KISMET

# RISK ASSESSMENT METHODOLOGY:

## FOR VIRTUAL ASSETS SERVICE PROVIDERS ON THE VIRTUAL ASSETS PLAYING FIELD

2022.FEBRUARY

CONTENTS



# 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 Risk Assessment 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 | RISK AND CONTEXT

The starting point for any assessment is an initial understanding of the VASP context, based on its risk and context.

This risk and context provide the necessary elements to calibrate the methodology and insure its maximal adherence to the VASP specific reality.

Recommendation 301 states that VASP shall determine the external and internal matters that are relevant to its purpose and that impact its capability to attain goals.

An effective risk management requires certain structural elements. The lack of such elements, or significant weaknesses and shortcomings in the general framework, may significantly impact the implementation and effectiveness of a risk management system.

Risk and context allow for an appropriate understanding of the VASP, and of the materiality and the relative importance of specific issues, to be applied in the rating. Appropriate weight is allocated to these factors when determining ratings for risk assessment, compliance, and effectiveness.

# 2 | OVERVIEW OF THE METODOLOGY

The risk assessment is based on the following risk categories:

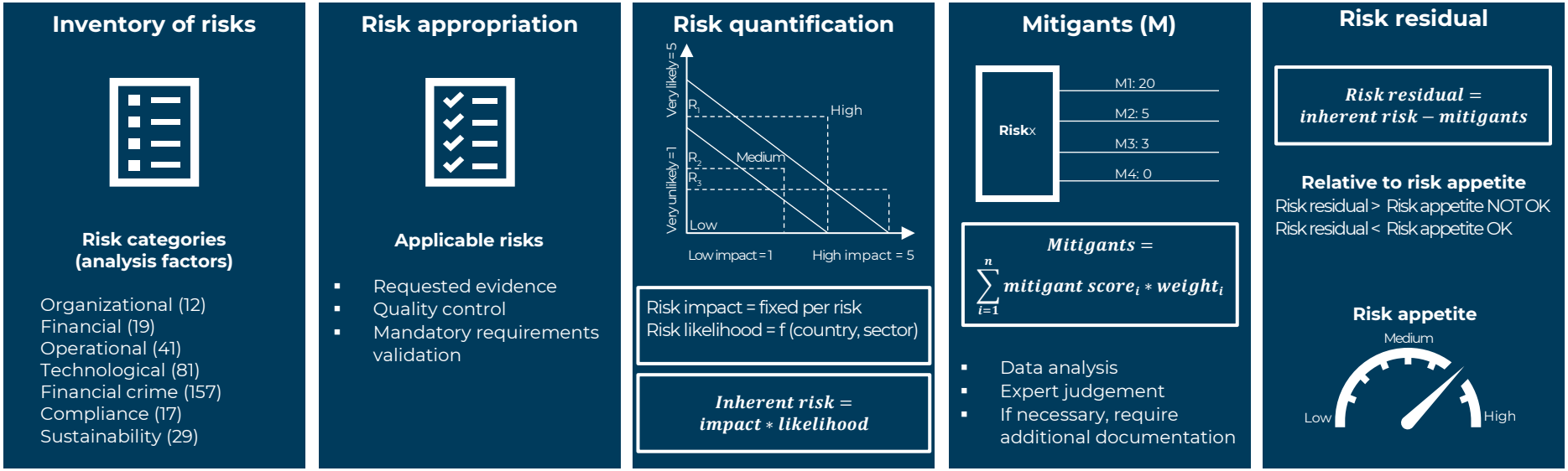
- Organizational risks, relating to any potential risk to the framework of rules and practices that ensure accountability, integrity and transparency, for all the stakeholders;
- Financial risks, reflect the risks that include financial consequences;
- Operational risks, reflect the material risks that the VASP incurs losses from people, inadequate or failed internal processes or systems, or external events;
- Technological risks, reflect any potential risk for technology failures and disruption;
- Financial crime risks, relating to the occurrence of any type of non-violent crime, which result in a financial loss;
- Compliance risks, relating to possible violations of applicable laws, regulations, contractual terms, or standards, where such violation could result in direct or indirect financial liability, regulatory sanctions, civil or criminal penalties, or other negative effects;
- Sustainability risks, relating to the negative materialization of ESG factors that may impact a sustainable future.

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. According to Kismet's methodology, the minimum residual risk considered is 2.

Kismet's risk assessment methodology is characterized as follows:



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