iceland would repay, to the U.K. and Netherlands, the costs these sovereigns incurred when paying deposit guarantees (up to the minimum guaranteed amount of €20,000 per depositor) to depositors in U.K. and Netherlands branches of Landsbanki Íslands hf. Under the agreement, the Icelandic state would also guarantee the payment of outstanding amounts (the shortfall) and interest on the deposit guarantee obligations.

We see potentially higher economic risks to Iceland associated with a prolonged period of uncertainty, as the Icesave issue will, we believe, likely return to the European Free Trade Association (EFTA) court. We expect that a ruling by the EFTA court could take a year or longer. The prolonged dispute over the Icesave issue could weaken Iceland's relationship with other European countries, increase its external financing risks, and hinder Iceland's

economic recovery prospects as well as delay the lifting of capital controls and its return to international capital markets, in our view.

The ratings on Iceland are constrained by high external and fiscal debt burdens that we believe could become heavier still were it not for capital controls limiting both residents' ability to invest overseas and nonresidents' ability to exchange krona holdings for foreign exchange. The ratings are supported by what we view as the flexibility of the country's relatively prosperous economy and by its institutional capacity to address its financial sector problems and build an environment more conducive to sustainable economic growth.

CreditWatch

We expect to resolve the CreditWatch within the next few weeks, after we analyze the implications of the rejection of the Icesave agreement on Iceland's economic, financial, and political outlook.

Related Criteria And Research

- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Sovereign Credit Ratings: A Primer, May 29, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Iceland (Republic of)		
Sovereign Credit Rating		
Foreign Currency	BBB-/Watch Neg/A-3	BBB-/Negative/A-3
Local Currency	BBB/Watch Neg/A-3	BBB/Negative/A-3
Senior Unsecured	BBB-/Watch Neg	BBB-
Senior Unsecured (local currency)	BBB/Watch Neg	BBB
Short-Term Debt	A-3/Watch Neg	A-3
Commercial Paper	A-3/Watch Neg	A-3

Ratings Affirmed

 Transfer & Convertibility Assessment

 Local Currency

 BBB-

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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