



Fitch Assesses Resilience of Icelandic Banks to Systemic Shocks

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Fitch Ratings-London-02 March 2006: Fitch Ratings says in a special report issued today that the three largest Icelandic banks - Kaupthing Bank, Landsbanki Islands and Islandsbanki - have improved over the past three years their resilience to domestic systemic shocks; however, given the small size of the Icelandic economy and existing macro-prudential imbalances, these risks are not negligible. The report, which addresses the banks' capacity to absorb specific shocks arising from foreign exchange, interest rate, funding and liquidity risks, follows the revision by Fitch of the Outlook on Iceland's sovereign Foreign Long-term Issuer Default Rating to Negative from Stable.

The banks' currently large capital bases give them the means to cushion to some extent shocks in their domestic market. The growing diversification of their activities also makes them less reliant on the Icelandic economy as a whole. "This rapid overseas growth has also resulted in the need for more sophisticated management by the banks of specific risks, such as foreign exchange risk and access to funding," says Alexandre Birry, Associate Director in Fitch's Financial Institutions team.

Current macro-prudential imbalances and the small size of the Icelandic economy make it more vulnerable to shocks, and the resulting risks for the banks in terms of FX, interest rate and access to funding are not negligible. However, "significant progress has been made by the banks in controlling and managing these risks, which gives some comfort as to their ability to withstand shocks in the domestic market, which is in turn reflected in the banks' ratings," adds Mr. Birry.

The Long-term Issuer Default Ratings of Kaupthing Bank, Landsbanki Islands and Islandsbanki were affirmed at 'A' on 23 February 2006. A broader analysis of the banks' risks, including credit and market risks, can be found in Fitch's credit analyses dated 22 and 29 November 2005.

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