

FITCH APPLIES CRITERIA CHANGES TO ICELAND'S RATINGS

Fitch Ratings-London-22 July 2016: Fitch Ratings has downgraded Iceland's Long-Term Local Currency (LTLC) IDR to 'BBB+' from 'A-'. The Outlook is Stable. The issue ratings on Iceland's long-term senior unsecured local currency bonds have also been downgraded to 'BBB+' from 'A-'. The Short-Term Foreign Currency (STFC) IDR has been affirmed at 'F2'. The issue ratings on Iceland's Short-Term foreign currency commercial paper have also been affirmed at 'F2'. A new Short-Term Local Currency (STLC) IDR of 'F2' has been assigned.

Under EU credit rating agency (CRA) regulation, the publication of sovereign reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from this in order to comply with their legal obligations. Fitch interprets this provision as allowing us to publish a rating review in situations where there is a change in our criteria that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status. The next scheduled review date for Fitch's sovereign rating on Iceland is 1H17, but Fitch believes that a portfolio review is now warranted based on recent changes to our criteria.

The rating committee that assigned the ratings included within this Rating Action Commentary was a portfolio review following recent changes to our criteria, and focused on three areas, namely the assignment of STLC IDRs, the review of existing STFC IDRs and the review of the notching relationship between existing LTLC IDRs and Long-Term Foreign Currency (LTFC) IDRs. The committee approved a variation from criteria on the basis that the review applied all relevant sections of our criteria related to the above rating types but did not apply the sections of the criteria related to LTFC IDRs, as the latter were not included in the scope of this review.

KEY RATING DRIVERS

The downgrade of Iceland's LTLC IDR to 'BBB+' from 'A-' reflects the following key rating driver and its weight:

HIGH

-In line with the updated guidance contained in Fitch's revised Sovereign Rating Criteria dated 18 July 2016, the credit profile of Iceland no longer supports a notching up of the LTLC IDR above the LTFC IDR. This reflects Fitch's view that neither of the two key factors cited in the criteria that support upward notching of the LTLC IDR are present for Iceland. Those two key factors are: (i) strong public finance fundamentals relative to external finance fundamentals, and (ii) previous preferential treatment of LC creditors relative to FC creditors.

The affirmation of Iceland's STFC IDR at 'F2' reflects the following key rating driver:

-In line with the updated guidance contained in Fitch's revised Sovereign Rating Criteria dated 18 July 2016, Iceland's STFC is derived from the mapping to the sovereign's LTFC IDR of 'BBB+'.

The assignment of a STLC IDR of 'F2' to Iceland reflects the following key rating driver and its weight:

HIGH

The assignment of the STLC IDR is consistent with Fitch's approach to assigning ST ratings by using its Long-Term/Short-Term Rating Correspondence table to map the STLC IDR from the

LTLC rating scale. According to Fitch's Rating Definitions, the Fitch Rating Correspondence Table is "a guide only and variations from this correspondence will occur". However, variations to this approach are rare in the case of sovereign ratings.

Iceland's STLC is derived from the mapping to the sovereign's LTLC IDR of 'BBB+'.

RATING SENSITIVITIES

The main factors that could lead to a change in the LTLC IDR are as follows:

- A change in the LTFC IDR
- A change in the key factors or supporting factors for notching up of the LTLC IDR from the LTFC IDR

The main factors that could lead to a change in the STFC IDR or the STLC IDR are as follows:

- A change in the LTFC IDR (for the STFC IDR)
- A change in the LTLC IDR (for the STLC IDR)

The rating sensitivities outlined in the previous Rating Action Commentary dated 15 July 2016 are unchanged in respect of the LTFC IDR. Consistent with the criteria variation referred to above, a review of the LTFC IDR and associated rating sensitivities was not included as part of this review.

ASSUMPTIONS

The assumptions outlined in the previous Rating Action Commentary dated 15 July 2016 are unchanged in respect of the LTFC IDR. Consistent with the criteria variation referred to above, a review of the LTFC IDR and associated assumptions was not included as part of this review.

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Applicable Criteria
Sovereign Rating Criteria (pub. 18 Jul 2016)

Related Research

Iceland - Rating Action Report

<https://www.fitchratings.com/site/re/885513>

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