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**Rating services — Assessment of  
creditworthiness of non-listed entities**

*Services d'estimation — Évaluation de la solvabilité des entités non  
listées*

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## Foreword

ISO (the International Organization for Standardization) is a worldwide federation of national standards bodies (ISO member bodies). The work of preparing International Standards is normally carried out through ISO technical committees. Each member body interested in a subject for which a technical committee has been established has the right to be represented on that committee. International organizations, governmental and non-governmental, in liaison with ISO, also take part in the work. ISO collaborates closely with the International Electrotechnical Commission (IEC) on all matters of electrotechnical standardization.

International Standards are drafted in accordance with the rules given in the ISO/IEC Directives, Part 2.

The main task of technical committees is to prepare International Standards. Draft International Standards adopted by the technical committees are circulated to the member bodies for voting. Publication as an International Standard requires approval by at least 75 % of the member bodies casting a vote.

In other circumstances, particularly when there is an urgent market requirement for such documents, a technical committee may decide to publish other types of normative document:

- an ISO Publicly Available Specification (ISO/PAS) represents an agreement between technical experts in an ISO working group and is accepted for publication if it is approved by more than 50 % of the members of the parent committee casting a vote;
- an ISO Technical Specification (ISO/TS) represents an agreement between the members of a technical committee and is accepted for publication if it is approved by 2/3 of the members of the committee casting a vote.

An ISO/PAS or ISO/TS is reviewed after three years in order to decide whether it will be confirmed for a further three years, revised to become an International Standard, or withdrawn. If the ISO/PAS or ISO/TS is confirmed, it is reviewed again after a further three years, at which time it must either be transformed into an International Standard or be withdrawn.

Attention is drawn to the possibility that some of the elements of this document may be the subject of patent rights. ISO shall not be held responsible for identifying any or all such patent rights.

ISO/TS 10674 was prepared by Project Committee ISO/PC 235, *Rating services*.

## Introduction

This Technical Specification is intended to help ensure process transparency and reliability of credit assessment ratings in the acquisition of trade information.

In view of the increasing number of credit assessment service organizations, each with its individual assessment system, there is now a clear need for a common evaluation and communication tool in the form of an international standard.

This Technical Specification is intended to be of particular use to serious credit bureaus and their customers (often small and medium-size businesses) who seek to operate in an international market. This Technical Specification is intended to help increase global trade by making it possible to obtain more reliable credit assessments of even the smaller partners in new markets.

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# Rating services — Assessment of creditworthiness of non-listed entities

## 1 Scope

This Technical Specification specifies terms, definitions and basic process requirements for the assessment of creditworthiness of non-listed companies, using model-based approaches, or committee-based approaches, or both.

This Technical Specification does not apply to the assessment of the creditworthiness of classes of, or individual obligations of, such companies or securities traded in the financial markets, nor does it relate to the provision of services assessing the creditworthiness of individuals (consumer scoring).

## 2 Terms and definitions

For the purposes of this document, the following terms and definitions apply.

### 2.1

#### **assessment report**

document containing all essential information and incorporated factors that have been relevant, combined with their weighting

### 2.2

#### **credit assessment institution**

##### **CAI**

organization that uses either a committee-based or a model-based approach to reach a credit assessment of an entity

EXAMPLE Credit insurance company; commercial information company.

### 2.3

#### **output**

assessment result reached by the CAI

## 3 Quality and integrity of the assessment process

### 3.1 Quality of the assessment process

The credit assessment institution (CAI) shall adopt, implement and enforce written procedures to ensure that the assessments it disseminates are based on a thorough analysis of all information known to the CAI that is relevant to its analysis in accordance with the CAI's published assessment methodology.

The CAI shall use assessment methodologies that are rigorous and systematic and, where possible, result in assessments that can be subjected to some form of objective validation based on historical experience.

In assessing an entity's creditworthiness, analysts involved in the preparation or review of any assessment shall use methodologies established by the CAI. Analysts shall apply a given methodology in a consistent manner, as determined by the CAI.

Credit assessment shall be assigned by the CAI and not by any individual analyst employed by the CAI; assessments shall reflect all information known, and believed to be relevant, to the CAI, consistent with its published methodology; and the CAI shall use people who, individually or collectively, have appropriate knowledge and experience in developing an assessment for the type of entity.

