

Research Update:

Eksporthfinans ASA Outlook To Negative On Weakened Business Model And Concerns Over Adequacy Of ERM; Ratings Affirmed

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Overview

- Eksportfinans ASA's business model has been placed under severe pressure by regulatory changes.
- Eksportfinans' enterprise risk management is, in our opinion, inadequate given the complexity of its business operations, which include the active management of a sizable portfolio of structured funding transactions.
- We are affirming our long-term issuer credit rating based on our continued belief in the "very high likelihood" of the Norwegian government's willingness to support Eksportfinans.
- We are changing our outlook on Eksportfinans to negative from stable to reflect our view of the ongoing pressure on Eksportfinans' stand-alone credit profile stemming from the viability of its current business model and the adequacy of its enterprise risk management.

Rating Action

On June 7, 2011, Standard & Poor's Ratings Services affirmed its 'AA' long-term issuer credit rating on Ekportfinans ASA (Eksportfinans). At the same time, the outlook was revised to negative from stable.

Eksportfinans provides medium- and long-term credit to Norwegian exporters. On behalf of the Kingdom of Norway (AAA/Stable/A-1+), it also manages the government support scheme for export credits and grants credits to developing countries. Eksportfinans' consolidated assets on March 31, 2011, stood at Norwegian krone (NOK) 212 billion (€27 billion at NOK7.83 to €1).

Rationale

We affirmed the ratings based on our view that there is a "very high likelihood" that the Norwegian government would provide support extraordinary support to Eksportfinans.

Under our methodology on rating government-related entities ("Rating Government-Related Entities: Methodology And Assumptions," Dec. 9, 2010) we derive the likelihood of support from Eksportfinans's:

- "Very important" role for the government, i.e., the support it provides Norwegian exporters. We assume that were Eksportfinans' activities to be disrupted, it could have a significant impact on the local economy.
- "Very strong" link with the government. We consider the government to be

a stable shareholder with a track record of providing support, in line with the other shareholders.

The ratings are underpinned by Eksportfinans's excellent loan loss history.

The outlook revision reflects the regulatory changes implemented in the wake of the 2008 financial crisis. These have highlighted the weakness in Eksportfinans' business model, which is built on low margins, low risk, and high leverage.

Going forward, we expect Eksportfinans to find it more difficult to maintain its financial profile because it will have to carry more conservative risk weights for bank exposures. These currently represent around 60% of the balance sheet.

Eksportfinans' stand-alone credit profile was downgraded to 'a-' from 'a', reflecting our view on the viability of its current business model and our concern that Eksportfinans' enterprise risk management is inadequate for the complexity of its business operations. These include the active management of a sizable portfolio of structured funding transactions. In our view, Eksportfinans' present business model requires substantial resources to control risks effectively. We also believe that resources and systems are inadequate relative to Eksportfinans' operations. Investments in systems have improved the situation, but additional work may still be warranted, in our opinion.

We believe that the government supports Eksportfinans because it provides subsidized CIRR-loans (Commercial Interest Reference Rates loans under the OECD Consensus Agreement 1978) to Norwegian exporters. However, Standard & Poor's cannot be certain that Eksportfinans' business will retain its present structure. In our view, the present situation may well trigger substantial changes to Eksportfinans' business model.

Eksportfinans' business model depends on it being able to offload risk to a handful of financial institutions for risk management purposes. But the EU decided to reduce interbank exposures by changing how it regulates large exposures; it sharply reduced the regulatory maximum exposures between banks. Without the ability to offload risk, we believe Eksportfinans may not be able to lend directly to corporate clients either. Its capital base is insufficient to manage such credits, given the size of the loans required.

At present, the Norwegian authorities have granted Eksportfinans a temporary exemption allowing it to continue operating under the old regulatory regime until year-end 2011. However, we understand any permanent regulatory exemption rests with the EU Commission because the applicable laws and regulation are EU law and not wholly within the purview of the Norwegian authorities. In Standard & Poor's opinion, the EU might grant a partial exemption covering Eksportfinans' core business of CIRR-loans.

In addition to the effect of changing regulation, we believe Eksportfinans is

affected by concentration risk well above the market average.

Outlook

The negative outlook reflects our view of the viability of Eksportfinans present business model. We continue to factor in an expectation of support and guidance from the Norwegian government and its other shareholders.

In our opinion, there are several possible scenarios for Eksportfinans' business model, including the following:

- The most likely, in our opinion, is that in the medium term, Eksportfinans is absorbed into a major financial institution capable of managing the concerns regarding Eksportfinans' large exposures and risk management. This would likely end Eksportfinans' status as a government related entity.
- We consider it less likely that Eksportfinans would be downsized to focus only on its core business of CIR-credits. This strategy would not, in our view, alleviate the shortcomings in Eksportfinans' enterprise risk management.
- Eksportfinans could be given a substantial increase in capital and the scope of its business expanded to allow it to continue to operate as an independent going concern, but we consider this outcome unlikely.

A negative rating action could follow if there were indications that there was a lower likelihood of Eksportfinans receiving extraordinary government support. A further downgrade of Eksportfinans' stand-alone credit profile could, under our rating criteria, also lead to a downgrade of Eksportfinans' issuer credit rating. Furthermore, a significant deterioration in term funding, its capital ratios, or risk profile could put pressure on Eksportfinans' ratings. A positive rating action or a revision of the outlook to stable appears relatively unlikely in the short term.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Bank Rating Analysis Methodology Profile, March 18, 2004
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Eksportfinans ASA		
Counterparty Credit Rating	AA/Negative/A-1+	AA/Stable/A-1+
Senior Unsecured	AA	

Subordinated	AA-
Junior Subordinated	A
Commercial Paper	A-1+

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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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