



RATING METHODOLOGY:

FOR VIRTUAL ASSETS SERVICE
PROVIDERS ON THE VIRTUAL ASSETS
PLAYING FIELD

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INTRODUCTION



Developments in recent years, in the field of new technologies, namely, with respect to the 4.0 Industrial Revolution in general, and blockchain in particular, have contributed to the advent of new products and services, have disrupted traditional financial services, and pose challenges for countries and organizations.

The deregulation associated with these new products and services presents high risks, in terms of criminality and economic stability, making it essential to understand the advantages and risks associated with virtual assets (VA) and virtual assets service providers (VASP).

Kismet's main objective is to set the standards on VA and VASP and to promote their implementation at strategic, legal and regulatory, and operational levels for an effective VA ecosystem.

Kismet's standard creation and enforcement contributes to a broader strategy on VA and VASP regarding the management of the associated risks. The final goal is to ensure a leveled playing field for VA and for VASP and to identify those, who pose significant threats to the financial industry.

Approach overview

Kismet's approach to VA and VASP is based on a comprehensive and integrated set of methodologies, which countries and VASP should adopt and implement in order to create an adequate VA ecosystem, consisting of:

- Conceptual framework
- Recommendations
- Risk assessment methodology

- Rating methodology.



In the conceptual framework, the different concepts related to VA and VASP are defined, to facilitate a broad understanding about complex concepts, by providing a common language, between the different key actors and between them and all the other stakeholders.

The Recommendations establish the basic principles for the implementation and management of a VA ecosystem, at strategic, legal and regulatory level, as well as regarding operational and risk management, aiming for medium and long-term sustainability.

The risk assessment methodology defines the set of risks to be analyzed to assess the correct adoption and implementation of the

Recommendations. For each risk identified, this methodology evaluates if a set of mitigating measures are in place, to calculate the VASP's risk exposure.

The rating methodology allows, based on the risk assessment methodology, to assign a rating to VASP, to demonstrate their level of adoption and implementation of the Recommendations, and measuring its effectiveness.

Kismet is committed to building a close and constructive dialogue with countries and VASP, other international stakeholders and national authorities, to protect the VA ecosystem and promote best practices regarding these assets.

This document contains Kismet's Rating Methodology.

About Kismet

Kismet, a company under Dutch law, is a leading organization in providing rating for virtual assets service providers on the virtual assets playing field. Kismet's approach and rating solutions, help countries and VASP increase trust and credibility and enable stakeholders to identify opportunities, manage the risks of doing business with VA, and make better decisions.

Kismet's people are from diverse generations and varied cultural backgrounds. They have solid academic and distinct professional experience, which allows for a multidisciplinary and transversal approach to the VA ecosystem.

For more information about Kismet, visit kismetconsulting.eu.

1 | OVERVIEW OF THE METODOLOGY



The rating methodology consists of three components: (a) a risk assessment; (b) the assessment of the compliance with the Recommendations; and (c) the assessment of the effectiveness in the implementation of the Recommendations.

This document sets out the outcomes, indicators, data, and other factors necessary for providing a rating, giving an overview of the assessment methodology, its background, and how it will be used in the rating process.

The risk assessment is based on an extensive risk catalog defined according to different risk categories. The risks are assessed according to their impact and probability of occurrence. The inherent risks are correlated with their mitigant factors, resulting in a residual risk.

The assessment of the compliance addresses the specific requirements of Kismet's Recommendations, namely how they are implemented by VASP. These represent the fundamental building blocks of an effective VA ecosystem.

The assessment of the effectiveness assesses the result of the implementation of Kismet's Recommendations and identifies the extent to which a VASP achieves a defined set of outcomes that are central to VA ecosystem. The focus of the effectiveness assessment is therefore on the extent to which the implementation of the Recommendations is producing the expected results.

Together, the assessments of the three components present a rating result for each of these components and an integrated result for the country or VASP, combined under the rating methodology. This result attests the

level to which the VASP is compliant and how successful it is in maintaining a strong risk management, as required by Kismet's Recommendations.

The overall rating score is a weighted average of the three rating components. The risk assessment is weighted at 60%, the compliance assessment at 15%, and the effectiveness assessment at 25%.