The CAI shall maintain internal records to support its credit assessments for a specified period of time or in accordance with applicable law.

The CAI and its analysts shall take steps to avoid issuing any credit analyses or reports that contain misrepresentations or are otherwise misleading as to the general creditworthiness of an entity.

The CAI shall ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all entities it rates. When deciding whether to assess or continue assessing an entity, it shall assess whether it is able to devote sufficient personnel with sufficient skill sets to make a proper credit assessment, and whether its personnel are likely to have access to sufficient information in order to make such an assessment.

The CAI shall structure its analytical team to promote continuity and avoid bias in the assessment process.

### 3.2 Monitoring and updating

Except for assessments that clearly indicate they do not entail ongoing surveillance, once an assessment is published, the CAI shall monitor on an ongoing basis and update the assessment by:

- regularly reviewing the entity's creditworthiness;
- initiating a review of the status of the assessment upon becoming aware of any information that might reasonably be expected to result in a change of assessment (including termination of an assessment), consistent with the applicable methodology; and,
- updating the assessment on a timely basis, as appropriate, based on the results of such review.

Where a CAI makes its assessments available to the public, the CAI shall publicly announce if it discontinues its assessments. Where a CAI's assessments are provided with monitoring service only to its subscribers, the CAI shall announce to its subscribers if it discontinues assessments. In both cases, continuing publications by the CAI of the discontinued assessment shall indicate the date the assessment was last updated and the fact that the assessment is no longer being updated.

### 3.3 Integrity of the assessment process

The CAI and its employees shall comply with all applicable laws and regulations governing its activities in each jurisdiction in which it operates.

The CAI and its employees shall deal fairly and honestly with the entities for which it provides credit assessments.

The CAI's analysts shall have high integrity and the CAI shall not employ individuals with demonstrably compromised integrity.

The CAI and its employees shall not, either implicitly or explicitly, give any assurance or guarantee of a particular assessment prior to an assessment process.

The CAI shall institute policies and procedures that clearly specify a person responsible for the compliance of the CAI and its employees with the provisions of the CAI's code of conduct and with applicable laws and regulations.

Upon becoming aware that another employee or entity under common control with the CAI is or has engaged in conduct that is illegal, unethical or contrary to the CAI's code of conduct, a CAI employee shall report such information immediately to the individual in charge of compliance or an officer of the CAI, as appropriate, so that proper action may be taken.

A CAI's employees are not necessarily expected to be experts in the law. Nonetheless, its employees are expected to report the activities that a reasonable person would question. Any CAI officer who receives such a report from a CAI employee is obligated to take appropriate action, as determined by the laws and regulations of the jurisdiction and the rules and guidelines set forth by the CAI. CAI management shall prohibit retaliation by other CAI staff or by the CAI itself against any employees who, in good faith, make such reports.

## 4 CAI independence and avoidance of conflicts of interest

### 4.1 General

The CAI shall not forbear or refrain from an assessment based on the potential effect (economic, political or otherwise) of the action on the CAI, an entity, an investor or other market participant.

The CAI and its analysts shall use care and professional judgment to maintain both the substance and appearance of independence and objectivity.

The determination of a credit assessment shall be influenced only by factors relevant to the assessment.

The credit assessment a CAI assigns to an entity shall not be affected by the existence of, or potential for a business relationship between, the CAI (or its affiliates) and the entity (or its affiliates) or any other party, or the non-existence of such a relationship.

The CAI shall ensure that ancillary business operations which do not necessarily present conflicts of interest with the CAI's assessment business have in place procedures and mechanisms designed to minimize the likelihood that conflicts of interest will arise.

### 4.2 CAI procedures and policies

The CAI shall adopt written internal procedures and mechanisms to

- a) identify, and
- b) eliminate, or manage and disclose (as appropriate)

any actual or potential conflicts of interest that can influence the assessments the CAI makes, or the judgment and analyses of the individuals the CAI employs who have an influence on assessments. The CAI's code of conduct shall also state that the CAI will disclose such conflict avoidance and management measures.

