

### Research Update:

## Icelanders' Referendum Rejection Of Plan To Repay Icesave Debt Has No Immediate Impact On Iceland Sovereign Rating

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### Table Of Contents

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Overview

Rating Action

Rationale

CreditWatch

Related Research

Ratings List

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## Overview

- The Icelandic electorate's resounding rejection at a referendum of legislation to compensate the governments of The Netherlands and the United Kingdom for their deposit insurance outlays on failed Icelandic internet bank Icesave has no immediate effect on the sovereign ratings.
- We are keeping our 'BBB-/A-3' foreign currency ratings and our 'BBB+/A-2' local currency ratings on Iceland on CreditWatch with negative implications.
- We expect to resolve the CreditWatch status when we obtain greater clarity on the availability of external financing.

## Rating Action

On March 8, 2010, Standard & Poor's Ratings Services said it was keeping its 'BBB-/A-3' long- and short-term foreign currency ratings and its 'BBB+/A-2' long- and short-term local currency ratings on the Republic of Iceland on CreditWatch, where they were placed with negative implications on Jan. 5, 2010.

## Rationale

The decision to keep the ratings on CreditWatch reflects our view that the Icelandic electorate's resounding rejection at a referendum over the weekend of legislation to compensate the governments of The Netherlands and the United Kingdom for their deposit insurance outlays on failed Icelandic internet bank Icesave, has no immediate effect on the rating on the Republic of Iceland. The popular rejection had been widely expected.

The government called the referendum after President Olafur Grimson had refused to sign the "Icesave Act" into law in early 2010. Subsequent negotiations between Reykjavik, London, and The Hague to agree on a compromise ended inconclusively. In our view, the referendum outcome does not constitute an outright repudiation of Iceland's international obligations, but merely reflects overwhelming popular discontent with the financial conditions of a bilateral loan offered by the British and the Dutch to finance their claim.

Standard & Poor's will analyse the implications of these developments for the future disbursements of the international financing package for Iceland by the International Monetary Fund (IMF) and Nordic governments. The financing is

intended to allow the Icelandic authorities to lift the currency exchange controls imposed following the collapse of the Icelandic banking system in late 2008 and to maintain investor confidence in the sustainability of public finances.

In principle, the disbursements of the Nordic loans were linked to the resolution of the Icesave issue, while the IMF in turn considered the Nordic disbursements to be a condition to secure sufficient funding for the adjustment program agreed between the Icelandic authorities and the IMF.

We believe that the referendum result will trigger new negotiations with the IMF on how the program will have to be restructured to allow for the reduced external financing prospects. At the same time, we believe it possible that the Nordic governments, or other international partners, may show some flexibility in disbursing funds as long as the government of Iceland continues to negotiate in good faith with its British and Dutch counterparts to resolve the Icesave problem. We note that the Nordic partners disbursed a first tranche in December 2009, even though the Icesave legislation had not been passed by parliament, as originally demanded, but had only been approved by the cabinet. We believe decisions on future disbursements will determine the strength of Iceland's bargaining position in the negotiations with the U.K. and The Netherlands.

Negotiations are likely to be complicated in the near term by forthcoming general elections in both the U.K. and The Netherlands, following last month's collapse of the Dutch government. However, we remain of the opinion that it would be in the best interest of all three governments to continue to find a solution.

Standard & Poor's does not believe that the Icelandic government will resign over the referendum or that the unresolved Icesave problem will thwart nascent EU membership talks, which at this stage, are not a rating factor.

## **CreditWatch**

We intend to resolve the CreditWatch placement before the end of April 2010. Over the next few weeks, we plan to monitor the progress of talks with the IMF and the Nordic governments on one hand and with the U.K. and Dutch authorities on the other. A hardening of positions or a worsening of Iceland's fragile economic equilibrium could lead us to lower the sovereign rating on Iceland to the 'BB' category. However, progress toward a resolution on Icesave or toward securing external funding for Iceland's adjustment program would lead us to stabilize the ratings at their current levels.

## **Related Research**

## Ratings List

### CreditWatch Action

|                         |                    |
|-------------------------|--------------------|
| Iceland (Republic of)   |                    |
| Sovereign Credit Rating |                    |
| Foreign Currency        | BBB-/Watch Neg/A-3 |
| Local Currency          | BBB+/Watch Neg/A-2 |

|                       |                   |
|-----------------------|-------------------|
| Iceland (Republic of) |                   |
| Senior Unsecured      | BBB+/Watch Neg/-- |
| Senior Unsecured      | BBB-/Watch Neg/-- |
| Short-Term Debt       | A-2/Watch Neg     |
| Commercial Paper      | A-3/Watch Neg     |

### Ratings Affirmed

|                                      |      |
|--------------------------------------|------|
| Iceland (Republic of)                |      |
| Transfer & Convertibility Assessment |      |
| Local Currency                       | BBB- |

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Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://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) 495-783-4011.

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