The rating assessment, as it is a highly technical methodology that requires expertise to be implemented, is only performed by Kismet and its people. To guarantee the independence and integrity of the assessment, the teams involved in providing ratings to VASP do not provide other services to these players.

2 | RISK ASSESSMENT



201 | Assessment framework

The risk assessment is based on an extensive risk catalog defined according to different risk categories. The risks are assessed according to their impact and probability of occurrence. The inherent risks are correlated with their mitigant factors, resulting in a residual risk.

For more information about the risk assessment, please refer to Kismet's Risk Assessment Methodology.

202 | Ratings

There are ten possible rating levels, and, in exceptional circumstances, a risk category may also be rated as not applicable. The risk assessment may be rated as follows:

Ratings	
AAA	Extremely strong
AA	Very strong
A	Strong
BB	Adequate
BB-	Slightly adequate
B+	Slightly inadequate
B	Inadequate
CCC	Weak

CC	Very weak
C	Extremely weak

3 | COMPLIANCE ASSESSMENT



301 | Assessment framework

The assessment of the compliance with the Recommendations refers to the implementation of the specific requirements of Kismet's Recommendations.

When deciding on the level of shortcomings for any Recommendation, the number and the relative importance of the criteria met or not met are considered.

A requirement may not apply, due to the structural, legal or institutional features of a VASP.

The individual criteria used to assess each Recommendation do not all have equal importance, and the number of criteria met is not always an indication of the overall level of compliance with each Recommendation.

When deciding on the rating for each Recommendation, the relative importance of the criteria in the context of the country or VASP is considered, as well as how significant any deficiencies may be, to a VASP.

302 | Rating

Each Recommendation will be assessed regarding the extent to which a VASP complies with the Recommendation. There are four possible levels of compliance, and, in exceptional circumstances, a Recommendation may also be rated as not applicable. The Recommendations assessment may be rated as follows:

Ratings		
C	Compliant	There are no shortcomings
LC	Largely compliant	There are only minor shortcomings
PC	Partially compliant	There are moderate shortcomings
NC	Non-compliant	There are major shortcomings
NA	Not applicable	The recommendation is not applicable

VASP Recommendations		
No	Recommendation	Assessment
301	CONTEXT OF THE VASP	C LC PC NC NA
302	CORPORATE STRATEGY	C LC PC NC NA
303	GOVERNANCE	C LC PC NC NA
303-1	Governing bodies and top management	C LC PC NC NA
303-2	Fit and proper	C LC PC NC NA
303-3	Expectation of stakeholders	C LC PC NC NA
304	ECONOMICS AND FINANCIALS	C LC PC NC NA
304-1	Market presence	C LC PC NC NA
304-2	Economic performance	C LC PC NC NA
304-3	Indirect economic impacts	C LC PC NC NA
304-4	Financial controls	C LC PC NC NA
305	OPERATIONAL	C LC PC NC NA
305-1	Planning and control	C LC PC NC NA
305-2	Non-financial controls	C LC PC NC NA
306	TECHNOLOGICAL	C LC PC NC NA
307	ANTI-FINANCIAL CRIME	C LC PC NC NA

307-1	Anti-financial crime policy	C LC PC NC NA
307-2	Anti-financial crime management system	C LC PC NC NA
307-3	Anti-corruption	C LC PC NC NA
307-3a	Corruption risk-assessment	C LC PC NC NA
307-3b	Procurement due diligence	C LC PC NC NA
307-4	Anti-money laundering and counter terrorism financing	C LC PC NC NA
307-4a	Money laundering and terrorism financing risk assessment	C LC PC NC NA
307-4b	Customer due diligence	C LC PC NC NA
307-4c	Sanctions	C LC PC NC NA
307-4d	Political exposed persons	C LC PC NC NA
307-4e	Transparency and beneficial ownership	C LC PC NC NA
307-4f	Monitoring of activities and transactions	C LC PC NC NA
307-4g	Suspicious transactions report	C LC PC NC NA
308	RISK AND COMPLIANCE	C LC PC NC NA
308-1	Compliance function	C LC PC NC NA
308-2	Risk-based approach	C LC PC NC NA
308-2a	Risk assessment	C LC PC NC NA
308-2b	Risk mitigation plan and controls	C LC PC NC NA
308-3	Data privacy and security practices	C LC PC NC NA
308-4	Marketing and labelling	C LC PC NC NA
308-5	Record-keeping and auditability	C LC PC NC NA
308-6	Awareness and training	C LC PC NC NA
309	ENVIRONMENTAL	C LC PC NC NA
309-1	Energy	C LC PC NC NA
309-2	Environmental compliance	C LC PC NC NA