The CAI's disclosures of actual and potential conflicts of interest shall be complete, timely, clear, concise, specific and prominent.

The CAI shall disclose the general nature of its compensation arrangements with assessed entities.

The CAI and its employees shall not engage in the trading of any securities or derivatives which present conflicts of interest with the CAI's assessment activities.

### 4.3 CAI analyst and employee independence

Reporting lines for CAI employees and their compensation arrangements shall be structured to eliminate or effectively manage actual and potential conflicts of interest. The CAI analyst shall not be compensated or evaluated on the basis of the amount of revenue that the CAI derives from entities that the analyst assesses, or with which the analyst regularly interacts.

The CAI shall not permit employees who are directly involved in the assessment process to initiate, or to participate in, discussions regarding fees or payments with any entity they rate.

No CAI employee shall participate in, or otherwise influence, the determination of the CAI's assessment of any particular entity or obligation if the employee has, or has had, any other relationship with the assessed entity or any related entity thereof that may cause, or may be perceived as causing, a conflict of interest.

The CAI's analysts and anyone involved in the assessment (or their spouse, partner or minor children) shall not buy, sell or engage in any transaction in any security or derivative based on a security issued, guaranteed or otherwise supported by any entity within such analyst's area of primary analytical responsibility, other than holdings in diversified collective investment schemes.

CAI employees shall be prohibited from soliciting money, gifts or favours from anyone with whom the CAI does business, and shall be prohibited from accepting gifts offered in the form of cash or any gifts exceeding a minimal monetary value.

Any CAI analyst who becomes involved in any personal relationship that creates the potential for any real or apparent conflict of interest (including, for example, any personal relationship with an employee of an assessed entity, or agent of such entity within his/her area of analytic responsibility) shall be required to disclose such relationship to the appropriate manager or officer of the CAI, as determined by the CAI's compliance policies.

#### **4.4 CAI responsibilities to assessed entities and assessment users**

##### **4.4.1 Transparency and timeliness of assessment disclosure**

The CAI shall distribute its assessments in accordance with its published policies and procedures.

The CAI shall publicly disclose its policies for distributing assessments, reports and updates.

The CAI shall indicate with each of its assessments when the assessment was last updated.

The CAI shall publish sufficient information about its procedures, methodologies and assumptions (including financial statement adjustments that deviate materially from those contained in the entity's published financial statements) that outside parties can understand how an assessment was reached by the CAI. If applicable, this information shall include (but not be limited to) the meaning of each credit assessment category and the definition of default or recovery, and the time horizon the CAI used when making an assessment.

Upon request of the assessed entity, the CAI shall inform the entity of the critical information and principal considerations upon which an assessment is based, and afford the entity an opportunity to clarify any likely factual misperceptions or other matters that the CAI would wish to be made aware of in order to produce an accurate assessment. The CAI shall duly evaluate the response.

In order to promote transparency and to enable the market to best judge the performance of the assessments, where possible, the CAI shall publish sufficient information about the historical default rates of CAI assessment categories and whether the default rates of these categories have changed over time, so that interested parties can understand the historical performance of each category and if and how assessment categories have changed, and be able to draw quality comparisons among assessment given by different CAIs. If the nature of the assessment or other circumstance makes a historical default rate inappropriate, statistically invalid or otherwise likely to mislead the users of the assessment, the CAI shall explain this.

The CAI shall also disclose its policies and procedures regarding unsolicited assessments.

Because users of credit assessments rely on an existing awareness of CAI methodologies, practices, procedures and processes, the CAI shall fully and publicly disclose any material modification to its methodologies and significant practices, procedures and processes. Where feasible and appropriate, disclosure of such material modifications shall be made prior to their going into effect. The CAI shall carefully consider the various uses of credit assessments before modifying its methodologies, practices, procedures and processes.

#### 4.4.2 Treatment of confidential information

The CAI shall adopt procedures and mechanisms to protect the confidential nature of information shared with them by entities under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. Unless otherwise permitted by the confidentiality agreement and consistent with applicable laws or regulations, the CAI and its employees shall not disclose confidential information in press releases, through research conferences, to future employers, or in conversations with investors, other entities, other persons or otherwise.