309-3	Supplier environmental assessment	C LC PC NC NA
310	SOCIAL	C LC PC NC NA
310-1	Employment process	C LC PC NC NA
310-2	Diversity and inclusion	C LC PC NC NA
310-3	Supplier social assessment	C LC PC NC NA
310-4	Social compliance	C LC PC NC NA
310-5	Literacy in VA	C LC PC NC NA

4 | EFFECTIVENESS ASSESSMENT



401 | Assessment framework

The assessment of the effectiveness seeks to evaluate the results of the implementation of the Recommendations and identify the extent to which a VASP achieves a defined set of outcomes that are central to the VA ecosystem.

Each of the outcomes represents a key goal for an effective VA ecosystem. The outcomes are not independent from each other. In many cases an issue considered specifically under one outcome will also contribute to the achievement of other outcomes.

The focus of the effectiveness assessment is therefore on the extent to which the implementation of the Recommendations is producing the expected results.

Assessing effectiveness is intended to: (a) identify the extent to which a VASP is achieving the objectives of the Recommendations, and identify any systemic weaknesses; and (b) enable VASP to prioritize measures to improve their system.

The effectiveness assessment is supported by evidence and examples, and taking into account the level of compliance with the Recommendations, as well as the specific context of a country or VASP.

VASP outcomes

No	Outcome	Key features
V001	GOVERNANCE	Suitable governance structure for the organization and demonstration that leadership have the right skills and backgrounds to properly insure governance, as well as commitment with respect to the organization's strategy, policies and management systems.
V002	ECONOMICS AND FINANCIALS	Evidence about market presence, consistency of the products and services with the specific markets, economic performance and proper financial reporting and controls.
V003	OPERATIONAL	Appropriate mechanisms for an efficient operations management aligned with the specific requirements and the corporate strategy.
V004	TECHNOLOGICAL	Appropriate systems and functionalities to work with its activities, products and services.
V005	ANTI-FINANCIAL CRIME	Integrated, coherent and assertive approach to anti-financial crime, both at preventive and detective levels, ensuring the proper implementation of policies, processes and controls.
V006	RISK AND COMPLIANCE	Appropriate mechanisms for an efficient risk and compliance management.
V007	ENVIRONMENTAL	Measurement and mitigation of the negative environmental impacts of Its specific activities and comply with environmental laws and regulations existing in their context of operations.
V008	SOCIAL	Human resources processes in place that insure a decent and inclusive work environment, as well as measurement and mitigation of the negative social impacts of their activities.

402 | Ratings

There are four possible levels of effectiveness, and, in exceptional circumstances, an outcome may also be rated as not applicable. The effectiveness assessment may be rated as follows:

Ratings		
H	High	The outcome is achieved to a very large extent
S	Substantial	The outcome is achieved to a large extent
M	Moderate	The outcome is achieved to some extent
L	Low	The outcome is not achieved
NA	Not applicable	The outcome is not applicable

VASP outcomes		
No	Outcome	Assessment
V001	GOVERNANCE	H S M L NA
V002	ECONOMICS AND FINANCIALS	H S M L NA
V003	OPERATIONAL	H S M L NA
V004	TECHNOLOGICAL	H S M L NA
V005	ANTI-FINANCIAL CRIME	H S M L NA
V006	RISK AND COMPLIANCE	H S M L NA
V007	ENVIRONMENTAL	H S M L NA
V008	SOCIAL	H S M L NA

5 | OVERALL RATING



The overall rating score is a weighted average of the three rating components. The risk assessment is weighted at 60%, the compliance assessment at 15%, and the effectiveness assessment at 25%.

There are ten possible overall rating levels, as follows:

Ratings	
AAA	Extremely strong
AA	Very strong
A	Strong
BB	Adequate
BB-	Slightly adequate
B+	Slightly inadequate
B	Inadequate
CCC	Weak
CC	Very weak
C	Extremely weak