The CAI shall use confidential information only for purposes related to its assessment activities or otherwise, in accordance with any confidentiality agreements with the entity.

CAI employees shall take all reasonable measures to protect all property and records belonging to, or in possession of, the CAI from fraud, theft or misuse.

CAI employees shall be prohibited from engaging in transactions in securities when they possess confidential information concerning the entity.

In preservation of confidential information, CAI employees shall familiarize themselves with the internal securities trading policies maintained by their employer and periodically prove their compliance, as required by such policies.

CAI employees shall not selectively disclose any non-public information about assessments or possible future assessments of the CAI, except to the entity or its designated agents.

CAI employees shall not share confidential information entrusted to the CAI with employees of any affiliated entities that are not CAIs. CAI employees shall not share confidential information within the CAI except on an "as needed" basis.

CAI employees shall not use or share confidential information for the purpose of trading securities or for any other purpose, except the conduct of the CAI's business.

## 5 Committee-based approach

### 5.1 System (committee-based approach)

A committee-based approach shall be based on an impartial evaluation by qualified analysts.

The final decision shall take place in an assessment committee consisting of at least two qualified analysts.

**NOTE** Even if automatic calculation is an essential part of the decision making, it is not the crucial factor. As most of the mathematical/statistical models refer only to quantitative data (e.g. balance sheet, profit and loss account), the qualitative criteria (strategy, organization, processes, personnel, etc.) are not necessarily included. The inclusion of qualitative criteria plays a decisive role in the committee-based approach. The assessment of these criteria requires a high degree of experience on the part of the credit analysts.

### 5.2 Committee-based assessment scales, symbols and modifiers

The assessment shall be assigned on (a) consistently-defined scale or scales. Any scales, symbols and modifiers can be used to present the outcome of the risk calculation, but shall be defined and comprehensively disclosed in a manner accessible to all users.

### 5.3 Committee-based assessment actions

The frequency and mechanisms of changes to assessments shall be defined and disclosed. The assessment committee can use terms relating to the current status of the rating in their communication in order to clarify the assessment.

**EXAMPLE** "Downgrade"; "assessment watch on"; "upgrade"; "withdrawn".

#### 5.4 Organization (committee-based approach)

The CAI shall separate its credit assessment business and its analysts, both operationally and legally, from any other business of the CAI (including consulting business) that may present a conflict of interest.

The assessment committee shall consider the relevant quantitative and qualitative issues to achieve the assessment that reflects most appropriately both the current situation and prospective performance.

The minimum committee size for assessment decisions shall generally be two analysts, and at least one of them shall be a senior analyst with professional experience of financial analysis.

#### 5.5 Process (committee-based approach)

Where feasible and appropriate, prior to issuing or revising a public assessment, the CAI shall inform the issuer of the critical information and principal considerations upon which an assessment will be based, and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the CAI would wish to be made aware of, in order to produce an accurate assessment. The CAI shall duly evaluate the response. Where, in particular circumstances, the CAI has not informed the issuer prior to issuing or revising an assessment, the CAI shall inform the issuer as soon as practical thereafter and shall, generally, explain the reason for the delay. The results of the assessment process shall always be documented in an assessment report.

#### 5.6 Validation (committee-based approach)

##### 5.6.1 General

The basis of the data and its throughput shall be specified by the CAI. This concerns especially the handling of the financial data and any additional (qualitative) data.

NOTE The degree of quality of the information and the throughput influences the assessment result.

##### 5.6.2 Input

**5.6.2.1** The input of all the information to an assessment system shall be valued on relevancy and circumstances.

NOTE The base of every financial analysis is the financial information provided by an organization, e.g. the annual accounts or an interim report.

**5.6.2.2** In order to validate the input for the committee-based approach, the CAI shall undertake the following activities:

- a) criteria selection: the basis for the criteria shall be made explicit;
- b) data aggregation: the level of aggregation of the input data shall be made explicit;
- c) measuring the quality of the internal input data: the validation of the credibility of the data shall be made explicit.

**5.6.2.3** It shall be specified whether the financial data is provided by an organization that is audited by an external accountant. The internal auditing shall be valued by an enterprise risk management system, SOX (Sarbanes-Oxley Act) compliancy or such.

- a) Measuring the quality of the external information: the source and the credibility of the provider of external data shall be objectively estimated.
- b) Development of assumptions: the CAI shall disclose for each assessment how assumptions have been developed for input data.

- c) Validating plausibility: the validation of the plausibility of the data shall be made explicit.
- d) Describing data fields: a description shall be maintained by the CAI for each data field used.

**5.6.2.4** The assessment system shall incorporate as a minimum the following data:

- legal status of the assessed entity;
- relevant owners/shareholders of the entity;
- group structures in which the entity is involved in a financial or economic way;
- relevant support of group members;
- the existence of profit and loss agreements or similar contracts;
- the existence of governmental support;
- accounting data from the rated entity (information concerning the type of financial statements, legal basis for accounting or relevant projections is included);
- non-financial indicators of entity potential;
- evaluation of risk management;
- data on peer-group companies for evaluation of the rated entity.

### **5.6.3 Throughput**

#### **5.6.3.1 General**

Throughput relates to the aggregation mechanisms, their methodological explanations and the data processing in the assessment process.

#### **5.6.3.2 Quality**

The following general criteria shall be used for the evaluation of the quality of the assessment system:

- a) assessment model: it shall be specified what combination of assessment models and modules the CAI applies in its assessment system;
- b) transparency and plausibility: it shall be specified how the assessment result is based on transparent and plausible criteria;
- c) validity: the CAI shall disclose the basis on which it values the validity of its assessments;
- d) accuracy: the CAI shall provide a measure of accuracy of the assessments assigned;
- e) consistency: it shall be specified how the CAI assigns assessments on a consistent basis;
- f) granularity: the CAI shall disclose why the number of assessment classes used provides an adequate differentiation of the risks measured;
- g) clarity of the assessment result and integrity of the required input data: the CAI shall not maintain multiple assessments on the same scale for the same entity;
- h) being up-to-date and robust: it shall be specified how often the assessment system is reviewed and, if necessary, updated;
- i) influence of entity-specific factors: it shall be specified whether the sector affiliation, legal form, size or other characteristics of the rated entity have a significant impact on the assessment system.

### 5.6.3.3 Individual assessment models

The following criteria shall also be used for the evaluation of individual assessment models:

- a) the CAI shall disclose the reasons for choosing a particular mathematical/statistical model and the principle limitations identified for the model;
- b) the CAI shall disclose its methodology for selecting individual factors;
- c) knowledge database: the sources and composition of the knowledge base shall be specified; it shall be specified about which categories the knowledge base can provide results;
- d) oversight system: it shall be specified which scaling applies to the input data as a result of the aggregation method selected;
- e) criteria for evaluating qualitative assessment factors:
  - 1) qualifications of the assessment analyst: information shall be provided on the qualifications and independence of the assessment experts;
  - 2) assessment process: it shall be specified to what extent the assessment process is standardized and how detailed the guidelines are that are followed by the experts;
  - 3) assessment quality assurance: it shall be specified how the quality of the assessment is assured.

### 5.6.4 Output

**5.6.4.1** The following steps shall be taken by the CAI to provide general information on how the assessment shall be interpreted:

- a) comparability: it shall be specified whether the scales used represent a cardinal or ordinal system;
- b) target: the target (event or measure) addressed by the assessment shall be described, e.g. whether the scales used are cardinal (e.g. predicted percentage default likelihood) or purely ordinal (a relative ranking only);
- c) transparency: the nature of the linkages between the selected factors and the final result shall be disclosed; the assessment shall be transparently documented in the assessment report; external disclosure of the assessment result depends on the assessment purpose.

The steps listed in 5.6.4.2 and 5.6.4.3 shall be taken by the CAI to provide information on how to interpret the assessment result.

**5.6.4.2** The following individual information shall be provided about the assessment result:

- a) entity legal status;
- b) currency and date-marking of the assessment result;
- c) consideration of country risk;
- d) the event or performance that the assessment is designed to measure;
- e) assessment scale, including a description of the assessment scale;
- f) definition of default or the relevant event measured by the assessment; individual definitions that deviate from this shall be explained.